

HEALTHCARE REFORM UPDATE

Please take time to review the responses to the most frequently asked questions (FAQs) concerning new taxes and the treatment of Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs) and Health Reimbursement Accounts (HRAs) under Health Care Reform.

We thank Steptoe & Johnson LLP for their analysis and summary. At the end of the update is the normal disclosure, and we encourage you to call your Van Gilder team with any questions.

For those who attended the June 15th seminar, thanks for being there, and based on the evaluation forms it was clear everyone in attendance gained a lot from the presentation and discussion.

TAXES, FSAs, HSAs, HRAs

PPACA TITLES IX AND X

General

1. **Can you please provide a list of all of the new taxes imposed under the new law and when they take effect?**
 - 10% sales-type tax on indoor tanning services (2010) (PPACA §10907; IRC §5000B)
 - MLR/Carrier Rebates (2011) (PPACA §1001, §10101; PHSA §2718)
 - Increase to 20% of tax on distributions from HSAs and MSAs (2011) (PPACA §9004)
 - Tax on pharmaceuticals, and increase fee by \$4.8 billion (2011) (PPACA §9008; HCEARB §1404)
 - Executive Compensation deductibility limit of \$500,000 (2013) (PPACA §9014; IRC §162(m))

- New 3.8% Medicare Investment Tax on high-income individuals (2013) (PPACA §9015)
- 0.9% increase the hospital insurance tax on High Income Individuals (2013) (PPACA §9015)
- 2.3% excise tax on Medical Devices (2013) (PPACA §9009; HCEARB §1405)
- Annual limitation on contributions to a health FSA of \$2,500 (2013) (PPACA §9005; IRC §125; HCEARB §1403)
- Elimination of deduction for expenses allocable to Medicare part D subsidy (2013) (PPACA §9012; HCEARB §1407)
- \$2 (per covered beneficiary) tax to fund the Patient-Centered Outcome Research Trust Fund (2013) (PPACA §6301, §10602)
- Employer Mandate – fine of \$2,000/employee (2014) (PPACA §1511-1515; HCEARB §1003)
- Individual Mandate – penalties equal the greater of \$95/individual or 1% of family income in 2014; \$325/individual or 2% of family income in 2015; \$695/individual or 2.5% of family income in 2016, and rise in accordance with cost-of-living adjustments thereafter. (2014) (PPACA §1501; HCEARB § 1002)
- Three year tax on TPAs and insurers to fund a transitional reinsurance program (2014) (PPAHCA §1341(b))
- Annual fee imposed on all health insurers (excluding self-insured plans), based on their market share (2014) (PPACA §9010; HCEARB §1406)
- 40% Excise Tax on certain “Cadillac Plans” (2018) (PPACA §9001; IRC §4980I; HCEARB §1406)

FSAs, HSAs, HRAs

2. **With regard to FSAs, I’ve seen 2011, 2013 and 2014 as the date that FSAs**

will be capped at \$2,500. Which one is correct?

The cap will take effect in 2013 (HCEARA § 1401(a)(2)(E)) (amending PPACA § 9005(a)(2)).

3. **How are flex plans used for dependent care cover affected by the bill?**

There is no impact.

4. **Are prescription drugs the ONLY thing that HSAs/FSAs/HRAs are permitted to reimburse, or can they still cover other qualified expenses like glasses, contacts, dental expenses, etc.?**

The legislation only affects the status of drugs; it does not affect the other qualified expenses for which reimbursement may be sought, so these accounts will still cover vision, dental expenses, etc.

5. **When does the HSA Reimbursement become limited to prescription drugs?**

January 1, 2011.

6. **If our FSA plan year begins July 1, 2010, will the \$2500 max apply at that time or the following plan year?**

The plan year is irrelevant; the \$2500 maximum will apply to the individual over the course of the calendar year, starting in 2013.

7. **What if your plan expires mid-year in 2011 will the over-the-counter drug reimbursement continue through your plan end date?**

The plan year is irrelevant; the over-the-counter restriction applies starting January 1, 2011 for money contributed to the account after that date. Administrators may want to consider informing participants of the change now to give them an opportunity to

use their funds to purchase non-prescribed over-the-counter drugs before the new restriction goes into effect.

8. There is an FSA contribution limit of \$2500 in 2011. Does this also apply to HSA accounts?

No, the new \$2500 contribution limit applies only to health FSAs, not to HSAs or HRAs. And note that the FSA contribution limit goes into effect in 2013, not 2011. (FAQ added/updated 5-28-10)

9. The response to one of the FAQs above states that the FSA cap goes to \$2,500 in 2013, but the question immediately above reads “There is an FSA contribution limit of \$2,500 in 2011. Does this also apply to HSA accounts?” Is it 2013 or 2011, and does the H.S.A. ever have the \$2,500 cap?

The \$2500 cap on health FSAs goes into effect in 2013. The questioner above is mistaken in asserting that the new health FSA limit starts in 2011 (we generally replicate the questions as asked). The \$2500 cap does not apply to HSAs. (FAQ added/updated 5-28-10)

10. Does the \$2,500 health FSA cap apply per individual, so that for a married couple each spouse could take the \$2,500 max, or does the cap apply per family?

The health care reform legislation does not change existing law in this regard, therefore, the \$2500 cap applies per individual employee, and each spouse could take the \$2500 maximum. (FAQ added/updated 5-28-10)

11. Is the \$2,500 cap regardless of covering an individual or a family?

Yes. The same health FSA maximum applies regardless of whether the employee is covering only themselves, or covering their family. (FAQ added/updated 5-28-10)

12. If a family has an H.R.A. of \$2,100 through one parent and an F.S.A. through the other parent, what is

the cap for the F.S.A. - \$2,500 per person, \$2,500 for the family or \$400 because you already gave \$2,100 in the H.R.A.?

Our understanding is that HRAs are contributions of employer monies only, and are to be treated separately from FSAs. Therefore, the contribution to the HRA does not affect the amount of the health FSA cap. And as previously noted, the health FSA cap is per employee.

Cadillac Plan Taxes PPACA § 9001 (adding IRC § 49801); HCEARA § 1401

13. Will an employee-paid voluntary plan (i.e. critical illness, cancer, accident health, hospital indemnity, etc.) that supplements their employer’s plan be included when calculating if the value of their health plan warrants the “cadillac” excise tax? Will it depend on whether the employee pays for it with pre-tax or post-tax dollars?

Any benefit that pays for medical claims will be included in the calculation. Contributions to HSAs, HRAs and Medical FSAs also will be included. The only medical expense exception is for stand-alone Dental and Vision coverage. Economic benefits that pay the beneficiary upon the occurrence of an event but that do not go directly to pay for medical care are also excluded from the scope of this calculation.

In the list of examples, it appears that both types of benefits are included but only the benefits that pay directly for medical care would be included in the cadillac tax calculation. That calculation does not depend on whether the employee uses pre- or post-tax dollars to purchase the benefit.

14. Will the “cadillac” excise tax be based on the entire cost of the plan regardless of how much of the cost is paid by the insured?

Yes.

15. For purposes of calculating the “cadillac” plans excise tax - would the value of these plans subject to the tax include our executive health

reimbursement plan like Exec-U-Care?

Yes. Contributions to such plans made by both the employer and the employee would be included in this calculation.

16. What are the final threshold amounts for the Cadillac plan provisions that take effect in 2018?

The threshold amounts in 2018 will be \$10,200 for an individual and \$27,500 for a family. Employees in “high risk professions” will have these threshold amounts increased by \$1650 for individual coverage and \$3450 for families. The thresholds will be increased after 2018 in accordance with the increase in the cost of living.

17. Are these amounts the total gross premium or the net employer contributed amounts?

Total gross premiums.

18. What is the excise tax level?

40%.

19. Who pays the excise tax in fully insured plans?

The benefit provider.

20. Is there a minimum benefit threshold that needs to be met to be considered a “Cadillac Plan”?

No. It is based strictly on cost.

21. What happens in small group plans age banded rates where an employee is in a high age bracket and their rate is over the “Cadillac Plan” threshold, but the rest of the group is not because they are younger?

The calculation is made separately for each employee; it is not made on a group basis.

22. Will the “Cadillac” benchmark limit also be used for health insurance deductions for self-employed people or employees using a Section 125 POP for pre-tax deductions?

The benchmark applies to all employer plans.



23. Are union members excluded from the taxes imposed on “Cadillac” plan?

No, the Cadillac tax provision does not distinguish between union and non-union employees.

Other

(i) W-2 Tax Reporting (PPACA § 9002 (amending IRC § 6051(a))

24. With respect to the employer obligation to report the value of health benefits on employees’ W-2s, are the employees taxed on this?

This reporting is to effectuate the Cadillac tax provisions; it will not subject the employees to any new tax obligations.

25. We are a construction company paying a rate per hour into a multi-employer trust for health insurance. Do we have to report amount paid in on the W-2, and how do we know if the insurance they are getting is in compliance?

We will not have a definitive answer to this question until the rules are issued on W-2 reporting, but we anticipate that the amounts paid by an employer into a trust toward an employee’s health insurance would be among the amounts required to be reported on the W-2. With respect to compliance responsibility, if the plan is sponsored by an entity other than the employer, we believe it will be that entity’s responsibility to ensure compliance.

26. For W-2 reporting purposes, does this include medical, vision, dental, FSA premium dollar amounts paid?

Keep in mind that the purpose of the new W-2 reporting is to effectuate the Cadillac tax, so the items to be reported are tied to the Cadillac tax provisions. The Cadillac tax provisions exclude standalone vision and dental from the definition of “coverage,” so the value of such items will not be

reported on the W-2. Contributions to HSAs, HRAs, and health FSAs are included in the definition of “coverage” under the Cadillac tax provisions, so those amounts will need to be reported on the W-2 to the extent that they are not currently reported on the W-2. The IRS will issue regulations on this to (we hope) fully clarify exactly what will be required to be reported on the W-2 and how that information will be reported.

In addition, note that anything that is already being reported on a W-2 (like HSA account contributions) need not be reported again.

(ii) Medicare Part D Subsidy (PPACA § 9012 (amending IRC § 139A))

27. We have been noticing that a number of companies are taking hits on their P&L referencing the healthcare reform. Will the new law affect us any?

This is a Medicare Part D subsidy issue for retiree prescription drug plans. If your company does not offer this program to your Medicare-eligible retirees, the change will not affect you. If your company does provide the benefit, the law will have two impacts.

First, employers currently qualify for a tax subsidy if they provide this benefit to their employees. Under the original law establishing the subsidy, employers were permitted to both exclude the subsidy from their income and to deduct the total cost of the plan contributions on their tax returns. Effective in 2013, the expense deduction must now net out the subsidy.

Second – and this is the P&L issue you are seeing – the accounting rules require the immediate recognition of an increased expense equivalent to the increase in the net present value of the total projected cost of offering this retiree benefit going forward. This accounting impact combined with the real increased cost of providing the benefit is leading many employers to reconsider whether they are going to continue to offer the benefit.

(iii) Individual Mandate Penalties (PPACA §§ 1501 (adding IRC § 5000A) & 10106(b); HCEARA § 1002)

28. For the Individual Requirement Tax Penalty: how will the government collect the taxes?

Theoretically, from the employees as part of their tax return burden. There has been a lot of attention focused on the fact that the IRS has been given no resources to use to try to collect these penalties however. There is no employer burden to deal with this issue.

(iv) Medicare Wage Tax PPACA §§ 9015 and 10906 (amending IRC § 3101(b))

29. How could an employer collect +.9% medicare tax on couples earning >\$250K? How would an employer know?

An employer is responsible only for collecting the additional Medicare wage tax for its own individual employees who earn more than the \$200,000 threshold.

This document is comprised of questions received from Council members and answered by The Council’s attorneys at Steptoe & Johnson LLP. All section references are to the Patient Protection and Affordable Care Act (Pub. L. No. 111-148) (“PPACA”) or the Health Care and Education Reconciliation Act of 2010 (Pub. L. No. 111-152) (“HCEARA”), as indicated in each response. Many of the changes in the legislation are in the form of amendments to the Public Health Service Act. References to that Act in this document will be to PHSA. Please keep in mind that the information provided here is not intended to be, and should not be construed, as a legal opinion or advice. It is recommended that you consult with your own attorney or other adviser relating to your specific circumstances or contact your Van Gilder team.