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SUPREME COURT UPHOLDS AFFORDABLE CARE ACT: IMPLICATIONS FOR EMPLOYERS

The Supreme Court has issued its long-awaited decision addressing the constitutional challenges to the landmark health reform legislation. In a 5–4 majority opinion, the Supreme Court held that the key provisions of the Patient Protection and Affordable Care Act ("ACA") are constitutional—including the controversial "individual mandate," which requires most Americans to buy health insurance or pay a penalty. Accordingly, the ACA remains intact and employers must continue to implement the law.

Many observers believe that the Supreme Court's decision is just the first act in a drama that will play out in the November elections and beyond, as the law's opponents seek to repeal the ACA and it supporters rally to its defense.

THE SUPREME COURT'S OPINION

The Supreme Court considered whether two provisions of the ACA exceeded Congress's authority under the Constitution: the individual mandate, which imposes a penalty on individuals who fail to buy health insurance, and the expansion of the Medicaid program, which denies federal funds to states that refuse to extend Medicaid coverage to a much larger segment of the low-income population.

INDIVIDUAL MANDATE. In a majority opinion written by Chief Justice Roberts, the Supreme Court held that the individual mandate imposes a "tax" on individuals who fail to purchase health insurance coverage, and that the broad taxing powers in the Constitution give Congress authority to impose this tax. (Applying an analysis that might seem inconsistent to anyone but a constitutional scholar, the Court held that the individual mandate penalty is *not* a tax for purposes of the Anti-Injunction Act, which otherwise would have barred consideration of the constitutional issues until 2015.)

The Chief Justice joined the conservative members of the Court in a separate opinion rejecting the alternative argument that the individual

HIGHLIGHTS

Employers must move quickly to implement the ACA requirements that become effective in 2012 and 2013.

Effective in 2012

- Uniform benefit summaries (SBCs)
- Reporting the cost of coverage on Form W-2
- Patient-centered outcomes fee

Effective in 2013

- $2,500 limit for health FSAs
- Increased FICA withholding
- Notice of state exchanges
- Loss of deduction for retiree drug subsidy

Political Reactions

- Both parties will try to use the Supreme Court decision to their advantage in the November elections
- If Republicans control both houses of Congress, they will pursue a "repeal and replace" strategy
- If Democrats retain control of the Senate, they might consider modest corrections and revisions to the ACA

mandate was a valid exercise of Congress's power to regulate commerce. The Court observed that the ACA does not regulate existing commercial activity, but instead compels individuals to engage in commercial activity by buying insurance.

Medicaid Expansion. The Court ruled that the federal government can deny increased Medicaid funds to states that refuse to increase Medicaid coverage. However, the Court struck down a provision that would have allowed the federal government to withdraw funding for a state's current Medicaid program if the state refused to participate in the expansion. As a result, states now have the option to continue their Medicaid programs at current federal funding levels, without implementing ACA's expansion of coverage.

In states that adopt this approach, there might be a coverage gap for individuals who are not eligible for Medicaid but whose income is too low to qualify for the federal subsidy that applies to insurance purchased through a state exchange. Uncompensated care provided to these individuals is likely to increase the cost of care for all payers.

PRESSING ACA REQUIREMENTS

Employers have very little time remaining in which to comply with significant new health plan requirements that become effective this year or next. The ACA requirements that take effect in 2012 and 2013 present significant challenges for employers.

2012 Requirements

Uniform Summaries of Benefits and Coverage. The ACA requires employers that sponsor group health plans to provide uniform summaries of benefits and coverage ("SBCs") to participants and beneficiaries during open enrollment periods that start on or after September 23, 2012. Employers must provide SBCs at various other times during a plan year to a limited number of individuals. An SBC is a four-page (double sided) description of each benefit package offered under an employer's group health plan. The employer must create an SBC using a template provided by the Departments of Health and Human Services, Treasury, and Labor (the "Departments") in accordance with instructions and other guidance provided by the Departments. For more information regarding the SBC requirement, please see our Advisory, which is available here.

Reporting Cost of Coverage on Form W-2. The ACA requires employers to report the aggregate cost of certain employer-sponsored health coverage on employees' Forms W-2. Treasury guidance requires large employers (*i.e.*, employers that are required to file 250 or more Forms W-2) to include the cost of health coverage on Forms W-2 furnished to employees in January 2013 for calendar year 2012. The reporting requirement also applies to retirees who receive a Form W-2 for other reasons (for example, to report the imputed cost of retiree life insurance).

Patient-Centered Outcomes Fee. Sponsors of self-insured group health plans and issuers of health insurance policies must pay a fee to fund the Patient-Centered Outcomes Research Institute, which will research, evaluate, and compare the effectiveness of different health-care strategies. The fee will be collected for plan years ending on or after October 1, 2012 and before October 1, 2019. Employers and insurers must report the fee on Form 720 and must pay it by July 31st following the applicable plan year (*e.g.*, by July 31, 2013, for a plan year ending December 31, 2012).

The fee is a specified dollar amount times the average number of covered lives. (The Treasury Department has proposed several alternative methods for counting covered lives.) The dollar amount for the first year is $1, for the second year is $2, and in later years will be determined based on increases in health care expenditures. The fee applies to self-insured plans, including health reimbursement arrangements ("HRAs") and retiree-only plans. For more information regarding the Patient-Centered Outcomes Fee, please see our Advisory, which is available here.

Quality Care Reporting. The ACA directed the Department of Health and Human Services to create reporting requirements for programs under employer group health plans that improve

health outcomes, prevent hospital readmissions, improve patient safety, and promote health and wellness. Although the ACA required the Department to create the new reporting rules by March 23, 2012, the Department has not yet issued the rules. As a result, the reporting requirement is not yet effective.

2013 Requirements

$2,500 Limit on Salary Reduction Contributions to Health FSAs. For plan years beginning after 2012, the ACA imposes a $2,500 cap on an employee's salary reduction contributions to a health flexible spending arrangement ("health FSA"). The limit generally does not apply to employer non-elective contributions to a health FSA or health reimbursement arrangement ("HRA"). Unused salary reduction contributions that are carried over for a grace period of not more than 2½ months in a subsequent year do not apply against the $2,500 limit for the subsequent year.

Employers have until the end of 2014 to amend their plans to reflect the limit, but they must operate their plans in compliance with the limit beginning January 1, 2013, for calendar year plans. Employers will need to communicate the limit when employees make salary reduction elections in 2012 for 2013; and employers that carry forward employees' salary reduction elections from year to year will have to decide how to treat elections that exceed the new $2,500 cap.

Withholding for FICA Medicare Tax Rate Increase. For years beginning on or after January 1, 2013, the ACA increases the Hospital Insurance tax rate by 0.9% for FICA wages over $200,000 ($250,000 for married couples filing jointly). The Hospital Insurance tax, which finances the hospital insurance program under Part A of Medicare, currently applies to all FICA wages at a rate of 1.45% for both employers and employees. The tax rate for employers is unchanged in 2013, but employers must ensure that their payroll systems are programmed to withhold the additional 0.9% from employees' FICA wages that exceed $200,000.

A comparable tax increase applies to self-employed individuals, such as outside directors and independent contractors. Although employers are not required to withhold the tax for these individuals, employers might wish to alert their outside directors to the tax increase.

Notice of State Insurance Exchanges. By March 1, 2013, employers must provide employees with written notices that include (1) information regarding the existence of a health insurance exchange, including a description of the exchange's services and contact information for the exchange, (2) if the employer's plan pays less than 60% of the covered benefits, a statement that the employee may be eligible for premium tax credits if the employee purchases coverage through the exchange, and (3) a warning that the employee might lose the employer contribution towards the cost of health coverage (including the tax favorable treatment of the employer's contribution) if the employee purchases coverage through an exchange. Notices must be in the form prescribed by the Department of Labor in guidance, which has not yet been issued.

Loss of Deduction for Medicare Part D Subsidy. Employers that provide retirees with prescription drug coverage that is actuarially equivalent to the coverage available under Medicare Part D are eligible for a federal subsidy equal to 28% of the employer's eligible retiree drug costs. Currently, these retiree drug subsidies are not included in taxable income, and an employer is not required to reduce its deduction for health care expenses by the amount of any subsidy it receives.

Beginning January 1, 2013, the ACA eliminates the tax deduction to the extent of the subsidy received. Many employers recognized the loss of future deductions in their financial statements in 2010, when the ACA was signed into law. It might be possible for employers to reverse or offset some of the adverse accounting consequences by taking action this year before the disallowance of the deduction becomes effective in 2013.

POLITICAL REACTION

President Obama and congressional Democrats are lauding the Supreme Court decision as a vindication of their efforts to pass the ACA in order to provide health coverage to millions of

Americans. The Obama Administration will continue vigorous efforts to implement the law by promulgating regulations and offering guidance on various provisions.

Republican presidential candidate Mitt Romney and congressional Republicans strongly disagree with the decision and plan to take it to the voters in the November election. Within an hour of the Supreme Court decision, the House Republican Leadership scheduled during the week of July 9th a vote to repeal the ACA. Within two hours of the decision, Romney reiterated his position in opposition to the law and raised an additional $1 million for his campaign.

The House has already held several votes during this Congress to repeal all or part of the ACA. The Senate is not expected to consider repeal of the legislation as long as the Democrats retain control of the Senate. As a result, it is highly unlikely that Congress will make changes in the ACA this year.

It is uncertain what impact the historic decision will have on the November elections and the make-up of the next Congress and Administration. If, after the election, control of the Senate shifts dramatically to the Republicans, and the House remains in Republican control, there is certain to be ACA-related legislative activity.

The Republican strategy probably will take the form of "repeal and replace." If Republicans control both houses, they will pass legislation to repeal the ACA and replace it with new health reform legislation. The Republicans have provided limited information so far on what shape the replacement legislation would take. If President Obama remains in the White House, the Republicans will need a two-thirds majority in both houses in order to override a presidential veto.

Most legislation requires 60 votes (a "filibuster-proof majority") to pass in the Senate; but the Senate can pass budget reconciliation legislation with a simple 51-vote majority. If Republicans gain control of the Senate by a narrow margin, they probably will pursue "repeal and replace" legislation under the reconciliation process. This is the same process the Democrats used to pass the ACA in 2010, after they lost Senator Kennedy's seat to Scott Brown, a Republican.

The reconciliation process limits the contents of the reconciliation package to measures that affect the federal budget. Republicans would be able to make major changes in the law, possibly including repeal of the individual mandate, since the penalty has been labeled a "tax" by the Supreme Court's decision. The budget reconciliation procedure would not allow Republicans to change certain key components of the ACA, however, such as many of the insurance reforms and employer mandates.

If Congress is controlled by the Democrats after the November election, Congress might consider modest, bipartisan legislation to reform the ACA and fix technical problems.

LONGER-TERM OUTLOOK

If the ACA remains intact, most individuals will be required to obtain minimum essential coverage or pay a penalty starting in 2014. The ACA contemplates that states will establish exchanges by 2014 to help their citizens purchase minimum essential coverage; but it is not clear that all states will be able to (or willing to) establish exchanges by the deadline. If a state fails to establish an exchange, the Department of Health and Human Services will establish an exchange for that state.

Employers will face many new ACA requirements that become effective in 2014 or later, including an excise tax for certain full-time employees who are not offered affordable coverage by the employer, a requirement to enroll employees in health coverage automatically, and a "Cadillac tax" on high-cost health plans.

If you have any questions concerning the material discussed in this advisory, please contact the following members of our employee benefits practice group or our government affairs practice group:

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