Northwestern Mutual

ADVANCED PLANNING ideas

Health Care Reform and Long-Term Care Insurance

Summary

Good news – the nondiscrimination rules and Cadillac health plan tax created by the 2010 Health Care Reform laws do not apply to employer-provided long-term care coverage provided through separate policies owned by employees.

Related Information

Using Individual Long-Term Care Insurance Policies as Part of an Employer-Sponsored Plan; Federal Income Taxation of Qualified Long-Term Care Insurance; Limited Pay LTC – An Employee Benefit that Hits the Sweet Spot; Getting the Long-Term Care Insurance Deduction for Owner/Employees of S Corporations (and Other Self-Employed Taxpayers)

Background

Long-term care insurance as an employee benefit has generated significant interest as a result of the aging Baby Boomer generation. Federal tax rules encourage the use of long-term care insurance in employee benefit plans by providing favorable income tax treatment for both the value of the protection provided and the benefits payable in the event of a claim.

The 2010 Health Care Reform legislation made the tax rules for health insurance more complicated by adding nondiscrimination rules that apply to employer-provided health benefit plans and a penalty tax for "Cadillac" plans that provide benefits that exceed a specified level.

Thankfully, employee-owned long-term care insurance as part of an employer-provided health plan is excepted from the application of both of these rules! Read on for details.

Nondiscrimination Rules

1. The rules generally. The Health Insurance Portability and Accountability Act of 1996 imposes a penalty on a failure of a group health plan to meet certain benefit requirements.[1] The penalty is $100 per day per individual to whom such failure relates.

   The Patient Protection and Affordable Care Act,[2] part of what is generally referred to as the "2010 Health Care Act," added nondiscrimination rules to the Public Health Service Act.[3]

[1] § 4980D.

 See Circular 230 disclosure at the end of this article.

These rules[4] mandate that all group health plans comply with § 105(h) of the Internal Revenue Code, which imposes nondiscrimination rules on self-insured medical reimbursement plans. A group health plan satisfies the provisions of § 105(h) if it does not discriminate in favor of highly-compensated employees with respect to eligibility or benefits.[5] The 2010 Health Care Act incorporates these nondiscrimination rules, subjecting a discriminatory group health plan to a penalty tax under § 4980D.

The term "group health plan" with respect to the penalty tax means "a plan (including a self-insured plan) of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families."[6]

2. Do the nondiscrimination rules apply to LTC coverage? When an employer provides a long-term care insurance benefit to employees by paying for separate policies the employees own personally, does the nondiscrimination penalty tax apply?

   It seems the answer is "no." Certain benefits are exempted from the penalty tax if they are provided under a separate policy, certificate, or contract of insurance or are otherwise not an integral part of the plan.[7] The excepted benefits are limited scope dental or vision benefits and, most importantly, *benefits for long-term care*, nursing home care, home health care, community-based care, or any combination of these.[8]

   Consequently, an employer-provided long-term care benefit provided through a policy separate from the group health plan is *not* subject to the § 4980D nondiscrimination penalty tax and can continue to discriminate in favor of highly compensated employees (and this is true for self-employed plans as well).[9]

The "Cadillac Tax"

1. The rules generally. The 2010 Health Care Act also imposes a penalty tax on high cost employer-sponsored health coverage.[10] This so-called "Cadillac tax" becomes effective in

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[2] P.L. 111-148 (enacted March 23, 2010).
[3] The other part of the "2010 Health Care Act" is the Health Care and Education Reconciliation Act, P.L. 111-152.
[4] Title XXVII, Part A, § 2716 of the Public Health Service Act.
[5] Highly-compensated employees include any one of the five highest paid officers, any shareholder who owns, with the application of attribution rules, more than 10% of the stock of the employer, or any employee among the highest paid 25%.
[6] § 9832(a).
[7] §§ 9831(c)(1).
[8] § 9832(c)(2).
[9] There's another reason to not worry about the nondiscrimination rules. They don't apply yet. Although these rules were originally designed to apply to any plans that began on or after September 23, 2010, the federal government has decided to postpone their application until regulations are issued (and they'll apply only to plan years that begin after such issuance). Notice 2011-1, 2011-2 I.R.B. 259.
[10] § 4980I.

2018, and will be imposed on any benefit in excess of a specified cost and is equal to 40% of the excess benefit.[11]

The "coverage provider" is liable for the tax. In the case of a group health plan, the "coverage provider" is the health insurance issuer. In the case of a plan where the employer makes contributions to HSA or MSA arrangements, the "coverage provider" is the employer. For other types of employer-provided coverage, the liability rests with the person that administers the plan benefits.

The "Cadillac tax" can apply to any "applicable employer-sponsored coverage" that provides an excess benefit, including coverage under any group health plan that is excludible from the employee's gross income under § 106.[12] The § 106 exclusion is available for any employer coverage under an accident or health plan, plans that provide reimbursement for deductible medical expenses, and contributions to HSA and MSA arrangements. Also included are eligible long-term premiums for qualified long-term care contracts.

The rules for self-employed individuals such as partners in a partnership, members in an LLC and more than 2% shareholders of S corporations, are somewhat different. Such individuals are not eligible for the § 106 exclusion for employer-provided coverage under accident and health plans noted above for employees. However, § 162(l) does provides a deduction to self-employed individuals for medical care insurance for the taxpayer, spouse, and dependents, including eligible long-term care insurance premiums. If a deduction is allowable under § 162(l) to a self-employed individual, then that coverage should be treated as applicable employer-sponsored coverage, at least at first blush.

2. Does the Cadillac tax apply to LTC coverage? Given the above, it looks like the Cadillac tax could apply to situations where an employer provides a long-term care insurance benefit to employees by paying for LTC policies they own personally.

   Fortunately, however, the Cadillac tax applies only to "applicable employer-sponsored coverage," and the definition of this concept clearly *excludes long-term care coverage* for employer-employee plans.[13] It also likely excludes long-term coverage for self-employed individuals too, but the wording of the relevant statute – § 4980I "Excise tax on high cost employer-sponsored health coverage" – is less clear on this point, offering alternative paths that seem to reach the same conclusion.

   To help explain, here are portions of § 4980I(d) with our added emphasis:

   (d) Applicable employer-sponsored coverage; cost.
   For purposes of this section—
   (1) Applicable employer-sponsored coverage.

[11] This tax would apply to individual coverage with an annual cost of $10,200 as adjusted for increases in health care costs and $27,500 for coverage other than individual coverage as adjusted for increases in health care costs.
[12] § 4980I(d).
[13] § 4980I(a) and (d)(1)(B).

> (A) *In general*. The term "applicable employer-sponsored coverage" means, with respect to any employee, coverage under any group health plan made available to the employee by an employer which is excludable from the employee's gross income under section 106, or would be so excludable if it were employer-provided coverage (within the meaning of such section 106).
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> (B) *Exceptions*. The term "applicable employer-sponsored coverage" shall *not* include —
>
> (i) any coverage (whether through insurance or otherwise) described in section 9832(c)(1) (other than subparagraph (G) thereof) or for long-term care, or
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> . . .
>
> (D) *Self-employed individual*. In the case of an individual who is an employee within the meaning of section 401(c)(1), coverage under any group health plan providing health insurance coverage shall be treated as applicable employer-sponsored coverage if a deduction is allowable under section 162(l) with respect to all or any portion of the cost of the coverage.

As stated, the first portions of subsection (d) – paragraphs (d)(1)(A) and (d)(1)(B) – clearly exclude long-term coverage from the definition of "applicable employer-sponsored coverage" for employer-employee situations. The only question is how to interpret (d)(1)(D), which applies to *self-employed* plans specifically.

a. *Argument that self-employed LTC plans are also excepted out by (d)(1)(B).* The most reasonable interpretation is that the (d)(1)(D) is meant merely to describe what self-employed plans could be deemed to provide "applicable employer-sponsored coverage" generally and thus be under the realm of subsection (d)(1) to begin with. But once a self-employed plan is governed by the general definition of (d)(1) – as pure employer-employee plans are also, due to (d)(1)(A) – it is subject to the several refinements of that definition as much as any other plan, including the exception for long-term care coverage listed in subparagraph (d)(1)(B).

b. *Argument that self-employed LTC plans are not also excepted out by (d)(1)(B).* Another interpretation is that (d)(1)(D) is meant not only to apply to self-employed plans specifically, but is also intended to *trump* the general definition and exceptions of "applicable employer-sponsored coverage" found in (d)(1)(A) and (d)(1)(B).

   Even if this (somewhat strained) approach is correct, however, it seems that the Cadillac tax would not apply to employer-provided LTC coverage anyway. The conclusion is simply reached in a more roundabout way. Follow the bouncing ball if you can:

   - Subparagraph (d)(1)(D) of § 4980I encompasses a "group health plan" providing "health insurance coverage," which takes us to the definition of those terms in §§ 4980I(f)(4) and (5).

- The § 4980I(f)(4) definition of "group health plan" in turn refers to the definition of that term as it appears in § 5000(b)(1), and there it includes self-employed plans to "provide health care," which could include long-term care coverage.
- The § 4980I(f)(5) definition of "health insurance coverage" in turn refers to the definition of that term as it appears in § 9832(b)(1), which could include long-term care coverage.
- Importantly, § 4980I(f)(5) also states that, when looking to the definition of "health insurance coverage" under § 9832(b)(1), we are to ignore § 9832(b)(1)(B), which refers to certain benefits listed in § 9832(c)(1) that are excepted from the definition of "health insurance coverage."
- Apparently, then, we can't take advantage of the excepted benefits listed in § 9832(c)(1).
- Nonetheless, nothing tells us to ignore § 9832(c)(2).
- And § 9832(c)(2) plays the same role here as it does with the nondiscrimination rules described earlier – it operates in tandem with § 9831(c)(1) to identify as "excepted benefits" those that provide, through a separate policy, coverage for "*long-term care*, nursing home care, home health care, community-based care, or any combination thereof."[14]

So it appears that, no matter how you cut it, employer-sponsored long-term care plans for self-employed taxpayers should also be exempt from the Cadillac tax. This makes sense, as there is little reason to treat them differently than pure employer-employee plans. In any event, the tax does not come into play until 2018, so there is plenty of time for the I.R.S. to issue clarifying guidance.

Observations

The regulation of employer-sponsored health benefit plans is beginning to look more and more like the regulation of tax-qualified pension and profit sharing plans. In addition to the specific penalty taxes discussed above, Congress has enacted a litany of requirements that employers and health care providers must understand and implement. An unintended consequence that the present administration hasn't advertised is the effect these provisions might have on stimulating the economy by increasing revenue to attorneys and accountants.

[14] § 9832(c)(2)(B) (emphasis added).

Advanced Planning Ideas

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