Patient Protection and Affordable Care Act: Tax and Other Aspects of the Law

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PPACA 2010-2012

Here is a quick reminder of some PPACA changes that went into effect in the years 2010-2012:

- Grandfather rules
- Dependent children covered to age 26 for medical insurance
- Pre-existing conditions limitations removed for children
- Group medical insurance tax credit program for employers with 25 or fewer employees with low average incomes
- Non-qualified HSA withdrawal tax surcharge increased from 10% to 20%
- OTC drugs not eligible for HSA or FSA reimbursement unless prescribed by a doctor
- Lifetime limits removed in medical insurance
- W-2s must include the total cost of health insurance in 2012 or 2013 depending on size of the employer (but benefits *not* taxable)

PPACA 2013

A few changes take effect in 2013:

- FSA limit reduced from unlimited to $2,500, regardless of plan year. Applies only to employee contributions.
- 2.3% excise tax added to certain durable medical device manufacturers
- The new required document, **Summary of Benefits and Coverage** (SBC), actually started on the first medical insurance renewal after September 23, 2012, but this will mostly be seen in 2013
- Medical expense deduction limit increased from **7.5%** of AGI to **10%** for under 65 (for 65+ is remains 7.5% until 2017)

PPACA 2013

Personal taxes in 2013:

- For those earning over $200,000 ($250,000 if jointly filing), there will be a .9% increase in tax for Medicare, but it is not matched by the employer. The tax is on the earnings above those limits. The employer must withhold the tax for earnings over $200,000.
- For the same income brackets, there is also a 3.8% income tax increase on net investment income, with several caveats.

PPACA 2014

This talk will focus particularly on the “Pay or Play,” but here are other changes that will go into effect on 2014:

- Pre-existing conditions exclusions will be removed for adults
- Remove annual limits on medical insurance
- Limit of 90-day waiting period for new employees to become eligible for medical insurance
- Health benefit exchanges start offering coverage to individuals and small groups
- Minimum essential benefits are required by health insurance
- Individual health insurance mandate
- Wellness discounts on health premiums could be as high as 30% (or 50% if authorized by the federal government—50% surcharge approved for smokers)

PPACA 2014

Individual Mandate:

U.S. citizens in 2014 who are above a minimum income threshold must do one of the following to comply with the "individual mandate" to purchase health insurance. If they do not, they must pay the higher of:

- The sum of months without coverage— 1/12 of the *greater* of:

  —a flat dollar amount ($95 in 2014, $325 in 2015, $695 in 2016); OR

  —an applicable percentage of income over a minimum threshold (1% in 2014, 2% in 2015, and 2.5% in 2016)

The child penalty is 50% of the above adult penalty, and there are limits for families

Some exemptions apply if such coverage is deemed "unaffordable"

Pay or Play

PPACA provides that an employer that has 50 or more employees (full-time and full-time employee equivalents), which is called a "large employer," must provide health coverage, or pay one of two penalties.

PPACA calls for two possible penalties:

- one for not offering "minimum essential" coverage [$2,000]
- one for offering coverage that is considered inadequate because it is not "affordable" and/or it does not provide "minimum value" [$3,000]

Determining "Large Employer"

- It is expected that large employer status would be determined by calculating the number of full-time and full-time equivalent employees for each month, totaling the monthly numbers and dividing by 12. The proposed process would be:
  - Calculate the number of full-time employees for each month of the prior calendar year
  - Calculate the number of FTEs for each month of the prior calendar year (if you get a fraction, keep the fraction)
  - Add the number of FT and FTEs for each month
  - Add the 12 monthly totals together
  - Divide by 12

- If the final result is a fraction, the employer would round down to the nearest whole employee.

If the result is 50 or more, the employer is a "large employer" and subject to the penalty; however if the employer only exceeds the 50 FT/FTE threshold for fewer than 120 days (4 months) of the year and seasonal employees caused it to exceed to 50 threshold, the seasonal employees can be disregarded when deciding if the employer is large.

How Will Part-Time Employees Be Counted?

- Employees who work less than full-time (30 hours per week) are considered "full-time equivalent employees" when deciding if the employer has 50 employees. Full-time equivalent employee numbers would be determined by:
  - Using the hours of service each month for each person who worked an average of less than 30 hours per week during the month
    - This includes the hours of seasonal employees who averaged less than 30 hours for that month
  - A maximum of 120 hours of service should be considered for any employee who is not full-time for a month
- Counting fractions for each monthly total, but rounding the total annual number down.
- "Seasonal employees" would mean retail employees who work only during holiday seasons and others who perform work that by its nature is only performed at certain times of the year (such as harvesting or tax season).

“No Offer” Penalty

- The “no offer” penalty of $2,000 applies if the large employer does not offer “minimum essential” coverage.
  - The agencies have said that they do not expect to apply the penalty to employers who offer coverage to the vast majority of their employees, but exclude a few for a legitimate business reason or because of an error; however as yet they have provided no details on how this limited exception might work.

- The “no offer” penalty is $166.67 per month ($2,000 per year) for each full-time employee who is not offered basic medical coverage. The penalty does not apply to the first 30 employees. **The penalty would not apply if the non-offering employer had no employees who qualified for a premium tax credit.** (Example: 100 eligible employees and no insurance offered= (100-30)*$2,000 = $140,000. Annual cost of “average” group health insurance in West U.S. [average $469/month] for 100 employees if employer pays 75%= $422,100.)

Inadequate Coverage

- The "inadequate coverage" penalty of $3,000 applies if the large employer offers medical coverage, but it is not "affordable" and/or it does not provide "minimum value."
  - Under a safe harbor that will be good at least through 2014, coverage is **"affordable"** for purposes of the employer penalty if the cost of single coverage is less than 9.5% of the employee's W-2 income.
  - Coverage is **"minimum value"** if the coverage is expected to pay at least 60 percent of claims costs.
- The penalty is $250 per month **($3,000 per year)** for each full-time employee who:
  - Is not offered coverage that is **both** minimum value <u>and</u> affordable coverage, and purchases coverage through an exchange, **and**
  - Receives a premium credit subsidy in the exchange (the household income must be below 400% of federal poverty level to qualify for a subsidy)

Penalty Calculations

- Note that the first 30 employees do count under this "inadequate coverage" penalty. Also, if the first ("no offer") penalty would be less expensive than the second ("inadequate coverage") penalty, the employer would pay the first penalty. Therefore it would be necessary to run both tests.

- For purposes of calculating the penalty, although part-time (less than 30 hour per week) employees count when deciding if the employer is "large," no penalty will be due if coverage is not offered to these employees. A penalty would be due on seasonal employees while they are working full-time, if adequate coverage is not offered.

Counting Employees Under PPACA

- **Large Employer** – PPACA defines as having at least 50 full time or full-time equivalent on average over prior calendar year.
  - If (FT employees each month + FTE each month)/12 >= 50,   (fractions round down) then subject to Pay or Play penalty
  - Families of companies are added together
- **Full-Time** – if employee works an average of at least 30 hours per week during the month, he/she is considered full time for that month.
- **FTE (Full-Time Equivalent)** – to calculate the number per month, divide total hours of service of all part-time employees by 120. This number (rounded down if a fraction) is added to the Full Time number to determine total number of Full-Time employees.

Counting Employees Under PPACA

- Part-Time – works less than 30 hours per week or 130 hours monthly
- Seasonal Employees – work either part-time or full-time hours during a busy season; not specifically defined in the new notice so will be employer's good faith determination at least for 2014.
- Variable Hours Employees – hours are uncertain and not reasonably expected to average 30 hours or more (includes both those working full time at first but knowing hours will be reduced later and those "on-call" employees).

Counting Employees Under PPACA
Common Law Employee

Common-Law Employee – no set definition but the parameters are:

- hirer has control over how an individual performs a task and where the tasks are performed;
- length of relationship is indefinite;
- hirer provides material needed to complete the task;
- ability to assign additional tasks;
- sets work hours;
- payment is made on set schedule of time;
- work is part of regular business;
- benefits and perks are provided and person is invited to company events;
- training is provided;
- expenses are reimbursed.

How Will Employers Count Hours?

- It is expected that current DOL rules for counting hours for pension plan purposes will be used to count an employee's hours of service as a full-time employee or full-time employee equivalent. Under these rules, a person is considered to have completed an "hour of service" with each hour for which he is paid for work, vacation, holiday, sick time, layoff, jury duty, military duty, etc.

- When converting time to a monthly basis, 30 hours per week would mean 130 hours per calendar month.

Counting Hours Methods

- The agencies are considering several possible methods of counting hours and have said that they expect that employers will be able to use different counting methods for different classes of employees. The proposed methods include:
  - For employees who are paid hourly, actual hours worked or paid would need to be used
  - For employees who are not paid hourly, alternatives would include:
    - Counting actual hours worked or for which vacation, holiday, etc. are paid
    - Crediting an employee with eight hours of work for each day for which the person was paid for at least one hour of work, vacation, holiday, etc.
    - Crediting an employee with 40 hours of work for each week for which the person was paid for at least one hour of work, vacation, holiday, etc.

Determining Average Hours Worked

- An employer may simply look at its population on a current, month by month basis if it wishes to. However, to avoid the complications that may arise if an employee alternates between working more and less than 30 hours, or to simply reduce calculation frequency, IRS Notice 2012-58 gives an employer the option of using longer calculation periods to get a smoother, more predictable result if it prefers to do that.

- If the employer wants to use a smoothing technique, different processes apply to existing and new employees.

Calculation Option for Existing "Ongoing" Employees

- Instead of tracking time currently, an employer may look at how many hours the employee averaged during a look-back period called a "**standard measurement period.**" Once the determination is made whether the employee worked full-time during the standard measurement period that determination will apply throughout the related "**stability period**" regardless how many hours the employee actually works.

Note that the employer will still have to track the employee's hours during the stability period, as that information will be needed to make the determination for the next standard measurement period.

Standard Measurement and Stability Period

- **Standard Measurement Period** – a “look-back” period of 3-12 months used to track and determine how many hours an employee worked on average during this time period.
  - The employer must choose a start date for the standard measurement period. It can be Jan. 1, the first day of the benefit period, a date near the start of open enrollment, or any other date the employer chooses

- **Stability Period** – period for which the employee is considered Full-Time or not Full-Time and must be:
  - At least as long as, but not longer than, Standard Measurement Period if the employee is Full-Time
  - At least 6 months if the employee is Full-Time but not more than 12 months

Standard Measurement and Stability Period

- Employers may use different standard measurement and stability periods and period start dates for these classes of employees:
  - Collectively bargained and non-collectively bargained
  - Hourly and salaried
  - Employees of different entities
  - Employees located in different states

New Employees Expected to Work Full-Time

- To avoid penalties, a new employee who is reasonably expected to work 30 or more hours per week must be offered coverage following satisfaction of the eligibility waiting period. Under PPACA, the waiting period generally cannot be more than 90 days. No pay or play penalty will be owed during the waiting period if the employee is offered coverage that would be effective on or before the end of the permissible waiting period.

New Employees Who Work Variable Hours

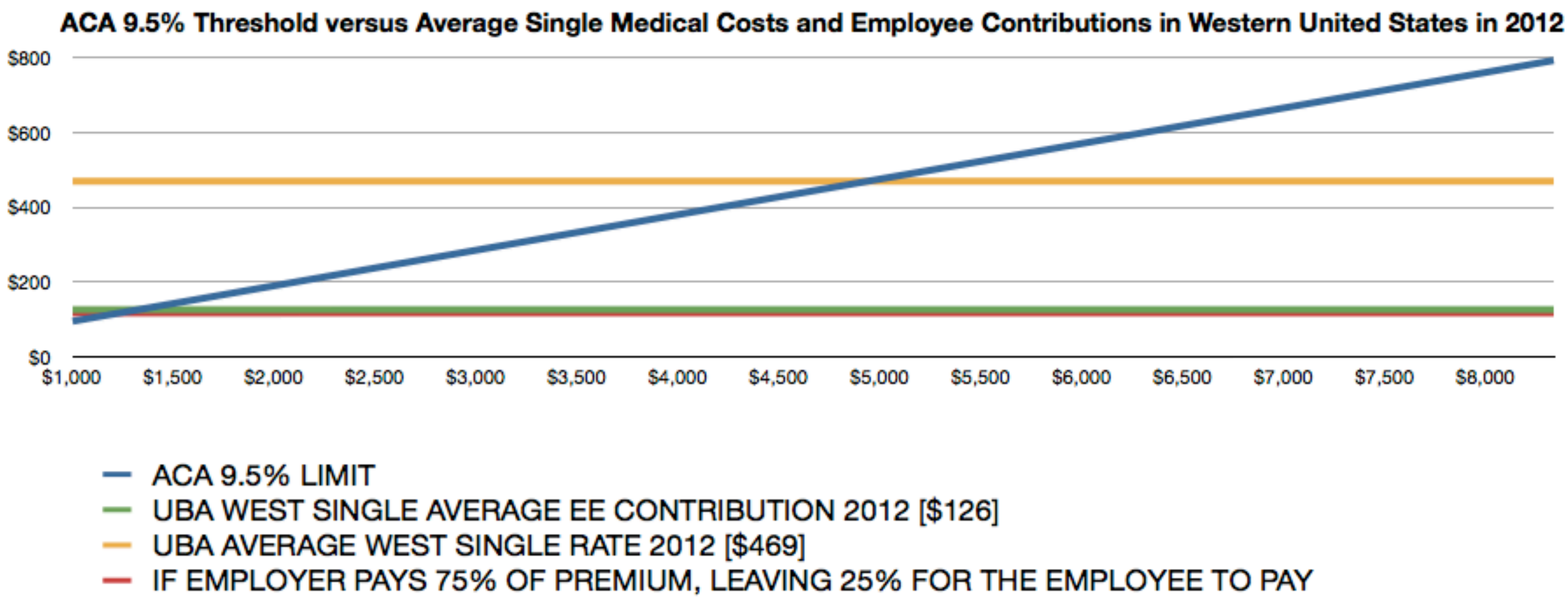
- At least for 2014, employers who hire seasonal or variable hours employees have significant flexibility in determining whether the new employee is full-time. Employers in this situation may elect to use an "initial measurement period" to determine whether the employee is full-time during a subsequent stability period. Additionally, no penalty is due during this initial measurement period, even if it is ultimately determined the employee averaged 30+ hours and was therefore a full-time employee during this time. Note that this method may only be used when the employer truly expects the employee's hours to fluctuate or the employee is a seasonal employee.
- "Seasonal employee" is not defined in the new notice and at least for 2014, an employer's good faith determination that an employee is seasonal will be honored. Usually, seasonal employment means employment for a limited period to perform a specific function, such as retail during holiday seasons, tax preparation during tax season, or agriculture during harvesting season.
- "Variable hours employees" are those whose hours are variable or are otherwise uncertain and who are not reasonably expected to average 30 or more hours per week over the measurement period. This would include both those expected to work full-time when initially hired but who are expected to have their hours reduced at some point (such as retail workers hired in November, and those whose hours vary from week to week such as on-call employees).

Scenarios That Can Occur

- Impact of reform is minor
  - Plans pass
  - Eligibility requirements today already comply
  - Positive employee or dependent enrollment reductions occur
- It costs more to cancel the plan than keep it
  - Penalties are non-tax deductible: $2,000 penalty = $3,077 expense
  - Employees are second income to family (high waivers)
- The plan costs jump dramatically
  - # of those eligible is increasing
  - Plans were not bronze level or essential before
  - New taxes and fees on top of inflation
- Rare: It is better for me and my employees to cancel coverage
  - Employer plan today has high medical cost, low wage earners

Graphical Look

Using the UBA national survey, we can see how the 9.5% *employee* cost threshold compares to average costs in the Western U.S.



Cadillac Tax

A New Excise Tax in 2018

- Applies to health plans or self-funded plans and not employers or employees *directly*
- Tax based on premium paid (or equivalent if self-funded)
- Tax (non-deductible) is 40% of the excess over the premium in 2018 of $10,200 single coverage or $27,500 for family (2+) coverage (higher in some cases for those with retirees or "high-risk" jobs)
- Those premium thresholds increase each year based on a formula

Accumulated Postretirement Benefit Obligation (APBO)

- While 2018 is far away, some believe the Cadillac Tax must be included now in projecting future retiree health costs
- That is not clear; the tax is not paid by the employer or employee, and the factors that go into a total health care cost are so varied and unknown that including the potential Cadillac Tax in the calculation but excluding other potentially more important changes could be actuarially unsound.

Other Issues

“Covered California” Exchange

The California Exchange has received $190 million thus far to get it operational but it must hurry to be ready for employers to be able to notify employees of the Exchange as mandated by the law. Here’s what is interesting:

- There is continued debate about how plans outside of the Exchange will have to conform to those that are inside the Exchange. How will the rates compare?
- Which carriers and health plans will offer coverage inside the Exchange?
- Will the Exchange get enough volume to be able to get by with only 2% premium surcharge or will it need more?
- Will the State seek to limit the ability of smaller employers to partially self-fund, thus preventing employers from bypassing the Exchange?
- How will the two federal plans that the Obama Administration has said it will offer inside the Exchange affect the marketplace?

Covered California needs to be up and running soon, and we thus far have more questions than answers.

Other Issues

Changing medical landscape in California:

We are seeing limited network plans move into the Northern California (they have been very common in Southern California).

"Covered California" exchange could have a dramatic impact on small group health insurance sales in California in 2014 (2-50 employees in 2014, 2-100 in 2016 and later).

Will partial self-funding make a strong come back in California due to PPACA?

Political Issues

Federal:

With the re-election of President Obama, and the Democrats retaining control of the Senate and the Republicans retaining control of the House, dramatic changes in PPACA are not expected. That is not to say, however, that budget negotiations will not impact the financing of PPACA.

State:

The recent election resulted in a Super Majority for the Democrats in Sacramento. It remains to be seen whether that will have a significant impact on healthcare legislation in California (Single Payer? DOI oversight of rates? Elimination of self-funding for smaller employers?).

Questions?

We are also happy to answer any questions on healthcare reform.

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