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Employee Benefits Update

Special Edition
March 16, 2017

REPUBLICAN HEALTH CARE BILL

The American Health Care Act: Key Takeaways for Employers

On March 9th, the House Ways and Means Committee reported out the American Health Care Act, a bill that would repeal taxes imposed by the Affordable Care Act (ACA) through the budget reconciliation process. This legislation is intended to be Part 1 of a three-part ACA replacement process.

UNDOING OBAMACARE

1. The **Cadillac tax** would be delayed until 2025. This enables Republicans to eliminate the tax in the short term, while avoiding the budgetary impact of a full repeal. We expect the tax to be delayed again as the 2025 date looms closer.
2. The **employer mandate** would be repealed, effective 1/1/2016. The bill zeroes out the excise tax under IRC 4980H for failure to offer affordable coverage.
3. The **individual mandate** would be repealed, effective 1/1/2016. Instead, penalties would apply for individuals who fail to maintain continuous coverage, in the form of 30% higher premiums for a 12-month period.
4. A **new premium tax credit** based on age (with an income phase-out) would replace the ACA premium subsidies, effective 1/1/2020. Credits would range from $2,000 to $4,000 per person, with a maximum of $14,000 per family.
5. **Retiree prescription drug** expenses would once again become deductible under IRC 139A, effective 1/1/2018. This effectively would allow employers to double dip, by receiving both a tax-free Retiree Drug Subsidy and a tax deduction equal to the value of benefits provided to retirees.
6. The **0.9% Medicare Tax** on high-income earners would be repealed, effective 1/1/2018. This additional tax has generated some withholding issues for employers, so the repeal may be a welcome change for payroll departments as well as higher-paid employees.
7. The **3.8% Net Investment Income Tax** would be repealed, effective 1/1/2018.
8. The **2.3% medical device excise tax** would be repealed, 1/1/2018.
9. The **162(m)(6) deduction limit** for health insurance executives earning over $500,000 would be repealed, effective 1/1/2018.

EMPLOYER REPORTING

The bill would call for "simplified" employer reporting on Form W-2, in 2020. It would not repeal the information reporting requirements of IRC 6055 or 6056, as these cannot be removed through Congress' budget reconciliation process. Thus, the ACA reporting rules stay in place for now, but may be replaced down the road.

FSA CHANGES

1. **Flexible Spending Accounts** (FSAs) would no longer be capped by IRC 125(i) at $2,600 per year, as indexed. Beginning 1/1/2018, employers could set their own contribution limits – or impose no limit at all.
2. **Non-Prescription Drugs:** The bill would eliminate limitations on paying for over-the-counter medicine and drugs from an FSA, beginning 1/1/2018. At present, an FSA cannot reimburse expenses for non-prescription drugs other than insulin, under IRC 223(d)(2).

HSA CHANGES

Republican leadership has touted the benefits of Health Savings Accounts (HSAs) as the cornerstone of a new healthcare regime. As expected, the bill makes a number of changes to promote HSA usage and design.

1. **Higher Limits:** The maximum annual contribution limit for HSAs would nearly double, to align with the maximum annual out-of-pocket costs for a high deductible health plan (HDHP). For a participant enrolled in self-only coverage, the limit would rise from $3,400 to at least $6,550 on 1/1/2018. For a participant enrolled in family coverage, the limit would rise from $6,750 to $13,100+ on 1/1/2018.
2. **Non-Prescription Drugs:** The bill would eliminate limitations on paying for over-the-counter medicine and drugs from an HSA, beginning 1/1/2018. At present, all non-prescription drugs (other than insulin) fail to qualify as "qualified medical expenses" under IRC 223(d)(2).
3. **Lower Penalties:** HSA withdrawals are subject to a 20% penalty if used for non-qualified medical expenses, under IRC 223(f)(4). The bill would reduce this penalty to 10%, effective for distributions made beginning 1/1/2018, to make HSAs more attractive to employees.
4. **Catch-Up Contributions:** Presently, participants age 55 or older can contribute an extra $1,000 per year to an HSA. The bill would allow the participant's spouse to make a catch-up contribution to the *participant's* HSA (without having to open a separate spousal account), effective beginning 1/1/2018.
5. **Administrative Obstacles:** The bill would make it easier for employers to set up an HSA. Expenses incurred during the first 60-days of HDHP coverage would be treated as qualified medical expenses (even if the HSA has not yet been established), effective 1/1/2018. This type of liberalization also might make it easier for plan sponsors to change vendors without worrying about the impact of such disruption on HSA participants.
6. **Spillover Tax Credits:** The bill would subsidize health care coverage through age-based federal tax credits with an income phase-out. If an individual does not exhaust the credits payable (for self and/or family coverage), then he or she could roll over any excess to an HSA.

SURPRISES

Early (leaked) drafts of the Republican bill would have limited the tax benefit for employer-paid medical premiums, beginning in 2020. This proposal would have capped the tax exemption for employer-sponsored insurance at the 90th percentile of 2019 premium levels, under IRC 106. Amounts above that threshold would have been includible in income for covered employees.

Employers will be relieved that this controversial provision has been omitted from the bill.

HSA & FSA ISSUES

Any expansion of HSAs and FSAs may make today's administrative issues more challenging for employers.

New HSA Enrollees: HSAs do not play nicely with others. A participant is ineligible to contribute to an HSA if he or she has funds remaining in a health flexible spending account, unless it is a limited purpose FSA restricted to out-of-pocket vision and dental expenses. In the past, unused FSA funds would be forfeited at year-end, under a "use it or lose it" system. Now, many FSAs allow expense reimbursement after the plan year closes, through carryovers (up to $500) and the use of grace periods.

We expect these issues to become more common if Congress eliminates the $2,600 dollar limit imposed on health FSAs under IRC 125(i). This change would make FSA carryovers more likely, thus disqualifying more potential HSA participants. Employers have several options for addressing FSA balances for new HSA enrollees, but they must act proactively, before the end of the prior plan year.

Nondiscrimination Rules: Removing the contribution limit for health FSAs will likely increase utilization for highly-paid employees. This can be problematic, since a health FSA remains subject to nondiscrimination testing rules under IRC 125. Although these 2007 rules remain in proposed form, they prohibit highly paid employees from electing FSA benefits disproportionately. An increase in the annual contribution limit for health FSAs may make it even more difficult for a plan to comply with this rule.

NEXT STEPS

The bills have been scored by the Congressional Budget Office and now stand before the House Budget Committee. More to follow.

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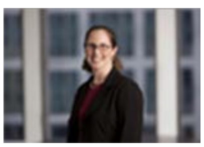

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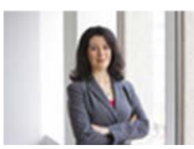

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IPB In The News

Robin Solomon quoted in Wall Street Journal on target date funds (Mar. 6, 2017)

Jodi Epstein and Doug Andre speak on Global Mobility – Practical Strategies at the TEI chapter in Charlotte NC (Feb. 24, 2017)

Ben Grosz interviewed on 401(k) fee litigation in PlanSponsor cover story "On Guard" (Jan/Feb 2017)

Ben Grosz served as featured panelist at Best of Plan Sponsor national conference in New York, on Lessons Learned from Litigation (Dec. 1, 2016)

Upcoming Presentations

Kevin O'Brien to discuss Comprehensive Tax Reform at D.C. Bar Tax Section Conference (Apr. 20, 2017)

Robin Solomon and Spencer Walters to lead a workshop on "Surviving a DOL Audit" at the Mid-Sized Retirement and Healthcare Plan Mgmt Conference in Baltimore MD (Apr. 25, 2017)

Ivins attorneys to present at the TEI chapter in Raleigh NC (Apr. 28, 2017)

EB Update Archives

January 2016 EB Update

March 2016 EB Update

May 2016 EB Update: Wellness Plans

June 2016 EB Update: DOL Fiduciary Rule

Sept 2016 EB Update

March 2017 EB Update: Health Savings Accounts