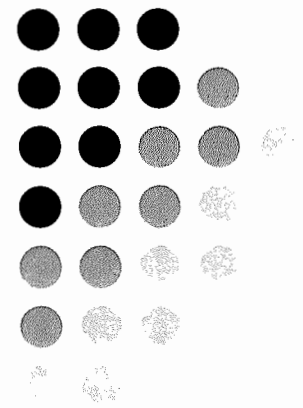
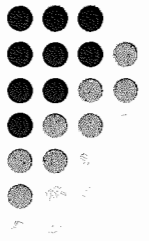


# **Tax Aspects of Health Care Reform**

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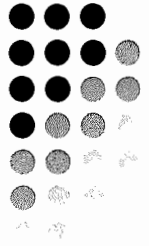
Sheldon H. Smith, Esq.  
Holme Roberts & Owen LLP  
Denver, Colorado





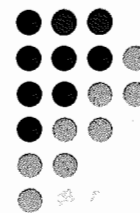
# Structure Mostly Intact

- **The health insurance structure that Americans seem to love in spite of its cost remains mostly intact**
- **There are, to be sure, reforms in the health insurance scheme, but those are mostly items that both Democrats and Republicans agree upon**
- **However, there will be significant “subsidized” health care paid for by taxpayers**
- **And here lies the rub**

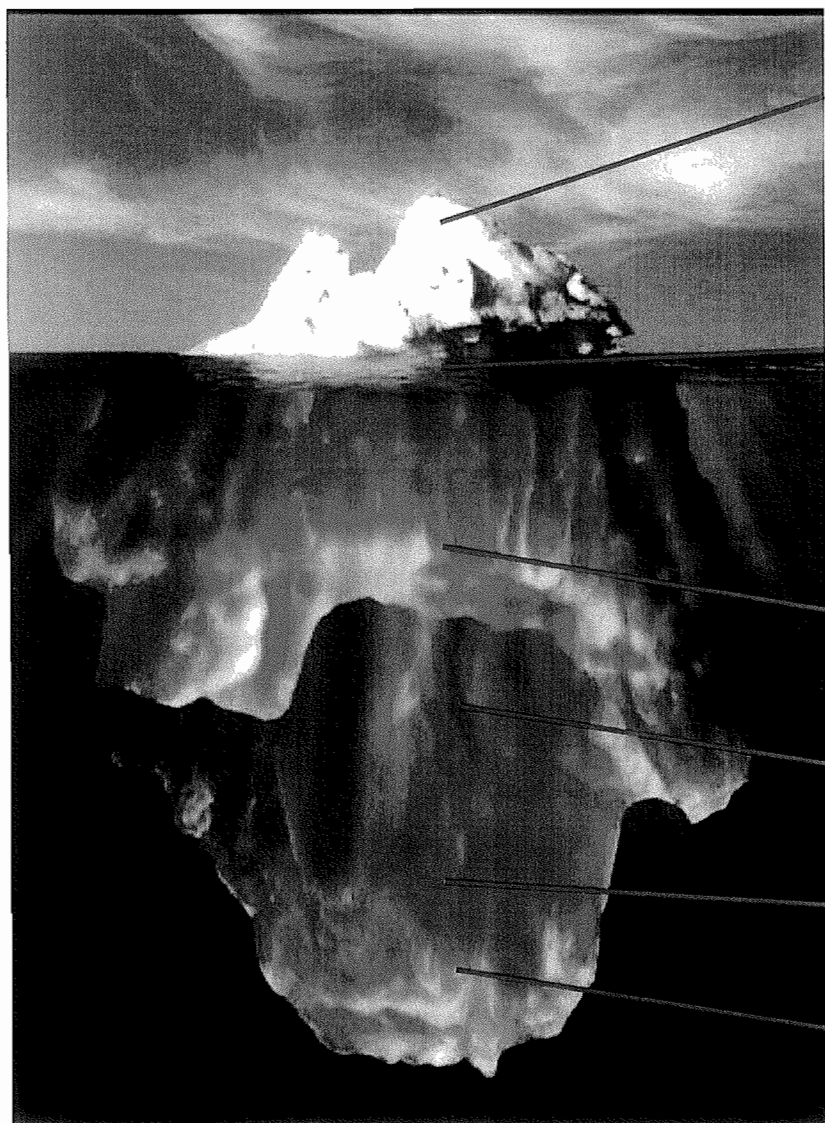


# Scope

- **This legislation will impact about 1/6<sup>th</sup> of the US economy**
- **It's economic impact on individuals and businesses will be significant**

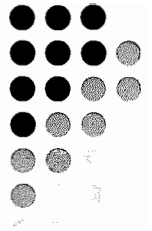


# What will drive employer costs?

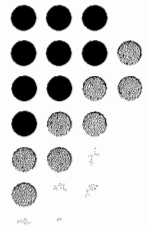


- Benefit mandates
- Reporting & Admin mandates
- Additional participants
- Loss of Part D subsidy
- Penalties
- System changes & other compliance costs
- Pay or play
- Tax implications
- Industry sector taxes
- Adverse selection
- Cost shifting

# **A Biggee: 2011 Coverage Mandates for All Plans**

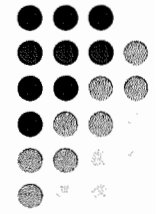


- **Lifetime and annual limits**
  - **Exception: Restricted annual limits with respect to essential health benefits for plan/policy years beginning before January 1, 2014**
  - **This exception only applies to grandfathered group health plans and not to a grandfathered health plan that is individual health insurance coverage**
- **Coverage for adult children not eligible for coverage under another employer plan**
- **Pre-existing conditions exclusions prohibited for children under age 19**



# Grandfathered Plan Examples

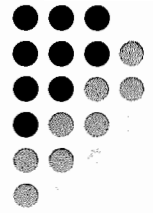
- **Beginning on page 9 of the outline**



## 2010: Small Business Tax Credit

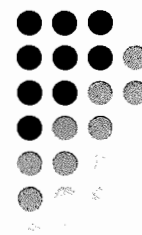
- **Small employers may claim up to a 35% tax credit (50% in 2014) for employer contributions paying 50% or more of each employee's health insurance premiums; small employer tax-exempts may offset payroll taxes up to 25% (35% in 2014)**

# 2010: Phase Out of Small Business Tax Credit



- **6.667% tax credit reduction for each full-time employee over 10; and**
- **4% tax credit reduction for each \$1,000 of average wages over applicable dollar amount**
- **Tax credit not eligible for amounts paid or incurred on behalf of a self-employed individual, 2% S-Corp Shareholder, 5% owner or § 152(d)(2)(A) to (G) individuals and their dependents under § 152(d)(2)(H)**
- **Tax credit only available for tax years in 2010 through 2015**

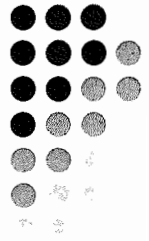




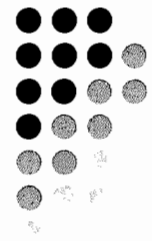
## 2010: Medicare Part D Deduction

- **Some employers will have a book impact from the write-down of deferred income-tax assets to reflect loss of deduction after 2012 for retiree drug benefit subsidized by Medicare Part D**

# **2010: Exclusion from Income for Child Coverage**

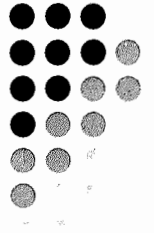


- **In Notice 2010-38, the IRS provides guidance to implement the Act's exclusion from gross income under Code § 105(b) applicable to an employee's child who has not attained age 27**
- **The Notice requires carriers and group health plans to continue to make coverage available for adult children to age 26**



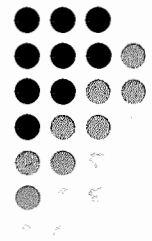
## 2010: Changes to Conform HSAs, HRAs, and Cafeteria Plans

- **§ 125 permits pre-tax elections between cash and certain qualified benefits, which generally means coverage under a group health plan or a health flexible spending arrangement**
  - **Notice 2010-38 provides that the IRS and the Treasury Department plan to coordinate the cafeteria plan rules with the Act's rules governing adult children such that a benefit will not fail to be a qualified benefit merely because it provides coverage or reimbursements for a child who has not attained age 27 as of the end of the employee's taxable year**
  - **These changes will require employers to amend their cafeteria plans by December 31, 2010 and the amendments can be retroactive to March 30, 2010**



## 2010: Child Coverage Examples

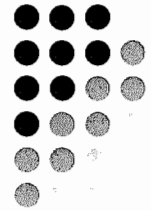
- **Examples begin on Page 19 of the outline**



## 2010: Excise Tax on Indoor Tanning Salon Services

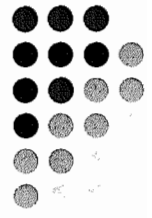
- **For services performed on after July 1, 2010, a 10% excise tax is imposed on amounts paid for indoor tanning services (whether paid by insurance or otherwise)**
- **Of all the industries in America which do you think had the weakest lobby?**

## 2011: Inclusion of Cost of Employer-Sponsored Health Coverage on Form W-2

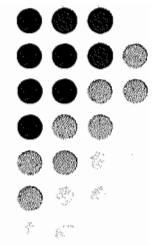


- **Employers must report on Form W-2 the aggregate value of all employer-provided health coverage for each employee**
  - Excludes* contributions to an MSA, HSA, salary reduction FSA
  - Includes* any portion paid by employee through after-tax premiums
- **The reported value is computed using rules similar to COBRA continuation coverage under § 4980B(l)(4) (and accompanying regulations) including the special rule for self-insured plans**

# 2011: Additional Tax on HSA and Archer MSA Distributions



- **Increased excise tax penalty to 20% on HSA withdrawals (currently 10% penalty) and MSA withdrawals (currently 15% penalty) for nonmedical expenses**

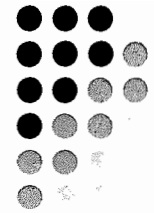


## **2011: What are the Requirements for a Simple Cafeteria Plan?**

- **Established and maintained by an eligible employer**
- **Annually satisfy specific plan eligibility requirements**
- **Annually satisfy specific plan participation requirements, and**
- **Annually receive minimum employer contributions**

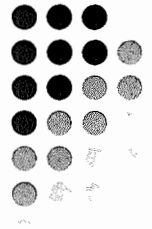


# 2011: SPC Definitions – HCE and Key Employee



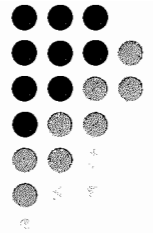
- **“Highly compensated employee” is determined using the rules of § 414(q)**
  - This definition applies only for purposes of the minimum contribution requirement to be a simple cafeteria plan
- **“Key employee” is determined using the rules of § 416(i) of the Code**
  - This definition applies only for purposes of the minimum contribution requirement to be a simple cafeteria plan

# 2011: SPC Requirements - Eligibility



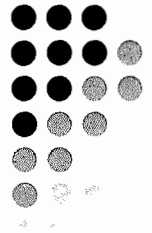
- **Under the plan's terms, all employees with at least 1,000 hours of service during the preceding plan year must be eligible to participate during the current plan year**
- **The employer may choose to exclude the following employees:**
  - **those who have not attained age 21 before the close of the current plan year (or such younger age as the employer may choose)**
  - **those who have fewer than 1,000 hours of service for the preceding plan year**
  - **those who have less than one year of service with the eligible employer as of any day in the current plan year (or such shorter period as the employer may choose)**
  - **those who are covered under a bona fide collective bargaining agreement**
  - **certain nonresident aliens working outside the U.S.**

# 2011: SPC Contribution Requirement – The Rub

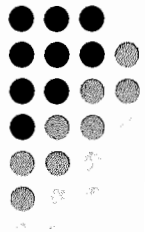


- **Under the terms of the simple cafeteria plan, the employer must be required to make a contribution for the year**
  - **to provide qualified benefits under the simple cafeteria plan**
  - **on behalf of each qualified employee**
  - **irrespective of whether the qualified employee makes any salary reduction contribution for the year**
  - **in an amount equal to at least the amount calculated under an alternative contribution formula**

# 2011: SPC Losing “Eligible Employer” Status

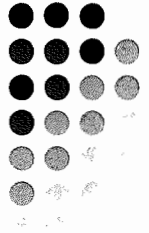


- **If, during a plan year, an eligible employer created a simple cafeteria plan and in a later year employed an average of more than 100 employees on business days in both of the preceding two years, that employer will continue to be treated as an eligible employer in each later year**
- **The “growth” rule will not apply in any subsequent plan year once the employer employs an average of 200 or more employees during any year preceding the subsequent year**



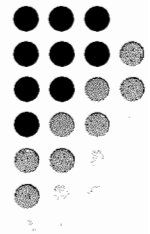
## Effective in 2012

- **Not much will be going on**
  - **Fortunately, Congress repealed the 1099 reporting requirement that was imbedded in the original statute**
- **Maybe a good year for reform except it's an election year yet again**
- **Can you believe how often we have to listen to those awful ads?**



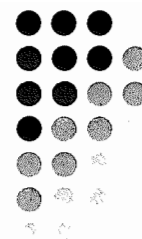
## 2013: Cap on Health FSAs

- **The Act caps an employee's salary reduction for a health FSA at \$2,500 in 2013, indexed to CPI-U (rounded to \$50) thereafter**
  - **The cap will apply in the aggregate to all cafeteria plans offered by an employer (as defined by §§ 414(b), (c), (m) and (o))**
  - **The Cap does not apply to an HRA or FSA that is not part of a salary reduction arrangement under a cafeteria plan**



## 2013: Increase AGI Limit

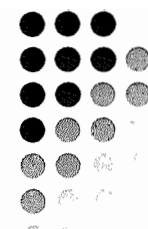
- **The Act increases the threshold to claim an itemized deduction for unreimbursed medical expenses from 7.5% of adjusted gross income (“AGI”) to 10% of AGI for regular income tax purposes**
  - **Exception: During 2013, 2014, 2015 and 2016, if either the taxpayer or the taxpayer's spouse turns 65 before the end of the taxable year, the increased threshold does not apply, and the threshold remains at 7.5% of AGI**



## 2013: Joint Filer Issue

- **An employer's withholding liability for any employee is based on wages in excess of \$200,000 paid by that employer to that employee for the year (without regard to filing status or wages of employee's spouse)**
- **Surprise for joint filers who don't individually have \$200,000**

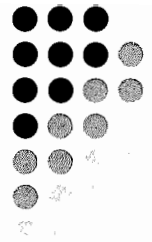




# 2013: Investment Income

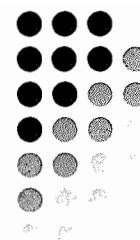
## Medicare Tax on Individuals

- **Tax is 3.8% of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount**
  - The threshold amount is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 in any other case
  - Modified AGI is AGI increased by the amount excluded from income as foreign earned income (net of the deductions and exclusions disallowed with respect to the foreign earned income)



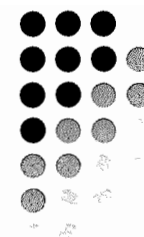
# 2013: Investment Income

- **The sum of:**
  - **Gross income from interest, dividends, annuities, royalties and rents (other than income derived from any trade or business to which the tax does not apply)**
  - **Other gross income derived from any business to which the tax applies**
  - **Net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in a trade or business to which the tax does not apply**
- **Investment income does not include distributions from a qualified retirement plan or amounts subject to self-employment tax**



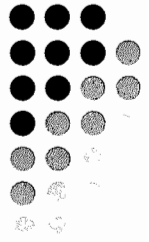
## 2013: Limitation on Excessive Employee Remuneration Under Code § 162(m)

- **The Act limits the deduction for employee remuneration paid by certain health insurance providers**
- **Under § 162(m), the limitation applies to certain individuals who are paid in excess of \$500,000**



## 2014: Employer Health Insurance Coverage Reporting Requirement

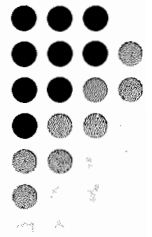
- **Every insurer and every employer providing a health plan (including a grandfathered plan) shall report to the IRS and to covered individuals on prescribed forms**
  - **Report must include health insurance coverage information, e.g., portion of premium paid by employer**



# 2014: The Employer Penalty

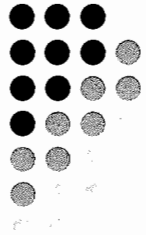
- **Applies when the applicable large employer**
  - **Does not offer coverage for all its full-time employees**
  - **Offers “minimum essential coverage” that is unaffordable**
  - **Offers minimum essential coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60%**

# 2014: How Do We Determine Employee Status?



- **An employee who in any month works an average of at least 30 hours or more per each week is counted as one employee**
- **All other employees are counted on a pro-rated basis**
- **The number of full-time equivalent employees is important only to determine whether an employer is an applicable large employer**

# 2014: Government Sponsored Programs



- **Include:**

- Medicare**

- Medicaid**

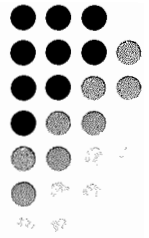
- Children's Health Insurance Program**

- Coverage for members of the U. S. military**

- Veterans health care**

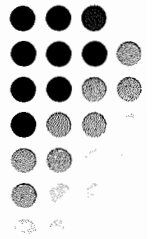
- Health Care for Peace Corps volunteer**

# 2014: More Minimum Essential Coverage



- **Any of the following if provided under a separate policy, certificate, or contract of insurance:**
  - limited scope dental or vision benefits**
  - benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof**
  - other limited benefits similar to those above, to the extent specified in regulations**
  - coverage only for a specified disease or illness**
  - hospital indemnity or other fixed indemnity insurance**
  - Medicare supplemental health insurance**
  - coverage supplemental to TRICARE**

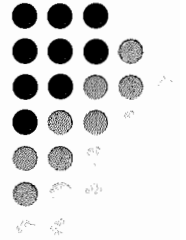




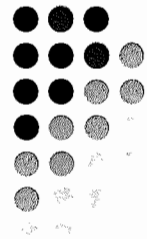
# 2014: Excise Tax Penalties

- **There are two aspects to the excise tax penalty**
  - **The applicable aspect depends on whether or not an applicable large employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer sponsored plan**
- **In either case, any excise tax penalty due is determined on a monthly basis**

# 2014: The Amount of the Penalty



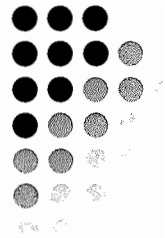
- **The penalty is the product of the number of the employer's FTEs (excluding the first 30 employees) multiplied by one-twelfth ( $1/12$ ) of \$2,000 (or \$166.67 per month)**
- **Determination is made without regard to the number of the employer's FTEs who are receiving a premium tax credit or cost-sharing reduction**
- **After 2014, this \$2,000 amount will be indexed**



## 2014: Unaffordable Coverage

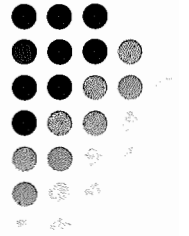
- **Employer-provided coverage is “unaffordable” if the premium required to be paid by the employee exceeds 9.5% of the employee's household income**
- **This percentage is indexed to reflect increases in the per capita growth in premiums as determined by the Secretary of HHS**
- **To demonstrate that coverage is unaffordable, the employee must obtain an affordability waiver from the exchange**
- **Special rules apply where an employer requires salary reduction contributions and employee reimbursements**

# 2014: Cafeteria Plans – No Exchange Coverage



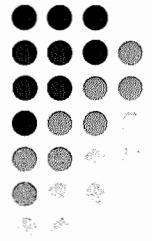
- **New § 125(f)(3) provides that a “qualified benefit” under a cafeteria plan does not include qualified health plan offered through an Exchange (with exception for certain small employers)**

# 2014: Individual Responsibility for Health Coverage

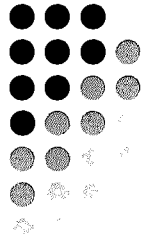


- **The Act requires non-exempt U.S. citizens and legal residents to maintain qualified health insurance coverage**
  - **Is this constitutional under the Commerce Clause?**
  - **Litigation is pending, and motion to dismiss was just denied**

# 2014 - 2016: Individual Excise Tax

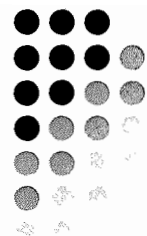


- **Individuals who fail to maintain minimum essential coverage will be subject to a penalty equal to the greater of:**
  - **2.5% of household income in excess of the taxpayer's income for the taxable year over the threshold amount of income required for income tax return filing; or**
  - **A flat dollar amount (when fully phased in by 2016) of \$695 per uninsured adult in the household**



## 2014 - 2016: The Penalty

- **The per adult annual penalty is phased in as follows: \$95 for 2014; \$325 for 2015; and \$695 in 2016**
  - **For years after 2016, the \$695 amount is indexed to CPI-U**

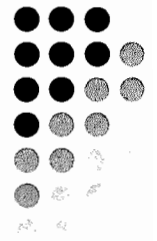


## 2014 – 2016: Can't Afford It

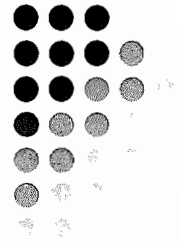
- **Individuals who cannot afford coverage because their required contribution for employer-sponsored coverage exceeds 8% of household income (or, alternatively, the lowest cost available bronze level plan available from the state exchange) are exempt**
- **In years after 2014, 8% is increased by the amount by which premium growth exceeds income growth**
- **Additional rules apply where self-only coverage is affordable to an employee but family coverage is not**
- **Taxpayers with income below the income tax filing IRS thresholds are also exempt**



## 2014: Employer-Provided “Free Choice” Vouchers to Avoid Penalty for Unaffordable Coverage



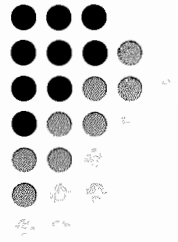
- **Employers who offer coverage under a health plan (and pay portion of premium) “shall” offer vouchers to “qualified employees”**
  - **Failure to offer voucher does not cause tax or penalty**
  - **The voucher relieves the employer of \$3,000 unaffordable-coverage tax for each employee receiving the voucher**
  - **The voucher is deductible to the employer, and tax-excludable by the employee**
  - **Employee uses voucher as credit against premium required for Exchange-provided coverage (employer actually pays voucher amount to Exchange)**



## 2014: Voucher Amount

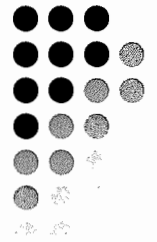
- **The amount of voucher is dollar value of employer's contribution to health plan (or, if multiple plans offered, dollar value of plan with largest percentage of employer-paid cost)**
- **The cost of plan is determined like COBRA cost, except it is adjusted for age and category of enrollment in accordance with regulations**
- **Not clear if vouchers will be permitted (or required) for retiree coverage**

# 2015- 2017: What the H\*\*\* Just Happened?



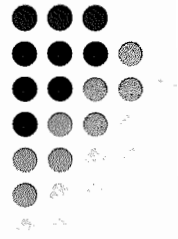
- Time to sit back and reflect
- Gather your wits and pay your taxes and penalties
- Wish that the Congress had the guts to put real reform in place

## 2018: Excise Tax on High Cost Employer-Sponsored Health Coverage – “Cadillac” Health Plans



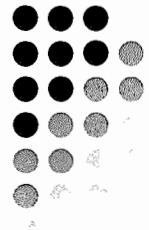
- **The Act imposes an excise tax on insurers and sponsors of self-funded group health plans where the aggregate value of employer-sponsored health insurance exceeds a threshold amount**
- **Union plans?**
- **Congress’ plan? Yeah, right!**

# 2018: Is There an Excess Benefit?

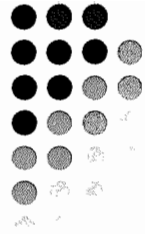


- **The tax is imposed with respect to coverage for a tax period if:**
  - **an employee is covered under any applicable employer-sponsored coverage at any time during the tax period, and**
  - **there is any “excess benefit” with respect to the coverage**

## 2018: Taxable Excess Benefit for Retirees and High Risk Professions



- **There are higher thresholds for qualified retirees and individuals covered by a plan if a majority of plan participants are in certain “high risk” professions**
- **The single coverage base threshold is increased to \$11,850 and the family coverage base threshold is increased to \$30,950**

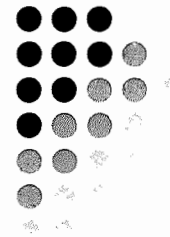


# 2018: High Risk Profession

- **Means:**

- **Employed to repair or install electrical or telecommunication lines**
- **Law enforcement (defined by reference to the Omnibus Crime Control and Safe Streets Act);**
- **Fire protection activities (defined by reference to the FLSA)**
- **Out-of-hospital emergency medical care;**
- **Longshoremen (as defined by reference to the Immigration and Nationality Act)**
- **Construction, mining, agriculture (but not food processing), forestry, and fishing**
- **Applies to retirees if they were in a “high risk” profession for at least 20 years**

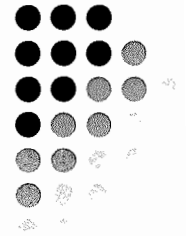
# 2018: Age and Gender Adjusted Excess Premium Amount



- **The age and gender adjusted excess premium amount is equal to the excess, if any, of:**
  - **The premium cost of standard FEHBP coverage for the type of coverage provided to the individual if priced for the age and gender characteristics of all employees of the individual's employer; over**
  - **The premium cost, determined under procedures proscribed by the Secretary of HHS, for that coverage if priced for the age and gender characteristics of the national workforce**
- **The adjustment is not applied to retirees and employees in high risk professions**

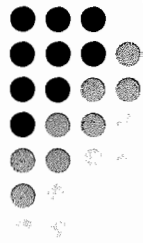


# 2018: Amount of Premium Measurement



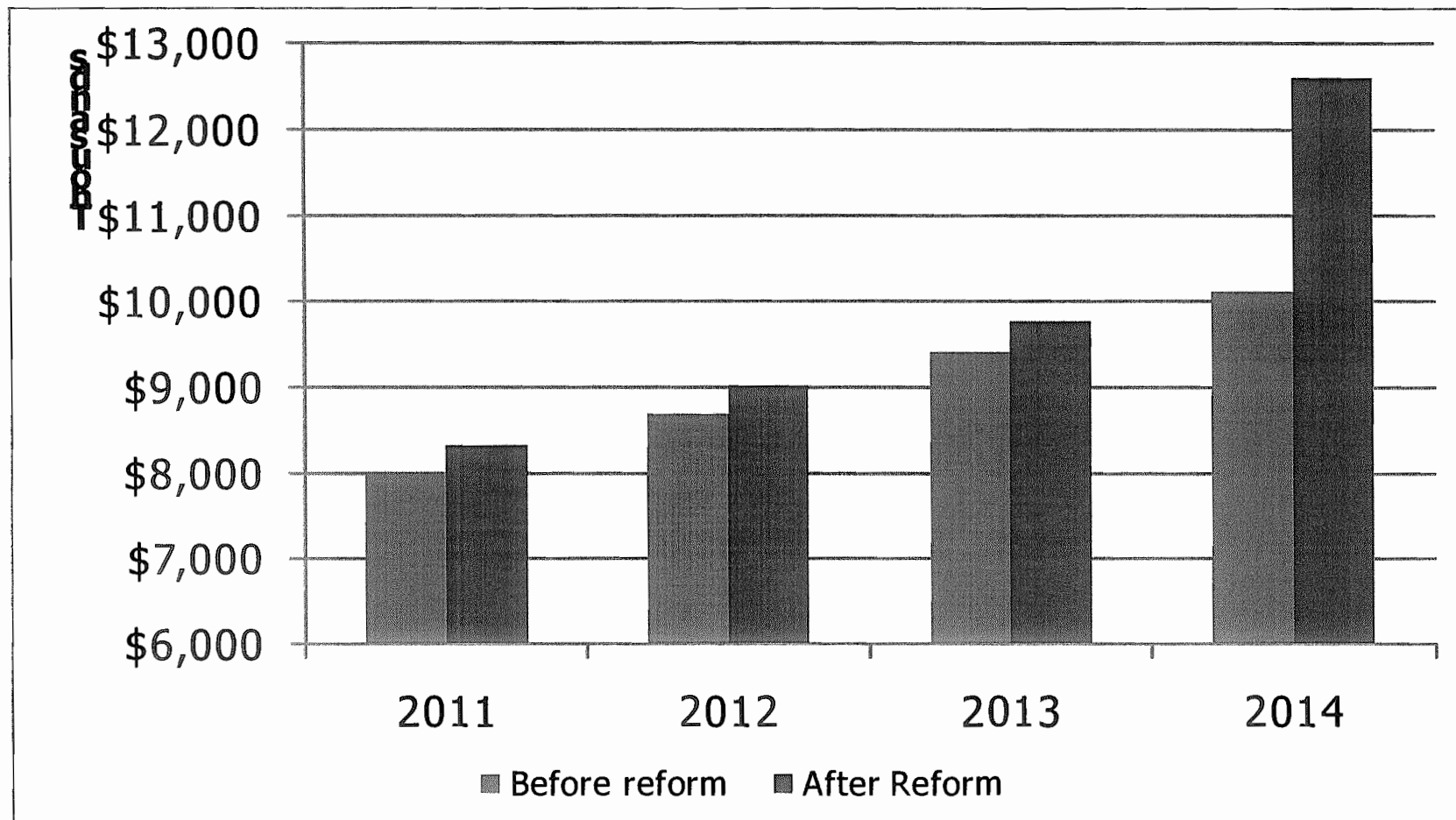
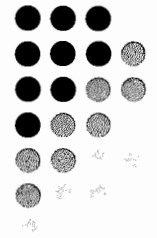
- **The excise tax is determined by reference to the aggregate value of all employer-sponsored health insurance coverage, and it is generally calculated in the same manner as the applicable premiums for the taxable year for the employee determined under the rules for COBRA continuation coverage, but without regard to the excise tax**

# 2018: Amount Subject to Excise Tax

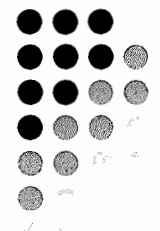


- **The amount subject to the excise tax is the sum of the aggregate premiums for health insurance coverage, the amount of any salary reduction contributions to a medical FSA for the taxable year, and the dollar amount of employer contributions to an HRA, HSA or an MSA, minus the dollar amount of the threshold**

# Overall Expected Cost Impact to Comply with Reform



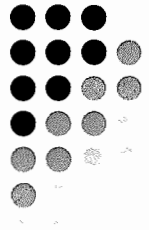
# “Before and After” in 2014



	Current Plans Before Reform	Current Plans After Reform	Terminate Coverage
Total Plan Cost	\$10,130	\$12,610	\$0
Employee Contributions	(\$960)	(\$1,190)	\$0
Employer Plan Cost	\$9,170	\$11,420	\$0
Corporate Tax Deduction	(\$70)	(\$90)	\$0
Free Rider Surcharge	\$0	\$0	\$2,040
Net Employer Cost	\$9,100	\$11,330	\$2,040
Difference		\$2,230	(\$9,290)

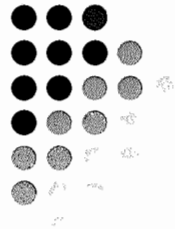
(In '000s)

# Employer Issues



- More covered lives
  - Dependents to age 26
  - Non-discrimination for Highly Compensated Employees
  - Part-time workers definition + Automatic enrollment
  - Higher contributions (“Qualifying and Affordable” coverage)
- More (and different) risk exposure
  - No annual or lifetime max
  - No pre-ex
  - Mini-med phase-out
  - Treatment limits and benefit carve-outs allowed
- More shifting to self-funding
  - Avoiding new insurer tax
  - “Same old reasons” more compelling
  - BIG UNKNOWN: Stop Loss cost impact given risk exposure
- More migration to exchanges
  - Primarily small groups
  - Also “high impact” industries (e.g., hospitality, construction, food, retail, healthcare)

# Disclaimers



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