HEALTH CARE REFORM
update

BlueCross BlueShield of Kansas City
An Independent Licensee of the Blue Cross and Blue Shield Association

Summary of Employer Taxation Provisions

On March 23, 2010 President Obama signed into law the "Patient Protection and Affordable Care Act" (PPACA). A reconciliation bill making changes to the Act was signed by the President on March 30, 2010. PPACA as amended by the reconciliation bill is collectively referred to as the Act in this summary.[1] This summary provides an overview of the following taxation provisions that impact employers:

- Excise Tax on High-Cost Employer Plans, *aka Cadillac Tax*
- Small Business Tax Credit & Employer Responsibility Penalties
- Adult Dependents Tax Treatment (See BlueKC's *Federal Healthcare Reform*: *Dependent Coverage* fact sheet for more information)
- Retiree Drug Subsidy (RDS) Changes
- Revisions to Rules relating to Health Savings Accounts (HSA), Flexible Spending Accounts (FSAs), Medical Savings Accounts (MSAs) and Health Reimbursement Accounts (HRAs)
- Hospital Insurance Tax on High-Income Taxpayers
- Comparative Effectiveness Fee (Patient-Centered Outcomes Research Trust Fund Fee)

Note, the Act also imposes tax obligations on health insurers, such as the insurer excise tax fee that starts at $8 billion in 2014 and grows thereafter. These tax obligations are summarized in another fact sheet and will impact the cost of insurance.

Excise Tax on High-Cost Employer Plans (the so-called Cadillac Tax)

This tax applies to taxable years begins after December 31, 2017. This is a tax on employer-sponsored coverage, assessed at 40% of the "excess benefit." The excess benefit is the aggregate value (e.g., cost) of certain employer sponsored coverage (including health coverage, prescription drug coverage, FSA, HRA and HSA contributions, etc. but not including dental or vision coverage) over an annual limit, which in 2018 starts at $10,200 for self-only coverage and $27,500 for coverage other than self-only. The annual limits are increased for certain high-risk professions, the age/gender of the employer's covered workforce, inflation, and other factors. The tax amount is calculated by the employer, who also informs the various benefit providers, if any, of their liability (PPACA §§9001 and 10901, creating Internal Revenue Code (IRC) §4980I; §1401 of the Reconciliation bill).

Small Business Tax Credit

Small employers with up to 25 full-time equivalent employees (FTEs) are eligible for a tax credit to partially offset the cost of providing health insurance coverage (PPACA §§1421 and 10105, creating IRC §45R).

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[1] PPACA: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3590enr.txt.pdf

Reconciliation: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4872pcs.txt.pdf

- To be eligible for the tax credit, the employer must pay at least 50% of the premium (for individuals).
- For taxable years beginning in 2010 (filed in 2011) through 2013, the credit amount is up to 35% (25% for tax exempt employers) of the lesser of the contributions the employer made to the health insurance premiums or to an average premium determined by the Department of Health and Human Services (HHS). Beginning in 2014, the percentage increases to 50% (35% for tax exempt employers).
- The full tax credit is available for employers with 10 or less full time equivalent employees (FTEs) and phases out completely for employers with 25 or more FTEs. The amount of the tax credit is also dependent upon the average wages for employees of the small employer, with the full credit available for employers with average wages of $25,000 or less, and phases out if the average wages are $50,000 or more. Once the exchanges are operating, the employer must purchase coverage through the exchange (the exchange is to become effective in 2014).
- An employer may take advantage of the tax credit each tax year from 2010 through 2013; however, starting in 2014, an employer can only receive the credit for two consecutive taxable years.
- More information is available from the Internal Revenue Service (IRS) www.irs.gov. The IRS has advised that in determining the employer's deduction for health insurance premiums, the amount of premiums that can be deducted is reduced by the amount of the credit.

Note: Beginning in 2014, employers with 50 or more full time employees will be required to offer minimum essential benefits to their employees. Employers that do not comply with the coverage requirement will be subject to certain penalties. The employer mandate and penalties are described in Blue KC's Employer Mandate fact sheet.

Adult Dependents Tax Treatment

(See Blue KC's *Federal Healthcare Reform: Dependent Coverage* fact sheet for more information.)

The Act amends §105(b) of the IRC to allow premiums for the expanded dependent coverage to be tax deductible. Recall that employers, whether self-funded or fully-insured, that provide coverage for dependent children are required to continue to make coverage available for an adult child until the child turns 26 years of age. These premiums are tax deductible as long as the child has not attained age 27 by the end of the tax year. The IRC provides deductibility to age 27 while the coverage obligation runs to age 26 (PPACA §1001 adding § 2714 to the Public Health Service Act; §§1004(d) and 2301 of Reconciliation Bill).

Retiree Drug Subsidy (RDS) Tax Treatment

The Act does not repeal the RDS, rather it eliminates the employer's ability to claim a deduction for the cost of the retiree drug plan for which the employer also receives a subsidy. This applies for taxable years beginning after December 31, 2012. Until that time, employers will be able to continue to both deduct the cost of the retiree drug plan and receive the retiree drug subsidy, the amount of which is not included in gross income. (PPACA §9012, amending IRC § 139A, the effective date was changed from 2010 to 2012 by §1407 of the

Reconciliation bill).[2]

HSA/FSA/MSA/HRA Rules

- **Prescription Medications & Insulin Only**. The medicines or drugs that can be paid for tax-free from an HSA, MSA, FSA, or HRA, are limited to those which are prescribed (even if the product is available over the counter) and to insulin. This limitation is effective for tax years beginning after December 31, 2010. (PPACA §9003, amending IRC §223(d)(2)(A) for HSAs, §220(d)(2)(A) for MSAs, and §106 for FSAs and HRAs).
- **Increased Penalties**. The taxes on distributions that are not used for qualified medical expenses are increased. For HSAs, the tax is increased from 10% to 20% and for MSAs from 15% to 20%. The increase is effective for disbursements made during tax years starting after December 31, 2010 (PPACA §9004, amending IRC §223(f)(4) (A) for HSAs and 220(f)(4)(A) for MSAs).
- **Cap on FSA contributions**. Employer contributions to an FSA are capped at $2,500, and indexed after 2013. This limitation is effective for tax years beginning after December 31, 2012 (PPACA §§9005 and 10902, amending IRC §125 and creating a new section (i); §1403 of the Reconciliation bill).

Hospital Insurance Tax on High-Income Taxpayers

The payroll tax for Medicare hospital insurance is presently 1.45%. The Act adds an additional tax of .9% points, for individual taxpayers with wages over $200,000 and joint filers over $250,000. It also adds a 3.8% tax on unearned income (interest, dividends, etc) for certain tax payers. These taxes are assessed in tax years beginning after December 31, 2012 (PPACA §§9015 and 10906 of PPACA, amending IRC §§3101(b) and 1401(b); §1402 of the Reconciliation bill imposing the tax on unearned income).

Comparative Effectiveness Fee (Patient-Centered Outcomes Research Trust Fund Fee)

A fee is assessed on health insurers and self-funded plans to support comparative effectiveness research. The amount of the assessment is equal to $1 multiplied by the "average" number of covered lives under the plan for policy/plan years ending at any time during the Federal government's 2013 fiscal year (i.e., between October 1, 2012 to September 30, 2013), and $2 multiplied by the "average" number of covered lives under the plan for policy/plan years ending at any time during the Federal government's 2014 fiscal year (i.e., between October 1, 2013 to September 30, 2014). Thereafter, annually the dollar amount is increased by the percentage increase in projected per capita amount in National Health expenditures, through policy years ending before October 1, 2019. The fee is assessed on each covered life, but not for policies if substantially all the coverage is for an excepted benefit under 9832(c), for example, dental or vision, or for Medicaid plans (PPACA §6301, amending IRC Ch. 34 by creating a new Subchapter B).

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[2] The Act eliminates the second sentence in this section: "Gross income shall not include any special subsidy payment received under section 1860D-22 of the Social Security Act. This section shall not be taken into account for purposes of determining whether any deduction is allowable with respect to any cost taken into account in determining such payment."

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Examples:

- A plan year that begins on November 1, 2011, and ends on October 31, 2012 (i.e., plan year ends during FY 2013), will be assessed an amount equal to $1 multiplied by the average number of lives covered.

- A plan year that begins on December 1, 2012, and ends on November 30, 2013 (i.e., plan year ends during FY 2014), will be assess an amount equal to $2 multiplied by the average number of lives covered.

The Act specifically references that this fee is treated as a deductible tax (IRC § 4377(c)) and therefore would be a subtraction from premiums in the MLR calculation. The fee applies to coverage issued to residents of the United States, including its possessions.

This fact sheet is not meant to be an exhaustive list of the tax provisions impacting employers. This summary is provided for informational purposes only and is not intended as legal advice. This summary does not reflect any guidance or federal regulations that may have been issued after the passage of PPACA. Please consult your legal advisor for additional information.