HONIGMAN

Health Care Reform Alert

July 1, 2010

New Taxes, Tax Credits/Subsidies and Other Tax Obligations – For Employers

The recently enacted Affordable Care Act (ACA) imposes various new taxes, tax credits and financial penalties on employer-sponsors of group health plans and health insurers. These are:

Taxes

- A fee of $1 times the number of covered lives for plan years ending during 2013, and $2 times the number of covered lives for plan years ending on or after September 30, 2012, but before October 1, 2019, will be imposed on insurers and self-funding employers. These revenues will fund a Patient-Centered Outcomes Research Fund.
- For employers who employ more than 50 employees, "pay or play" excise taxes are imposed for (i) employers that do not offer minimum essential coverage ($2,000 per employee), and (ii) those that do offer coverage, but whose employees qualify for subsidized State Insurance Exchange coverage ($3,000 per employee who opts for Exchange coverage, subject to a cap equivalent to the penalty that could be imposed if the employer did not offer coverage, *i.e.*, $2,000 times all employees). Up to 30 full-time employees may be disregarded in calculating the penalty. The Exchanges must report to the IRS and the employer the name and taxpayer number of each individual eligible for a premium or cost sharing subsidy who is also eligible for employer-sponsored coverage (effective for plan years beginning on or after January 1, 2014).
- Employers who offer coverage that costs the employee more than 8% of his/her household income, and that employee's household income is below 400% of the federal poverty level, must provide vouchers equal to the portion of the plan cost that the employer would have paid on the employee's behalf to enable them to purchase less costly coverage on a State Insurance Exchange. The cost of the voucher is deductible to the employer, and if the cost of the exchange coverage is less than the amount of the voucher, the employee can keep the difference as taxable income (effective for plan years beginning on or after January 1, 2014).
- An excise tax will be imposed on so-called "Cadillac" plans, *i.e.*, those with high premium costs. The excise tax will be 40% of the amount by which the cost of coverage (as determined under the rules for determining COBRA premiums) exceeds $10,200 for individual coverage and $27,500 for family coverage, determined on a monthly basis. There are higher dollar limits for plans that cover employees in high risk professions or who install or repair electrical or telecommunication lines. Higher limits also apply in 17 designated high-cost states. These limits are to be indexed for inflation. The tax will be on the amount of the premium which exceeds these limits. The cost of stand-alone dental and vision benefits would not be factored into the premium costs for the purposes of calculating this excise tax (effective for plan years beginning on or after January 1, 2018).

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- An annual fee will be imposed on health care insurers ($8 billion in 2014, $11.3 billion in 2015, $11.3 billion in 2016, $13.9 billion in 2017, and $14.3 billion in 2018). After 2018, the fee will be the fee for the prior year increased by the rate of premium growth as calculated for the premium tax credits available under ACA. For non-profit insurers, only 50% of net premiums are taken into account, and non-profits who target elderly or low income populations and VEBAs not established by an employer are exempt from the fee.
- An annual fee is imposed on pharmaceutical manufacturers and importers of branded prescription drugs ($2.5 billion for 2011, $2.8 billion for 2012, $2.8 billion for 2013, $3 billion in 2014-16, $4 billion for 2017, $4.1 billion for 2018 and $2.8 billion for 2019 and each year thereafter), to be allocated by the proportional share of total branded drug sales during the prior calendar year to the government's Medicare, Medicaid, VA and TRICARE Programs.
- An excise tax of 2.3% is imposed on the sale of any taxable medical device, but does not apply to eyeglasses, contact lenses, hearing aids or any other device deemed by the Secretary to be available for regular retail purposes (effective for tax years on or after January 1, 2013).
- Employers receiving the Medicare Part D subsidy for providing retiree medical benefits will no longer be able to deduct the subsidy amount for tax years beginning on or after January 1, 2013. The subsidy will remain available, but will no longer be deductible.
- The deductibility of executive and employee compensation (both direct and deferred) is limited to $500,000 per individual for "covered" health insurance providers. This is effective for current compensation paid in years after 2012 but will apply to deferred compensation earned after January 1, 2009. Before 2012, "covered health insurance providers" include any insurer providing health care coverage; after 2012, this includes any insurer that gets at least 25% of gross premiums from health insurance plans that meet the minimum coverage requirements of the ACA.
- For sponsors of insured group health plans, beginning in plan years starting on or after September 23, 2010, the IRC § 105(h) nondiscrimination rules will apply. Unlike self-funded plans, violations of these rules will not impose additional taxes on the affected highly compensated individuals (HCI), but will be imposed on the employer. The penalty is $100 per day for each HCI to whom the failure relates, up to a maximum penalty of the lesser of: (i) $500,000 or (ii) 10% of the employer's annual health care costs for the previous year.

Tax Credits/Subsidies

- Small employers with no more than 25 full-time equivalent employees (FTEs) and average annual wages of less than $50,000 that purchase qualifying health insurance for employees will get a tax credit. Owners and their family members are not counted, nor are seasonal workers who do not work more than 120 days per year.

To determine the number of FTEs, employers should add up the number of hours worked for all employees during the tax year and divide by 2080. The credit applies to premiums paid on or after January 1, 2010.

For tax years 2010 through 2013, the tax credit will equal 35% of the employer's contribution toward health care coverage if the employer contributes at least 50% of the total premium cost, not counting any salary reduction arrangements (or 50% of a benchmark premium). Tax-exempt small business are eligible for credits of up to 25% of the employer's contribution towards the health insurance premium. Beginning in 2014, the credit increases to 50% of employer contributions for small tax-paying businesses, and to 35% for tax-exempt employers. The definition of a "small employer" is the same for both taxable or tax-exempt businesses.

Small employers with 10 or fewer FTEs and whose employees' average annual wages are less than $25,000 will be entitled to 100% of the credit. Small employers whose workforce is between 10 and 25 FTEs with average annual salaries between $25,000 and $50,000 will be entitled to a proportionally smaller percentage of the full credit.

Tax-exempt employers may take the credit as an offset to their payroll taxes, which effectively caps their credit at the sum of the taxes withheld by the employer plus the employer and employee's share of the Medicare tax.

- Companies with 250 employees or less and who are involved with certain kinds of medical research may be eligible for a tax credit or cash payment for up to 50% of the company's costs incurred during 2009 and 2010 directly related to a qualifying therapeutic discovery project (QTDP). A QTDP is a project designed to achieve any of the following objectives:

  i. to treat or prevent diseases by conducting pre-clinical activities, clinical trials, clinical studies or carrying out research protocols to get approval for a product by the FDA or the Public Health Service;

  ii. to diagnose diseases or conditions or to determine molecular factors related to diseases or conditions by developing molecular diagnostics to guide therapeutic decisions; or

  iii. to develop a product, process or technology to further the delivery or administration of therapeutics.

  The credits or cash are subject to recapture if the patents or other resulting property is transferred within 5 years. The QTDP grants are capped at $1 billion.

  The Secretary of the Treasury was to issue final application guidance by May 21, 2010, and applications must be approved or denied within 30 days. In granting applications, the

following goals will be considered; (i) develop new therapies to treat areas of unmet medical need or to prevent, detect or treat chronic or acute diseases or conditions, (ii) to reduce long term health care costs, (ii) to advance the goal of curing cancer in the next 30 years, (iv) to create and sustain (directly or indirectly) jobs in the U.S., and (v) to advance U.S. competitiveness in the fields of life, biological or medical science.

- Small employers (including tax-exempt employers) with less than 100 employees who work 25 or more hours per week that did not have wellness programs on March 23, 2010, are eligible for grants for up to five years if they establish wellness programs. For this purpose, $200 million has been set aside and the grants will be available for federal fiscal years 2011 through 2015, or earlier if the $200 million runs out before 2015.
- Tax-deductible coverage for adult children up to the last day of the calendar year in which they turn 26 (effective as of March 30, 2010).
- The incentives available to employers for motivating employees to participate in wellness programs is increased from 20% of the cost of coverage to 30%, though this could be increased to 50% at the discretion of the Secretaries of the DHHS, DOL and IRS (effective for plan years beginning on or after 2014).

Other Items

- Insurers must provide annual rebates to participants if the percentage of premiums spent on clinical services are less than 85% for coverage in the large group market and 80% for coverage in the small group market.

Action Steps

Employers must assess which, if any, of the tax credits they may be eligible for and apply for or claim them. They also must determine the consequences of any potential new taxes or tax penalties that could be imposed, and plan for how best to minimize or avoid them. Alternatively, employers must undertake a cost-benefit analysis as to how the continued cost of health care coverage balances against these increased tax costs.

If you have any questions about these new taxes, tax credits/subsidies or tax penalties or any of the other changes imposed by the ACA, please contact any of the Honigman attorneys listed on this Alert.