

ALERTS AND UPDATES

Healthcare Reform: What Is the Impact on Employers?

March 29, 2010

President Obama signed into law the Patient Protection and Affordable Care Act on March 23, 2010, and will sign into law the Health Care and Education Reconciliation Act (collectively, the "Act") on March 30, 2010, to extensively reform the American healthcare system.

The Act imposes significant new responsibilities on employers and employer-sponsored group-health plans. While some provisions are effective immediately or within a short period of time, many provisions do not take effect until 2014 or later, or are gradually phased in.

The Act is likely to impact employers in the following ways.

Effective January 1, 2010

- **Small-Business Tax Credit.** A small-business tax credit of up to 35 percent of the employer's contribution to purchase health insurance for employees is now established for "qualified small employers." A "qualified small employer" is an employer that has no more than 25 full-time equivalent employees for the taxable year—and the average annual wages of those employees do not exceed \$40,000. When health-insurance exchanges are established in 2014, the available tax credit will increase to 50 percent of premiums.
- **Medicare Part D.** The Act provides a \$250 rebate check for all Part D enrollees who enter the "donut hole." Currently the "donut hole" coverage gap falls between \$2,830 and \$6,440 in total drug spending by Part D enrollees.
- **Adoption Tax Credit.** The Act increases the adoption tax credit and adoption assistance exclusion by \$1,000 (now set at \$13,150), makes the credit refundable and extends the credit through 2011.

Effective 90 Days After Enactment (*i.e.*, June 21, 2010)

- **Early Retirees.** The Act establishes a temporary reinsurance program to provide reimbursement to employer health plans offering health coverage for early retirees (ages 55 to 64) and their families. The reinsurance program would reimburse employer health plans for 80 percent of the cost of benefits provided per enrollee in excess of \$15,000 and below \$90,000. The employer health plans are required to use the funds to lower costs assumed directly by participants and beneficiaries, and the program incentivizes plans to implement programs and procedures to better manage chronic conditions.
- **Pre-Existing Conditions.** The Act provides that group-health plans and health-insurance issuers offering group or individual health-insurance coverage may not impose any pre-existing condition exclusions with respect to such plans or coverage. Therefore, group-health plans that include such pre-existing condition exclusions will no longer be permitted.

Effective Six Months After Enactment (*i.e.*, September 23, 2010)

- **Additional Protections for Children.** The Act: (1) bars health-insurance companies from imposing pre-existing condition exclusions on coverage for children and (2) requires any group-health plan or plan in the individual market that provides dependent coverage to continue to make that coverage available until the child turns 26 years of age, if the child does not have access to other health coverage (without regard to the child's marital status).
- **Lifetime Limits.** The Act prohibits insurers from imposing lifetime limits on benefits. Additionally, beginning in 2014, the Act prohibits insurers from imposing annual limits on the amount of coverage an individual may receive.
- **Preventive Health Services.** The Act requires that all new group-health plans and plans in the individual market provide first-dollar coverage for preventive services (*i.e.*, not subject to a deductible). Examples of preventive services include well-childcare visits and certain immunizations.

Effective January 1, 2011

- **Medicare Part D.** The Act provides a 50-percent discount on all brand-name drugs and biologics in the "donut hole" and begins phasing in additional discounts in brand-name and generic drugs to completely fill the "donut hole" by 2020 for all Part D enrollees.
- **W-2 Reporting.** The Act requires employers to disclose the value of the benefit provided by the employer for each employee's health-insurance coverage on the employee's annual Form W-2. This is a W-2 reporting obligation and will not result in additional taxable income to employees.
- **Additional Tax for Health Savings Account (HSA) Withdrawals.** The Act increases the additional tax for Health Savings Account withdrawals prior to age 65 that are not used for qualified medical expenses from 10 percent to 20 percent.
- **Cafeteria Plans.** The Act creates a Simple Cafeteria Plan to provide a vehicle through which small employers can provide tax-free benefits to their employees. Small employers are defined as employers who on average employ 100 or fewer employees over the previous two years. The Act aims to ease the administrative burden of sponsoring a cafeteria plan for such small employers. The Act also exempts small employers who make contributions for employees under a Simple Cafeteria Plan from pension-plan nondiscrimination requirements applicable to highly compensated and key employees.

Effective January 1, 2013

- **Healthcare Flexible Savings Accounts.** The Act limits the amount of contributions to healthcare reimbursement flexible-spending accounts to \$2,500 per year. No limit was previously imposed upon healthcare reimbursement flexible-spending accounts. This new limit will raise healthcare costs for employees with unreimbursed healthcare expenses in excess of \$2,500 annually, to the extent the employee currently has a flexible-spending account that permits contributions in excess of \$2,500—and would potentially create increased taxable income for employees.
- **Itemized Deduction for Medical Expenses.** The Act increases the income threshold for claiming the itemized deduction for medical expenses from 7.5 percent to 10 percent. Individuals over age 65 would be able to claim the itemized deduction for medical expenses at 7.5 percent of adjusted gross income through 2016.
- **Limiting Deductibility of Executive Compensation for Insurance Providers.** With respect to services performed after 2009, the Act limits the deductibility of executive compensation under section 162(m) of the

Internal Revenue Code for insurance providers if at least 25 percent of the insurance provider's gross premium income from health business is derived from health-insurance plans that meet the minimum creditable-coverage requirements. The deduction is limited to \$500,000 per taxable year (as opposed to the typical \$1,000,000 limitation) and applies to all officers, employees, directors and other workers or service providers performing services for, or on behalf of, a covered health-insurance provider.

- **Medicare Part D.** The Act eliminates the federal income-tax deduction for the 28-percent subsidy for employers who maintain prescription drug plans for their Part D eligible retirees.

Effective January 1, 2014

- **Promoting Employer Responsibility.** The Act requires employers with 50 or more employees who do not offer health coverage to their employees to pay \$2,000 annually for a "full-time employee" (*i.e.*, an employee working 30 or more hours per week). The 50-employee threshold is based on the employer's average number of employees on business days during the preceding calendar year. Both full-time and part-time employees are considered in determining whether the employer has 50 or more employees; however, the number of part-time employees to be counted is determined by dividing the aggregate number of hours of service for those part-time employees for each month by 120. The \$2,000 penalty then applies only to full-time employees who work 30 or more hours per week. In order to encourage employers to expand beyond 50 employees, the first 30 employees are not included in calculating the applicable penalty amount. The penalty can also increase to \$3,000 for a full-time employee receiving a federal tax credit in the exchange where the employer offers health coverage, but that coverage would be deemed "unaffordable" because the employee has to pay more than 9.8 percent of his or her income, or the employer contributes less than 60 percent of the actuarial value of the plan. Therefore, while employers are not required to offer health coverage under the Act, significant penalties may be imposed on those employers that do not offer it or that only offer health coverage deemed "unaffordable." In addition, employers may still impose a waiting period for coverage without being subject to a penalty, but this waiting period may not exceed 90 calendar days.
- **Exchanges.** The Act provides for the creation of health-insurance exchanges at the state level in 2014, where individuals and small employers would be able to buy health coverage in a manner similar to that of larger employers. Initially, the state exchanges would be open to individuals and small employers with 100 or fewer employees, unless the state opts to limit this to organizations with 50 or fewer employees. Beginning in 2017, states would have the option to expand the exchange to larger employers.
- **Wellness Programs.** The Act provides that employers can offer increased incentives to employees for participation in a wellness program or for meeting certain health-status targets. The Act permits rewards or penalties, such as premium discounts of up to 30 percent of the cost of coverage. Existing wellness regulations are limited to wellness incentives of up to 20 percent of the total premium, provided that certain conditions are met. In addition, the Act creates a \$200 million, five-year program to provide grants to certain small employers (fewer than 100 employees) for comprehensive workplace-wellness programs. The grants would go to small employers that did not have a wellness program when the Act was enacted. Implementation of such wellness programs may help employers lower costs, thereby avoiding the high-cost plan excise tax discussed below.

Effective January 1, 2018

- **High-Cost Plan Excise Tax.** The Act imposes a nondeductible excise tax of 40 percent on insurance companies and plan administrators (including self-insured plans) for any health-insurance plan where the combined annual employer/employee premiums exceed the threshold of \$10,200 for self-only coverage and \$27,500 for family coverage. The tax would apply to the amount of the premium in excess of the threshold. An additional threshold amount of \$1,650 for singles and \$3,450 for families would be available for retired individuals over the age of 55 and for plans that cover employees engaged in high-risk professions (e.g., law-enforcement professionals, EMTs, construction and mining).

The Act provides that health coverage offered under a collective-bargaining agreement that was ratified prior to the Act's effective date (*i.e.*, March 23, 2010) will not be subject to the Act until the current collective-bargaining agreement expires.

The Act contains significant changes on how employers can sponsor their group-health plans and on an employer's initial decision regarding whether to sponsor such a plan. With this recent legislation, it remains to be seen how employers and their financial decisions will be impacted. Duane Morris will continue to monitor and publicize developments regarding the Act and the impact of any changes on employers and their group-health plans.

For Further Information

If you have any questions about this *Alert*, please contact any of the [attorneys](#) in our [Employment, Labor, Benefits and Immigration Practice Group](#) or the attorney in the firm with whom you are regularly in contact.