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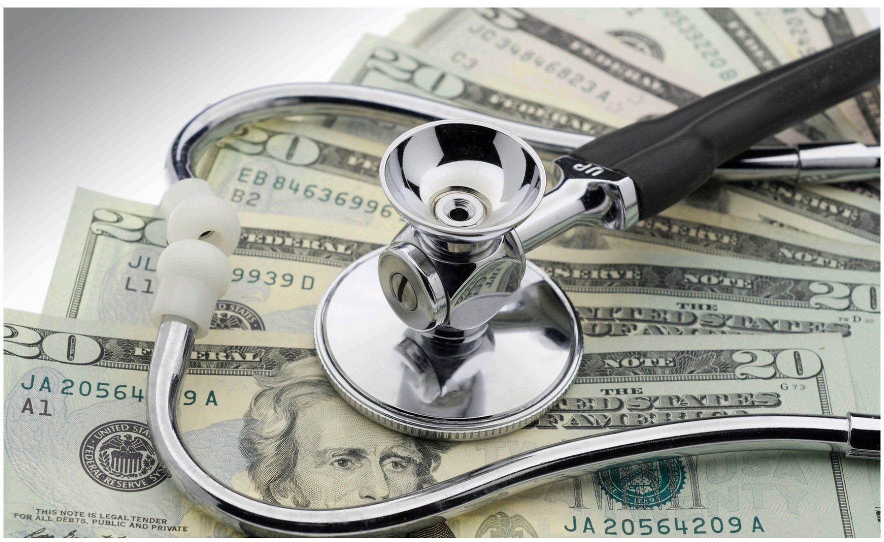
Special Issues Facing Manufacturers Under ObamaCare



Special Issues Facing Manufacturers Under ObamaCare

Beginning in 2013, many of the provisions in the Patient Protection and Affordable Care Act of 2010 ("ACA") will have a significant impact on how employers deal with employee health care needs.

As an initial matter, employers will face new limitations on how they structure employee health care plans (whether insured or self-insured). More significantly, many employers must now face the question of whether it is cost-effective for them to even sponsor an employee health care plan at all. This article will discuss the ways in which these issues and choices have distinct relevance for manufacturing employers.

As discussed below in greater detail, the added tax and financial burdens being placed on manufacturing employers by ACA can be summarized as follows:

Beginning in 2013:
1. New annual 2.3% excise tax on medical devices;
2. Reduction in Income Tax Deduction for Retiree Drug Coverage; and
3. New annual excise tax measured by number of employees covered by the employer's group health plan.

Beginning in 2014:
1. New employer mandates under the "Pay or Play" provisions of Section 4980H of the Internal Revenue Code ("IRC"); and
2. New Health Insurance Tax on certain health insurance policies.

2013 Concerns

The Medical Device Tax

Operation

Subject to certain exceptions, manufacturers of "taxable medical devices" must pay a tax of 2.3% of the sales price of the devices sold after December 31, 2012. For purposes of this tax, a "taxable medical device" is any "device" intended for humans. The term "device" is, in turn, defined as any instrument, apparatus, implement, machine, or other similar article that is intended either (i) for the use in the diagnosis, cure, mitigation or treatment of disease, or (ii) to affect the structure or any function of the body. Included among the stated exceptions to this tax are the sales of eyeglasses, contact lens, hearing aids, and any other medical device that is purchased by the public at retail for individual use.

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The next level of service

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Impact on Manufacturers

This special tax is targeted solely at manufacturers. According to the National Association of Manufacturers ("NAM"), this tax will hamper innovation and job growth in the medical device industry. In addition, since this tax will result in higher manufacturing costs to manufacturers, it is probable that some, if not all, of these higher costs will simply be passed on to the end user of these devices in the form of a hidden tax on them. According to industry insiders, in the first two months of 2013, this new tax raised nearly $200 million.

The Reduction in an Employer's Federal Income Tax Deduction for Retiree Drug Coverage

Operation

The Social Security Act presently requires the Social Security Administration to pay a subsidy to those employers which sponsor a prescription drug plan for certain of the employer's retirees. The subsidy is $28 for each $100 of drug expenses paid under the plan by the employer. Up and until December 31, 2012, not only was the subsidy excluded from the employer's gross income for federal income tax purposes, but also did not reduce the employer's deduction for the drug expenses paid by it under the plan. Commencing for an employer's tax year beginning after December 31, 2012, ACA amended the Internal Revenue Code to provide that the employer's drug cost deduction under the retiree prescription drug plan must now be reduced by any drug subsidies received from the Social Security Administration.

Impact on Manufacturers

Retiree drug coverage plans are not uncommon among larger manufacturing companies providing prescription drug coverage to its retirees. The increased cost could result in some of the manufacturers dropping retiree prescription drug coverage. The net effect of dropping this coverage will be to place additional cost burdens on Medicare (through its Part D prescription drug program) and thus increase the likelihood of increased Medicare taxes on working taxpayers - the very problem the subsidy program, as initially structured, was intended to avoid.

Tax on "Specified Health Insurance Policies" and "Applicable Self-Insured Health Plans"

Operation

A tax is imposed on each "specified health insurance policy" and each "applicable self-insured health plan" for policy or plan years, respectively, that end after September 30, 2012 and before October 1, 2019. For the taxes on health insurance policies, the insurer pays the tax. For taxes on self-insured plans, the employer pays the tax. In each case, the tax is due by the following July 31. Accordingly, the first tax payment is due July 31, 2013 for calendar year policies and plans. The tax is basically the product of (i) the "applicable dollar amount" times (ii) the average number of lives covered under the policy/plan. For 2012 calendar year policies/plans, the "applicable dollar amount" is $1; for 2013 it is $2, and thereafter it increases due to the increase in the per capita amount in National Health Expenditures.

Impact on Manufacturers

This tax will only increase the costs imposed on any plan sponsor of a group health care plan, whether or not the plan is insured, since there is little doubt that health insurance carriers will pass the cost on to the plan sponsors. This can be a particularly troubling development for smaller manufacturers since many of them operate on a fairly thin profit margin as it is.

2014 Concerns

The "Pay or Play" Employer Mandate Provisions

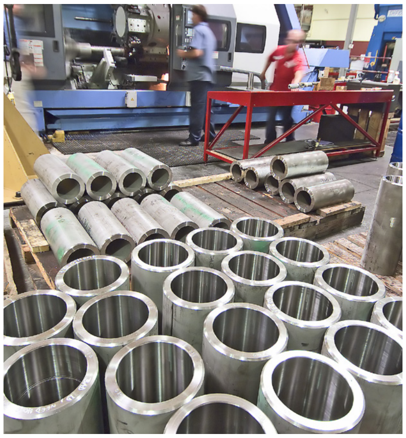
Operation

For tax years commencing after December 31, 2013, all "Applicable Large Employers" potentially face a significant tax penalty under Section 4980H of the Internal Revenue Code ("IRC"). This tax penalty under IRC Section 4980H is often-times referred to as the "Pay or Play" tax. The tax is triggered IF either of the following events occurs:

1. An Applicable Large Employer does not offer to at least 95% of its "full-time" employees and their dependents the ability to enroll in a group health plan sponsored by the employer <u>and</u> at least one "full-time" employee of the employer obtains federally subsidized coverage through a State or Federally sponsored Health Exchange. In this event, the Pay or Play penalty is an annual tax of $2,000 for each "full-time" employee of the employer (less the first 30 "full-time" employees); or

2. An Applicable Large Employer does offer to at least 95% of its "full-time" employees the ability to enroll in a group health plan sponsored by the employer, <u>but</u> the coverage is either considered to be "unaffordable" or fails the "minimum value" requirement <u>and</u> at least one "full-time" employee of the employer obtains federally-subsidized coverage through a State or Federally sponsored Health Exchange. In this event, the Pay or Play penalty is equivalent to an annual tax of the lesser of (i) $3,000 per subsidized full-time" employee, or (ii) $2,000 for each full-time" employee of the employer (less the first 30 "full-time" employees).

Although the details of the assessment of this tax have not been fully developed, we do know that this tax penalty will be assessed by the IRS after the end of the year for which the tax is otherwise applicable. At that point, the tax will be payable by the employer upon notice and demand by the IRS. It should be noted, however, that whichever of the above described taxes is determined to be applicable, the tax is actually determined on a month-to-month basis. So, an employer may owe a lesser amount if a penalty applies for only a portion of a year. Unfortunately, the tax is not deductible for federal income tax purposes.



The initial consideration in determining whether the IRC Section 4980H tax applies is determining whether an employer is considered to be an "Applicable Large Employer". ACA defines an "Applicable Large Employer" as a company that employs an average of at least 50 "full-time" employees (including, for this purpose, "full-time equivalent" employees) on business days during the preceding calendar year. So, for 2014 (the first year for which the tax is applicable), an employer's status as an "applicable large employer" will be based on the number of its "full-time" employees and "full-time equivalent" employees during all of 2013 (subject to a special transitional rule that applies just to 2013).

Next, if an employer is determined to be an "Applicable Large Employer", then it is necessary to identify the employer's "full-time employees", since, if the tax is found to apply, the amount of the tax is dependent on the number of the identified "full-time" employees of the employer. Interestingly, the process for identifying the employer's "full-time" employees is different from the process of determining if the employer is an "Applicable Large Employer" in the first case.

For purposes of IRC Section 4980H, a "full-time" employee is defined as an employee who is employed an average of 30 hours of service per week by the employer. The number of "full-time equivalent" employees is defined as the quotient of the hours of service for a month by all employees who are not "full-time" employees by 120.

Impact on Manufacturers

Manufacturers That Sponsor Single-Employer Health Plans: The Pay or Play rules can be particularly harsh as applied to manufacturers if they employ substantial numbers of part-time employees. Because of the concept of "full-time equivalent" employees, these rules can result in many manufacturing companies being treated as "Applicable Large Employers" even though in their mind they do not regard themselves as large employers. As such, these companies are now potentially subject to tax penalties if they do not provide coverage to at least 95% of their "full-time" employees which meet the fairly generous standards of ACA. Consequently, a possible effect of mandating health care benefits coverage by manufacturers who employ large numbers of part-time employees will be an increased cost of doing business. Faced with this choice, many manufacturers may simply drop their existing group health care plans and just pay the Pay or Play penalty required under ACA (not a good result for the company or its workers).

Manufacturers That Contribute to a Multi-Employer Health Plan: At first glance, IRC Section 4980H appears to be geared to companies that sponsor "single employer" health plans in which their employees participate. Such focus would be understandable since employers sponsoring these types of plans have control over plan design, costs, and participation requirements, and can take the necessary steps to adjust their plans as needed to avoid the Pay or Play tax imposed under IRC Section 4980H.

Unfortunately, IRC Section 4980H also applies to multi-employer health plans that employ union workers subject to a collective bargaining agreement between several unrelated employers and one or more unions representing their employees. This is especially troubling since an employer that has employees covered by a multi-employer plan rarely has any day-to-day control over the design or operation of the plan, including the health benefits offered under the plan or its costs.

But, many manufacturers are contributing employers to multi-employer health plans for their union employees. How are they supposed to navigate around the many obstacles presented by the Pay or Play provisions of IRC Section 4980H?

Fortunately, the IRS has acknowledged some of the unique features of a multi-employer plan setting and has agreed to provide a special one-time transition rule for 2014. Under this transition rule, an "Applicable Large Employer" will not be subject to a Pay or Play tax under IRC Section 4980H that would otherwise apply to the employer with respect to one of its "full-time" employees if, generally speaking, the "full-time employee is (i) covered under the multi-employer plan to which the employer makes required contributions under a collective bargaining agreement, and (ii) the coverage offered under the plan is considered to be "affordable" (i.e., the employee must pay no more that 9.5% of his wage income towards coverage under the plan).

Health Insurance Tax

Operation

For each calendar year beginning after December 31, 2013, an annual tax will be imposed on each health insurance carrier providing health insurance with respect to U.S. health risks. The tax is based on the insurer's "net premiums" written with respect to such U.S. health risks. It is estimated that this tax will raise $8 billion starting in 2014 and increase each year thereafter, reaching $14.3 billion by 2018.

Impact on Manufacturers

This is just one more cost that will be passed on by insurers to employers sponsoring insured group health care plans. Many of the smaller manufacturers will no doubt have difficulty absorbing yet another increased cost for providing health care benefits for their employees.

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MANUFACTURING INDUSTRY INSIGHT

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