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Health Care Reform: Impact on Employers and Employees

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After at least a year in the making and months of uncertainty, landmark health care reform legislation has been signed into law.

The new health care law makes sweeping changes to our nation's health care system. Many provisions will have a significant impact upon employers and their employees. While many of the changes are phased in gradually over the next eight years, many changes take effect this year. The **attached chart** summarizes many provisions of the health care law and the relevant effective dates.

Landmark Legislation

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act, H.R. 3590 (the Patient Protection Act). The Patient Protection Act was passed by the Senate on Dec. 24, 2009 and by the House of Representatives on March 21, 2010. On March 21, 2010, the House also passed the Health Care and Education Reconciliation Act of 2010, H.R. 4872 (the Reconciliation Act), which amended the Patient Protection Act to reflect provisions proposed by the President in February of 2010 and provisions requested by certain members of Congress. The Reconciliation Act was passed by the Senate on March 25, 2010 and was signed into law by President Obama on March 30, 2010. The following is an overview of how the Patient Protection Act, as amended by the Reconciliation Act, may impact employers and their employees.

Health Care Reform Overview

The new law is designed to provide coverage to over 32 million uninsured or under-insured Americans. The new law reforms Medicare, Medicaid and other government programs, reforms insurance markets, establishes new state-based exchanges, and imposes individual and employer mandates and new reporting and notification requirements. To finance the cost of health care reform, the new law imposes varying levels of taxes on insurers, employers, administrators and individuals, as well as numerous cost savings measures.

Individual Mandate

Starting in 2014, individuals must maintain "minimum essential coverage" or pay a penalty. The penalty will equal the greater of (1) 1 percent of modified adjusted gross income (AGI) or $95 per person in 2014, (2) 2 percent of AGI or $325 per person in 2015, and (3) 2.5 percent of AGI or $695 per person in 2016, indexed for inflation in later years. "Minimum essential coverage" includes coverage under a qualifying or grandfathered insurance company or employer-sponsored plan, government-sponsored program such as Medicare or Medicaid or a state-based exchange. The penalty for dependents under the age of 18 will be capped at 50 percent of the adult individual's penalty. The penalty for each family will be capped at 300 percent of the adult individual's penalty. The maximum penalty will also be capped at an amount equal to the average national premium for exchange coverage.

There are a number of exceptions to the individual mandate, including exceptions for individuals who have income below the tax filing threshold, incur hardships, have religious objections, are not lawfully present in the United States, are incarcerated or are overseas.

Employer 'Play or Pay' Mandate

Like the individual mandate, employers will be required to offer health care coverage for their employees or pay a penalty. This is often referred to as the employer "play or pay" mandate.

Large employers will be required to offer qualifying health coverage or pay a penalty of $2,000 per full-time employee, except the first 30 employees. For this purpose, "large employers" are employers who employ an average of at least 50

full-time employees on business days during the preceding calendar year. "Full-time employees" are limited to employees who average at least 30 hours of service per week. Smaller employers will be exempt from the "play or pay" mandate.

Employers must also pay a penalty of $3,000 for each full-time employee with income below 400 percent of the federal poverty level (FPL) (in March 2010, $88,200 for a family of four) who opts for exchange coverage in lieu of employer-based coverage. Employers must also offer "free choice" vouchers to certain lower income employees if the employee's cost of employer-provided health coverage ranges from 8 percent to 9.8 percent.

Qualifying Health Coverage

The new law sets minimum requirements for individually-mandated and employer-provided health coverage. Insurance companies and plans subject to the new law must offer minimum essential health benefits including ambulatory patient services; emergency services; hospitalization; maternity and newborn care; mental health and substance use disorder services, including behavioral health treatment; prescription drugs; rehabilitative and habilitative services and devices; laboratory services; preventive and wellness services and chronic disease management; and pediatric services, including oral and vision care.

The new law will also:

- require automatic enrollment of employees, subject to opt-out rights;
- prohibit waiting periods of more than 90 days;
- prohibit pre-existing condition exclusions;
- limit out-of-pocket maximums;
- prohibit annual and lifetime maximums; and
- extend coverage for dependents to age 26.

Many of these provisions become effective this year and in early 2011.

Fortunately for insurers and employers, grandfathered plans will not be subject to most of the requirements of the new law, except for the prohibitions on excessive waiting periods, lifetime limits, rescissions and extensions of dependent coverage.

The new law also contains several provisions that will impact retirees, including elimination of the Medicare Part D "donut hole" through gradual reduction, and a reinsurance program for early retirees.

Reporting and Disclosure

The new law also imposes a number of new reporting and disclosure requirements. Employers will be required to report to the federal government information on health insurance coverage for each participant and beneficiary, excess amounts subject to the "Cadillac" plan excise tax, and report on Form W-2 the cost of health, dental, vision, and employer HSA and HRA contributions. Employers will be required to notify employees and plan participants of numerous rights under the new law, including for example automatic enrollment and opt-out rights, and exchange act and subsidy rights. In addition, plan documents, insurance contracts, administrative service contracts, summary plan descriptions and forms, policies and procedures will need to be amended to reflect health care reform.

Health Care Financing

To help finance health care reform, the new law will impose a 40 percent excise tax on "Cadillac" plans starting in 2018. Cadillac plans are plans with premiums greater than $10,200 for individual coverage and $27,500 for family coverage, indexed for inflation in later years. Higher thresholds will apply to retirees and those in high risk professions such as law enforcement officers and first responders. Adjustments will also apply to employers whose health costs are higher because of the age or gender of their employees. Dental and vision benefits are not counted toward the premium limits.

The new law also increases the threshold for itemized deductions from 7.5 percent to 10 percent starting in 2013 and the Medicare payroll tax from 1.45 percent to 2.35 percent for those with annual income over $200,000 (single filers) or $250,000 (joint filers) starting in 2013.

Finally, to help finance health care reform, the new law:

- limits annual contributions to health flexible spending accounts (FSAs) to $2,500;
- increases the excise tax on distributions from HSAs not used for qualified medical expenses from 10 percent to 20 percent;
- prohibits HSAs, Archer MSAs, FSAs, HRAs and other reimbursement programs from covering medicine that is either not prescribed or is not insulin; and
- prohibits the payment of exchange premiums from cafeteria plans.

Impact on Employers and Employees

Health care reform will have a significant impact upon employers and their employees and benefit plans. Many provisions, such as elimination of pre-existing condition exclusions for certain dependents, annual and lifetime limits on coverage, and extension of dependent coverage until age 26, take effect for plan years beginning on or after Sept. 23, 2010 (This means Jan. 1, 2011 for calendar year plans). Other requirements, such as reporting the value of health coverage in W-2 income beginning in 2011, take effect next year while other key changes are phased in gradually over the next eight years.

As a result, many employers will need to take prompt action to comply with the new law, including working with insurance companies and administrators to amend plans to reflect the changes this year and with their payroll departments to prepare for new Form W-2 reporting. Employers will also need to assess and review their current health plan arrangements to weigh the various alternatives to comply with health care reform going forward, including whether and to what extent to maintain grandfathered plans, amend plans to provide qualifying coverage or to opt for paying a penalty in lieu of providing coverage. These decisions will have a significant impact on employers and their employees for years to come.

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