

# PwC Accounting Symposium and Tax Colloquium

## Tax Implications of Health Reform

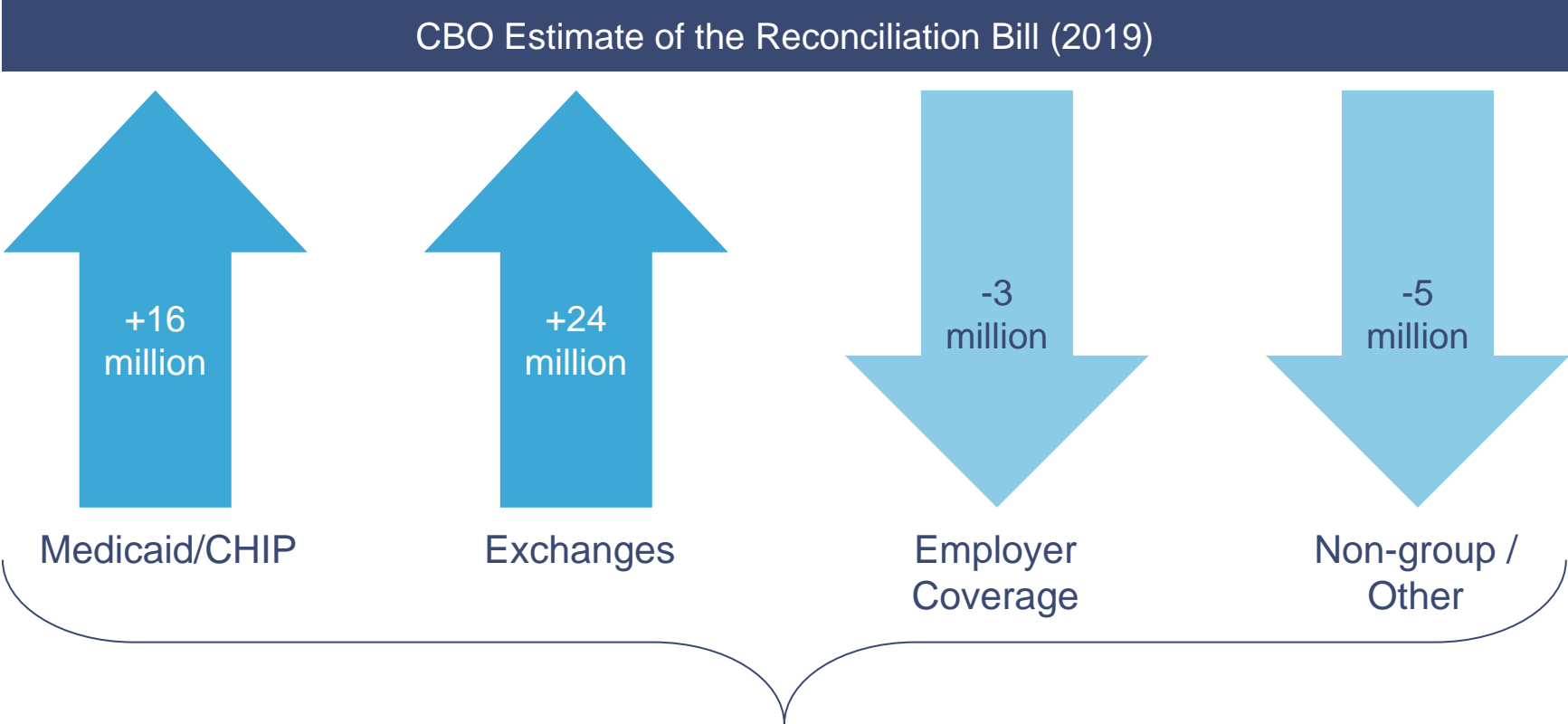
July 2010

# Agenda

- Overview of Patient Protection and Affordable Care Act (PPACA)
- Tax Changes in Health Reform
- A New World for Employers

# Overview of the Patient Protection and Affordable Care Act (PPACA)

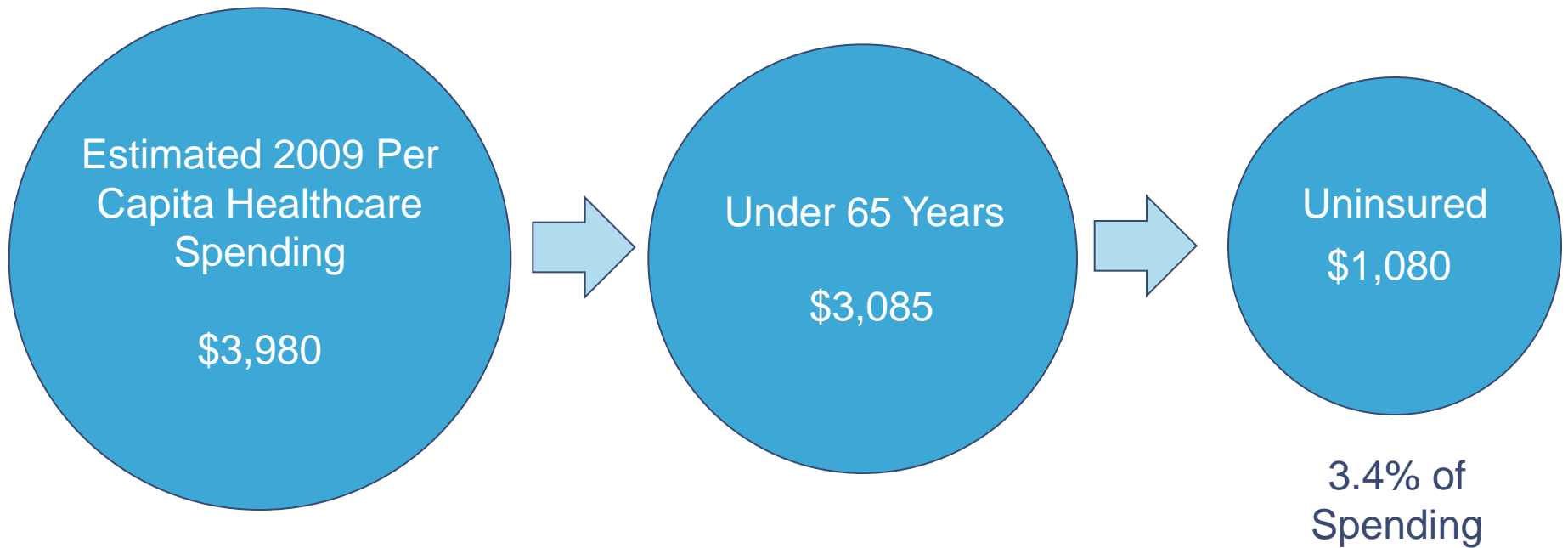
# Health reform expansions reduce the number of uninsured by 32 million by expanding Medicaid and creating exchanges



32 million individuals gain insurance coverage at a cost of \$214 billion in 2019

Sources: CBO, Letter to Nancy Pelosi, 20 March 2010.

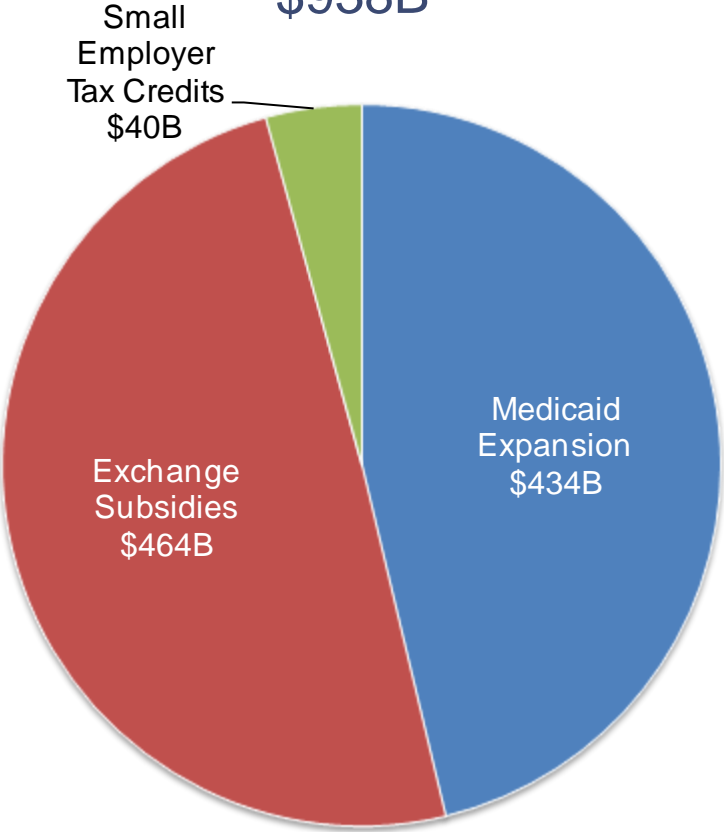
While the uninsured comprise 15.4% of the U.S. population, their share of spending is much lower



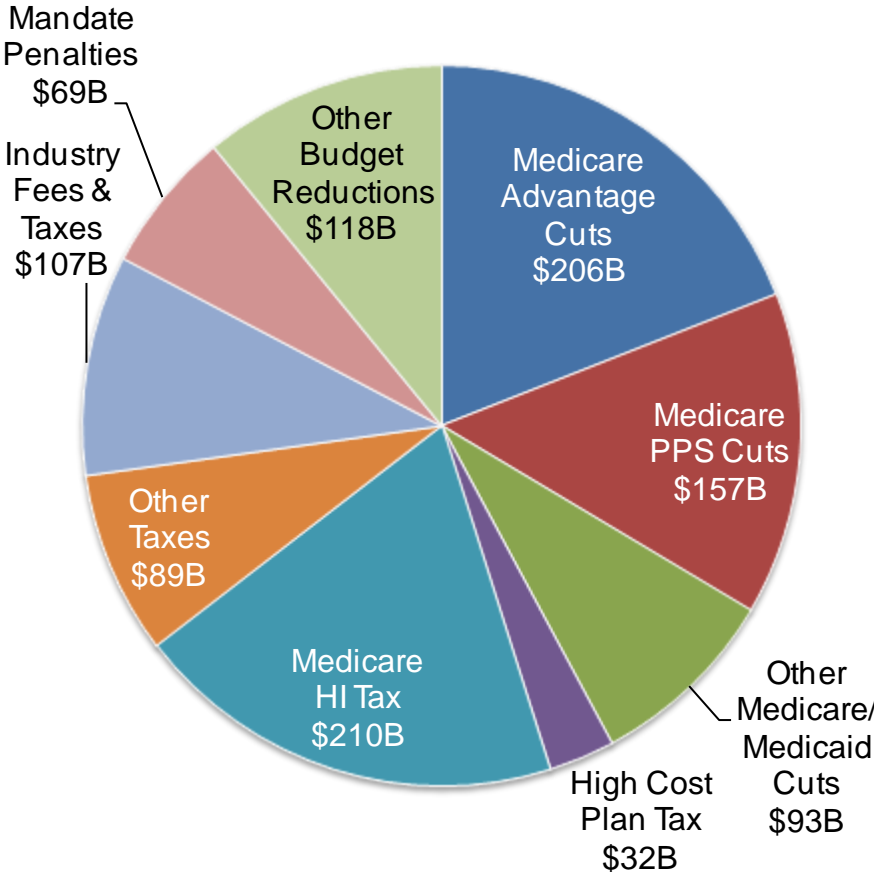
Sources: MEPS 2006, National Health Expenditure Accounts

# Expansion of coverage is paid for with new fees, taxes and payment reductions

Spending on health reform – \$938B




Paying for health reform - \$1,081B

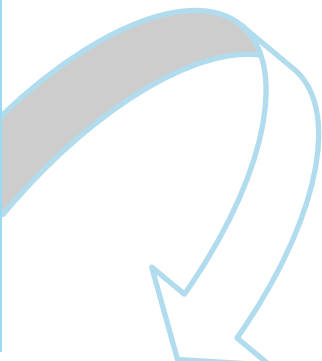


# Three tranches of health reform

## Regulation and coverage (2010-2013)

- Elimination of pre-existing coverage exclusions for children and lifetime coverage limits and rescissions; dependent coverage through age 26
  - MLR minimums for non-grandfathered plans
  - Medicare Part D gap narrows, Medicare Advantage rates frozen, bonuses available, beneficiary rebates, free preventive care
  - Temporary high risk pools
  - Fee on brand -name pharmaceutical manufacturers
  - Community Living and Support Services Act (CLASS Act)
- 

## Major expansion of coverage (2014)

- Mandates for individuals
  - Employer penalties for those that do not provide coverage
  - Health insurance exchanges
  - Small employer and individual subsidies
  - Health insurer industry fee
  - Guaranteed issue, rating bands, and risk adjustment
  - Medicaid expansion
  - Disproportionate share payment reductions to hospitals
- 

## Bending the cost curve (2015-2020)

- Penalty for not adopting electronic medical records
- Independent Payment Advisory Board (IPAB)
- High-cost plan excise tax
- Medicare Part D “Doughnut Hole” closes
- Reduced payment for hospital-acquired conditions

# Major Components of Health Reform

<p><b>Individual Mandate</b></p>	<ul style="list-style-type: none"> <li>Income surtax penalty ranging from \$695 (single) per year up to a maximum of \$2,085 per family or 2.5% of household income, whichever is higher. Penalties will be phased in beginning in 2014.</li> </ul>
<p><b>Employer Mandate</b></p>	<ul style="list-style-type: none"> <li>Firms &gt;50 employees that do not offer coverage pay \$2,000 per fulltime employee, excluding the first 30 employees, if at least one employee receives a premium tax credit</li> <li>Firms &gt;50 employees that offer coverage pay \$3,000 per fulltime employee receiving subsidy, capped at \$2,000 per FTE employee (excluding first 30).</li> </ul>
<p><b>Medicaid</b></p>	<ul style="list-style-type: none"> <li>Eligibility up to 133% FPL without regard to family condition or disability</li> <li>Feds pay 100% of the cost for new Medicaid patients from 2014 to 2016, and then decreasing down to 90% through 2019</li> </ul>
<p><b>Subsidies / Tax Credits</b></p>	<ul style="list-style-type: none"> <li>Provides tax credit for small employers with &lt;25 employees with average annual earnings &lt;\$50,000</li> <li>Individual Subsidy: sliding scale 2% to 9.5% of income up to 300% FPL/flat cap at 9.5% 300%-400% FPL; cost-sharing subsidies for 100%-200% FPL</li> </ul>
<p><b>State Insurance Exchanges</b></p>	<ul style="list-style-type: none"> <li>At least two multi-state health plans on each state exchange will be offered, at least one would be a non-profit plan</li> <li>Individuals and small businesses eligible with &lt;100 employees in 2014. Firms with more than 100 employees may be eligible in 2017</li> <li>Minimum credible coverage of 60%; Four tiers of benefits range between 60% and 90% actuarial value; catastrophic policy for young adults up to age 30</li> </ul>
<p><b>Insurance Market Reform</b></p>	<ul style="list-style-type: none"> <li>Dependent coverage to age 26 beginning in 2010</li> <li>Adjusted community rating of 3:1</li> <li>Plans must meet 85% of medical loss ratio (MLR) for large group market; 80% MLR in small group market</li> <li>No annual or lifetime limits, no rescissions, first dollar preventive care, etc.</li> </ul>

# Key Points About PPACA

## Health Reform is Just Beginning

- The implementation timeline spans to 2020 with more than sixty major regulatory deadlines that must be addressed. Organizations will need to align strategic and operational planning to the reform timeline.

## Implementation Details are TBD

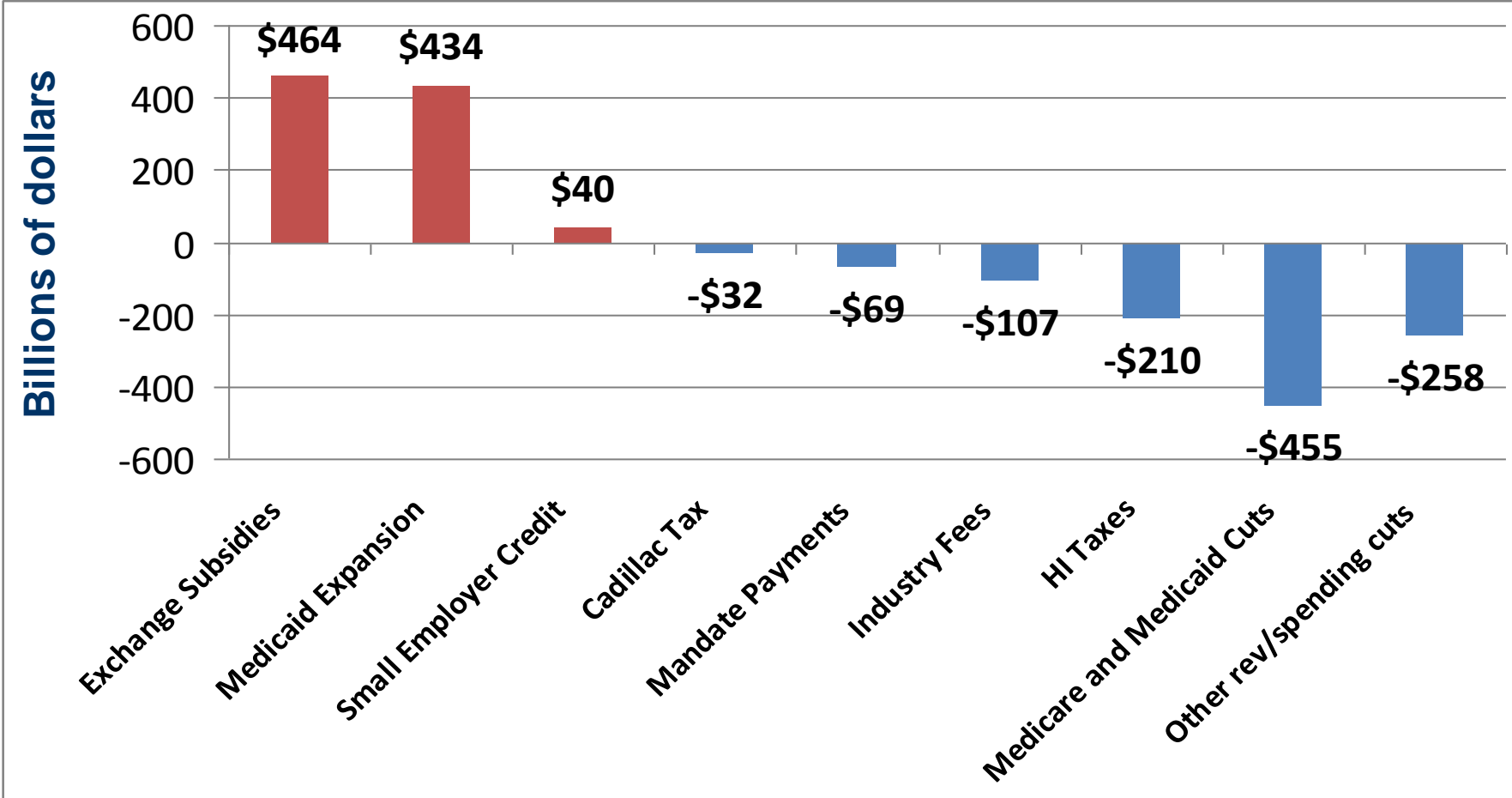
- The reform law provides a framework but regulatory details will be decided through the rulemaking process. Organizations will wish to follow and participate in the rulemaking through the public comment process.

## New Regulators Mean New Regulation

- The reform law establishes more than 10 new regulators and greatly expands the powers of five existing ones. These new regulators will be developing new policies, payments and research and will require expanded compliance efforts.

# Tax Implications of the Patient Protection and Affordable Care Act (PPACA)

# Budgetary Impact of Selected Health Care Provisions



Source: CBO, March 20, 2010. Combined budgetary impact of H.R. 3590 and H.R. 4872.

# Paying for Health Care Reform

Provision	Effective	10-year Revenue
Qualifying therapeutic discovery project credit (thru 2010)	2009	(\$0.9 billion)
Exclusion of “black liquor” from cellulosic biofuel producer credit	2010	\$23.6 billion
Codify economic substance doctrine and impose underpayment penalty	4/1/10	\$4.5 billion
10% excise tax on indoor tanning services	7/1/10	\$2.7 billion
Modification of section 833 treatment of certain health organizations	2010	\$0.4 billion
Annual fee on manufacturers and importers of branded drugs	2011	\$27 billion
Conform medical expense definition (no reimbursement of OTC medicines)	2011	\$5 billion
Increase tax on nonqualified distributions from HSA/MSA to 20%	2011	\$1.4 billion
Employer W-2 reporting of value of health benefits	2011	N/A
Require information reporting on payments to corporations	2012	\$17.1 billion

Source: Joint Committee on Taxation

# Paying for Health Care Reform (cont'd)

Provision	Effective	10-year Revenue
Comparative effectiveness fee on insured and self-insured health plans	9/30/12	\$2.6 billion
Additional 0.9% Medicare tax on AGI over \$200K/\$250K and 3.8% surtax on investment income of taxpayers with AGI over \$200K/\$250K	2013	\$210.2 billion
2.9% excise tax on medical device manufacturers and importers	2013	\$20 billion
Raise 7.5% AGI floor on medical expense deduction to 10%; AGI floor for 65 and over (and their spouses) remains at 7.5% thru 2016	2013	\$15.2 billion
Limit cafeteria plan Health FSA contributions to \$2,500 (indexed)	2013	\$13 billion
Eliminate deduction for expenses allocable to Medicare Part D subsidy	2013	\$4.5 billion
\$500K executive comp deduction limit for health insurance providers	2013	\$0.6 billion
Annual fee on health insurance providers	2014	\$60.1 billion
40% excise tax on health coverage in excess of \$10,200/\$27,500 (\$11,850/\$30,950 for retirees/high-risk professions)	2018	\$32 billion
Total (includes additional, miscellaneous provisions)		\$438 billion

Source: Joint Committee on Taxation

# Codification of Economic Substance Doctrine

- Effective for transactions after March 30, 2010
- Threshold for Application: where relevant as determined under prior law
- Two-prong test
  - Nontax business purpose
  - Meaningful change in economic position
- Strict Liability Penalty (no reasonable cause/good faith exception)
  - 20% of underpayment/40% if not adequately disclosed
- Impact on Tax Planning

# Taxation of Retiree Drug Subsidy

- PPACA changes the tax treatment related to the federal subsidy that is payable to sponsors of certain retiree drug plans, the Retiree Drug Subsidy (RDS), by requiring the amount of the subsidy received to be offset against the employer's deduction for health care expenses. The effective date under PPACA is tax years beginning after December 31, 2012.
- *The impact of this provision may be significant both economically and from a financial reporting perspective. The impact of the new tax had to be recognized immediately in the income statement for the period that included the enactment date of PPACA (that is, March 23, 2010.)*

## Annual Fee on Pharmaceutical Companies

- The annual fee is allocated based on share of total federal government sales.

Varies by size of company and level of total government sales

Annual Net Brand Government Program Sales			
(\$ millions)			2010 Sales / 2011 Fee Estimated Rates
\$0	to	\$5	0%
\$5	to	\$125	0.4%
\$125	to	\$225	1.5%
\$225	to	\$400	2.8%
\$400	+		3.7%

## Annual Fee on Insurance Companies

- Health Insurance companies (excluding employer plans) must pay an annual fee, equal to the Company's included net premiums written during the calendar year to the "Applicable Amount"

Company's net premiums	Percent taken into account
Not more than \$25 million	0%
\$25 to \$50 million	50%
Over \$50 million	100%

Year	Applicable Amount
2011	\$2 billion
2012	\$4 billion
2013	\$7 billion
2014-2016	\$9 billion
2017 and later	\$10 billion

# New Medicare Taxes

Beginning in 2013, additional Medicare (HI) taxes will be assessed on high income taxpayers:

- Additional 0.9% tax on income in excess of
  - \$200,000 for single taxpayers, or
  - \$250,000 for married filing jointly
- Employers are required to withhold on employee wages exceeding \$200,000
  - This may result in under-withholding if the employee is married filing a joint return and family income exceeds \$250,000, or over-withholding if the employee is married filing jointly and family income is less than \$250,000
  - The individual is responsible for any additional tax if withholding is not sufficient

# Medicare Tax on Unearned Income

3.8% tax imposed on unearned income; tax is imposed on the lesser of:

- Net investment income, or
- AGI in excess of \$200,000 single or \$250,000 joint (\$125,000 married filing jointly)

Net Investment Income	
Includes:	Does Not Include:
Interest	Qualified Pension, Profit-Sharing, Stock Bonus Plan distributions
Dividends	Employee annuities
Annuities	IRAs (traditional and Roth)
Rents and Royalties (other than income derived from an active trade or business)	Deferred compensation plans
Net Capital Gain	Amounts subject to SECA tax

# Individual Mandate

Effective in 2014, uninsured US citizens and legal immigrants must pay a penalty. The penalty for an uninsured individual under age 18 is one-half the adult penalty, and the total household penalty may not exceed the lesser of 300 percent of the per-adult penalty (for 2016, \$2,085), or the national average annual premium for bronze level plans in the Exchange for the household size. Penalty is:

Year	Greater of	
	Dollar Amount	% of Household Income
2014	\$95	1%
2015	\$325	2%
2016	\$695	2.5%
Later years	Indexed to CPI-U	2.5%

# Other Tax Changes Affecting Individuals

- Changes to Consumer-directed health care vehicles
  - FSA contribution capped at \$2,500 beginning in 2013
  - Increased excise tax of 20% on nonqualified distributions from HSAs/HRAs beginning in 2011
  - Over-the-counter drugs no longer reimbursable from these plans beginning in 2011
  
- New Maximum Marginal Rates

	Wages	Long Term Capital Gains	Dividends	Portfolio/Passive Income	Active Income from Partnership	Active Income from S Corp
2009 Top Rate	36.45%	15.00%	15.00%	35.00%	37.90%	35.00%
Expiration of Tax Cuts in 2011	4.60%	5.00%	24.60%	4.60%	4.60%	4.60%
New HI Tax Effective in 2013	0.90%	3.80%	3.80%	3.80%	0.90%	-
2013 Top Rate	41.95%	23.80%	43.40%	43.40%	43.40%	39.60%
Increase from 2009 to 2013	5.50%	8.80%	28.40%	8.40%	5.50%	4.60%

# Cadillac Plans Tax

- PPACA imposes an excise tax if the aggregate value of employer-sponsored health insurance coverage for an employee exceeds a threshold amount, the so-called "Cadillac plans tax".
  - For these purposes, a former employee, surviving spouse and any other primary insured individual is treated as an employee.
  - The threshold for 2018 is \$10,200 for individual coverage and \$27,500 for family coverage
- The tax is equal to 40 percent of the excess value over the threshold.
  - The excise tax is not deductible for Federal income tax purposes.
- This provision will be effective for tax years beginning after December 31, 2017.

# A New World for Employers

Mandated Changes in Benefits  
Required Information Reporting  
Employer Mandate

# Impact on Employers (all health care & non-health care sectors)

- The new law affects insured and self insured plans
- Provisions phased in over 9 years
- Impact on virtually all aspects of employment-based health benefits, including:
  - Eligibility
  - Benefit plan design
  - Underwriting rules
  - Regulatory compliance
  - Funding
  - Taxes
- Affects active employee and retiree benefit plans
- Creates new disability benefit fund (CLASS Act)
- Creates new State Health Insurance Exchanges – alternative to employment-based benefits

# Copying your neighbor won't help; employers need to determine what new rules best apply to their worker populations

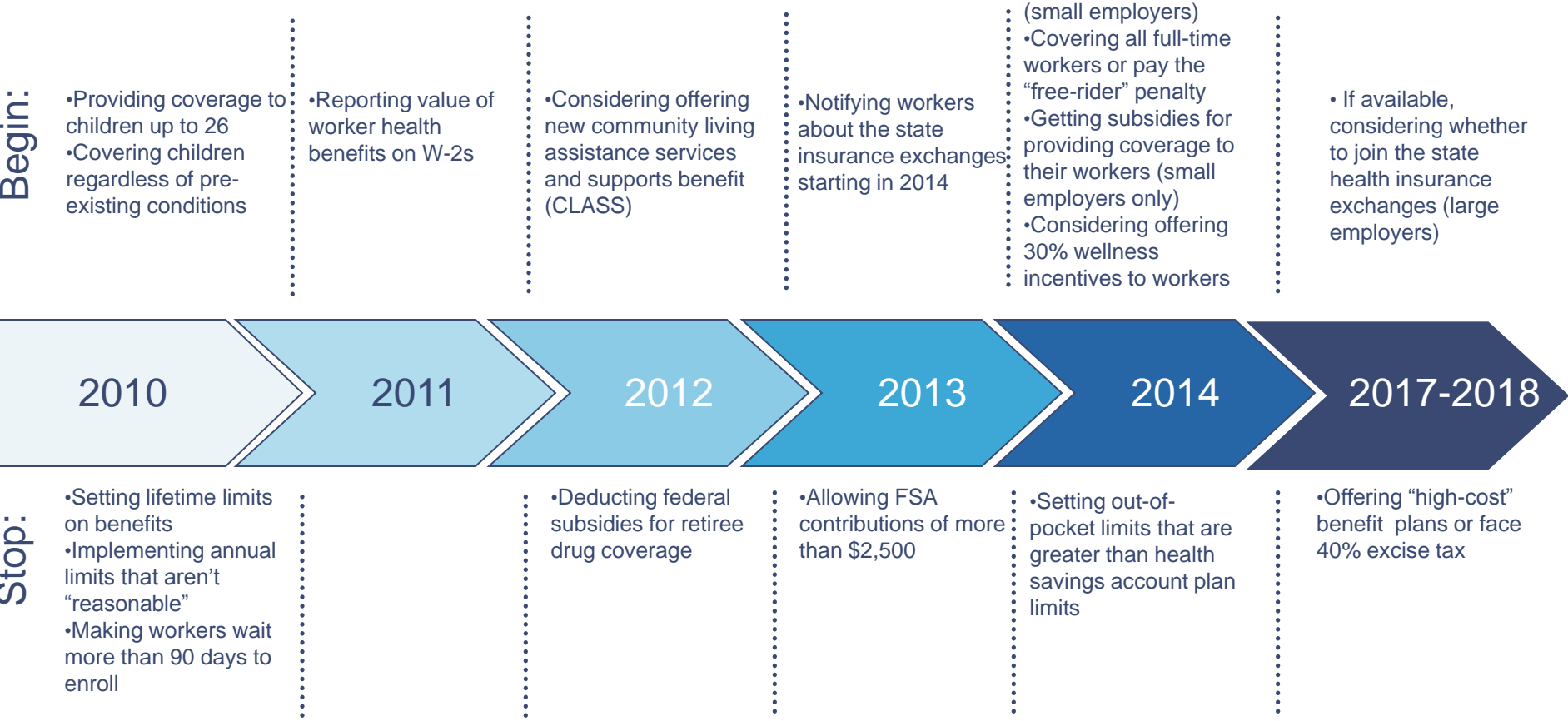
Employer segment	High impact provisions	Key decisions
Retail industry low-wage, high turnover workforce	<ul style="list-style-type: none"> <li>• Coverage expansion</li> <li>• Free rider penalty</li> <li>• Free choice voucher</li> </ul>	<ul style="list-style-type: none"> <li>• Revise employee coverage</li> <li>• Consider dropping coverage</li> <li>• Consider funding access to the exchange (when available)</li> </ul>
Mature industry with large retiree population	<ul style="list-style-type: none"> <li>• Retiree drug subsidy</li> <li>• Temporary pre-65 reinsurance</li> <li>• Potential high cost plan excise tax</li> </ul>	<ul style="list-style-type: none"> <li>• Monitor availability of reinsurance application (Due end of June 2010)</li> <li>• Identify plan options to mitigate excise tax (if applicable)</li> </ul>
Industry with high average wage (e.g. financial services)	<ul style="list-style-type: none"> <li>• Additional 0.9% Medicare tax</li> <li>• New 3.8% Medicare tax on unearned income</li> <li>• No discrimination based on salary for new plans</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate potential under-withholding to 2 wage-earner families</li> <li>• Consider additional qualified plan options (distributions not subject to 3.8% tax) or shifting capital gains to earned income</li> </ul>

# Employer “Free-Rider” Penalties Effective in 2014

- PPACA will impose penalties on employers who do not provide coverage, as well as on employers whose coverage is inadequate or unaffordable for low-paid employees, beginning in 2014.
  - Employers with fewer than 50 full-time employees (FTEs) (counting the full-time equivalents of part-time employees to determine whether there are 50 FTEs) are exempt from this penalty.
  - A full-time employee is defined as an employee working at least 30 hours a week.
- The penalty for an employer that does not offer coverage will be \$2,000 multiplied by the number of FTEs, excluding the first 30 FTEs.
- The penalty for an employer that offers coverage, but has any employee who qualifies for a tax credit for coverage in an Exchange will be the lesser of:
  - \$3,000 for each employee receiving tax credits and subsidies for coverage in an Exchange, or
  - \$2,000 times the number of FTEs, excluding the first 30

# Health reform implementation timeline and new rules for employer-sponsored insurance plans

## The health reform laws require companies to:



# New administrative requirements for all plan sponsors

	1 <sup>st</sup> Plan Year After 9/23/2010				2011			2013	2014					2017	2018		
Administrative Process Affected	Cover Children to Age 26	Elimination of Pre- Existing Condition Exclusion for Children	Elimination of Lifetime Maximums	Restrictions on Annual	W-2 Reporting (due January 2012)	No OTC Under FSA, HRA or HSA (w/o Prescription)	Change HSA Penalties	CLASS Act Option	\$2,500 FSA Maximum	90-Day Waiting Period	“Free Rider” Penalties and Free-Choice	HSA Annual OOP Limits (for plans that	Communicate Exchange	No Pre-Existing (All)	Preventive & Wellness Incentives	Exchange May Open to Large Employers	High Cost Plan Excise Tax
Employee Communications	X	X	X	X	X	X		X	X	X	X	X	X	X	X	X	
Vendor Coordination	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Compliance	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Payroll / Accounting	X				X			X	X		X				X	X	X
Web-Portal	X	X	X			X		X	X	X	X	X	X	X	X	X	
Eligibility	X	X						X		X	X		X	X		X	

# What should Employers be doing now?

Recommendation	Driver
<b>Identify and address immediate changes – Phase I: effective first plan year beginning after September 23, 2010</b>	<ul style="list-style-type: none"><li>• Dependent coverage to age 26</li><li>• No lifetime limits</li><li>• "Reasonable" annual limits on benefits</li><li>• No pre-existing condition exclusions for children</li><li>• No waiting periods &gt; 90 days,</li><li>• Auto enroll employees in a plan (effective date unclear)</li><li>• For non-grandfathered plans (not in effect on March 23, 2010):<ul style="list-style-type: none"><li>• HHS-approved external review process</li><li>• First dollar coverage for preventive health services</li><li>• Nondiscrimination in insured benefits</li></ul></li><li>• Temporary re-insurance program for early retirees</li></ul>

# What should Employers be doing now?

Recommendation	Driver
<b>Identify and address immediate changes – Phase II: effective “January, 2011”</b>	<ul style="list-style-type: none"><li>• Scope of benefits: OTC drugs not qualified medical expense</li><li>• Reporting value of benefits on W-2</li><li>• Accounts: Increased penalty for non-qualified HSA distributions</li><li>• Retirees: begin to fill Part D donut hole</li><li>• Increased penalty for nonqualified HSA or Archer MSA distributions</li><li>• CLASS Act auto-enrollment, \$65 payroll deduction w/ opt out</li></ul>

# What should Employers be doing now?

Recommendation	Driver
<b>Assess impact of changes to be phased in 2012-2018</b>	<ul style="list-style-type: none"><li>• 2013: RDS tax; \$2,500 Maximum FSA contribution; Medicare Advantage payment cuts, Medicare surtaxes; CRE fee per Employee</li><li>• 2014: “Free Rider” Assessment, vouchers for exchanges; individual mandate, HIPAA-allowed incentives for wellness up to 30 percent, Out-of-Pocket (OOP) Max must be less than or equal to HSA OOP Max., no annual limits</li><li>• 2017: Exchanges open to large group market</li><li>• 2018: “Cadillac Plans” tax</li></ul>

# What should Employers be doing now?

Recommendation	Driver
<b>Revise strategy based on provisions that affect the company</b>	The law necessitates plan changes, increases compliance costs and provides longer term alternative (exchanges) to employer-sponsored health coverage.

# Questions and Answers

# THANK YOU