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The Forgotten Penalty: Health Care Reform Excise Taxes Could Devastate Employers

As many of you are likely well aware, this summer, the federal government postponed, until 2015, the enforcement of federal health care reform's so-called "pay or play" mandate, which requires employers with 50 or more full-time employees to offer affordable health insurance to all full-time employees and their dependents. Failure to comply with this mandate can trigger significant penalties – up to $3,000 per employee, per year.

But a potentially much more significant penalty has gone virtually unnoticed: *an excise tax of $100 per affected individual, per day* that will be imposed on any employer – regardless of the size of its workforce – that offers a group health plan that fails to comply with a laundry list of coverage requirements and restrictions (e.g., maximum waiting period, maximum out-of-pocket expense limits for covered participants, mandatory and free provision of contraceptive devices, etc.). If the deficiency in the employer's plan persists for an entire year, the price tag would be *$36,500 per affected individual*.

For most employers, this excise tax is a huge (and most unwelcome) surprise. But what many don't realize is that this excise tax *already applies*. That means that employers not in compliance are racking up excise taxes every day – right now.

This Alert, therefore, is intended to provide a brief overview of the new excise tax – what it is, how it's triggered, and what employers should do to avoid it. While the government does not appear to have undertaken much enforcement yet, it is likely just a matter of time before federal regulators begin assessing penalties against employers sponsoring non-compliant group health plans.

What exactly is the excise tax?

The excise tax is a tax imposed under Section 4980D of the Internal Revenue Code. It applies to any failure by an employer-sponsored group health plan to comply with an array of specific coverage mandates and prohibitions, which are discussed below and summarized in detail in the accompanying chart. The amount of the tax is $100 per day, per "individual to whom the failure relates." This can add up very quickly.

> **Example:** In a much-publicized recent case, Hobby Lobby agreed to provide its employees with 16 of the 20 forms of contraceptives required by the government, but objected to four forms of contraceptives for religious reasons. This is enough to trigger the excise tax of $100 per day. Multiplied by the 13,000 individuals insured under the Hobby Lobby plan, the excise tax would amount to $1.3 million per day, or nearly $475 million per year. To put this into perspective, if Hobby Lobby were simply to drop its health insurance coverage altogether, it would be subject to "only" a $26 million annual penalty under the "pay or play" rules beginning in 2015.

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What is an "individual to whom the failure relates"?

Until the IRS issues guidance, we will not know exactly how the government intends to define the term "individual to whom the failure relates." We also don't know when such guidance will be released. What we do know is that, in the Hobby Lobby case discussed above, the U.S. Court of Appeals for the Tenth Circuit calculated Hobby Lobby's estimated excise tax based on the number of "individuals insured under the Hobby Lobby plan." This would presumably include not only employees who elect coverage, but also their spouses and dependents covered under the plan.

Wait – didn't the government postpone the employer requirements this summer?

Not all of them. In July, the IRS postponed enforcement of the so-called "pay or play" mandate. This is the mandate that requires "applicable large employers" (that is, employers with 50 or more "full-time" employees) to offer affordable health insurance coverage to all of their full-time employees (i.e., employees averaging at least 30 hours/week). Employers failing to comply with this mandate could be subject to significant penalties. These penalties were set to take effect on January 1, 2014, but the IRS has decided to delay enforcement until 2015. As noted earlier, though, the "pay or play" penalty has nothing to do with the excise tax, which is already in effect.

Who is subject to the excise tax?

The excise tax applies to ***any*** employer – ***regardless of its size*** – that sponsors a group health plan that fails to satisfy one or more of the coverage requirements/restrictions set forth in the accompanying chart.

Are any group health plans exempt from the excise tax?

Yes. Group health plans that are sponsored by *federal* governmental employers are completely exempt from this tax. However, all other employer-sponsored group health plans (including church plans) are subject to the excise tax in one form or another. Non-governmental plans are subject to the excise tax under the Internal Revenue Code (the **"Code"**). State and local governmental plans, although technically exempt from the Code's excise tax, are subject to a virtually identical $100 per day per affected individual penalty under the Public Health Service Act (the **"PHSA"**). This PHSA penalty is enforced by the Department of Health and Human Services (**"HHS"**).

What failures trigger the excise tax?

Health care reform created a huge number of new mandates and restrictions on health plans. Many of these mandates and restrictions are enforced by the excise tax. The accompanying chart summarizes the key coverage requirements and prohibitions that group health plans must satisfy to avoid the excise tax. A partial list of mandates enforced by the excise tax includes the following:

- No preexisting condition exclusions or other discrimination based on health status;
- Cost sharing (or "out of pocket") limits;
- Maximum waiting period of 90 calendar days;

- No annual or lifetime limits on essential health benefits;
- Must cover 100% of the cost (i.e., no deductibles or co-payments are permitted) of any "preventive services" (including any FDA-approved contraceptive device) if the plan is not "grandfathered";
- Must offer dependent coverage to all children up to age 26;
- Must provide a Summary of Benefits and Coverage; and
- Must have adequate claims appeal and external review processes.

The excise tax is triggered if a plan fails to satisfy any one mandate, even partially. So be very, very careful in establishing and administering your health care plan.

How is the excise tax paid?

Employers are required to self-report and pay their excise tax liability using an IRS Form 8928.

What if the failure triggering the excise tax is accidental?

If a plan fails one or more of the excise tax mandates because of "reasonable cause" and not "willful neglect," the plan sponsor may be able to avoid some or all of the excise tax under the following circumstances:

- If the failure was due to "reasonable cause" and not "willful neglect," *and* if the failure was corrected within 30 days, then no excise tax is due.
- If the failure was due to "reasonable cause" and not "willful neglect," but the failure was not corrected within 30 days, then the excise tax is capped at the lesser of (i) $500,000 or (ii) 10% of the amount paid or incurred by the employer for its group health plans.

What is "reasonable cause" and "willful neglect"?

The IRS has not yet defined these terms in the context of the Affordable Care Act excise tax. Based on how the IRS and courts have defined the terms in other tax settings, however, it is safe to say that, if an employer *knew or should have known* of a failure, the IRS will most likely find that the failure was due to "willful neglect" rather than "reasonable cause."

Do "mini-med" plans trigger the excise tax?

Yes – unless the specific mini-med plan being offered has been granted an official waiver by HHS. And if you do have an HHS waiver, be aware that it will expire at the end of the plan year that began in 2013 (so, for a calendar year plan, an HHS waiver will expire on December 31, 2013).

So-called "mini-med" plans come in all shapes and sizes, and go by various names – skinny, limited benefit, fixed indemnity, mandate lite, etc. But from what we have seen to date, in nearly all forms, these plans run afoul of the mandates enforced by the excise tax. The requirement most fatal to these plans is health care reform's prohibition on annual and lifetime limits. By their nature, mini-med plans do impose such limits, and thus will trigger the excise tax.

Some states, including Kansas, have authorized insurers to offer so-called "mandate lite" policies that do not cover all of the benefits required by the Affordable Care Act. We strongly urge employers to exercise extreme caution with respect to these policies, because they are likely to result in excise tax liability.

Can an employer avoid the excise tax by offering one plan that complies with all mandates and another bare-bones plan that doesn't?

No. The mandates that trigger the excise tax are imposed on each plan individually, so every group health plan offered by an employer must satisfy the mandates on its own. This excise tax is different than the Affordable Care Act's employer "pay or play" mandate. Under the latter, an employer can offer multiple plans, some of which may not be "affordable" or provide "minimum value." An employer with at least 50 full-time employees can escape any penalties, however, so long as it makes available to such full-time employees at least one plan that is "affordable" and provides "minimum value." By contrast, ***any*** plan of ***any*** employer that does not satisfy all the mandates described above and in the accompanying chart will subject the employer to the $100 per day per affected individual excise tax.

Is it possible for both the excise tax *and* the "pay or play" penalties to be imposed at the same time?

Yes. Theoretically, if an employer with at least 50 full-time employees offers coverage that fails one or more of the excise tax mandates, *and* that coverage is either (i) not offered to substantially all full-time employees or (ii) not "affordable" or fails to provide "minimum value," then both the excise tax and one of the "pay or play" penalties could be imposed. The bottom line is that the excise tax is entirely independent of the better known "pay or play" rules.

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

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Mandates Triggering the Section 4980D Excise Tax

Mandate	Description	Effective	Individual	Small Group	Large Group	Self-Insured	Grandfathered
Premiums	Premium rate limits, rating area, age bands	PYB 1/1/14	YES	YES	Generally No*	NO	NO
Guaranteed availability	Issuer must accept every employer and individual who applies for coverage	PYB 1/1/14	YES	YES	YES	NO	NO
Guaranteed renewability	Issuer must renew/continue coverage at option of plan sponsor / individual	PYB 1/1/14	YES	YES	YES	NO	NO
Preexisting conditions	No preexisting exclusions or other discrimination based on health status	PYB 1/1/14	YES	YES	YES	YES	YES
Eligibility	No eligibility rules based on health status-related factors	PYB 1/1/14	YES	YES	YES	YES	NO
Providers	No discrimination against health care providers	PYB 1/1/14	YES	YES	YES	YES	NO
Essential health benefits	Issuer must cover essential health benefits	PYB 1/1/14	YES	YES	NO	NO	NO
Cost-sharing	Limits on annual cost-sharing	PYB 1/1/14	NO	YES	YES	YES	NO
Deductibles	Limits on annual deductibles	PYB 1/1/14	NO	YES	NO	NO	NO
Waiting periods	No waiting periods longer than 90 days	PYB 1/1/14	NO	YES	YES	YES	YES
Clinical trials	No denial of participation in clinical trials	PYB 1/1/14	YES	YES	YES	YES	NO
Disclosure of information	Issuer must disclose premium and benefit information to employers and individuals	PYB 1/1/14	YES	YES	YES	NO	NO
Annual limits	No annual limits on dollar amount for essential health benefits	PYB 1/1/14	YES	YES	YES	YES	YES
Lifetime Limits	No lifetime limits on dollar amount for essential health benefits	PYB 9/23/10	YES	YES	YES	YES	YES
Rescissions	No rescission of coverage	PYB 9/23/10	YES	YES	YES	YES	YES
Preventive services	Preventive services mandate – must cover 100%	PYB 9/23/10	YES	YES	YES	YES	NO
Dependent coverage	Dependent coverage up to age 26	PYB 9/23/10; GF 1/1/14	YES	YES	YES	YES	YES
SBC	Summary of Benefits and Coverage	PYB 9/23/12	YES	YES	YES	YES	YES
Reporting	Report claims, enrollment, etc. to HHS, state insurance commissioner, public, and (if applicable) Exchange	PYB 9/23/10	YES	YES	YES	YES	NO
Nondiscrimination	Nondiscrimination rules	pending guidance	NO	YES	YES	NO	YES
Quality of care reporting	"Quality of care" reporting requirement	pending guidance	YES	YES	YES	YES	YES
MLR rebates	Medical Loss Ratio rebates	2011 calendar year	YES	YES	YES	NO	YES
Claims appeals	Claims appeal and external review	PYB 9/23/10	YES	YES	YES	YES	YES
Doctor choice, emergency, pediatrics, OB-GYN	Choice of health professional, emergency services, pediatric care, OB-GYN	PYB 9/23/10	YES	YES	YES	YES	YES
Newborns' & Mothers' Health Protection Act	Benefits for mothers and newborns		YES	YES	YES	YES	YES
Mental Health Parity & Addiction Equity Act	Restricts annual and lifetime limits for mental health/substance use benefits		YES	YES	YES	YES	YES
Women's Health & Cancer Rights Act	Mandates reconstructive surgery following mastectomy		YES	YES	YES	YES	YES
Michelle's Law	Dependent student absent from school on medically necessary leave of absence must still be treated as a student if eligibility dependent on status as student		YES	YES	YES	YES	YES

* In general, issuers offering coverage in the large group market are not subject to the premium rules under Section 2701 of the PHSA. However, if a state permits issuers in the large group market to offer large group coverage through the state exchange, then all issuers in the large group market are subject to the Section 2701 premium rules -- even if they do not actually offer such coverage through the exchange.