



IN THE BUSINESS OF YOUR SUCCESSSM

HEALTH CARE REFORM

Eye on Washington

HEALTH CARE REFORM WILL AFFECT PREMIUM-ONLY CAFETERIA PLANS – BUT HOW?

Premium-only cafeteria (“POP”) plans have been a popular way for employers to help employees obtain favorable tax treatment for their share of premiums for health insurance and other qualified benefits. POP plans provide a “win-win” solution – employees save by paying their share of insurance premiums on a pre-tax basis, and employers save by not paying FICA and federal unemployment taxes on those amounts.

Under current law, the term “qualified benefit” is broadly defined to include many types of insurance coverage, whether offered on a group or individual basis (for example, medical, dental, vision, disability, AD&D, and group term life insurance). Beginning January 1, 2014, the Affordable Care Act (“ACA”) adds a new section 125(f)(3) to the Internal Revenue Code (“Code”). This provision significantly narrows the definition of “qualified benefit” to exclude individual insurance coverage offered through a State Exchange. Although the scope of the ACA change remains unclear, and the precise impact on POP plans remains unknown, we expect POP plans will continue as a tax-favored vehicle after ACA. This article outlines the new rules, and describes the potential impact.

Background

The ACA provides incentives for States to establish and operate two types of Exchanges – American Health Benefit Exchanges (“Individual Exchanges”) and Small Business Health Option Program Exchanges (“SHOP Exchanges”). Individual Exchanges will help people purchase individual health insurance coverage, and SHOP Exchanges will help qualified employers purchase group health insurance coverage. States also have discretion to consolidate Individual and SHOP Exchanges into a single Exchange. If a State chooses not to set up Exchanges, then the Federal Government will establish and operate Exchanges in that State.

The Exchanges will sell only qualified health plans. These are health insurance plans that cover essential health benefits, meet specific cost-sharing rules and satisfy actuarial value requirements (bronze, silver, gold, platinum and a catastrophic plan for individuals under 30). Exchanges are not exclusive – subject to

State regulation, individuals and employers will also be able to purchase individual and group health insurance coverage “off” the Exchanges. But people with income between 100% and 400% of the federal poverty level have a strong incentive to purchase individual health insurance coverage on the Individual Exchange – premium tax credits are not available for coverage purchased “off” the Exchange.

There are a multitude of definitions related to Exchanges. A “qualified employer” is a small employer that makes all full-time employees eligible for small group health insurance coverage on a SHOP Exchange. A “small employer” is an employer with no more than 100 employees, although States may choose to use a narrower definition for 2014 and 2015 (an employer with no more than 50 employees). Beginning in 2017, States may also choose to allow larger employers to purchase group coverage on a SHOP Exchange.



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New Restrictions on Qualified Benefits

New Code section 125(f)(3) includes a general rule and an exception. Under new Code section 125(f)(3)(A), the general rule is that the term “qualified benefit” does not include a qualified health plan offered through an Exchange. The legislative history suggests this rule is intended to prevent employers from using cafeteria plans to allow employees to make pre-tax purchases of individual health insurance coverage from an Individual Exchange. And new Code section 125(f)(3)(B) provides the exception – the general rule does not apply to “qualified employers” (as defined above) that offer employees the opportunity to enroll in a qualified health plan through an Exchange. The legislative history suggests this rule is intended to allow qualified employers to use cafeteria plans to allow employees to pay their share of premiums for group health insurance coverage from a SHOP Exchange.

Winners and Losers?

Predicting winners and losers at this point is dicey. One challenge is that the law includes ambiguities, and the IRS has not yet issued guidance. Another challenge is that several interpretations are left to the States – how to define the term “small employer” for 2014 and 2015, whether to let larger employers purchase coverage on the SHOP Exchange beginning in 2017, and whether to combine the Individual and SHOP Exchanges.

Are POP plans doomed? Not at all. But POP plans will need to change modestly to reflect the new restrictions. For example, POP plans will not be able to facilitate the pre-tax purchase of individual health insurance from an Individual Exchange. This will be true for both small and large employers. But otherwise, POP plans will remain quite viable. For example, POP plans can facilitate the pre-tax payment of an employee’s share of premiums for qualified employers that purchase group coverage on an Exchange. In addition, POP plans can facilitate the pre-tax purchase of individual health insurance “off” an Individual Exchange. And POP plans can also facilitate the pre-tax payment of an employee’s share of premiums for large employers that purchase group coverage “off” the Exchange.

Summary

Based on what we know today, we believe that POP plans will generally continue to be available as a vehicle to provide tax favorable premium conversion benefits for employers and employees. However, beginning in 2014, employers will not be able to use POP plans to help employees make pre-tax purchases of individual health insurance coverage on an Individual Exchange. We’ll keep you informed as additional guidance becomes available.

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