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A PROFESSIONAL CORPORATION

EXECUTIVE COMPENSATION & EMPLOYEE BENEFITS ALERT

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Health Insurance Providers May Feel The Pinch Of The Internal Revenue Code's New Sting

One unquestionable outcome of the Affordable Care Act is that next year health insurance companies will see increased revenues as a result of the growing population of individuals purchasing health insurance. To curtail executive pay directly correlated to these additional insureds, a new tax rule will prevent health insurance companies from deducting the pay of certain individuals on the health insurer's tax returns. Importantly, "covered" health insurance providers affording "minimum essential coverage" as that term is defined in the Affordable Care Act ("ACA"), will be subject to the new deduction limitation whether or not they benefit from increased revenues .

Specifically, Internal Revenue Code ("Code") Section 162(m)(6), was added to the Code by Section 9014 of the ACA, limits the allowable tax deduction to \$500,000 for compensation (deferred or otherwise) provided by individuals to "covered" health insurance providers for taxable years beginning 2013. Significantly, the tax deductibility cap includes deferred compensation that is attributable to services performed in years 2010, 2011 and/or 2012 when paid in 2013 or later. Essentially, all current and deferred compensation (other than through a qualified defined contribution or defined benefit plan) must be taken into account for the \$500,000 cap. There is no exception for performance-based compensation, commissions or binding contracts.

Code Section 162(m)(6) is not only applicable to a certain number of top-paid employees, officers, executives, or even to employees. Rather, it broadly applies to an "individual" who provides services for or on behalf of a company (whether or not publicly traded) that collects at least 25% of its revenue from health insurance premiums used for the provision of minimum essential coverage. This includes the covered entity's 80% or more controlling parents or 80% or more controlled subsidiaries (but specifically excluding any brother-sister entity within the controlled group). Notwithstanding the foregoing, the Code exempts controlled groups who collectively meet a 2% test. This means that all premiums received for providing minimum essential coverage must be less than 2% of the employer's gross annual revenue for that year.

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