

Health Care Reform: Tax Provisions

Membership Conference Call
on Compliance Issues, Part 3

April 8, 2010



AMERICAN BENEFITS
COUNCIL

Overview: Employer Tax Issues

- High cost plan excise tax (“Cadillac Plan” tax)
- W-2 Reporting requirement
- Changes affecting FSAs, HRAs, HSAs
- Extension of sec. 105(h) nondiscrimination requirements
- Elimination of RDS deduction
- Additional Medicare (HI) tax on wages
- Unearned income Medicare contribution tax
- Sec. 162(m) deduction limitation
- Adult child coverage requirement
- Other tax issues for employers to consider

Reminder

- Interpretation of the health care reform legislation requires examining three sources:
 - Senate-passed bill, H.R. 3590 (now P.L. 111-148)
 - Manager's amendment to the Senate bill
 - Reconciliation bill, H.R. 4872

“Cadillac Plan” Excise Tax

- Effective beginning in 2018
- New 40% excise tax on value of employer-provided coverage exceeding certain dollar thresholds
 - \$10,200 for self-only coverage
 - \$27,500 for other coverage, e.g., employee +1, family
- Increased thresholds available to select groups
 - Qualified retirees + employees in high-risk jobs (thresholds increased by \$1,650 for self-only coverage and \$3,450 for family coverage)
 - Individuals covered by multi-employer plans (family coverage threshold applies to self-only coverage)
 - For plans that carry a higher premium cost because of age or gender (compared to FEHBP)
- Act provides for auto-increase in thresholds in 2018 if health care inflation exceeds expectations
- Indexing in 2019 based on CPI-U +1%; CPI-U thereafter



“Cadillac Plan” Excise Tax (Cont’d)

- What coverage gets counted for purposes of the new tax?
 - Applies to all “applicable employer-sponsored coverage”
 - Generally, this means all health coverage provided and/or sponsored by an employer
 - Regardless of whether paid for by direct employer subsidy, through a cafeteria plan via salary reduction by an employee, or on an after-tax basis, i.e., payroll deduction, by an employee
 - This includes, among others:
 - Contributions to FSAs (subject to new \$2,500 cap in 2013) or HRAs
 - Contributions to HSAs
 - On-site medical clinics
 - Medicare supplemental policies

“Cadillac Plan” Excise Tax (Cont’d)

- What coverage gets counted for purposes of the new tax?
 - Certain limited coverages excepted
 - What’s out?
 - Stand-alone dental and vision
 - Employee-pay-all hospital indemnity and specified disease or illness
 - Long-term care insurance
 - Accident and disability insurance
 - Liability insurance
 - Auto med insurance

“Cadillac Plan” Excise Tax (Cont’d)

- What happens if the value of the coverage exceeds the thresholds?
 - Amount of excess must be reported by the employer
 - If self-insured, to the plan administrator (likely the employer itself)
 - If fully insured, to the insurer
 - Where coverage is provided by multiple entities, then pro rata share of excess must be reported to each entity
 - Responsible parties (i.e., plan administrators and/or insurers) must then pay a 40% excise tax on the excess share
 - Insurers likely to seek indemnification or establish other ways to pass liability to employers vis-à-vis contract
 - The tax is **NOT** deductible for federal income tax purposes
 - Potential residual liability for employers who fail to accurately report value of coverage generally



New W-2 Reporting Requirement

- Effective for 2011 tax year (i.e., Form W-2 issued in January 2012)
- Employers are required to calculate and report the value of all employer-provided coverage
 - What specifically gets counted?
 - All “applicable employer-sponsored coverage” (i.e., the same definition of coverage that applies for purposes of the “Cadillac Plan” excise tax)
- How do I calculate the value of the coverage?
 - Act says use rules similar to COBRA valuation rules to determine “aggregate cost”
 - Cost versus fair market value issue
 - Rulemaking project to update COBRA regulations underway
 - Likely challenges for employers –
 - May need to value self-insured coverages not currently subject to COBRA (such as Medicare supplemental policies)
 - Valuing on-site medical clinics

Changes Affecting FSAs, HRAs, HSAs

- Employee salary reduction contributions under cafeteria plan to health FSA limited to \$2,500
 - Effective in 2013
 - Limit indexed to CPI-U
- Restrictions on the reimbursement of over-the-counter (OTC) drugs from FSAs, HRAs, HSAs, or other employer-provided health coverage
 - Exception for prescribed OTC drugs
 - Effective in 2011
- Increase in additional tax on distributions from HSAs not used for qualifying medical expenses from 10% to 20%
 - Effective in 2011



Nondiscrimination Requirements

- PPACA extends Code sec. 105(h) nondiscrimination requirements to insured group health plans, effective for plan years beginning 6 months from enactment (2011 for calendar year plans)
- Does not apply to grandfathered plans
- 105(h) requirements include complex eligibility tests and benefits tests
- Under 105(h), violations result in taxation of some or all benefits to HCIs
- PPACA amendment is to PHSA, with conforming amendments to Code and ERISA
- Appears tax consequence of violations is HIPAA group health plan \$100/day excise tax, not taxation of benefits



Elimination of Retiree Drug Subsidy Deduction

- MMA OF 2003 enacted Medicare Part D prescription drug benefit and 28% federal subsidy to employers who provide actuarially equivalent retiree drug coverage
- Subsidy was non-taxable and does not reduce employer's deduction
- PPACA disallows deduction for retiree drug expenses to the extent of the subsidy
- Has effect of increasing employer's cost of providing retiree coverage

Elimination of Retiree Drug Subsidy Deduction

- Under Reconciliation bill, change is effective beginning in 2013
- But under accounting rules, change results in an immediate charge to tax expense in employer's income statement for quarter of date of enactment
- Recent accounting announcements have generated substantial press coverage and political controversy
- House Energy and Commerce Subcommittee hearing scheduled for April 21
- Studies on effect change will have on employer coverage vs. Part D coverage

Additional Medicare (HI) Tax On Wages

- Employee HI tax applies to 1.45% of covered wages
- Under PPACA, an additional employee HI tax of 0.9% will apply to wages in excess of \$250,000 (joint filers) and \$200,000 (others)
- Effective for wages received after 2012
- Employer withholding requirements, based on employee's wages from employer in excess of \$200,000

Unearned Income Medicare Contribution Tax

- Under Reconciliation bill, a new 3.8% tax applies to the "net investment income" of taxpayers with modified AGI in excess of \$250,000 (joint filers) and \$200,000 (others)
- Effective in 2013
- Modified AGI includes amounts excluded as foreign earned income under Code sec. 911
- Net investment income generally includes interest, dividends, capital gains, annuities, royalties, and rents, and certain (generally "passive") trade or business income
- Distributions from qualified retirement plans, 403(b)s, IRAs, Roth IRAs, and 457(b)s are excluded
- Does not appear that distributions from nonqualified plans are included, although not entirely clear



162(m) Deduction Limitation On Compensation Paid By Health Insurance Providers

- Limits deduction for compensation paid by health insurance providers to \$500,000
- Effective for compensation paid after 2012 with respect to services performed after 2009
- Patterned somewhat on 162(m)(5) TARP limitation
 - Applies to deferred compensation
 - No performance-based compensation exception
- But also applies to more than top-5 executives
 - Officer, director or employee
 - Anyone who provides services for or on behalf of insurer



162(m) Deduction Limitation On Compensation Paid By Health Insurance Providers

- Guidance under TARP on pro rata allocation of long-term incentive compensation
 - Does not recognize condition-based performance measures
- Controlled group rules may expand reach of provision
- Possible model for future, generally applicable "revenue raisers"

Adult Child Extended Coverage

- Act requires plans to provide adult child coverage if it provides for any dependent coverage
 - Effective for plan years beginning on or after September 23, 2010 (i.e., 2011 for calendar year plans)
 - For plan years beginning prior to 2014, a “grandfathered” group health plan must only provide adult child coverage to qualifying individuals who are not eligible for other employer-sponsored coverage
- Requires that coverage be made available to adult children up to age 26
 - Statute does not incorporate tax dependent definition or related tests
 - Statute says HHS Secretary shall issue regulations defining those “dependents” that are eligible
 - Is there an age-in requirement? Unclear, but probably “no”
 - How does this apply to medical savings plans (such as HRAs) with dependent death benefits?

Adult Child Extended Coverage (Cont'd)

- What types of coverage are subject to the coverage extension?
 - Generally applies to individual or group health coverage
 - However, generally does **NOT** apply to HIPAA-excepted benefits (including Medicare supplemental insurance and on-site medical clinic coverage)
- Corresponding tax change made by reconciliation bill
 - Makes employer-paid coverage (directly or via cafeteria plan) for an adult child tax-free (i.e., excludable from income) for any tax year ending prior to the year in which such child attains age 27
 - Why the disconnect between coverage and tax provision?
 - Employers need not dis-enroll adult children mid-year
 - Should also help with state adult child coverage rules that often run through age 27

Other Tax Considerations

- Automatic enrollment
 - The Act amends the FLSA to require employers with 200+ employees to auto-enroll employees if offer coverage
 - Effective date appears to be once regulations are published by Secretary of Labor
 - Tax issues are likely to arise
 - Employers will presumably want to auto-enroll new employees into cafeteria plans to allow for salary reduction of group premiums
 - Payroll tax issues regarding opt-out – Is opt-out prospective only?
 - Do opt-outs get a pass on the uniform coverage rules under Code section 125?
- Employer’s new role regarding tax subsidies, vouchers and penalties
 - Premium tax credits, i.e., subsidies, for individuals and small businesses
 - W-2 will be highly relevant here
 - Employer “pay or play” penalties
 - Assessed and paid as tax assessment



Discussion and Questions

➤ Reminder:

- Next call is April 22 at 1:30 p.m. ET
- **Topic:** Retiree Reinsurance and CLASS programs
- Please send topics for future calls

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