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HEALTH CARE REFORM INFORMATION FOR BUSINESSES

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The Patient Protection and Affordable Care Act, as modified by the Health Care and Education Reconciliation Act of 2010 (together, the Affordable Care Act), which was upheld by the Supreme Court, had some key provisions that apply to businesses. Perhaps the item of most interest to employers is that beginning in 2014, many businesses that do not offer affordable health insurance coverage that provides a certain minimum value to full-time employees (and their dependents) may be subject to an excise tax (i.e., penalty).

Businesses that already offer health insurance coverage for employees must carefully evaluate the coverage their health plan provides. Many provisions of the new law do not apply to plans that were in existence on March 23, 2010 (i.e., grandfathered plans), as long as the plan maintains its grandfathered status. However, some provisions apply to these grandfathered plans.

The legislation also requires additional reporting requirements relating to employees. However, along with these additional requirements are some incentives, including tax credits for certain small businesses and the ability for certain small employers and their employees to save taxes by using a simple cafeteria plan.

Many of the health care legislation's provisions that affect employers were effective in either 2010 or 2011. Others are not effective until later. Undoubtedly, additional legislation or guidance will affect provisions that have a delayed effective date. Now that the Supreme Court has upheld the law, businesses should be diligent about taking the proper steps to identify any changes in processes and procedures that are needed to comply with the law. This information provides a brief overview of the key legislative changes affecting businesses.

Grandfathered Health Plans. We will start with information on health plans that were in existence on March 23, 2010 (i.e., the enactment date of the Affordable Care Act). These grandfathered plans are exempt from many of the legislation's provisions affecting a plan's health insurance coverage as long as they do not do anything that causes them to lose their grandfathered status. However, the following key provisions do apply:

1. No Annual or Lifetime Dollar Limits. Effective for plan years beginning on or after September 23, 2010, no lifetime limits on the dollar value of certain benefits (i.e., essential health benefits) can be established. No annual limits on the dollar value of essential health benefits can be established beginning after 2013. However, for plan years beginning before January 1, 2014, a restricted annual dollar limit can be established, as long as it meets certain guidelines.

2. Prohibition of Rescission of Coverage. Effective for plan years beginning on or after September 23, 2010, an individual's coverage cannot be rescinded once the Individual is enrolled in the

plan unless he or she commits a fraudulent act or intentionally misrepresents a material fact, as prohibited by the terms of the plan or coverage.

3. Extension of Dependent Coverage. Effective for plan years beginning on or after September 23, 2010, a health care plan that offers coverage for dependent children must continue to offer the coverage until the child reaches age 26. The child, if otherwise qualifying, must continue to be offered coverage by the parent's health plan even if he or she does not qualify as the parent's dependent for income tax purposes. However, for plans years beginning before January 1, 2014, grandfathered plans do not have to offer coverage to a child who has not reached age 26 if that individual is eligible to enroll in an employer-sponsored health plan that is not a group health plan of a parent.

4. Prohibition of Pre-existing Condition Exclusions. Effective for plan years beginning on or after September 23, 2010, no exclusions for a pre-existing condition can be imposed on any individual under age 19. The ban on pre-existing conditions applies to all individuals effective for plan years beginning on or after January 1, 2014.

5. No Excessive Waiting Periods. Effective for plan years that begin on or after January 1, 2014, for group health plans and group coverage, no waiting period (i.e., the period before an individual is eligible to be covered for benefits under a plan) can exceed 90 days.

6. New Reporting Requirements. Generally, beginning in September 2012, plans must begin providing applicants, enrollees,and policyholders or certificate holders a summary of benefits and coverage (SBC) that conforms to standards set by the Department of Health and Human Services (HHS).

Grandfathered plans are limited in the modifications they can make while maintaining their grandfathered status. Before a current plan makes any changes in benefits offered or increases premiums, the plan sponsor should obtain guidance to ensure the plan does not lose its grandfathered status unintentionally. Our firm has the knowledge to assist you in updating plan documents for required changes under the new law, and to help your business make adjustments in the coverage that will maintain the grandfathered status of the plan.

New Health Plans. Businesses that did not have health insurance coverage for employees in place by March 23, 2010, are subject to not only the provisions previously listed that apply to grandfathered plans, but to a host of other provisions, including meeting nondiscrimination requirements, first dollar coverage (i.e., no deductible or cost sharing) for certain preventive care, and premium limitations. Our firm can provide information on the legislation's provisions that apply to new health care plans and plans that lose their grandfathered status. We are available to assist your business in evaluating and comparing the costs of various health insurance plans from a financial and tax perspective.

Small Employer Health Insurance Tax Credit. Effective for tax years beginning in 2010-2013,the Affordable Care Act provides a new tax credit for small employers that pay a portion of the health insurance premiums for their employees. To qualify for this new credit, an employer must employ less than 25 full-time equivalent (FTE) employees during the tax year (not including the owner and certain

other related parties), pay average annual FTE wages of less than $50,000 per employee, and pay a uniform percentage of the health insurance premiums (that is at least 50%) for employees who enroll in the employer-sponsored health insurance plan. The credit is a percentage of the nonelective employer-paid premiums.

The full credit amount (35% for businesses; 25% for tax-exempt entities) is available to employers that have 10 or fewer FTEs with average wages of $25,000 or less. As the number of employees and the average wage amount increases, the credit decreases.The small employer health insurance credit is claimed on the employer's income tax return as an offset to both regular income taxes and alternative minimum tax (AMT). Generally, any unused credit can be carried back for one year and forward for 20 years to offset income taxes.

In addition, after 2013, eligible small employers who purchase health insurance coverage for their employees through the small business health options program (SHOP) of a state insurance exchange will be eligible for a tax credit of up to 50% (35% for tax-exempt entities) of the employer-paid premiums for health insurance for two years.

If you pay any portion of your employees' health insurance premiums, we encourage you to contact us to see if you meet the uniform percentage payment criteria (which is very confusing) to qualify for the credit. Additionally, employers with a large employee turnover, or with part-time workers, may find calculating the number of FTE employees and the FTE average annual wages daunting. Our firm is available to assist in calculating the credit. We can quickly help you determine if you may qualify for the credit and give you an estimate of the credit amount to which your business may be entitled, using some general payroll information provided by you.

Dependent Coverage In Employer Health Plans. Effective March 30, 2010, the general exclusion from income for employer-provided health care coverage and reimbursements is expanded to apply to employees' children who have not attained age 27 as of the end of the employee's tax year (i.e., generally the calendar year). To qualify for this tax break, the child must be the individual's son, daughter, stepson, stepdaughter, or eligible foster child. The child does not have to qualify as the employee's dependent for income tax purposes. Similarly, self-employed individuals can deduct, as a self-employed health insurance deduction on page one of Form 1040, the cost of insurance coverage for their children who have not attained age 27 as of the end of the tax year.

Automatic Enrollment of Employees In Employer Health Plans. Employers with more than 200 full-time employees must automatically enroll new employees, and continue enrollment for current employees, in the employer's health benefit plan. Additionally, employers must provide adequate notice to employees of their ability to opt out of coverage in which they are automatically enrolled. This provision was effective March 23, 2010, but the Department of Labor (DOL) has delayed compliance until additional guidance is issued.

Simple Cafeteria Plans Available for Small Employers. Many small employers have not established cafeteria plans for their employees because they cannot meet the cafeteria plan nondiscrimination requirements, which can be harsh. To make it easier for small employers to provide qualified cafeteria plan benefits for their employees, the Affordable Care Act established simple cafeteria plans. For tax

years beginning after December 31, 2010, certain small employers (i.e., those that employed on average 100 or fewer employees during either of the two preceding tax years) may establish a simple cafeteria plan. These simple cafeteria plans are deemed to meet the applicable nondiscrimination rules by satisfying certain minimum eligibility, participation, and contribution requirements. Our firm can provide additional information on this new benefit and help your business set up a simple cafeteria plan, if you are interested.

Reimbursement of Over-the-counter Medication Costs. Prior to the health care legislation, certain over-the-counter medications not prescribed by a doctor qualified as reimbursable medical expenses through a health reimbursement account (HRA) or a health flexible spending arrangement (health FSA). Additionally, health savings accounts (HSAs) and Archer medical savings accounts (Archer MSAs) could provide tax-free distributions for certain over-the-counter medications not prescribed by a doctor. For reimbursements of expenses incurred after December 31, 2010, the cost of over-the-counter drugs not prescribed by a doctor are no longer qualifying medical expenses for HAAs and health FSAs. Likewise, distributions from HSAs or Archer MSAs for over-the-counter drugs not prescribed by a doctor are nonqualified distributions, subject to income tax and a penalty tax.

Limit on Contributions to Health FSAs. A health FSA, which is one of a number of tax-advantaged arrangements that can be set up through an employer's cafeteria plan, allows an employee to set aside a portion of his or her wages on a pre-tax basis to pay for qualified medical expenses as defined in the cafeteria plan. Currently, there is no limit in the tax law on the amount of contributions to a health FSA (although some plans may have a limit). However, effective for plan years beginning after December 31, 2012, employee pre-tax salary contributions are limited to no more than $2,500 per year. The dollar amount will be indexed for inflation for plan years beginning after 2013.

Cost of Employer-sponsored Health Coverage Included on Form W-2. Beginning with Forms W-2 issued for calendar year 2012 (i.e., Forms W-2 that will be provided in January 2013), most employers must report the aggregate cost of employer-sponsored health insurance coverage on the employee's Form W-2. The IRS has provided relief from the reporting for calendar year 2012 to certain small employers. Employers should begin now to determine what information will be needed to calculate this value, and how the information will be gathered. Our compensation specialists can assist you in this effort.

Additional Medicare Tax for High-wage Earners. Currently, the Medicare portion of FICA taxes is 2.9%, with the employer and employee each paying 1.45% on all earnings subject to FICA (i.e., there is no earnings limit). Beginning in 2013, the employee portion of the Medicare taxes will be increased by 0.9% on wages over $200,000 ($250,000 for married filing jointly and surviving spouses; $125,000 for married, filing separately). An employer will be required to withhold and remit the additional tax for any employee to whom it pays at least $200,000 in FICA wages. Our firm is ready to assist you in setting up a system to implement this new withholding requirement. We can also help you explain the new tax to your employees, who may need to adjust their federal income tax withholding on Form W-4 because you are not required to withhold the additional tax (because the employee's wages are not over $200,000), but the employee will be subject to the tax because the combined wages of the employee and his or her spouse are over $250,000. Similarly, the Medicare tax imposed on self-employment income in excess of the previously mentioned thresholds will be increased by 0.9%. Therefore, self-employed business owners will need to adjust their quarterly estimated tax payments to account for this increased tax.

Penalty for Employers Not Offering Affordable or Adequate Health Insurance Coverage. Beginning in 2014, certain large employers [i.e., generally those who had an average of at least 50 full-time equivalent (FTE) employees in the previous calendar year] that do not offer health Insurance coverage for all full-time employees (and their dependents), or offer health insurance coverage that is unaffordable or does not provide a certain minimum value, must pay a penalty if the employer is notified that any full-time employee is allowed or paid either a premium assistance credit to purchase health insurance in the individual market through a state insurance exchange or a cost-sharing-reduction subsidy to help with out-of-pocket expenses. Any penalty paid under this provision is not deductible as a business expense for federal income tax purposes. Many small businesses will not be subject to this provision. However, any business that has close to 50 full-time employees, and hires part-time workers could unintentionally pass the 50 FTE threshold, and become responsible for offering health insurance. Our compensation specialists can explain this new provision and assist you in determining if your business meets the threshold, or based on projections, may meet the threshold by 2014. We can also help you calculate the penalty and compare it to the cost of offering health insurance to your employees and their dependents.

Annual Certification of Coverage to the IRS and Covered Employees. After 2013, employers that provide health insurance coverage through an employer-sponsored plan must provide information statements regarding certain health insurance coverage to the IRS and to the covered employee. Our staff can assist you in gathering the information and preparing the information statements.

Excise Tax on High-cost Employer-sponsored Health Coverage (Cadillac Plans). Beginning in 2018, a nondeductible 40% excise tax will be levied on so-called Cadillac plans. These plans are employer-sponsored health plans with annual premiums (i.e.,excess benefits) exceeding $10,200 for self-only coverage and $27,500 for any other coverage. Slightly higher premium thresholds apply for retired individuals age 55 and older who are not eligible for enrollment in Medicare or entitled to Medicare benefits, and for plans that cover employees engaged in high-risk professions. For coverage under a group health plan, the 40% excise tax will be imposed on Insurance companies, but it is expected that employers (and their employees) will ultimately bear this tax in the form of higher premiums passed on by insurers. Employers will be responsible for the tax if coverage is provided by employer contributions to HSAs or Archer MSAs. Employers will be responsible for calculating the excess benefit amounts and reporting those amounts to the applicable insurer. Employers that currently offer generous health benefits (especially if the benefits are to the owners and related persons) should carefully analyze their plans to see if changes are needed to avoid having plans that will be subject to this tax. Additional guidance will be issued on this excise tax (and in fact, additional legislation may change some of these provisions). We will keep you informed of any new information as it becomes available.

That is a brief highlight of the major provisions of the health care legislation that will affect businesses. As noted above, some of the Affordable Care Act provisions apply to all businesses, while other provisions only apply to employers once a certain employee threshold (generally, 50 FTE employees) is met. Please give us a call if you have any questions or would like to discuss the impact of the new legislation on your business.

If you would like more details about any of these provisions or have questions about the effects of these provisions to you and your business, please do not hesitate to call the KKAJ tax and accounting professionals at 818.848.5585, 661.705.4222 or toll free at 888.837.9321.