



BABY STEPS: AN EMPLOYER'S FIRST YEARS UNDER HEALTH REFORM

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INTRODUCTION

The Patient Protection and Affordable Care Act (the "Federal Health Care Act") is complicated legislation that will affect most Americans. Although the major changes will not go into effect for years, and could be revised or revoked, there are immediate issues for 2010 and 2011 that employers must address. We will provide periodic updates as more guidance is issued.

PAYROLL TAX CHANGE FOR PARENTS OF NON-DEPENDENT CHILDREN

In effect now. Until now, there was a federal tax cost to a parent who covers an older non-dependent child on an employer health plan. The IRS required that the value of the child's coverage be "imputed" as non-cash taxable income and reported on the W-2 as wages. The Federal Health Care Act removes that requirement, effective for April payrolls, provided the child has not reached age 27 in the calendar year. The transition in 2010 is a little tricky. W-2s for the 2010 year will reflect three months of imputed income (January through March) and nine months of tax-free income. After that, there is no federal tax cost for such coverage. Note that the requirement to impute federal income for coverage of other non-dependents (such as ex-spouses and same-sex spouses that do not qualify as dependents under the Internal Revenue Code) is not changed.

REQUIREMENT TO EXTEND COVERAGE TO OLDER CHILDREN

For Plan years starting after September 22, 2010. Parents must be allowed to elect dependant coverage for older children until they reach age 26. How does this square with the current Massachusetts requirement to cover older children?

- ▶ The Massachusetts law applies to insured plans. The federal law applies to insured and self-insured plans.
- ▶ The Massachusetts law requires coverage until the earlier of age 26 or two years as a non-dependent. The federal law has no two year limit, and requires coverage until age 26.
- ▶ The federal law, until the plan year starting in 2014, permits plans to reject older children who have access to other group coverage. Massachusetts law does not permit rejection for that reason.

As such, this will be confusing in Massachusetts until 2014, because the Massachusetts "two year"

continuation requirement, without regard to availability of other coverage for the older child, is more liberal during that two year period than the pre-2014 rule in the Federal Health Care Act.

The IRS will issue regulations before the effective date of this requirement to define more precisely which older children are entitled to coverage and which are not. At this date, it is clear that even married children (but not their children) are intended to benefit from the extended coverage requirement.

CAFETERIA PLAN CHANGES

In effect now. This is a corollary of the payroll tax change described above. It would seem that a Section 125 plan can now be amended so that parents may receive tax-free reimbursement from medical flex accounts for expenses of older non-dependent children, provided the child is less than age 27 during the calendar year. This is not a required change.

Calendar 2011. The cost of over-the-counter medicine (other than insulin or doctor prescribed medicine) cannot be reimbursed through a health FSA, HRA, HSA or Archer MSA.

Calendar 2011. Start planning now. A “simple” cafeteria plan can be installed that will be exempt from a confusing array of discrimination tests, including the 25% concentration test that penalizes small business owners. The simple cafeteria plan will be available for dependent care, medical expense reimbursement, group life insurance, and employee group health premiums. Unfortunately, owners and partners of unincorporated businesses, and 2% S-Corporation owners are still banned from participation.

Employers who elect “simple” will be required to contribute a small amount, because a simple plan cannot be salary deferral only. For each eligible employee, the contribution can be limited to 2% of compensation. Alternatively, the employer can match employee savings, and contribute the lesser of 2 x the savings rate or 6% of compensation. Contributions at the same level are permitted, but not required, for highly compensated employees and key employees.

To be eligible, an employer must have had fewer than 100 employees in the previous year. As long as it then does not grow beyond 200 employees in a previous year, it can keep the simple plan. Other permitted exclusions are for employees who have less than one year of service or are less than age 21 by the last day of the year or who have less than 1,000 hours in the previous year. Bargaining unit members who have not bargained for coverage, and non-resident aliens are also excludible.

Calendar 2013. Medical and dental expenses under a flexible Section 125 account will be limited to \$2,500.

SMALL EMPLOYERS (INCLUDING TAX-EXEMPTS) CAN GET TAX CREDITS

Calendar 2010 and later years. Eligible small employers will get tax credits for their contributions to purchase employee health insurance, provided they contribute at least 50% of the cost. The maximum credit is 35% in years 2010 – 2013. After 2013, the credit can be claimed for two additional years and is boosted to 50%, but only if the employer stops providing group insurance and subsidizes employees to buy individual policies through a state exchange (such as the Connector in Massachusetts). If the premium exceeds the average premium for small group coverage in an employer’s state, the credit will be computed on that average cost, rather than actual cost.

The credit is not a subsidy for non-profitable businesses. It will only apply against taxable income, but can be carried back one year or carried forward for 20 years. This is not an exceptional windfall for companies which would have deducted the premium anyway, because the business deduction for employer premiums must be reduced by the credit. It's a great deal for small tax-exempt employers, however. Non-profit employers can get credits of 25% (2010 - 2013) and 35% (any 2 years after 2013). For non-profits, the credit is further limited to the sum of (i) income tax withheld from wages, and (ii) the 2.9% "hospital tax" portion of FICA, lessening the value of the credit when low wage employees elect minimal withholding.

What is an eligible small employer? Employers with 10 or fewer full time employees (FTEs) during the year with average annual fulltime equivalent wages of less than \$25,000 get the maximum credit, which is phased down as the small employer gets larger. More than 25 FTEs or average wages in excess of \$50,000 make the employer too big to qualify. All employees in a controlled group of businesses must be counted.

Importantly, companies with large numbers of part-time employees might still qualify. The number of FTEs is determined by dividing total employee hours by 2,080 (with no more than 2,080 credited to any employee). More than 5% owners, partners, the self-employed, and family members do not count as employees, either for purposes of the small employer headcount or for purposes of enjoying the benefit. There are also rules to disregard seasonal employees and holiday retail help.

Small employers should expect more guidance during the year. Massachusetts employers who count hours to determine if they have 11 employees will notice that 2,080 hours is more than the 2,000 hours used under Massachusetts law for FTE computation for Massachusetts fair-share tax and cafeteria plan requirements.

HELP FOR NURSING MOTHERS

In effect now. There is no specified effective date, so cautious employers should treat this as effective now. They must provide reasonable unpaid break time for an employee to express breast milk for her nursing child for one year after the child's birth. This includes providing a place, other than a bathroom, that is shielded from view and free from intrusion from co-workers and the public.

Employers with fewer than 50 employees will be exempt only if the new law imposes undue hardship or expense. This law is in addition to any state laws that protect nursing mothers, such as MGL Ch. 111, Section 221 that permits mothers to nurse in public places.

It is unclear how many breaks must be allowed, and for how long. This was introduced by Oregon Senator Jeff Merkley, and if his state law is used as a guide by the US Department of Labor, four breaks of 30 minutes each will be the federal standard. Stay tuned for more guidance from our employment lawyers.

ADOPTION ASSISTANCE PLANS

In effect now. The Federal Health Care Act was used as a vehicle to extend adoption assistance benefits, which some employers provide. The scheduled "sunset" was extended another year through 2011. Also, the 2010 permitted tax-free employer contribution was increased by \$1,000 to \$13,170. Corresponding increases were also made to the tax credit. The limit continues to be phased out as the taxpayer's

modified adjusted gross income exceeds dollar limits (from \$182,520 up to full phase out at \$222,520 in 2010). Employers that sponsor these plans should determine if they can afford the permitted increase, and modify documents if necessary.

MORE CHANGES

Although not immediately required, human resources officers should consider what is on the horizon for next year. For example:

- ▶ For plan years starting after September 22, 2010, plans will no longer be allowed to have lifetime caps, and there will be limits on annual caps. This affects virtually all self-insured plans.
- ▶ W-2 statements for 2011 payrolls (i.e. due in January 2012) will need to disclose the employer share of health care premium.
- ▶ Discrimination rules similar to those which apply to self-insured plans will apply to insured health plans starting in 2011, eliminating the tax-free nature of discriminatory plans.

We will provide more guidance as information becomes available.

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