American Payroll Association

Health Insurance Reform Bills Enacted

On March 23, President Obama signed into law the Patient Protection and Affordable Care Act (PPACA; Pub. L. No. 111-148), as passed by the Senate (see PAYROLL CURRENTLY, Issue No. 1, Vol. 18). A bill amending the PPACA – the Health Care and Education Reconciliation Act of 2010 (HCERA; Pub. L. No. 111-152) – was signed into law just a week later, on March 30. The provisions of the PPACA (as amended by the HCERA) of interest to payroll professionals are discussed here.

W-2 reporting of cost of employer-provided health coverage

Employers will have to report the total cost of employer-provided health coverage on employees' Forms W-2, effective for tax years beginning after 2010 (Forms W-2 for 2011 filed in 2012). For example, if an employee enrolls in employer-sponsored health insurance coverage under a major medical plan, a dental plan, and a vision plan, the employer must report the total value of the combination of all of these health related insurance policies. The cost of coverage will be determined by calculating the applicable premiums under the rules for COBRA continuation coverage. But if the plan provides for the same COBRA premium for individual and family coverage, the plan will have to calculate separate premiums for this purpose. *Note:* This requirement does not apply to the amount of salary reduction contributions to a health Flexible Spending Arrangement (FSA) under a cafeteria plan or to amounts contributed to an Archer Medical Savings Account (MSA) or Health Savings Account (HSA).

Medicare tax increase on high earners

The Medicare tax rate increases from 1.45% to 2.35% on wages earned over

$200,000 for single filers and $250,000 for joint filers ($125,000 for a married individual filing separately). Because employers will not know the wages of an employee's spouse, they are directed to withhold the increased amount from all workers with wages exceeding $200,000, regardless of the marital status claimed on their Form W-4. Overwithholding and underwithholding for employees will be reconciled when they file their tax returns.

Employers do not have to match the increased Medicare tax amounts withheld from employees' wages. Self-employed individuals will also be subject to the Medicare tax increase if they meet the income thresholds, and will not be allowed to deduct the additional tax as a business expense. If an employer fails to withhold and deposit the extra Medicare tax and the employee pays it with their tax return, the tax will not be collected from the employer, but the employer faces penalties for its failure to withhold the tax. This provision is effective for taxable years after December 31, 2012.

Λ **NEW MEDICARE TAX ON INVESTMENT INCOME –** The HCERA imposes a further 3.8% Medicare tax on the net investment income of individuals with a modified adjusted gross income over $200,000 ($250,000 for joint filers), but it is paid by the individuals when they file their tax returns. It is not withheld from their earnings by their employers or matched by their employers.

Change in definition of 'medical expenses'

The definition of "medical expense" with respect to medicines, for purposes of health FSAs, Health Reimbursement Arrangements (HRAs), Health Savings Accounts (HSAs), and Archer MSAs is conformed to the definition used in determining the itemized deduction for medical expenses, except that "prescribed drug" is determined

without regard to whether the drug is available without a prescription. This means that only the cost of medicine prescribed by a doctor and insulin can be reimbursed through a health FSA or HRA or on a tax-free basis through an HSA or Archer MSA. This changes the current rule allowing such reimbursements for nonprescription drugs if the plan provides for it. This change only affects over-the-counter medicines, not other medical products, such as bandages, braces, etc., which can still be reimbursed on a tax-free basis. This change takes effect for tax years beginning after December 31, 2010.

Reduced health FSA deferral limits

Salary reductions by an employee into a health FSA are limited to $2,500, effective for tax years beginning after December 31, 2012 (indexed for inflation after 2013 to the next lowest multiple of $50). This does not limit the exclusion for health coverage offered through an HRA.

Higher penalty for non-medical HSA reimbursements

The additional tax on distributions from an HSA that are not used for medical expenses is increased from 10% to 20% of the distributed amount. The increase is effective for distributions made during tax years starting after December 31, 2010.

Expanded information reporting on Form 1099-MISC

The general information reporting requirements regarding services provided to a trade or business are modified. The exception for payments to corporations is eliminated. In addition, the class of payments for which information reporting is required is expanded to include gross proceeds for both property and services. The current regulatory exception for payments to tax-exempt organizations is not affected. The

changes will take effect for payments made after December 31, 2011.

Simpler cafeteria plan nondiscrimination rules for small employers

For tax years beginning after 2010, a “simple” safe harbor from the nondiscrimination requirements for cafeteria plans for an eligible small employer (generally 100 or fewer employees) is provided. The safe harbor will also apply to the nondiscrimination requirements for specified qualified benefits offered under a cafeteria plan, including group-term life insurance, coverage under a self-insured group health plan, and benefits under a dependent care assistance program. The safe harbor will require that a cafeteria plan satisfy minimum eligibility and participation requirements and minimum employer contribution requirements.

To meet the eligibility requirement, all employees who cannot be excluded must be eligible to participate, and each eligible employee must be able to elect any benefit available under the plan. The plan can exclude employees who don’t reach age 21 before the end of a plan year, work less than 1,000 hours in the preceding plan year, worked less than one year for the employer by the beginning of the plan year, are covered by a union contract if the plan benefits were bargained by the union and the employer, or are nonresident aliens working outside the U.S.

To meet the minimum contribution requirement, the employer must contribute at least 2% of each eligible nonhighly compensated employee’s compensation or make a minimum matching contribution of the lesser of 100% of the employee’s salary reduction contribution or 6% of the employee’s compensation.

Medical benefits for adult children expanded, excluded from income

Effective for plan years beginning on or after September 23, 2010 (6 months after

the date of enactment), PPACA requires health plans that offer coverage of dependent children to continue to make such coverage available until the child turns 26 years old.

Effective March 30, 2010 (the date of enactment), HCERA extends the general exclusion from income for medical expense reimbursements under an employer-provided accident or health plan to any child of an employee who has not attained age 27 as of the end of the taxable year. This change also applies to the exclusion for employer-provided health coverage for injuries or sickness for such a child.

Expansion of adoption assistance programs

For taxable years beginning in 2010, the maximum amount of the income exclusion for employer-provided adoption assistance is increased to $13,170 (currently $12,170) and is adjusted for inflation after 2010. In addition, the income exclusion is extended through December 31, 2011, from the current expiration date of December 31, 2010.

Excise tax on high-cost health coverage

For tax years beginning after 2017, health insurers will be subject to an excise tax of 40% on the cost of employer-sponsored health coverage in excess of $10,200 for individuals and $27,500 for families, with these amounts indexed for inflation in later years. The thresholds will be higher for retirees who are at least age 55 but not yet eligible for Medicare and for employees in certain high-risk professions, such as firefighting, law enforcement, construction, agriculture, and mining. The thresholds also will be adjusted if health care costs increase more than expected in the coming years. Employers will have to provide information to the IRS and insurers about the amounts subject to the excise tax.

Enrolling employees in health care plans: rules for employers

Large employers. Effective for months beginning after December 31, 2013, an "applicable large employer" (employer with an average of at least 50 full-time employees during the preceding calendar year) that does not offer coverage for all its full-time employees, offers minimum essential coverage that is unaffordable, or offers minimum essential coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60%, is required to pay a penalty if any full-time employee is certified to the employer as having purchased health insurance through a state exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee.

The penalty for any month is an excise tax equal to the number of full-time employees over a 30-employee threshold during the applicable month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) multiplied by one-twelfth of $2,000.

A separate penalty is assessed to large employers if they offer their employees minimum essential coverage under an employer-sponsored plan and any full-time employee is certified as having enrolled in coverage purchased through a state exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee. The penalty is an excise tax of one-twelfth of $3,000 for each such employee per month, up to a maximum amount that equals the penalty for not providing affordable coverage noted earlier. No penalties are assessed for employees enrolled in Medicaid.

Small employers. Effective for tax years beginning after December 31, 2009, a

tax credit is provided for “qualified small employers” (employers with no more than 25 full-time equivalent (FTE) employees and whose average annual FTE wages are no more than $50,000) for nonelective contributions to purchase health insurance for their employees. However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees are paid average annual FTE wages from the employer of less than $25,000. These wage limits will be adjusted for inflation beginning in 2014.

An employer’s FTEs are calculated by dividing the total hours worked by all employees (no more than 2080 hours can be counted for any single employee) during the employer’s tax year by 2080. For tax years beginning in 2010 through 2013, the credit is 35%, and qualifying health insurance for claiming the credit is generally coverage purchased from an insurance company licensed under state law. For tax years beginning in 2014 and 2015, the credit is 50%, and is only available to an employer that purchases coverage for its employees through a state exchange. The employer must make its nonelective contributions during the year and claim the credit on its tax return. Smaller credits are allowed to small tax-exempt entities, who will take the credit against their payroll taxes – withheld federal income tax and the employer and employee shares of social security and Medicare taxes.

Other new reporting requirements

For insurers. For calendar years beginning after 2013, insurers (including employers who self-insure) that provide minimum essential coverage to any individual during a calendar year must report the following to both the covered individual and to the IRS under new IRC §6055: (1) the name, address, and taxpayer identification

number (TIN) of the primary insured, and the name and TIN of each other individual obtaining coverage under the policy; (2) the dates during which the individual was covered under the policy during the calendar year; (3) whether the coverage is a qualified health plan offered through an exchange; (4) the amount of any premium tax credit or cost-sharing reduction received by the individual with respect to such coverage; and (5) such other information as the Treasury Secretary may require.

To the extent coverage is through an employer-provided group health plan, the insurer is also required to report the name, address, and employer identification number of the employer, the portion of the premium, if any, required to be paid by the employer, and any other information the Treasury Secretary may require to administer the new tax credit for eligible small employers. The insurer must provide all this information, plus the insurer's name, address, and contact information, to the insured individual by January 31 of the year following the year for which the information is required to be reported. Insurers that fail to comply with these reporting requirements are subject to the general penalties for failure to file information returns and furnish payee statements.

For employers. For periods beginning after December 31, 2013, there will be new reporting requirements for large employers subject to the employer responsibility rules discussed earlier and employers offering minimum essential coverage and paying part of the cost that require employees to contribute more than 8% of their wages to the premiums. Such employers will have to report to the IRS: (1) the name, address, and EIN of the employer; (2) a certification whether the employer offers its employees the opportunity to enroll in minimum essential coverage under an employer-sponsored plan; (3) the number of full-time employees for each month during the calendar year; (4) the

name, address, and TIN of each full-time employee employed by the employer for each month during the calendar year and the number of months during which the employee (and any dependents) was covered by a plan sponsored by the employer; and (5) any other information the IRS may require. Employers that offer minimum essential coverage must report other items as well.

These employers must report to each individual employee the above information with respect to the employee, plus the name, address, and contact information of the employer, by January 31 of the year following the calendar year for which the information is required to be reported to the IRS. Employers that fail to comply with these new reporting requirements will be subject to the general penalties for failure to file information returns or furnish payee statements. The IRS may provide that the information required to be provided by this new requirement may be provided on Form W-2 or the form required to be provided by the insurer under new §6055.

Offering qualified health plans through §125

Under another PPACA provision, reimbursement or direct payment for the premiums for health coverage under a qualified plan offered through a state exchange is a qualified benefit under a cafeteria plan offered by a qualified employer. A qualified employer is generally a small employer that elects to make all its full-time employees eligible for qualified plans offered in the small group market through an exchange.

Fair Labor Standards Act amendments

Automatic health insurance enrollment, Under new §18A of the Fair Labor Standards Act (FLSA), employers that have more than 200 full-time employees and that offer them enrollment in a health benefit plan must automatically enroll new full-time

employees in one of the plans offered and continue the enrollment of current employees. An automatic enrollment program must include adequate notice and the opportunity for an employee to opt out of coverage the employee was automatically enrolled in. Nothing in this section supersedes any state law establishing "any standard or requirement relating to employers in connection with payroll" unless the law prevents an employer from instituting an automatic health insurance enrollment program.

Required notice of coverage to employees. Beginning March 1, 2013, covered employers must provide each new employee (and all current employees no later than March 1, 2013) written notice:

● of the existence of a health insurance exchange, including a description of the services provided by the exchange and the manner for contacting the exchange to request assistance;

● that, if the employer plan's share of the total cost of benefits provided under the plan is less than 60%, the employee may be eligible for a premium tax credit and a cost-sharing reduction if the employee purchases a health plan through the exchange and the employer does not offer a "free choice voucher"; and

● that, if the employee purchases a health plan through the exchange, the employee may lose the employer's contribution to any health benefits offered by the employer and that all or part of the employer's contribution may be excludable from income for federal income tax purposes.

New anti-retaliation provision. Employers are prohibited from discharging or otherwise discriminating against an employee because the employee has received a premium tax credit or a cost-sharing reduction under the PPACA, has provided

information to the federal or state government relating to a violation of PPACA provisions relating to affordable health care, has testified or participated in a proceeding concerning such a violation, or has refused to participate in an activity that the employee reasonably believes violates such provisions.

Break time for nursing mothers. Employers must provide a reasonable break time for an employee to express breast milk for her nursing child for one year after the child's birth each time the employee needs to do so, in a place, other than a bathroom, that is shielded from view and free from intrusion from coworkers and the public. This break time may be unpaid. Employers with fewer than 50 employees do not have to comply with this requirement if it would impose an undue hardship by causing the employer "significant difficulty or expense" in relation to the employer's "size, financial resources, nature, or structure." State laws that provide greater protection to nursing employees are not preempted by this provision.

Λ **APA OFFERS HEALTH CARE REFORM WEBINAR –** The APA will present a live 90-minute webinar on May 4 at 1:00 p.m. ET, "Health Care Reform – It Does Impact Payroll!" Get all the details on how this landmark legislation will impact your payroll and benefit processes and procedures. Visit the APA website at www.americanpayroll.org/course-conf/webinars.