



A Busy End to 2010: Healthcare Reform Guidance and Extension of Tax Relief for Employee Benefits

The end of 2010 was a busy time for health and other welfare benefit legislation and guidance. During the last two weeks of 2010, Congress extended tax benefits for a number of welfare benefit programs and the IRS issued guidance postponing the nondiscrimination requirements for fully insured group health plans and clarified the requirements for health debit card use for prescribed over-the-counter drugs and medicines. This article provides a summary of these year end changes and the IRS guidance.

COMPLIANCE EXCLUSIVE

A Newsletter from SHPS HR Solutions

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Extension of Tax Benefits under the Tax Relief Act

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("Tax Relief Act"). The Tax Relief Act generally extends for two years the Bush-era tax cuts until December 31, 2012. The Tax Relief Act also extends a number of employee benefit provisions that were set to expire at the end of 2010 or 2011.

Educational Assistance Programs

The Tax Relief Act extends the income and employment tax exclusion for qualified employer-provided educational assistance for two years, through December 31, 2012. This is the provision that provides for an exclusion of up to \$5,250 annually for tuition and related qualified expenses for both undergraduate and graduate level courses. Unlike the more restrictive work-related exclusion, the courses need not bear any relationship to current job activities. The alternative work-related exclusion requires a facts and circumstances review which requires a detailed and often complicated analysis.

Temporary Extension for Parity for Mass Transit and Vanpool Benefits

Prior to the American Recovery and Reinvestment Act (ARRA), both employer provided parking and mass transit (and vanpooling) benefits were excludable from an employee's income and employment taxes; however, the maximum monthly exclusion for parking benefits (\$230 for 2009) was greater than the maximum exclusion for transit and van pooling (\$120 for 2009). ARRA provided temporary parity by increasing the exclusion for mass transit and van pooling to the level of parking (\$230 for 2010). The Tax Relief Act extends this parity for one year, through December 31, 2011.

Adoption Assistance

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) enhanced the exclusion for employer provided adoption assistance by increasing the amount of the exclusion, extending the exclusion to non-special needs children, and increasing the income phase-out limit for the exclusion. Under the EGTRRA provisions (which were extended through 2011 by the Patient Protection and Affordable Care Act), up to \$13,360 (for 2011) per child of employer provided adoption assistance is excludible from gross income and employment taxes. The exclusion applies to both special needs and non-special needs children. The exclusion is phased out for taxpayers with incomes

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between \$185,210 and \$225,210 (for 2011). These provisions were scheduled to expire at the end of 2011 and were extended for one year, through 2012, by the Tax Relief Act. The dollar amounts of the exclusion and income phase-outs are indexed for inflation.

Employer Credit for Providing Child Care

An employer may claim a tax credit of up to \$150,000 per year for qualified expenses of constructing or operating a child care facility for employees or under a contract with a third party to provide child care to employees. This credit was set to expire at the end of 2010 and was extended for two years, through 2012, by the Tax Relief Act.

IRS Postpones Compliance with Nondiscrimination Rules for Fully Insured Group Health Plans Until Issuance of Further Guidance

Section 2716 of the Public Health Service Act (PHSA) as added by PPACA (and incorporated by reference into the Code and ERISA), extends nondiscrimination rules to non-grandfathered fully insured plans. Section 2716 is effective for plan years beginning on or after September 23, 2010. Section 2716 provides that rules “similar to” the nondiscrimination rules in Code Sections 105(h)(3) (nondiscrimination with respect to eligibility), 105(h)(4) (nondiscrimination with respect to benefits) and 105(h)(8) (application of certain controlled group rules) shall apply to insured plans. The sanction for failure to comply with section 2716 is imposition of an excise tax equal to \$100 per day per individual who is discriminated against (i.e., the employees who are not included in the discriminatory plan).

Prior to the enactment of Section 2716, the nondiscrimination rules under 105(h) were only applicable to self-insured group health plans. The sanction for failure to comply with section 105(h) is loss of the exclusion for the benefits for highly compensated employees. Two common strategies used by employers to avoid application of section 105(h) was to provide benefits on a fully insured basis and/or require that executives pay for benefits on an after-tax basis (i.e., with taxable compensation). It is unclear whether either of these strategies is available under Section 2716

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Notice 2011-1 delays the application of Section 2716 until the Departments of Treasury, Labor and Health and Human Services issue further guidance.

On December 23, 2010, the IRS issued Notice 2011-1 delaying the application of Section 2716 until the Departments of Treasury, Labor, and Health and Human Services (the “Departments”) issue further guidance. In Notice 2011-1, the Departments acknowledged that guidance must specify in what respects insured plans are subject to the same statutory provisions that apply to self-insured plans under Code Sections 105(h)(3), (4) and (8) and in what respects insured plans are subject to rules reflecting a different application of those statutory provisions.

The Notice was issued in response to numerous comments that there is insufficient guidance under section 105(h) to determine how those rules should apply under Section 2716. Consequently, many employers could not determine whether their plans were considered discriminatory under the new rules. Because regulatory guidance is essential to the operation of the statutory provisions, the Departments determined that compliance with Section 2716 should not be required until after regulations or other administrative guidance has been issued. Notice 2011-1 also indicates that compliance will not be required until a specified period after guidance has been issued to allow employers time to implement changes required to comply with the new nondiscrimination rules. Penalties for noncompliance with the nondiscrimination rules for insured plans will also be delayed until the additional guidance has been issued.

Notice 2011-1 acknowledges that the nondiscrimination rules for insured plans must include additional guidance with respect to a number of issues, including the following:

- Whether employer contributions toward the cost of coverage or eligibility waiting periods are included in the definition of “benefits;”
- Whether a highly compensated employee is defined in accordance with Code section 414(q);
- Whether the nondiscrimination standards can be applied separately to distinct geographic locations;
- Whether employers will be permitted to aggregate different but substantially similar coverage options;
- How the rules apply to employees who voluntarily waive coverage; and
- Whether paying for the coverage of highly compensated individuals on an after-tax basis affects the nondiscrimination requirements.

Notice 2011-1 invites public comment on Section 2716; the comment deadline is March 11, 2011.



The IRS issued Notice 2011-5 that confirms that health FSA and HRA debit cards may continue to be used to purchase prescribed OTC medicines and drugs at participating IAS merchants provided that the described requirements are met.

Clarification with Respect to the Use of Health Debit Cards for Prescribed Over-the-Counter Drugs and Medicines

PPACA provides that, effective January 1, 2011, over-the-counter (OTC) medicines and drugs may not be reimbursed under a health FSA or HRA unless the medicine or drug is prescribed. Initial guidance under this new OTC rule was issued by the IRS in Notice 2010-59. Notice 2010-59 caused concern by providing that, except with respect to “90-percent merchants,” after January 16, 2011, debit cards could not be used to purchase OTC medicines and drugs under an FSA or HRA, even if the OTC was prescribed. Thus, under this Notice, manual substantiation of such claims seemed to be required.

On December 23, 2010 the IRS issued Notice 2011-5 that confirms that health FSA and HRA debit cards may continue to be used to purchase prescribed OTC medicines and drugs at participating IAS merchants provided that the following requirements are met:

1. Prior to purchase, a prescription is presented to the pharmacist, the OTC drug is dispensed by the pharmacist in accordance with applicable legal requirements, and an Rx number is assigned;
2. The pharmacy or other vendor retains a record of the Rx number, the name of the purchaser or patient, and the date and amount of the purchase in a manner that meets IRS recordkeeping requirements for card programs;
3. The records are available to the employer or its agent upon request;
4. The card system will not accept a charge for an OTC drug unless an Rx number has been assigned; and
5. The existing IRS requirements regarding card programs are satisfied.

The debit card transaction will be considered fully substantiated at the time and point-of-sale if these requirements are satisfied.



About the Author



John Hickman is head of Alston & Bird's Health Benefits Practice where he leads five attorneys devoted exclusively to HIPAA privacy, flexible benefits, and other health and welfare benefit issues. He has been a pioneer in the consumer-directed healthcare arena and has worked closely with health plans, financial institutions and employers as well as the Internal Revenue Service, Treasury, and

Department of Labor in developing guidance for tax-favored health reimbursement arrangements and health savings accounts. John has lectured widely and published articles on HIPAA, ERISA litigation and cafeteria and health plan issues. He is co-author of the *Cafeteria Plans Manual*, *HIPAA Portability and Privacy*, and *Consumer-Driven Health Care* (published by the Employee Benefits Institute of America). John is also an adjunct professor of law at Emory University School of Law.

About SHPS

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