

THE NEW HEALTH CARE ACT: A FIRST LOOK

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The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (the "Act" for purposes of this Alert) is now law. The Act is going to be the subject of ongoing commentary for some time. As a first tiny step, this Alert will address two provisions that will change the administration of employer-provided health benefits.

Health Coverage For Dependents

Under the Act, any group health plan or a health insurance issuer that offers group or individual health insurance coverage that provides coverage of dependent children must continue to make dependent coverage available for an adult child until the child turns 26 years of age.

New Hampshire law already defines a "dependent child" for insurance coverage purposes as a child who is unmarried, under age 25 if a full-time student or under age 26, if a resident of New Hampshire and not otherwise provided coverage. Similar rules already apply in Massachusetts as well. Although the new federal law is not a word-for-word match with the New Hampshire or Massachusetts law, it is still true that this provision of the Act is not entirely new to New Hampshire or Massachusetts employers.

What is new - and what should be a welcome change to employers who struggle with the payroll treatment of employees who already cover their older dependent children - is a change in the Tax Code.

Under a separate provision of the Act, the Code is amended so that, effective March 30, 2010, the Act extends the general exclusion from income taxation for an employee's share of premium payments to any child of an employee who has not attained age 27 as of the end of the tax year. The Act also provides that this change is intended to apply to the income tax exclusion for the employer-paid portion of the premium as well, for such a child.

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Previously, an employer would need to withhold additional payroll tax on behalf of some employees on account of the mismatch between state law that required coverage of older dependents and federal law that imposed different income tax treatment of that coverage v. the same coverage for younger dependents. Employees have had to accommodate this difference by requiring additional information from employees in order to properly withhold payroll tax and to properly add imputed income to the compensation of some employees.

This Tax Code change should end the disconnect that employers have had to manage, when a child is eligible for coverage under an employer's health plan but has not been deemed a "dependent" under the Tax Code.

New FSA Contribution Limit

A flexible spending account, or FSA, is one of a number of tax-advantaged financial accounts that can be set up through a cafeteria plan of an employer. An FSA allows an employee to set aside a portion of his or her earnings to pay for qualified expenses as established in the cafeteria plan, most commonly for medical expenses but often for dependent care or other expenses.

Under current law, there is no limit on the amount of contributions an employee can make to a health FSA. Under the Act, however, allowable contributions to health FSAs will be capped at \$2,500 per year, effective for tax years beginning after December 31, 2012. The dollar amount will be indexed for inflation after 2013.

This is not an immediate change in the operation of FSAs. During the interim years, employers can review their present FSA operation and pave the way for the transition to this benefit change. In fact, employers should have already affirmatively determined the contribution amount an employee can commit to an FSA, as a part of the employer's written plan document for the FSA. Federal law has not imposed a limit on accounts, but employers can do so.

An FSA is structured so that the entire amount an employee commits to pay into his FSA is immediately available to cover qualified medical costs, even if the employee's salary deferral contributions have not yet covered the amount of a claim. Usually, by year's end, the FSA account is fully paid by the employee and the employee's claims should have consumed the entire amount. The employer is at risk, however, of having to cover the cost of FSA expenses incurred by an employee who receives covered medical care early in the year, but then terminates employment before completing his or her contribution to the FSA. Separately, an employer may experience a shortfall in its cash-flow if too many large medical expenses are payable early in the

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year, before the FSA contributions catch up to the payments already made.

As a prudent practice, employers should always consider limiting the amount an employee can contribute to an FSA account. Often, this contribution ceiling is in the \$3,000 range. This is still, however, higher than the pending limits imposed by the Act, and affected employees may still experience a reduction in the amount of compensation they may set aside to pay for self-determined medical expenses not covered by their health plan.

Just by page count alone, there is plenty more to consider in the new Act. Expect more review and commentary in future Alerts.

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