

Health Care Reform Limits Deduction for Compensation Paid by Insurers

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The Patient Protection and Affordable Care Act, the recently enacted health care reform legislation, added subsection (m)(6) to Section 162 of the Internal Revenue Code that denies a deduction to any “covered health insurance provider” for compensation paid to any employee in excess of \$500,000.

For companies subject to this new limitation, the new Section 162(m)(6) makes the following changes to the regular limits under Section 162(m):

- The limit on deductible compensation is lowered to \$500,000 from \$1,000,000;
- The limit applies to both privately held and publicly-traded companies;
- The limit applies to compensation for any employee, officer, director or individual service provider rather than just the CEO and top 3 highest paid employees (other than the CFO); and
- The limit applies to all compensation. There is no exclusion for qualified performance based compensation.

In general, this new limitation applies to any insurance company, insurance service or insurance organization (including a health maintenance organization) that provides health benefits that qualify as “minimum essential coverage” and that receives 25% or more of its gross premiums from providing that coverage. Stand-alone dental benefits, vision benefits, limited scope health policies (like a cancer insurance policy) and limited indemnity plans (for example, a policy that pays a fixed dollar amount per day of hospitalization) are not minimum essential coverage and are excluded. The determination of whether an employer is a covered health insurance provider subject to this limitation is made on a controlled group basis.

Affected employers will lose their compensation deduction for tax years beginning January 1, 2013; however, the law has been drafted to apply to compensation provided for services performed in 2010 that is taxed in 2012 or later, such as deferred compensation or equity awards.

Insurance companies should be aware of this change and begin identifying payments and employees potentially subject to the limitation on deductibility immediately.

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