Capital BLUE

Answers about Health Care REFORM for your business

Since the time of its enactment in 2010, the health care reform law has remained controversial — at least in part due to a constitutional challenge to the law's requirement that almost all Americans carry health insurance or pay a penalty tax. In June 2012, the U.S. Supreme Court upheld the law's "individual mandate." As a result, except as noted below, the law is generally slated to continue to take effect as scheduled.

Background

The Patient Protection and Affordable Care Act (the "Act," as amended) overhauls the health care environment in the U.S. The goal: to provide a minimum level of health care coverage for eligible individuals. For example, the law requires most U.S. citizens and legal residents to have health insurance. Income eligible individuals and families will receive premium tax credits to help pay for coverage. Those choosing not to carry coverage will pay a penalty tax.

The Act places new responsibilities on employers that, over time, may well change the nature of employer-provided health care. Large employers choosing not to offer their employees qualifying coverage will pay an additional tax to help finance their employees' health care. This requirement was recently delayed until 2015. An exception applies for smaller businesses.

The law's provisions generally go into effect on dates ranging from 2010 through 2018. For more details, see the *Calendar of Effective Dates* later in this publication.

The following pages summarize the key provisions of the Act that may affect your business. You will gain insight as to how the law applies in defined situations and learn ways to plan for the law's impact. But keep in mind that the Act contains many complex rules and exceptions. Professional guidance is recommended before applying anything you read here to your individual or business situation.

Access to Coverage — The Basics

It is important for business owners and executives to understand how the Act expands individuals' access to health care insurance coverage, since those rules tie into the provisions affecting employers' responsibilities. Among other provisions, the law:

- Generally requires most individuals to have at least a minimum level of health care coverage ("minimum essential coverage").
- Creates state-based Exchanges now known as the "marketplace" through which individuals can buy coverage.
- Provides advance refundable premium tax credits and cost-sharing reductions to make health care more affordable for individuals/families with income up to 400% of the federal poverty level (for example, at 2013 levels, a family of four with income up to $94,200).
- Imposes a penalty tax on individuals who fail to carry minimum essential coverage. Exceptions apply (e.g., for those whose income is below the threshold for filing a federal income-tax return).
- Allows personal or employer-provided health benefit coverage existing at the time of enactment to stay in place under a "grandfather" provision.

Employer Shared Responsibility for Health Care Coverage

While the Act does not *require* employers to provide minimum essential health care coverage to employees, it strongly encourages them to do so. How? By offering "incentives" in the form of both carrots and sticks.

Small Business Exchange: The Act creates state-based Exchanges (Small Business Exchanges).

Small Employer Health Care Tax Credit: The Act offers certain small employers that meet certain size and salary requirements and purchase health insurance coverage for employees a sliding-scale income-tax credit to help them pay for the plan.

Employer Penalty: Beginning in 2015, the law will exact a penalty on certain larger employers that fail to provide adequate minimum essential health care coverage. An "applicable large employer" is defined as one having an average of at least 50 full-time (or full-time equivalent) employees on business days during the previous calendar year.

In general, the penalty will apply where the employer offers:

- no minimum essential coverage,
- minimum essential coverage that is "unaffordable" (it costs the employee more than 9.5% of household income), or
- minimum essential coverage for which the plan's share of the total allowed cost of benefits provided to employees ("actuarial value") is less than 60%.

Large employers that (1) do not offer minimum essential coverage and (2) have at least one employee who receives a premium tax credit or cost-sharing reduction to help pay for individual coverage will incur an additional "assessable payment" (read: tax). The assessment is equal to $2,000 per full-time employee per year (computed on a monthly basis). The Act excludes the first 30 employees from the payment calculation.

> ***Example:*** *Sample Corporation has 65 full-time employees. It does not offer minimum essential health care coverage throughout the year. The amount payable by Sample Corporation will be 35 (65 minus 30) employees multiplied by 1/12 of $2,000, or $5,833.33 a month, or $70,000 a year.*

A penalty will also apply to large employers that offer minimum essential coverage where that coverage is either "unaffordable" or has an "actuarial value" of less than 60%. If at least one full-time employee receives a premium tax credit or cost-sharing reduction, the employer will pay $3,000 for each employee receiving a premium credit or cost-sharing reduction *or* $2,000 multiplied by the total number of full-time employees, if that amount is less.

Note that employers with fewer than 50 employees are *exempt*. Note, too, that large employer grandfathered plans could be subject to a possible assessment if the coverage falls within the penalty provisions.

Which Employers Are Affected?

Several of the Act's changes apply only to employers that have specified numbers of employees. Here is a brief summary of the limitations.

Act Provision	Applies to Employers with:
Small Business Exchange eligibility	50 or fewer employees
Small employer tax credit for providing health insurance	25 or fewer employees; $50,000 maximum average wage
Penalty for not providing minimum essential health coverage or affordable coverage	50 or more employees
Simple cafeteria plans for small businesses	100 or fewer employees
Automatic enrollment in employer health plan	Employers that have more than 200 employees and offer health coverage

Other Employer Coverage Information: The Act contains several other important provisions affecting employer-provided coverage. Among them:

- An employer with more than 200 full-time employees (or equivalents) will be required to automatically enroll employees in a health insurance plan it offers. The employees may opt out of coverage altogether or elect another plan offered by the employer.
- Beginning in 2015, most employers providing minimum essential coverage will be required to file information about the coverage with the IRS. The filings will identify individual employees, number of months covered, the coverage type, and the premium amount paid by each employee. Employers will also have to file information about employee

coverage with the U.S. Department of Health and Human Services. Failure-to-file penalties apply.

- Employers that provide health insurance coverage will have to disclose the benefit's cost on each employee's annual Form W-2, *Wage and Tax Statement*. This provision does *not* alter the tax-free treatment of employer-provided health coverage.
- Employers generally will have to provide employees, upon hire, a notice that describes the availability of and the services provided by the Exchange and the eligibility requirements for buying insurance through the Exchange, as well as the consequences if an eligible employee chooses to do so. Other employee notices may be required.
- Eligible small businesses will be able to establish "simple cafeteria plans" that allow them to offer tax-free health and other benefits to their employees. An employer is eligible to sponsor a simple cafeteria plan if, during either of the preceding two years, the business employed 100 or fewer employees on average (based on business days). Minimum contribution and eligibility/participation requirements apply.
- Each Small Business Exchange will be required to offer at least two multi-state plans to employers so that employers having employees in different states can obtain such coverage.
- It also allows employers to offer employees awards (premium discounts, waivers of deductibles or co-pays) of up to 30% of the cost of coverage for participation in a wellness program and up to 50% in the case of a wellness program designed to "prevent or reduce tobacco use" and meeting certain health-related standards.

Excise Tax on High-cost Insurance

In 2018, the Act imposes a 40% nondeductible excise tax on issuers (insurance companies and self-insured plan administrators) of high-end, public or private employer-sponsored health plans (so-called "Cadillac" plans). The tax will generally apply to the extent annual premiums are

Calendar of Effective Dates of Health Care Reform Law Provisions

2010

- Small Employer Health Care Tax Credit (initial phase)
- Reinsurance program for age 55 or older retiree health coverage
- Dependent coverage to age 26 (for dependents not covered by another employer-sponsored plan)
- No lifetime caps on dollar value of health benefits
- No preexisting condition exclusions for children
- No rescissions unless fraud
- Increase in exclusion for employer-provided adoption assistance

2011

- Restrictions on using funds in a health FSA, HRA, HSA, or MSA for over-the-counter medicines
- 20% additional tax on HSA and MSA withdrawals not used for medical expenses
- Fee on branded prescription drug manufacturers and importers
- New simplified cafeteria plan for small businesses

2012

- Summary of Benefits and Coverage (SBC) to be distributed to health plan applicants and enrollees

2013

- Additional .9% Medicare tax on wages/self-employment income of high earners
- 3.8% Medicare surtax on investment income of higher income taxpayers
- $2,500 limit on annual health FSA contributions
- 10% floor on itemized medical expense deduction
- Elimination of business deduction for certain retiree prescription drug costs

2013 (continued)

- Limit on deduction for compensation paid to insurance company executives (for services performed after 2009)
- 2.3% excise tax on medical device sales

2014

- Individual health care minimum essential coverage mandate/penalties/subsidies
- Individual and Small Business Exchanges available
- Small Employer Health Care Tax Credit (second phase)
- No annual limits on coverage in grandfathered individual and group plans
- No preexisting condition exclusions for individuals
- Employee awards for wellness programs permitted
- Annual fee on health insurance providers (for net premiums written after 2012)
- Increases in required estimated tax payments for large corporations

2015

- Employer shared responsibility mandate/penalties (assessments)
- Expanded information reporting regarding employer-sponsored health plans

2017

- States can allow businesses with more than 100 employees to purchase coverage through Small Business Exchanges

2018

- 40% excise tax on high-cost health coverage provided by employers more than $10,200 for individual coverage and $27,500 for family coverage. The threshold amounts are higher — $11,850 (individual) and $30,950 (family) — for plans covering employees engaged in certain high-risk

Plan Features Required by the Act

Health care plans must contain certain plan features. Here's a basic rundown. Some exceptions apply.

Required Feature	Individual Coverage and Group Coverage Purchased Through Exchanges	Grandfathered Employer-provided Health Coverage
Guaranteed issue and guaranteed renewable	•	
Rating variation based only on age, family composition, tobacco use, and location	•	
Dependent coverage for adult children to age 26 (if plan offers coverage)	•	•
Coverage for preventive services	•	
No limits on the dollar value of essential benefits	•	•
No rescission of coverage except if fraud exists and misrepresentation	•	•
No waiting periods in excess of 90 days	•	•
Limited deductibles and co-pays	•	
No preexisting condition exclusions for children (in 2014 for adults)	•	•

professions or retired individuals age 55 and older who are not eligible for Medicare. Standalone dental and vision plans are excluded in figuring the amount subject to tax.

New Restrictions on Health FSAs, HRAs, HSAs, and Archer MSAs

The Act imposes several new restrictions on health flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), health savings accounts (HSAs), and Archer medical savings accounts (MSAs).

FSA Contributions: The Act places a $2,500 annual limit on an employee's salary reduction contributions to a health FSA under a cafeteria plan. The limit will be indexed for inflation.

Definition of Medical Expense: The law generally conforms the definition of medical expense for purposes of employer-provided health coverage to the definition for purposes of the itemized deduction for medical expenses. As a result of this change, the cost of over-the-counter medicines is not reimbursable with excludable income through a health FSA, HRA, HSA, or MSA unless a physician prescribes the medicine.

Penalty Taxes: Withdrawals from HSAs before age 65 that aren't used for qualified medical expenses will be subject to an additional tax of 20%, up from 10% under prior law. The law also increases the additional tax on MSA withdrawals not used for qualified medical expenses from 15% to 20%.

Medicare Tax Increases for High Earners

The Act imposes Medicare tax increases on higher income taxpayers.

Additional Hospital Insurance Tax: Individual taxpayers who earn more than $200,000 a year, married taxpayers filing jointly who earn more than $250,000, and married taxpayers filing separately who earn more than $125,000 will face higher taxes on a portion of their wages. These taxpayers will have to pay an additional

Medicare tax equal to .9% of their wages over the relevant threshold amount for their filing status. In effect, this change increases the Medicare tax rate on those earnings from 1.45% to 2.35%.

Under a parallel provision, self-employed individuals will be liable for an additional tax of .9% on their self-employment income to the extent it exceeds the applicable threshold amount. The additional self-employment tax is not deductible.

Note that employers only have to withhold the additional .9% tax on an employee's wages over $200,000. Employees will need to be made aware that in certain circumstances, their full liability for the additional tax may not be covered through withholding.

Surtax on Investment Income: The law also imposes a 3.8% surtax — called the "unearned income Medicare contribution" — on the investment income of higher income individuals, estates, and trusts. For individuals, the tax is equal to 3.8% of the *lesser* of (1) net investment income for the year or (2) the amount by which modified adjusted gross income (AGI) exceeds an annual threshold amount. The thresholds are the same as for the additional Medicare tax on earnings (e.g., $200,000 a year for individual taxpayers) and are not inflation-adjusted.

Net investment income includes gross income from interest, dividends, annuities, royalties, rents, net capital gain, and income earned from passive trade or business activities. However, the 3.8% surtax does *not* apply to qualified retirement plan and individual retirement account distributions.

Increased Floor on Medical Deduction

Under the law, individuals generally will be able to deduct their medical expenses as an itemized deduction only to the extent that their aggregate expenses exceed 10% of adjusted gross income. However, a 7.5%-of-AGI floor will continue to apply through 2016 if either the taxpayer or the taxpayer's spouse is age 65 or over.

Retiree Prescription Drug Cost Deduction

Employers that receive federal subsidy payments for providing prescription drug coverage to retirees eligible for Medicare Part D will no longer be able to claim a business expense deduction for retiree prescription drug expenses to the extent of the subsidy payments received.

Targeted Revenue Raisers

The law includes several revenue raising provisions targeted at specific industries.

Insurance Company Executive Compensation: The Act places an annual cap on deductions that certain companies may claim for executive compensation and certain other compensation paid. Where applicable, the deduction limit is $500,000 per individual.

Health Insurance Providers: Insurance companies will be subject to an annual fee, allocated based on market share of net insured premiums written.

Pharmaceutical Manufacturers and Importers: The Act also imposes an annual flat fee on businesses that manufacture or import branded prescription drugs for sale to, or in connection with, specified government programs. The aggregate fee will be apportioned to companies according to market share.

Medical Device Manufacturers, Producers, and Importers: These companies will pay a 2.3% excise tax on the sale of taxable medical devices. Eyeglasses, contact lenses, hearing aids, and other IRS-specified medical devices sold at retail establishments for personal use are exempted.

Other Business-related Provisions

Business owners may also want to take note of these additional provisions included in the Act.

Uniform Coverage Summary: The Act requires private individual and group health plans to provide a uniform Summary of Benefits and Coverage (SBC) to all applicants and enrollees. The law's intent is to enable consumers to compare health insurance coverage options before they enroll and understand their coverage once they enroll. The provision applies to all individual and group health plans, regardless of whether they are grandfathered or not.

Estimated Taxes: Large corporations are subject to increases in certain required payments of estimated taxes.

Summary

Health care reform has impacted — and will continue to impact — your business. To what extent depends on a number of factors: your business' size, its current health care benefits, and the makeup of its work force, to name just a few.

We hope this description of the Patient Protection and Affordable Care Act helps you gain a better understanding of the changes nearly every individual and business will face over the next several years. It is important to consider how the law will affect your situation.

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