



*Working with and
through our State
Associations, NSBA
Advocates for Equity and
Excellence in Public
Education through
School Board Leadership*

March 10, 2011

Internal Revenue Service
CC:PA:LPD:RU (Notice 2011-1)
P.O. Box 7604, Room 5203
Ben Franklin Station
Washington, D.C. 20224

Dear Jamie Dvoretzky:

The National School Boards Association (NSBA), representing through our state associations approximately 14,500 school districts, offers the following comments to IRS Notice 2011-1 on the application of the nondiscrimination requirements of § 105(h)(5) of the Internal Revenue Code to fully insured, non-grandfathered group health plans (enacted in § 2716 of the Patient Protection and Affordable Care Act, as amended (PPACA)).

NSBA requests that the regulatory agencies totally exempt school districts and other government entities from application of the nondiscrimination rules to fully insured, non-grandfathered group health plans. In the event the agencies do not completely exempt school districts, NSBA asks that the agencies do any/all of the following: exclude premiums from the definition of “benefit”; change the definition of “highly compensated employees” to exclude middle class workers; adopt a reasonable “safe harbor”; conclude the availability of coverage means compliance with the nondiscrimination rules; allow highly qualified employees to pay a tax on excess benefits instead of fining employers; exclude union employees and retirees from testing; and postpone the effective date of the regulations until all existing collective bargaining agreements and employment contracts expire. NSBA begins its comments by describing health insurance benefits generally offered by school districts to school employees.

Background on health insurances benefits offered by school districts

There is certainly much diversity among health insurance benefits offered in our nation’s 14,500-plus public school districts. Most full-time public school employees are offered health insurance coverage paid nearly in full by the district. In the majority of states, health insurance benefits for teachers and support staff employees are bargained collectively. Teachers and support staff generally are not in the same bargaining unit. Support staff may all be in one bargaining unit, or they may be in a number of bargaining units based on job classification.

It is common for bargaining units to participate in the same health insurance plans that offer the same coverage. However, it is also common for bargaining units to have negotiated different employer premium contribution levels and different deductibles and co-pays. For example, in some districts teachers may have lower deductibles and co-pays and higher employer premium contributions than support staff. In addition, it is not unusual for teachers and support staff to have differing contributions to consumer-driven plans such as Health Savings Accounts, Health Reimbursement Arrangements, and Flexible Spending Accounts.

Administrators are not eligible to bargain collectively in most states. Instead, administrators are offered (or negotiate) health care benefits in individual employment contracts. It is not unusual for a school district to pay 100% of a superintendent's health insurance premiums (including premiums for family coverage) but pay less than 100% of premiums (or 100% of single coverage) for teachers and support staff employees. Superintendents and other administrators typically participate in the same health insurance plans and receive the same coverage and benefits as those agreed to (or provided to) teachers and other support staff. However their out-of-pocket expenses for health care costs may be less.

School district employees across the country generally do not make as significant premium (and co-pay and deductible) contributions to the cost of health care as private sector employees. So, for example, even if the superintendent and other senior administrators at the school district are not contributing anything to premiums, teachers may be paying only five percent or less of the applicable premium cost. Similarly, even if support staff is paying 10 percent of the total health insurance premium cost, many similar positions in the private sector do not offer employer-paid health insurance at all.

Collective bargaining agreements are typically two or three years in length but might be as long four or five years. Negotiating a collective bargaining agreement could take longer than a year. Typically, school districts have no or limited ability to require unions to reopen agreements midterm.

School administrator contracts are typically two or three years in length. However, in some states like Illinois, they may be up to five years in length. Contracts also typically have a "rolling" feature; therefore, the employment contracts of most administrators are for the most part continuously in place for two or three years. Contracts do not typically contemplate, and many times expressly prohibit, amendments that would decrease benefits or compensation to the administrator. If a contract is silent on amendments, basic contract principles would prohibit unilateral employer amendment to the detriment of the contracting administrator. Even if administrator contracts may be amended, contract terms may require that a new contract be entered into if the terms are changed.

In non-union states, superintendents also may receive greater health care benefits than other school district employees. For example in Mississippi, all school district employees who work 20 or more hours a week receive *single* health insurance coverage paid in full by the district. Some superintendents, however, have negotiated contracts where they receive *family* health insurance coverage paid in full by the district.

Complete exemption

As its most important goal, NSBA seeks a complete exemption for public school employers from application of the nondiscrimination rules to fully insured, non-grandfathered group health plans. NSBA also supports an exemption for other state and local government employers. In general, NSBA believes that the § 105(h) nondiscrimination rules were adopted to limit health insurance benefits offered to highly compensated executives which really has no analogy in the school district sector. The highest paid school superintendents make a few hundred thousand dollars a year (most make much less), even though they are running multi-million and sometime multi-billion dollar institutions. For example, the highest paid superintendent in Mississippi makes less than \$200,000 a year, and the average Mississippi superintendent makes a little more than \$100,000. The disparities between superintendent compensation and teacher compensation are not even close to the disparities in compensation between CEOs in the private sector and rank and file employees. Likewise, as discussed above, in most cases the superintendent's coverage and level of benefits is identical to other district employees. The difference in out-of-pocket costs for premiums, deductibles, co-pays, etc. is in most cases not significant.

It is not without precedent for school districts and other state and local governmental entities to be exempt from nondiscrimination requirements related to employee benefits. For example, school districts and other state and local governmental entities are exempt from the nondiscrimination rules generally applicable to employer contributions under a 403(b) plan. *See* 26 U.S.C. § 403(b)(12)(C). Moreover, state and local governmental entities also are exempt from similar nondiscrimination rules for tax qualified retirement and savings plans (for example, 26 U.S.C. §§ 401(a)(4) and 410(b)). *See, e.g.*, Section 1505 of the Taxpayer Relief Act of 1997; IRS Notice 2003-6. Similarly, Congress has exempted employee benefit plans of school districts and other governmental entities from ERISA. *See* 29 U.S.C. §1003(b)(1). Further, certain educational employers were provided with a specific exception to the taxing effects of non-qualified deferred compensation plans under IRC 457(f).

NSBA submits that the IRS and other regulatory agencies have the general authority under § 2716(a) of PPACA to exempt (in whole or in part) state and local government plans from the nondiscrimination rules. This would be particularly helpful given the substantial difficulties school districts and other state and local governmental entities will have in determining who is highly compensated (especially if the controlled group rules apply). At the same time, an exemption would avoid the untoward result of requiring the payment of potentially significant

penalties by school districts for non-egregious circumstances from taxpayer funds intended for educational purposes.

Perhaps it seems that school districts could simply reduce health benefits of highly compensated employees to achieve compliance with the nondiscrimination rules, making an exemption for school districts unnecessary. However, premium contribution and other health care cost sharing changes often may be difficult to achieve both practically and politically. For example, say a superintendent receives a 100% premium contribution from the district and all other employees receive a 90% employer premium contribution. Even if the superintendent was willing to open his or her contract mid-term and exchange a lesser employer premium contribution for a higher salary, the superintendent might balk at higher compensation as a matter of principle (and politics) because employees in his or her district have not received a raise this year. Likewise, say in a district where some teachers are highly compensated employees (which will typically be the case given the current definition—see the discussion below), teachers receive a 90% district premium contribution and support staff receive an 85% premium contribution. In unionized states, it may be difficult for a school district to successfully negotiate with the teachers to change to a lower employer premium contribution. In addition, restructuring compensation and benefits may cause complications under state pension systems. An increase in compensation may trigger employer penalties or result in pension offsets.¹

Premiums not a benefit

Question 1 in IRS Notice 2011-1 asks what constitutes a “benefit” and specifically whether the employer’s rate of premium contribution is a benefit. It appears that the most significant perceived noncompliance with the nondiscrimination rules among school districts is districts contributing more to the premiums of highly compensated employees than non-highly compensated employees. If the agencies apply the nondiscrimination rules to school districts, they would benefit from a determination that premiums are not a benefit, but instead coverage is, and that the difference in premium payments for different employees is not discrimination. Likewise, school districts would benefit from a very precise definition of “benefit” and/or a number of examples that make clear exactly what is a “benefit.”

¹ In Illinois, for example, the Teachers’ Retirement System state pension laws and regulations provide that increases in compensation exceeding six percent in a given year, with some limited exceptions, will trigger significant employer penalties if any of those compensation dollars fall within the calculation of final average salary for pension purposes. 40 ILL. COMP. STAT. 5/16-158; 80 ILL. ADMIN CODE 1650.481. In addition, in the last seven years of employment, any change in compensation and benefit structure resulting in the decrease in a non-reportable benefit (such as employer payment of insurance premiums) may be deemed to constitute a conversion, requiring any increases in compensation to be discounted for pension calculation purposes. 80 ILL. ADMIN CODE 1650.450(c)(6).

Change the definition of “highly compensated employees”

Currently, a highly compensated employee under § 105(h) is defined to include anyone who is among the highest paid 25% of all employees. *See* 26 U.S.C. § 105(h)(5)(C). In the case of school districts, this would typically include almost all administrators and many teachers. If the regulatory agencies do not grant school districts an exemption, it would make good sense from a policy standpoint to change the definition of highly compensated employees to ensure that modestly paid middle class workers are not considered highly compensated. For example, the regulatory agencies could change the definition of highly compensated employee to be anyone who: (1) earns over \$150,000 a year and (2) who is among the highest paid 25% of all employees.

Or, at a minimum, instead of following §105(h)(5)(C) in full, it would be appropriate to apply the compensation floor set out in the definition of highly compensated employee under 26 U.S.C. § 414(q)(1)(B), which currently defines a highly compensated employee for purposes of tax-qualified pension plans as anyone who earns compensation in excess of \$110,000. While it is not clear that the IRS and other regulatory agencies have the authority to alter the highly compensated employee definition under § 2716(b), NSBA submits that this is a sensible result that could be obtained by virtue of the discretion given the agencies under § 2716(a).

Safe harbor

If the regulatory agencies decide the nondiscrimination rules apply to school districts, NSBA asks the agencies to adopt a reasonable “safe harbor” compliance provision for such entities. For example, NSBA recommends that the agencies adopt a “safe harbor” for state and local government entities that provides that employer premium contributions above a certain percent would automatically meet nondiscrimination requirements. For example, say the floor was a 70% single premium contribution for employers. Under this “safe harbor,” if the employer contributed at least 70% to single premiums for all eligible employees, the “safe harbor” would be met (even if some or all highly compensated employees received a higher percentage contribution). NSBA thinks that a 70% floor would be fair. The disparity between 100% employer contributions and 70% employer contributions, even when the employer is paying 100% of family premiums for some highly compensated employees, is generally reasonable in the school district sector. Most school districts contribute at least 70% to single premiums of all full-time employees.

NSBA also encourages the agencies to exclude part-time employees in eligibility *and* benefits testing for fully insured, non-grandfathered health plans. It makes little sense to compare benefits offered to full-time and part-time employees and require part-time employees to receive health benefits as great as full-time employees.

Health insurance plans offered to employee groups may have different deductibles and co-pays too. The “safe harbor” provision would have to explain if and how these plan design features figure into the “safe harbor.” NSBA submits that a safe harbor similar to one recommended above would generally work as well here.

Availability of coverage equals compliance

Question 2 in IRS Notice 2011-1 asks about whether the agencies should issue rules indicating that the availability of coverage alone would mean compliance with the nondiscrimination rules. To the extent the agencies apply the nondiscrimination rules to public school districts, NSBA supports this change. Most full-time school district employees are offered single health insurance coverage paid full (or nearly in fully) by the district, and family health insurance coverage with a significant employer contribution. Under an availability of coverage test, most school districts would comply with the nondiscrimination rules.

If, however, the concept of “benefit” is expanded beyond the benefit itself to include employer contributions toward the benefit, school districts across the country would be at risk of noncompliance with the nondiscrimination rules due to differing levels of employer contribution toward benefits of different categories of employees. Further, such an expansion of the term “benefit” would blur the line between traditional benefits and cash payments or increased salary given to employees in lieu of benefit contributions, effectively restricting the school district’s ability to structure compensation even on a taxable basis.

After tax payments

According to IRS Notice 2010-63, an insured group health plan failing to comply with the nondiscrimination requirements of § 105(h) is subject to the taxes, remedies, and penalties that generally apply for a plan failing to comply with the requirements of Chapter 100 of the IRC. Section 4980D of the IRC provides, in turn, that the failure of a group health plan to meet group health plan requirements results in a tax of \$100 for each day in the noncompliance period “with respect to each individual to whom such failure relates.” *See* 26 U.S.C. 4980D(b)(1). With respect to application of this standard to the nondiscrimination rule, NSBA asserts that the individuals “to whom such failure relates” are the highly compensated employees receiving the discriminatory benefit. According to the position taken by the IRS in Notice 2010-63, however, an insured group health plan failing to comply with the nondiscrimination requirements of § 105(h) is subject to a tax of \$100 per day *per individual discriminated against* for each day the plan does not comply with the requirement. NSBA urges the agencies to reconsider this interpretation in light of the language of Section 4980D and the severe impact this would have on school districts. A \$100 per day penalty per affected employee for non-compliant school districts would be an exorbitant expense which, as mentioned above, would have to be paid for directly out of taxpayer funds that would otherwise go to educate children.

In addition, this penalty is significantly more than requiring the highly compensated employee to simply pay the tax on the excess benefit provided to him or her as allowed for self-insured plans. Per question 10 in IRS Notice 2011-1, NSBA would welcome guidance that the incremental premium paid with after tax dollars by the highly compensated employee will avoid the penalty.

Exclude union employee from testing

Self-insured health plans are subject to an eligibility test and a benefits test. To the extent that union members do not participate in a benefit they may be excluded from eligibility testing for self-insured plans. If the regulatory agencies apply the nondiscrimination rules to school districts, in the case of fully insured health plans, to the extent that union members are covered under a collective bargaining agreement that covers health benefits, then the district should be able to exclude them from testing and treat their benefits as automatically compliant. This is consistent with what the IRS has done under comparable nondiscrimination rules for tax qualified plans. *See, e.g.*, 26 U.S.C. §§ 401(a)(4) and 410(b).

Moreover, it makes sense that union employees are excluded from testing entirely. Unionized employees are able to negotiate for the best possible health insurance benefits that their bargaining power will allow; to penalize the unionized employees and the school district for benefits that were obtained through legal collective bargaining rights seems contrary to the underlying principles of the nondiscrimination rules. Teachers and other unionized employees do not seem to be the groups of employees that the nondiscrimination rules are intended to apply to. Groups excluded from testing also should be excluded from the IRS's interpretation of the individuals to whom the noncompliance relates for purposes of the \$100 penalty.

Retirees

If the agencies apply the nondiscrimination rules to school districts, NSBA supports the exclusion of retirees for purposes of nondiscrimination testing for fully insured plans. Retiree benefits may have been negotiated years or even decades ago and different retirees may have different benefits depending on what collective bargaining agreement they retired under. These differences, along with the fact that retirees and current employees are dissimilarly situated (common sense indicates retirees who are no longer currently contributing to the work of the district would receive significantly lower benefits than current employees), make including retirees in nondiscrimination testing complicated and irrelevant.

Employers have very little room to renegotiate benefits with retirees. Court and arbitration decisions have held that employees continue to have a right to enforce benefits under collective bargaining agreements no longer in effect. So, a retiree who retired under a collective bargaining agreement provision guaranteeing a certain level of employer contributions to insurance likely has a contractual right to same. Requiring school districts (or other employers) to either pay

exorbitant penalties or breach hundreds or thousands of collective bargaining agreements and pay damages for the same is unworkable.

The retiree exclusion must allow for flexibility to accommodate the widespread governmental practice of rehiring retirees under parameters set by state pension laws. Due to teacher shortages, especially in specific subject areas such as math and science, and the decreased pool of experienced administrators due to increased early retirement initiatives, school districts across the country often rehire teachers or administrators who have retired from the district and are receiving pensions and may be participating in the district's insurance plan as retirees. Even though the employment position may be for short term or may be without benefits, the fact that retirees are employed by the district may prevent the retiree plan from coming within the exception.

In the alternative, NSBA support guidance that if the retirees are insured by a separate health plan, then retirees may be excluded for purposes of testing the active health plan and vice versa. Further, NSBA supports guidance that a retiree-only health plan is not subject to non-discrimination testing for the same reasons as described above.

Postponement of the effective date and transition period relief

As stated above, NSBA's most important goal in these comments is to convince the IRS and the other regulatory agencies not to apply the nondiscrimination rules (or significantly limit their application) to school districts offering non-grandfathered, fully insured group health plans. To the extent these nondiscrimination rules are applied to school districts, NSBA requests that the agencies postpone compliance for all non-grandfathered, fully insured group health plans covered in collective bargaining agreements and employment contracts until the existing or current agreements/contracts and any extensions expire.

IRS Notice 2011-1 states that compliance with the nondiscrimination rules is not required until after regulations have been issued. If the agencies make the final regulations effective immediately or within three or even six months of issuance, school districts will not have sufficient time to comply with them. As discussed above, school districts could be in the midst of two or three year collective bargaining agreements with unionized staff and contracts of a similar or even longer length with non-union staff. School districts could have limited or no ability to reopen contracts until their expiration.

Providing that the regulations will not be effective until all collective bargaining agreements and contracts outstanding on the day the regulations are issued expire should give school districts sufficient time to comply with the regulations. In addition, given the significant time and effort generally needed by state and local government entities to evaluate their options and make administrative and other changes from a political and legislative standpoint, NSBA submits that

a longer transition period be provided for these entities as well (as has been done in the past for other significant regulatory changes).

Respectfully submitted,


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