

WHAT HEALTH CARE REFORM



MEANS FOR
YOUR BUSINESS

PKF

Health care reform is now the law of the land. And nearly every individual and business in the U.S. will be affected by the new law's provisions.

The Patient Protection and Affordable Care Act (the "Act," as amended) overhauls the health care environment in the U.S. The goal: to provide a minimum level of health care coverage for eligible individuals. For example, the new law requires most U.S. citizens and legal residents to have health insurance. Income eligible individuals and families will receive premium tax credits to help pay for coverage. Those choosing not to carry coverage will pay penalties.

The Act places new responsibilities on employers that, over time, may well change the nature of employer-provided health care. Employers choosing not to offer their employees qualifying coverage will pay an additional tax to help finance their employees' health care. An exception applies for smaller businesses.

The new law's provisions will generally go into effect on dates ranging from within a short time after the date of enactment through 2018. For more details, see the *Calendar of Effective Dates* later in this publication.

The following pages summarize the key provisions of the Act that may affect your business. You will gain insight as to how the new law applies in defined situations and learn ways to plan for the new law's impact. But keep in mind that the Act contains many complex rules and exceptions. Professional guidance is recommended before applying anything you read here to your individual or business situation.

Access to Coverage — The Basics

It is important for business owners and executives to understand how the Act expands individuals' access to health care insurance coverage, since those rules tie into the provisions affecting employers' responsibilities. Among other provisions, the new law:

- Generally requires most individuals to have at least a minimum level of health care coverage (“minimum essential coverage”).
- Creates state-based American Health Benefit Exchanges through which individuals without health insurance can buy coverage.
- Provides refundable premium tax credits and cost-sharing reductions to make health care more affordable for individuals/families with income up to 400% of the federal poverty level (for example, at 2010 levels, a family of four with income up to \$88,200).
- Imposes penalties on individuals who fail to carry minimum essential coverage. Exceptions apply (e.g., for those whose income is below the threshold for filing a federal income-tax return).
- Allows personal or employer-provided health benefit coverage existing at the time of enactment to stay in place under a “grandfather” provision. The Act considers the grandfathered coverage to meet the law’s individual coverage mandate, if requirements are met.

Employer Shared Responsibility for Health Care Coverage

While the Act does not *require* employers to provide minimum essential health care coverage to employees, it strongly encourages them to do so. How? By offering “incentives” in the form of both carrots and sticks.

Small Business Exchange: The Act creates state-based exchanges (known as Small Business Health Options Program, or “SHOP,” Exchanges) through which small businesses can pool together to spread their financial risk and buy health care insurance coverage for employees (and possibly save money by doing so). SHOP Exchanges will generally be available to employers with up to 100 full-time employees until 2017, at which time states may allow larger businesses to participate.

Your Planning: If you are a smaller employer, stay informed about how your state is handling a SHOP Exchange and, once the program is available, investigate whether the coverages offered can meet your and your employees’ needs at a reasonable cost.

Small Employer Health Insurance Tax Credit: The Act offers small employers that purchase health insurance coverage for employees a sliding-scale income-tax credit to help them pay for the plan. For purposes of the credit, a “small employer” is defined as one with no more than 25 full-time (or full-time equivalent) employees and average annual wages of no more than \$50,000 per employee. The credit has two phases.

- For tax years 2010 through 2013, the law allows a tax credit of up to 35% of the employer’s contribution toward employees’ coverage. In general, the employer must contribute at least 50% of the total premium cost. Employers with 10 or fewer employees with average annual wages of less than \$25,000 will be entitled to the full credit. The credit phases out for employers with more employees and/or higher average wages.
- Starting in tax year 2014, eligible small businesses that purchase coverage through a state-based SHOP Exchange may qualify for a credit of up to 50% of their contribution toward the coverage. The employer must contribute at least 50% of the total premium cost. The credit will be available to a qualifying employer for up to two tax years after 2013. Again, the full credit is available to employers with no more than 10 employees who earn an average annual wage of less than \$25,000 (adjusted for inflation), with a phaseout as employee counts and/or average wages increase.

Example: Starting in 2010, Small Business, which meets the Act’s requirements, receives a 35% tax credit to help pay for its health insurance plan. In 2014, Small Business purchases coverage through a SHOP Exchange. The 50% credit will be available to Small Business for two years, 2014 and 2015, only.

A small employer tax credit is available to qualifying small tax-exempt employers, but at a reduced credit percentage. The credit is taken against payroll taxes.

Observation: Be aware that certain employees (for example, 2% S corporation shareholders and more-than-5% owners of the employer) are not included in the definition of “full-time employee” for purposes of the small employer tax credit. Neither are seasonal workers who work 120 days or less during the year. This can impact the amount of any credit your company may be entitled to.

Employer Penalty: The new law will exact a penalty on certain larger employers that fail to provide adequate minimum essential health care coverage. An “applicable large employer” is defined as one having an average of at least 50 full-time (or full-time equivalent) employees on business days during the previous calendar year. (Defined seasonal workers don’t count.)

In general, the penalty applies where the employer offers:

- no minimum essential coverage,
- minimum essential coverage that is “unaffordable” (it costs the employee more than 9.5% of household income), or
- minimum essential coverage for which the plan’s share of the total allowed cost of benefits provided to employees (“actuarial value”) is less than 60%.

Large employers that (1) do not offer minimum essential coverage and (2) have at least one employee who receives a premium tax credit or cost-sharing reduction to help pay for individual coverage will incur an additional “assessable payment” (read: tax). The assessment is equal to \$2,000 per full-time employee per year (computed on a monthly basis). The Act excludes the first 30 employees from the payment calculation.

Example: *Sample Corporation has 65 full-time employees. It does not offer minimum essential health care coverage throughout the year. The amount payable by Sample Corporation will be 35 (65 minus*

30) employees multiplied by 1/12 of \$2,000, or \$5,833.33 a month, or \$70,000 a year.

A penalty also applies to large employers that offer minimum essential coverage where that coverage is either “unaffordable” or has an “actuarial value” of less than 60%. If at least one full-time employee receives a premium tax credit or cost-sharing reduction, the employer will pay \$3,000 for each employee receiving a premium credit or cost-sharing reduction or \$2,000 multiplied by the total number of full-time employees, if that amount is less.

Note that employers with fewer than 50 employees are *exempt* from the additional assessments imposed by the Act. Note, too, that large employer grandfathered plans could be subject to a possible assessment if the coverage falls within the penalty provisions.

Observation: The Act’s provisions may discourage businesses with fewer than 50 full-time employees from expanding their payrolls to 50 or more. To avoid dealing with new benefits, administrative costs, and penalties, some employers may decide to use more independent contractors and contingent workers rather than full-time employees.

Your Planning: For employers subject to potential penalty assessments, it will be important to consider the options as to offering — or not offering — a qualifying health insurance plan. For some employers, not offering insurance and paying the assessment may be a cheaper alternative to paying premiums for employer-provided coverage. Make sure to consult a qualified professional to help you review your choices and determine which makes the most sense for your business.

Free Choice Vouchers: Employers that offer coverage to their employees will be required to provide “Free Choice Vouchers” to certain employees whose income is not more than 400% of the federal poverty level. To qualify for a voucher, the employee’s required contribution to the employer-provided coverage would have to exceed 8%

Which Employers Are Affected?

Several of the Act's changes apply only to employers that have specified numbers of employees. Here is a brief summary of the limitations.

Act Provision	Applies to Employers with:
SHOP Exchange eligibility*	100 or fewer employees**
Small employer tax credit for providing health insurance	25 or fewer employees**; \$50,000 maximum average wage
Penalty for not providing minimum essential health coverage or affordable coverage	50 or more employees**
Simple cafeteria plans for small businesses	100 or fewer employees**
Automatic enrollment in employer health plan	Employers that have more than 200 employees** and offer health coverage
Grants for wellness programs	Fewer than 100 employees who work 25 or more hours a week

* Beginning in 2017, states may loosen restrictions on SHOP Exchange eligibility.
** Full-time or full-time equivalent employees

of household income (but not exceed 9.8% of income) and the employee must elect to enroll in a plan through the American Health Benefit Exchange.

The voucher amount will generally be the amount the employer would have paid to cover the employee under the employer's plan. If the value of the voucher exceeds the cost of the Exchange plan chosen by the employee, the employee keeps the excess. The employer won't be subject to the additional assessment described earlier for employees who receive vouchers.

Observation: In addition to the penalty assessments or Free Choice Voucher costs, some employers could see premium costs rise. Lower-income healthy employees could leave the higher-cost employer plan to secure coverage through an Exchange, leaving fewer healthy older employees in the plan. Plus, if the amount of the voucher the employer provides is more than the cost of the Exchange-provided coverage, these opting-out employees may receive a windfall.

Other Employer Coverage Information: The Act contains several other important provisions affecting employer-provided coverage. Among them:

- An employer with more than 200 full-time employees (or equivalents) will be required to automatically enroll employees in a health insurance plan it offers. The employees may opt out of coverage altogether or elect another plan offered by the employer.
- Most employers providing minimum essential coverage will be required to file information about the coverage with the IRS. The filings will identify individual employees, number of months covered, the coverage type, and the premium amount paid by each employee. Employers will also have to file information about employee coverage with the U.S. Department of Health and Human Services. Failure-to-file penalties apply.
- Employers that provide health insurance coverage will have to disclose the benefit's cost on each employee's annual Form W-2, *Wage and Tax Statement*. This provision does *not* alter the tax-free treatment of employer-provided health coverage.
- Employers generally will have to provide employees, upon hire (or, for existing employees, by March 1, 2013), a notice that describes the availability of and the services provided by the American Health Benefit Exchange and the eligibility requirements for buying insurance through the Exchange, as well as the consequences if an eligible employee chooses to do so. Other employee notices may be required.
- Eligible small businesses will be able to establish "simple cafeteria plans" that allow them to offer tax-free health and other benefits to their employees. An employer is eligible to sponsor a simple cafeteria plan if, during either of the preceding two years, the business employed 100 or fewer employees on average (based on business days). Minimum contribution and eligibility/participation requirements apply.

Calendar of Effective Dates of Health Care Reform Law Provisions

2010

- Small Employer Health Insurance Tax Credit (initial phase)
- Reinsurance program for age 55 or older retiree health coverage
- Dependent coverage to age 26 (for dependents not covered by another employer-sponsored plan)
- No lifetime caps on dollar value of health benefits
- No preexisting condition exclusions for children
- No rescissions unless fraud
- Increase in exclusion for employer-provided adoption assistance

2011

- Grants available for small business wellness programs
- CLASS program automatic enrollment and voluntary payroll withholding
- W-2 reporting of the value of employer-sponsored health insurance coverage
- Restrictions on using funds in a health FSA, HRA, HSA, or MSA for over-the-counter medicines
- 20% additional tax on HSA and MSA withdrawals not used for medical expenses
- Fee on branded prescription drug manufacturers and importers
- New simplified cafeteria plan for small businesses

2012

- Information reporting for payments to corporations

2013

- Automatic enrollment of employees in large employer plans
- Additional .9% Medicare tax on wages/self-employment income of high earners
- 3.8% Medicare surtax on investment income of higher income taxpayers

2013 (continued)

- \$2,500 limit on annual health FSA contributions
- 10% floor on itemized medical expense deduction
- Elimination of business deduction for certain retiree prescription drug costs
- Limit on deduction for compensation paid to insurance company executives (for services performed after 2009)
- 2.3% excise tax on medical device sales

2014

- Individual health care minimum essential coverage mandate/penalties/subsidies
- Employer shared responsibility mandate/penalties (assessments)
- Individual and small business (SHOP) exchanges available
- Small Employer Health Insurance Tax Credit (second phase)
- Free Choice Vouchers start
- No annual limits on coverage in grandfathered individual and group plans
- Employee awards for wellness programs permitted
- Annual fee on health insurance providers (for net premiums written after 2012)
- Increases in required estimated tax payments for large corporations

2017

- States can allow businesses with more than 100 employees to purchase coverage through SHOP Exchanges

2018

- 40% excise tax on high-cost health coverage provided by employers

Plan Features Required by the Act

Health care plans must eventually contain certain plan features. Here's a basic rundown. Some exceptions apply.

Required Feature	Individual Coverage and Group Coverage Purchased Through Exchanges	Grandfathered Employer-provided Health Coverage
Guaranteed issue and guaranteed renewable	•	
Rating variation based only on age, family composition, and tobacco use	•	
Dependent coverage for adult children to age 26 (if plan offers coverage)	•	•
Minimum coverage for preventive services	•	
No limits on the dollar value of coverage	•	•
No rescission of coverage except if fraud exists	•	•
No waiting periods in excess of 90 days	•	•
Limited deductibles and co-pays	•	
No preexisting condition exclusions for children (in 2014, for adults)	•	•

- The Act creates a temporary reinsurance program for employers that provide health insurance coverage to retirees age 55 and older who are not eligible for Medicare.
- Each SHOP Exchange will be required to offer at least two multi-state plans to employers so that

employers having employees in different states can obtain such coverage.

- The new law provides grants for up to five years (starting in 2011) to small employers that establish wellness programs. It also allows employers to offer employees awards (premium discounts, waivers of deductibles or co-pays) of up to 30% of the cost of coverage for participation in a wellness program and meeting certain health-related standards.
- The Act establishes a national, voluntary long-term care insurance program for buying community living assistance services and support (CLASS). The program will provide individuals with specified functional limitations a cash benefit of \$50 a day or more to purchase services and support. The benefit vests over five years. The CLASS program is not employer sponsored or funded; however, it will require all employed adults to be automatically enrolled in the program through work. If the employer elects, employees' premium payments may be made through payroll withholding. Employees could opt out of the program.

Excise Tax on High-cost Insurance

The Act imposes a 40% nondeductible excise tax on issuers (insurance companies and self-insured plan administrators) of high-end, public or private employer-sponsored health plans (so-called "Cadillac" plans). The tax will generally apply to the extent annual premiums are more than \$10,200 for individual coverage and \$27,500 for family coverage. The threshold amounts are higher — \$11,850 (individual) and \$30,950 (family) — for plans covering employees engaged in certain high-risk professions or retired individuals age 55 and older who are not eligible for Medicare. Standalone dental and vision plans are excluded in figuring the amount subject to tax.

New Restrictions on Health FSAs, HRAs, HSAs, and Archer MSAs

The Act imposes several new restrictions on health flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), health savings accounts (HSAs), and Archer medical savings accounts (MSAs).

FSA Contributions: The Act places a \$2,500 annual limit on an employee’s salary reduction contributions to a health FSA under a cafeteria plan. The limit will be indexed for inflation.

Definition of Medical Expense: The new law generally conforms the definition of medical expense for purposes of employer-provided health coverage to the definition for purposes of the itemized deduction for medical expenses. As a result of this change, the cost of over-the-counter medicines will not be reimbursable with excludable income through a health FSA, HRA, HSA, or MSA unless a physician prescribes the medicine.

Penalty Taxes: Withdrawals from HSAs before age 65 that aren’t used for qualified medical expenses will be subject to an additional tax of 20%, up from 10% under prior law. The new law also increases the additional tax on MSA withdrawals not used for qualified medical expenses from 15% to 20%.

Medicare Tax Increases for High Earners

The Act imposes Medicare tax increases on higher income taxpayers.

Additional Hospital Insurance Tax: Individual taxpayers who earn more than \$200,000 a year, married taxpayers filing jointly who earn more than \$250,000, and married taxpayers filing separately who earn more than \$125,000 will face higher taxes on a portion of their wages. These taxpayers will have to pay an additional Medicare tax equal to .9% of their wages over the relevant threshold amount for their filing status. In effect, this change increases the Medicare tax rate on those earnings from 1.45% to 2.35%.

Observation: The rate increase applies only to the *employee* portion of the Medicare tax. The employer portion of the Medicare payroll tax continues to be 1.45% of earnings (with no cap). Also, the threshold earnings amounts are not indexed to inflation.

Under a parallel provision, self-employed individuals will be liable for an additional tax of .9% on their self-employment income to the extent it exceeds the applicable threshold amount. The additional self-employment tax is not deductible.

Note that employers only have to withhold the additional .9% tax on an employee’s wages over \$200,000. Employees will need to be made aware that, in certain circumstances, their full liability for the additional tax may not be covered through withholding.

Example: Linda works for Acme. She earns \$100,000, and her husband Ted makes \$210,000 at his job. Their combined wages of \$310,000 are \$60,000 over the \$250,000 threshold for joint filers. However, Acme is not required to withhold any portion of the additional Medicare tax from Linda’s salary, since it is under \$200,000. And Ted’s employer withholds the additional .9% tax only on \$10,000, the earnings in excess of \$200,000. Since their employers don’t withhold enough to cover all their additional Medicare tax liability, Linda and Ted should take the shortfall into account for estimated tax payment purposes.

Surtax on Investment Income: The new law also imposes a 3.8% surtax — called the “unearned income Medicare contribution” — on the investment income of higher income individuals, estates, and trusts. For individuals, the tax is equal to 3.8% of the *lesser* of (1) net investment income for the year or (2) the amount by which modified adjusted gross income (AGI) exceeds an annual threshold amount. The thresholds are the same as for the additional Medicare tax on earnings (e.g., \$200,000 a year for individual taxpayers) and are not inflation-adjusted.

Example: David is single and has modified AGI of \$230,000. Of that amount, \$100,000 is net investment income. His liability for the unearned income Medicare contribution tax is \$1,140 — 3.8% of \$30,000, the amount of his modified AGI in excess of \$200,000.

***Example:** Abby, a single taxpayer, has modified AGI of \$310,000 and net investment income of \$100,000. Her unearned income Medicare contribution tax is 3.8% of \$100,000, the full amount of her net investment income, since that amount is less than \$110,000 (the excess of modified AGI over \$200,000, the threshold for her filing status).*

Net investment income includes gross income from interest, dividends, annuities, royalties, rents, net capital gain, and income earned from passive trade or business activities. However, the 3.8% surtax does *not* apply to qualified retirement plan and individual retirement account distributions.

Increased Floor on Medical Deduction

Under the new law, individuals generally will be able to deduct their medical expenses as an itemized deduction only to the extent that their aggregate expenses exceed 10% of adjusted gross income. However, a 7.5%-of-AGI floor will continue to apply through 2016 if either the taxpayer or the taxpayer's spouse is age 65 or over.

Retiree Prescription Drug Cost Deduction

Employers that receive federal subsidy payments for providing prescription drug coverage to retirees eligible for Medicare Part D will no longer be able to claim a business expense deduction for retiree prescription drug expenses to the extent of the subsidy payments received.

Observation: For companies that offer prescription drug coverage to their retirees, taking away the deduction adds to the cost of providing the benefit. Large companies in particular could see a substantial reduction in earnings stemming from recognizing the tax impact of the provision in their financial statements.

Targeted Revenue Raisers

The new law includes several revenue raising provisions targeted at specific industries.

Insurance Company Executive Compensation: The Act places an annual cap on deductions that certain companies may claim for executive compensation and certain other compensation paid. Where applicable, the deduction limit is \$500,000 per individual.

Health Insurance Providers: Insurance companies will be subject to an annual fee, allocated based on market share of net premiums written. The fee doesn't apply to companies whose net premiums written are \$25 million or less.

Pharmaceutical Manufacturers and Importers: The Act also imposes an annual flat fee on businesses that manufacture or import branded prescription drugs for sale to, or in connection with, specified government programs. The aggregate fee will be apportioned to companies according to market share.

Medical Device Manufacturers, Producers, and Importers: These companies will pay a 2.3% excise tax on the sale of taxable medical devices. Eyeglasses, contact lenses, hearing aids, and other IRS-specified medical devices sold at retail establishments for personal use are exempted.

Other Business-related Provisions

Business owners also may want to take note of these revenue raising and miscellaneous tax provisions included in the Act:

- Businesses that make payments aggregating \$600 or more in a year to a single corporation (other than a tax-exempt corporation) for the provision of property or services will have to report the payments on IRS information returns.
- Employers may continue to provide adoption assistance as a tax-favored employee benefit through 2011. The new law increases the maximum available exclusion to \$13,170 per eligible child (inflation-adjusted after 2010).
- Large corporations are subject to increases in certain required payments of estimated tax.

HIRE Act

Another new law, the Hiring Incentives to Restore Employment Act of 2010 (the HIRE Act), was enacted shortly before the health care reform law. Among other provisions, the HIRE Act:

- Relieves employers of the obligation to pay the employer's share of Social Security employment taxes on wages paid to employees hired after February 3, 2010, and before January 1, 2011, if the law's requirements are met. This "payroll tax holiday" is available for 2010 wages paid after March 18.
- Offers employers a tax credit for retaining the newly hired workers for at least 52 consecutive weeks. (Other requirements apply.)
- Allows businesses to expense up to \$250,000 of their qualifying asset purchases in 2010 under Section 179 of the tax code. The \$250,000 expensing limit begins to phase out when qualifying asset purchases exceed \$800,000.

Summary

Health care reform will impact your business. To what extent depends on a number of factors: your business' size, its current health care benefits, and the makeup of its work force, to name just a few.

We hope this description of the Patient Protection and Affordable Care Act helps you gain a better understanding of the changes nearly every individual and business will face beginning in 2010 and over the next several years. It is important to consider how the law will affect your situation. We can help. Let our professionals be of service to you.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. However, the general information herein is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purposes of avoiding tax penalties.



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