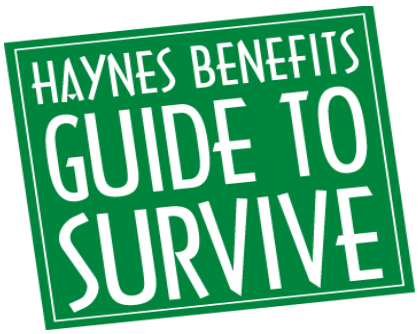

. . . Health Care Reform 2010

Alert 6: Revenue Provisions

Our sixth alert will focus on some of the revenue provisions in the Pension Protection and Affordable Care Act, as amended by the Reconciliation Bill (the "Act"). The Congressional Budget Office estimated the cost of the coverage components of the Act to be $940 billion over ten years, which would be financed by the combination of savings from Medicare and Medicaid and new taxes and fees. This alert will describe some of these new taxes and fees which have not been mentioned in one of our previous alerts. Our comments are in italics.

Excise Tax on Indoor Tanning Services. Effective July 1, 2010, a ten percent (10%) excise tax will be imposed on amounts paid for indoor tanning services, which is defined to not include phototherapy performed by a licensed medical professional.

Over-the-Counter Prescription Drugs and Medicines. Effective January 1, 2011, nonprescription drugs and medicines (except for insulin) may not be reimbursed under a health flexible spending account, a health reimbursement arrangement, a health savings account (HSA) or an Archer medical savings account (MSA).

Excise Tax on Certain HSA/MSA Distributions. Effective January 1, 2011, the excise tax on distributions from an HSA that are not qualifying medical expenses will be increased from 10% to 20%. The excise tax on distributions from an MSA that are not qualifying medical expenses will be increased from 15% to 20%.

New Annual Fees Imposed on Drug Manufacturers and Importers. Effective January 1, 2011, a new fee will be imposed on any manufacturer or importer of branded prescription drugs offered for sale in the United States to certain governmental programs, such as Medicare, Medicaid, the Veterans Administration, the Department of Defense or TRICARE. These drug manufacturers and importers are referred to in the Act as "covered entities." An aggregate annual fee will be imposed on all covered entities beginning at $2.5 billion for the 2011 fiscal year, gradually increasing to $4.1 billion for the 2018 fiscal year and then reduced to $2.8 billion for the fiscal year ending on September 30, 2019. There are no fees for plan years beginning on or after October 1, 2019. The Secretary of the Treasury will allocate each year's fee in proportion to each covered entity's market share of covered domestic sales of branded

prescription drugs for the prior year as prescribed in the Act. Payment of this new fee must be made each year by not later than September 30. The fee payments will be credited to the Medicare Part B Trust Fund.

Fees on Insured and Self-Insured Health Plans to Help Fund Comparative Effectiveness Research. Effective for plan years beginning on or after October 1, 2012, a fee will be imposed on both insured and self-insured health plans to fund comparative effectiveness research by a tax exempt trust fund The Secretary of the Treasury will be the Trustee of this trust fund.

The fees to partially fund this program will start at one dollar per participant for the plan year ending in 2013 and will increase to two dollars per participant for the plan year beginning on or after October 1, 2013. Effective October 1, 2014, these fees will be adjusted based on projected increases in per capita health care spending. These fees will not apply to plan years beginning on or after October 1, 2019. The remainder of the funding will be from appropriations from Congress.

Insured or self-insured plans providing only "excepted benefits", as defined in HIPAA, such as dental, vision, long-term care or accident only coverage are not subject to this fee. Governmental entities are not exempt from this fee, but certain governmental health plan programs are exempt. The fee will be treated as a tax for procedure and administration purposes.

> *After 2019, this fee could be continued after October 1, 2019 because there will still be a need for comparative effectiveness research to identify cost-effective treatment of diseases.*

Flexible Spending Account Limit. Effective January 1, 2013, the health flexible spending account limit will be capped at $2,500. The limit is to be adjusted annually for inflation beginning in 2014.

> *This provision was the subject of intense lobbying by industry groups representing employer and third party administrators interested in cafeteria plans, who saved Health FSAs from possible extinction.*

Itemized Deduction Threshold for Medical Expenses Increase. Effective January 1, 2013, the threshold for itemized deductions for medical expenses for federal income tax purposes, including for alternative minimum tax purposes, for a taxpayer (or spouse) who is not age 65 or older will increase from 7.5% to 10% of adjusted gross income. The 7.5% threshold for itemized deductions for medical expenses of a taxpayer (or spouse) who is age 65 or older will continue to apply until December 31, 2016, except for alternative minimum tax purposes. Effective January 1, 2013, the threshold for itemized deductions for medical expenses, for alternative tax purposes only, for a taxpayer (or spouse) who is age 65 or older will be 10% of adjusted gross income. Effective January 1, 2017, the threshold for itemized deductions for medical expenses

for all federal income tax purposes for a taxpayer age 65 or older will be 10% of adjusted gross income.

Elimination of the Deduction for Federal Subsidies of Certain Retiree Prescription Drug Plans. Effective in 2013, employers who receive a subsidy for certain allowable drug costs for retirees will not be able to deduct the subsidy. This tax deduction was included in the Medicare Prescription Drug Improvement and Modernization Act in 2003 to encourage employers providing retiree prescription drug coverage to continue doing so (which reduces Medicare costs).

> *Several large employers, whose stock is publicly traded, have announced material reductions in earnings (equal to the present value of the loss of future tax deductions) as a result of this provision in the Act. These earnings reductions have been made in accordance with GAAP income tax accounting rules. This may encourage some sponsors of retiree medical plans to discontinue retiree medical coverage, thereby shifting the costs of such plans to Medicare.*

Additional Medicare Tax on High Income Individuals. Effective January 1, 2013, the employee portion of the hospital insurance part of FICA taxes will be increased by 0.9% of wages or self-employment income in excess of $200,000 (or $250,000 in the case of a joint return or $125,000 in the case of a married taxpayer filing a separate return). The employer, however, only withholds this additional FICA tax on wages in excess of $200,000, regardless of the employee's marital status or whether a married employee files a joint or a separate tax return.

> *The hospital insurance part of FICA taxes for an employee is 1.45% and for a self-employed individual is $2.9%. This makes the hospital insurance tax on the applicable excess wages of an employee 2.35% (i.e., 1.45% plus 0.9%) and the hospital insurance tax on the applicable excess self-employment income 3.8% (i.e., 2.9% plus 0.9%).*

Fee on Net Health Insurance Premiums. Effective January 1, 2014, a new fee will be imposed on providers of insurance for any United States health risk. The health insurance provider (or reinsurance provider) who will be subject to this fee are defined as "covered entities". The aggregate fee to be imposed on all covered entities from 2014 through 2018 will be as follows:

2014	$8 billion
2015	$11.3 billion
2016	$11.3 billion
2017	$13.9 billion
2018	$14.3 billion

The Secretary of the Treasury will allocate a portion of the aggregate fee to each covered entity each year based on each entities relative market share of net premiums written for the

previous year. The net premiums written, including net reinsurance premiums written, will be determined by the Secretary of the Treasury, based on reports which covered entities will be required to file.

Employers that self fund health benefits are not subject to the fee. The annual fee must be paid by the payment date specified by the Secretary of the Treasury, which shall not be later than September 30 of each year. There are prescribed penalties for the failure to file the report or for a report that understates the amount of the net premiums written.

High Cost Plan Excise Tax. Effective in 2018, a forty percent (40%) excise tax will be imposed on health coverage providers to the extent that the value of coverage for employer sponsored health coverage exceeds a threshold amount. This is generally referred to as the "Cadillac health plan tax". For 2018, the threshold amount will be $10,200 for individual coverage and $27,500 for family coverage, adjusted by (1) a health cost percentage adjustment, and (2) an age and gender adjustment.

> *We do not cover many of the details of this tax. The excise tax on high cost plans is one of the most unpopular provisions in the Act. Therefore, before 2018, this excise tax may be repealed or substantially modified.*

July 20, 2010