

Health Care Reform Has Arrived

March 23, 2010

Health care reform has arrived as have new mandates on employers and medical service providers. On Sunday night, March 21, 2010, the U.S. House of Representatives passed the Patient Protection and Affordable Care Act (H.R. 3590), which had been previously approved by the Senate on December 24, 2009 (the "Reform Act"). With this law approved by both bodies, health care reform is now here, and has been signed into law today by President Obama.

A remaining question is whether the proposed Health Care & Education Affordability Reconciliation Act of 2010 (H.R. 4872) ("Reconciliation Act") also approved by the House on March 21, 2010 will be passed by the Senate. The Reconciliation Act would amend the Reform Act to reflect House concerns that were not addressed in the Reform Act. Republicans in the Senate are expected to fight passage of the Reconciliation Act, a fight that will officially begin on the Senate floor after the President signs the Reform Act into law.

Below is a summary of pertinent provisions of the Reform Act as well as the impact the Reconciliation Act would have on those provisions if passed by the Senate and signed into law by the President.

What Happens Right Now

Many of the Reform Act's provisions take effect in 2013, 2014, or later years, or are gradually phased in. Some provisions, however, become effective immediately or within a short time. A few of these are:

- A temporary national high-risk pool will go into effect within 90 days of enactment.
- Restrictions on insurers regarding lifetime limits, excessive waiting periods (over 90 days), rescissions, and pre-existing condition exclusions for children.
- Limitations on insurers' ability to impose annual limits on the dollar value of coverage as determined by the Secretary of Health and Human Services.
- New insurance must pay the full cost of specified preventive care.
- Children can stay on their parents' insurance policies until they are 26.
- Rebates on Medicaid prescription drugs are increased effective January 1, 2010.
- Starting in 2011, health insurers must make rebates to enrollees if medical loss ratios are lower than specified levels.

- Effective January 1, 2011, the elimination of the ability of employers to exclude from taxation (Medicare Part D) the subsidies they receive for maintaining retiree drug coverage for their Medicare-eligible retirees.
- Effective January 1, 2011, contributions to employee flexible spending accounts will be limited to \$2,500 per year, indexed to CPI, and reimbursements for non-prescription drugs will no longer be allowed.

Impact on Employers

Employer Mandate. Effective January 1, 2014, the Reform Act assesses a fee of \$750 per full-time employee (30+ hours per week) on employers with 50 or more employees that do not offer health coverage and that have at least one full-time employee who receives a premium tax credit. For employers that impose a waiting period before employees can enroll in coverage, there will be a penalty payment of \$400 for any full-time employee in a 30-60 day waiting period and \$600 for any full-time employee in a 60-90 day waiting period. The length of permitted waiting periods is particularly important for employers with a high turnover workforce. The Reconciliation Act would increase the penalty to \$2,000 per full-time employee, excluding the first 30 employees from the assessment. Employers would not be assessed any payments if they require a waiting period before any employee can enroll in the health coverage, but the amount of any waiting period will be limited to 90 days.

Grandfathering. The Reform Act generally grandfathers existing individual and group health plans with respect to the new benefit standards under the Reform Act as well as the Reform Act's requirement to provide coverage for dependent children up to age 26. The Reform Act also appears to generally grandfather existing individual and group health plans with respect to the prohibition on lifetime limits, excessive waiting periods and rescissions. Under the Reconciliation Act, the prohibition on lifetime limits, excessive waiting periods, rescissions, and dependent coverage up to age 26 would apply to Grandfathered Plans within six months of the law's enactment.

Automatic Enrollment. Subject to regulations, the Reform Act requires employers with more than 200 employees to automatically enroll them into health plans unless an employee demonstrates that the employee has coverage from another source.

High-Cost Plan Excise Tax. Effective January 1, 2013, employer-sponsored health plans with aggregate values that exceed \$8,500 for individual coverage and \$23,000 for family coverage (\$9,850 and \$26,000 for retirees and high-risk professionals) will have to pay an excise tax equal to 40% of the excess benefit. The tax is owed by insurers of insured plans and the employer or administrator in the case of self-insured plans. The thresholds will be indexed to inflation. The threshold amounts will be increased by 20% in the 17 states with the highest healthcare costs, and this increase will be subsequently reduced by half each year until it is phased out in 2015. Under the Reconciliation Act, the excise tax does not take place until January 1, 2018, and the thresholds increase to \$10,200 for individual coverage and \$27,500 for family coverage (\$11,850 and \$30,950 for retirees and high-risk professionals) and may increase upward if healthcare costs unexpectedly rise prior to 2018.

Taxation of Retiree Drug Subsidies (Medicare Part D). Effective January 1, 2011, employers will be taxed on the Medicare Part D subsidies they receive for maintaining retiree drug coverage for their

Medicare-eligible retirees. Because this provision requires employers to treat the subsidies as taxable income, it is thought by some that the provision would be a deterrent to the continued maintenance of employer sponsored retiree drug coverage. The Reconciliation Act would delay the elimination of the tax exclusion until January 1, 2013.

Flexible Spending Accounts. Effective January 1, 2011, the Reform Act limits contributions to employee flexible spending accounts to \$2,500 per year, indexed to CPI. Such a limit will raise health care costs for employees with unreimbursed health care expenses in excess of \$2,500 to the extent the employee currently has a flexible spending account that permits contributions in excess of \$2,500. The Reform Act also excludes over-the-counter drugs as an expense that is reimbursable under flexible spending accounts. The Reconciliation Act would delay the limits on employee flexible spending accounts until January 1, 2013.

Tax Issues

Medicare Tax. Effective January 1, 2013, the employee's share of the Medicare (hospital insurance) tax rate on wages would increase by an additional 0.9 percent (in addition to the existing 1.45 percent) for individuals with a modified adjusted gross income of \$200,000 or \$250,000 in the case of married couples filing jointly. The Reconciliation Act would also modify the Medicare tax to include net investment income in the Medicare tax base, which would be taxed at 3.8 percent, for individuals who file jointly with a modified adjusted gross income of \$250,000 or \$200,000 in the case of a single return. Net investment income includes gross income from interest, dividends, annuities, royalties, rents, and disposition of properties and excludes (among other items), distributions from qualified retirement plans and IRAs.

Economic Substance Doctrine. As a revenue-raiser, the Reconciliation Act codifies the "economic substance" doctrine; this judicial doctrine denies tax benefits when the transaction generating the benefits lacks economic substance. Under the codification of this doctrine, a taxpayer must demonstrate that the transaction changes in a meaningful way (apart from tax effects) the taxpayer's economic position, and that the taxpayer has a substantial non-tax purpose for entering into the transaction.

Reporting of Payments to Corporations and for Goods. Effective for payments made beginning in 2013, the Reform Act expands the current Form 1099 information reporting requirement for compensation paid for services to individuals and partnerships to payments made to corporations and to payments made for goods as well as services.

W-2 Reporting. Effective for tax years beginning after December 31, 2010, the Reform Act requires employers to report on Form W-2 the aggregate cost of health coverage (determined on a basis similar to that under COBRA) received by an employee under the employer's healthcare plan. For this purpose, FSAs, HRAs, and Archer medical savings accounts are excluded from the cost analysis.

Impact on Providers

Health Insurers. Providers of health insurance will face dramatic changes in how they can do business, starting almost immediately. Changes include limitations on policy restrictions and exclusions as well as on premiums as they relate to expenditures for medical services. The health insurance industry will also

be subject to an excise tax starting in 2011. The Reconciliation Act would delay this tax to 2014. Medicare Advantage payments to managed care organizations will be reduced.

Physicians and Hospitals. The Reform Act largely eliminates on a going-forward basis the exception to the Federal physician self-referral law that permitted physicians to have ownership or investment interests in whole hospitals. The Reconciliation Act would provide that primary care physicians serving Medicaid patients must be paid no less than the Medicare rate for such services. Hospitals will see Medicare and Medicaid disproportionate share payments go down as the level of uninsured population decreases. Physicians, hospitals, and other providers will receive enhanced payment for higher-quality services. Beginning in 2012, accountable care organizations of physicians and hospitals will participate in shared savings programs. Under the Reconciliation Act, hospitals in counties with the lowest per capita Medicare spending will receive additional Medicare payments in federal fiscal years 2010 and 2011.

Provider Scrutiny and Transparency. Providers, particularly durable medical equipment suppliers, who seek to enroll as Medicare or Medicaid providers will face increased scrutiny. Review of suspicious bills before, rather than after, payment will become more frequent. Provider audits will be expanded. Pharmaceutical and medical device companies will be required to publicly disclose payments made to physicians, hospitals, and other providers starting for the 2012 calendar year. Tax-exempt hospitals will be required to make greater disclosures of their plans to meet community needs and will be limited in the amounts they can charge patients receiving partial charity care. Finally, false claims and fraud and abuse laws are strengthened and enforcement resources increased.

Pharmaceutical and Medical Device Manufacturers. Pharmaceutical companies will be subject to an industry fee starting in 2010 based on sales of brand name pharmaceuticals for government health programs. The Reconciliation Act would delay this fee to 2011. Medical device manufacturers will be subject to a percentage excise tax on medical device sales starting in 2011. The Reconciliation Act would delay this tax to 2013.

Long-Term Care. Long-term care institutions face a number of new requirements under the Reform Act, including detailed ownership disclosure and the implementation of compliance and ethics plans.

Evaluation and Investment. The Reform Act provides for many payment demonstration programs as well as investments in the health care workforce and in training.

As discussed above, the Reconciliation Act in certain circumstances will delay some of the Reform Act's effective dates should the Reconciliation Act become law.

Proskauer's Health Care Reform Task Force is well poised to help employers and providers navigate these new mandates. Comprised of members of the Employee Benefits, Executive Compensation & ERISA Litigation Practice Center, the Health Care Department, the Labor and Employment Department and the Tax Department, the Task Force brings to bear a unique interdisciplinary approach and perspective that will assist employers and providers in addressing health care compliance issues.

We plan on providing more in-depth analysis of some of the issues highlighted above in future Client Alerts and will continue to update our clients on new developments in this rapidly changing area of the law. In the meantime, please feel free to contact your regular Proskauer attorney or any member of our

Health Care Reform Task Force should you have questions regarding the Reform Act or the Reconciliation Act.

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