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Health Care Reform for Employers: New PCOR Fee For Employers With Self-Insured Plans Must Be Paid by July 31, 2013

Health care reform requires employers with *self-insured medical* plans to pay an annual fee for each individual who is covered under the plan. This fee, which is known as the "PCOR fee," will be due for the first time for most employers this summer – on ***July 31, 2013***. The fee is $1.00 per covered person for the first year, increases to $2.00 per covered person in the second year, and is subject to cost-of-living increases in future years. The fee will be in effect for seven years, after which it is scheduled to phase out. The fee cannot be paid by a third party administrator – it must be paid by the employer – and it cannot be paid using plan assets.

The PCOR fee directly affects employers with self-insured medical plans and most employers with health reimbursement arrangements ("**HRAs**"). If you are such an employer, you are subject to the PCOR fee and you need to read the rest of this Alert.

You will not need to pay the PCOR fee if you are fully insured. As noted above, having an HRA will generally cause you to be considered to be self-insured for purposes of this fee. Having a health flexible spending account ("**Health FSA**"), on the other hand, will generally not cause you to be considered to be self-insured for purposes of this fee since most Health FSAs will fit within an exception to the fee.

As you can probably already tell, the details concerning the PCOR fee are complicated. Those details are explained below.

Q-1. What is a "PCOR fee"?

A-1. The Patient Protection and Affordable Care Act ("**PPACA**") created an entity called the Patient-Centered Outcomes Research Institute. The institute is funded by fees ("**PCOR fees**") charged to issuers of health insurance policies and sponsors of self-insured health plans. In December 2012, the Internal Revenue Service ("**IRS**") issued final regulations governing PCOR fees. (Click here to read those regulations.)

Q-2. Who is required to pay the PCOR fee?

A-2. There are actually two different PCOR fees: one imposed on issuers of health insurance policies (i.e., insurance companies), and another imposed on employers and other sponsors of self-insured group health plans. Our focus in this Alert is on the PCOR fee that must be paid by employers and other sponsors of self-insured plans.

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Q-3. What types of plans are subject to the PCOR fee?

A-3. The PCOR fee applies to all self-insured group health plans unless an exception applies. Plans and benefits that are excepted from the PCOR fee under the regulations include the following:

- Plans providing only "excepted benefits," including nearly all Health FSAs, stand-alone dental and vision plans, and supplemental coverage for specific diseases (e.g., cancer insurance);
- Most employee assistance, disease management, and wellness programs; and
- Plans designed to cover employees who live and work outside of the United States (commonly referred to as "expatriate plans").

There are no exceptions for self-insured plans that provide "major medical" benefits, which means that such plans are subject to the PCOR fee.

Q-4. Are governmental plans subject to the PCOR fee?

A-4. Yes – in general, a self-insured group health plan sponsored by a governmental entity is subject to the PCOR fee. An exception exists for "exempt governmental programs," such as Medicare or Medicaid. However, a governmental employer that is sponsoring a plan for the benefit of its employees is subject to the fee.

Q-5. Are retiree-only plans subject to the PCOR fee?

A-5. Yes. While retiree-only plans are not subject to some requirements of health care reform, a self-insured group health plan covering only retirees is subject to the PCOR fee.

Q-6. Are HRAs subject to the PCOR fee?

A-6. If an HRA is combined (or "integrated") with a *fully-insured* plan, the PCOR fee will apply to both plans separately. This is because, as noted in Q&A-2, there are actually two different PCOR fees – one for insurance companies and one for sponsors of self-insured plans.

Q-7. Is a stand-alone HRA subject to the PCOR fee?

A-7. Because of health care reform's prohibition on annual and lifetime limits, most stand-alone HRAs will not be allowed to continue. There are a handful of narrow exceptions to this rule, most notably stand-alone HRAs that are used only to pay for "excepted benefits" such as dental or vision coverage, and stand-alone retiree-only HRAs.

Retiree-only plans are not subject to health care reform's prohibition on annual and lifetime limits. Consequently, stand-alone, retiree-only HRAs are permitted, even if coverage is not limited to "excepted benefits." Because such plans are self-insured group health plans that are not limited to "excepted benefits," they are subject to the PCOR fee.

As noted in Q&A-3, stand-alone dental and vision plans, including stand-alone HRAs that cover those benefits, are not subject to the PCOR fee.

Q-8. To what plan years does the PCOR fee apply?

A-8. The PCOR fee is assessed on a plan year basis, and applies to plan years ending on or after October 1, 2012, and before October 1, 2019. Note that the application of the PCOR fee requirement depends on the date the plan year ends, rather than the date it begins.

> **Example #1 – Calendar Year Plan:** A calendar year plan with a plan year beginning January 1, 2012, and ending December 31, 2012, will be subject to the PCOR fee for the first time for the 2012 plan year because that is the first plan year that ended after October 1, 2012. The last PCOR fee that would be due for a calendar year plan would be for the 2018 plan year since the plan year ending December 31, 2018, would be the last plan year ending before October 1, 2019.

> **Example #2 – Fiscal Year Plan:** A fiscal year plan with a plan year beginning on October 1 and ending September 30 will be subject to the PCOR fee for the first time for the plan year that begins October 1, 2012 and ends September 30, 2013, since that is the first plan year that will end after October 1, 2012. The last PCOR fee for such a plan would be assessed for the plan year that will begin October 1, 2018 and end September 30, 2019.

Q-9. How is the PCOR fee paid?

A-9. The PCOR fee must be paid using the Quarterly Federal Excise Tax Return, also called Form 720.

Q-10. What is the deadline to pay the PCOR fee?

A-10. The deadline to file the Form 720 and pay the PCOR fee is July 31 of the calendar year following the last day of the plan year.

> **Example #1 – Calendar Year Plan:** For a plan year that ended on December 31, 2012, the PCOR fee for will be due on July 31, 2013.

> **Example #2 – Fiscal Year Plan:** For a plan year that ended on January 31, 2013, the PCOR fee would not be due until July 31, 2014 because that is the July 31 of the year following the last day of the plan year.

Q-11. Can a TPA file the Form 720 and pay the PCOR fee on behalf of a plan sponsor?

A-11. No, IRS regulations do not permit third-party reporting or payment of the PCOR fee. Plan sponsors are required to file and pay the fee directly.

Q-12. Can the PCOR fee be paid out of plan assets?

A-12. No. The PCOR fee is imposed on the plan sponsor – not the plan itself. As a result, the fee is generally not a permissible plan expense, and plan assets (including trust assets and participant contributions) may not be used to pay the fee.

A narrow exception exists for a certain type of plan that is maintained pursuant to a collective bargaining agreement (known as a "multiemployer plan"). Otherwise, though, the PCOR fee may not be paid out of plan assets.

Q-13. How is the PCOR fee calculated?

A-13. The formula to calculate the PCOR fee is:

- The "applicable dollar amount" multiplied by
- The "average number of covered lives."

Both of these terms are explained in more detail below.

Q-14. What is the "applicable dollar amount"?

A-14. For plan years ending between October 1, 2012 and September 30, 2013 (i.e., the first plan year for which the PCOR fee is due), the "applicable dollar amount" will be $1.00 per covered life. For plan years ending between October 1, 2013 and September 30, 2014, the "applicable dollar amount" goes up to $2.00 per covered life. For future years, this amount is subject to adjustment for cost-of-living increases.

Q-15. How is the "average number of covered lives" determined?

A-15. A plan sponsor may choose between one of four methods to determine the average number of covered lives for a given plan year:

(1) Actual count method;
(2) Snapshot count method;
(3) Snapshot factor method; and
(4) Form 5500 method.

Each of these four methods is explained in more detail below. A little advance warning: They are somewhat complicated.

Q-16. What is the "actual count" method?

A-16. With the actual count method, a plan sponsor must add together the total number of individuals covered by the plan on <u>each</u> day of the plan year, and then divide that total by the number of days in the plan year. While this method is precise, it can also be administratively burdensome.

> **Example:** The plan sponsor of a calendar year plan adds together the total number of individuals covered by the plan for each day of the plan year ending on December 31, 2013. The resulting number is 3,285,000. The average number of covered lives is 3,285,000 divided by 365 days – in other words, 9,000 covered lives. The employer would then multiply 9,000 covered lives by $2.00 (the applicable dollar amount for the year). The resulting number – $18,000 – is the PCOR fee.

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Q-17. What is the "snapshot count" method?

A-17. With the snapshot count method, at regular intervals (**"snapshot days"**) during a plan year (at least once per quarter), a plan sponsor adds together the total number of individuals covered by the plan on the snapshot days, and then divides that total by the number of snapshot days. The resulting number is an estimated average of the number of covered lives for the plan year.

> **Example:** On January 4, 2013 a calendar year plan covers 2,000 lives; on April 5, 2013, it covers 2,100 lives; on July 5, 2013, it covers 2,075 lives; and on October 4, 2013, it covers 2,025 lives. Under the snapshot count method, the plan sponsor adds together the numbers from these four dates (2,000 + 2,100 + 2,075 + 2,025), resulting in a total of 8,200. This number is then divided by four. This produces an average of 2,050 covered lives, which is then multiplied by the applicable dollar amount ($2.00) and results in a PCOR fee of $4,100.

Q-18. What is the "snapshot factor" method?

A-18. Like the snapshot count method, the snapshot factor method calculates the average number of covered lives by looking at specific snapshot days. However, rather than actually counting the number of covered individuals, under the snapshot factor method, the plan sponsor adds together the following:

- Number of participants with self-only coverage, plus
- 2.35 times the number of participants with other coverage (e.g., family coverage)

Example: A self-insured group health plan uses a calendar plan year and has the following number of participants on the following dates:

	Self-Only Coverage	Other Coverage
January 4, 2013	600	1,000
April 5, 2013	550	1,000
July 5, 2013	550	900
October 4, 2013	500	900

Under the snapshot factor method, the plan sponsor adds together the numbers from these four dates (600 + 550 + 550 + 500 and 1,000 + 1,000 + 900 + 900), resulting in a total of 2,200 participants for self-only coverage and 3,800 participants for other coverage. Each number is then divided by four. This produces an average of 550 participants with self-only coverage and 950 participants with other coverage. The number for other coverage (i.e, 950) is multiplied by 2.35, which equals 2,233. This amount is added to the 550 participants with self-only coverage. This equals 2,783, which is then multiplied by the applicable dollar amount ($2.00, in this case) and results in a PCOR fee of $5,566.

Q-19. What is the "Form 5500" method?

A-19. Plan administrators of self-insured plans that are subject to ERISA are required to file an annual report, known as a Form 5500, with the Department of Labor (**"DOL"**). Among other things, the Form 5500 reports the number of participants in a plan on the first and last days of the plan year.

For plans offering self-only coverage, but no other types of coverage, covered lives under the Form 5500 method equals the sum of the total participants at the beginning and end of the plan year, divided by two.

> **Example – Employee-Only Plan:** For example, if a self-only plan filed a Form 5500 for the plan year that showed 3,000 participants on the first day of the plan year and 4,000 participants by the last day of the plan year, the average number of covered lives would be 3,000 plus 4,000, divided by two – that is, 3,500 covered lives. For the first plan year to which the PCOR fee applies, this number would be multiplied by $1.00, resulting in a fee of $3,500.

Plans offering other coverage in addition to self-only may use the same formula, without dividing by two – in other words, these plans may add together the number of participants at the beginning and end of the plan year.

> **Example – Plan Providing Dependent Coverage:** For example, if a plan offered self-only and other coverage (e.g., coverage for spouses and/or dependents), then, using the participant numbers in the previous paragraph, the average number of covered lives would be 3,000 plus 4,000, or 7,000. For the first plan year to which the PCOR fee applies, this number would be multiplied by $1.00, resulting in a fee of $7,000.

Q-20. Are HRAs that are subject to the PCOR fee also required to use one of the four permitted methods to calculate "covered lives"?

A-20. It depends. If the only self-insured plan maintained by a plan sponsor is an HRA, then the plan sponsor is permitted use of a special counting rule that treats each participant's HRA as a single "covered life," disregarding any spouses or dependents that might be covered under the HRA.

On the other hand, if a plan sponsor maintains an HRA and another self-insured group health plan, this special counting rule would only apply to participants in the HRA who do not also participate in the other self-insured plan.

Q-21. Does the IRS grant extensions for filing the Form 720 and paying the PCOR fee?

A-21. No. This can pose a problem for plans using the Form 5500 method. While both the Form 5500 and the Form 720 have the same due date – July 31 – the Department of Labor will grant an automatic extensions to October 15 for the filing of the Form 5500, as long as the extension is requested by July 31. No such extension is available for the Form 720.

Q-22. Can a plan change its calculation method?

A-22. Within a single plan year, a plan sponsor is not permitted to change the method it uses to calculate covered lives. However, the method may be changed from one year to the next.

Q-23. Are there any special rules for the first PCOR fee, which is due July 31, 2013?

A-23. Yes. The IRS has adopted a special transition rule for self-insured plans with plan years beginning before July 11, 2012 and ending on or after October 1, 2012. This transition rule allows plan sponsors to use "any reasonable method" to determine the number of covered lives for purposes of the PCOR fee. For future plan years, however, the plan sponsor must use one of the authorized calculation methods. The IRS has not indicated what might constitute a "reasonable method."

Q-24. What is the penalty for not complying with the PCOR rules?

A-24. As with many of the other health care reform rules, failure to comply with the PCOR fee requirement can trigger a penalty of $100 per day. However, the IRS has stated that it will waive the penalties for late filing and payment if: (1) the plan sponsor has reasonable cause; and (2) the failure was not due to willful neglect.

If you have any questions regarding the new PCOR fee requirement, or have questions regarding the impact of health care reform on employers, please feel free to call Eric Namee, Steven Smith, or Brad Schlozman at (316) 267-2000.

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