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Individual Tax Credits to Trigger Employer Penalties

The Affordable Care Act (ACA) created a **premium tax credit** to help eligible individuals and families purchase health insurance through an Affordable Insurance Exchange (Exchange). By reducing a taxpayer's out-of-pocket premium costs, the credit is designed to make coverage through an Exchange more affordable. The Exchanges are scheduled to become operational in 2014, with enrollment beginning Oct. 1, 2013.

On May 23, 2012, the Internal Revenue Service (IRS) published **final regulations** to provide guidance on various aspects of the premium tax credit, including the eligibility criteria for claiming the tax credit. Comments on the regulations will be accepted until Aug. 21, 2012.

Even though the credit is only available to individuals, the IRS' guidance is significant for large employers. For this purpose, a "large employer" is one with **an average of 50 or more full-time equivalent employees**. If a large employer's health coverage does not meet ACA's minimum essential coverage requirements and a full-time employee receives a premium tax credit under an Exchange, the employer may be subject to ACA's shared responsibility penalty beginning in 2014.

For 2014, ACA's monthly shared responsibility penalty for large employers whose coverage is not considered minimum essential coverage is equal to 1/12 of $3,000 ($250) for each full-time employee who receives a premium tax credit. However, the total monthly penalty for an employer would be limited to the total number of the company's full-time employees (minus 30), multiplied by 1/12 of $2,000.

A separate penalty applies to large employers not offering health coverage. For 2014, ACA's monthly penalty for these employers is equal to the number of full-time employees (minus 30), multiplied by 1/12 of $2,000 ($166.67).

OVERVIEW OF FINAL REGULATIONS

The final regulations provide guidance on determining eligibility for the premium tax credit, computing the premium tax credit, reconciling the credit and advance credit payments, and complying with the information reporting requirements for Exchanges.

To be eligible for the premium tax credit, a taxpayer:

- Must have household income for the year between 100 percent and 400 percent of the federal poverty line (FPL) for the taxpayer's family size;
- May not be claimed as a tax dependent of another taxpayer; and
- Must file a joint return if married.

In addition, to receive the premium assistance a taxpayer must enroll in one or more qualified health plans through an Exchange and the taxpayer **cannot be eligible for minimum essential coverage**.

The final regulations clarify these general eligibility criteria. For example, the final regulations provide guidance on determining family size and household income. The regulations also explain that, if married taxpayers reside in separate states with different FPL guidelines, or if a taxpayer resides in states with different FPL guidelines during a year, the FPL guideline that applies is the higher one.

MINIMUM ESSENTIAL COVERAGE

If a taxpayer is eligible for minimum essential coverage, he or she is ineligible for the premium tax credit. "Minimum essential coverage" includes coverage under:

- Government-sponsored minimum essential coverage, such as coverage under the Medicare or Medicaid programs; or
- Employer-sponsored minimum essential coverage.

Government-sponsored Coverage

The final regulations provide that an individual who meets the eligibility criteria for government-sponsored minimum essential coverage must complete the administrative requirements necessary to receive benefits. An individual who fails to complete these administrative requirements by the last day of the third full calendar month following the event that established his or her eligibility for the coverage will generally be treated as eligible for government-sponsored minimum essential coverage. This treatment will begin as of the first day of the fourth calendar month following the event that established his or her eligibility for the government-sponsored coverage. This rule does not apply to a veteran's health care program.

Example: A taxpayer turns 65 on June 3, 2015, and becomes eligible for Medicare. The taxpayer fails to enroll in the Medicare coverage during his or her initial enrollment period. The taxpayer is treated as eligible for government-sponsored minimum essential coverage as of Oct. 1, 2015, the first day of the fourth month following the event that established the taxpayer's eligibility (turning 65).

Employer-sponsored Coverage

An employee who may enroll in an employer-sponsored plan, and an individual who may enroll in the plan because of a relationship with the employee, are generally considered eligible for minimum essential coverage if the plan is **affordable** and provides **minimum value**.

Employees who are eligible for minimum essential coverage through an employer-sponsored plan are not eligible for the premium tax credit. This is significant because ACA's shared responsibility penalty for large employers is triggered when a full-time employee receives a premium tax credit for coverage under an Exchange.

According to the IRS, it will issue additional regulations in the future to address the determination of whether employer-sponsored coverage is affordable and provides minimum value. In the meantime, the final regulations provide the following guidance:

- An employee is not considered eligible for minimum essential coverage and may qualify for the premium tax credit during any **waiting period** before the employer coverage becomes effective. (However, it is expected that the IRS will issue guidance providing that, at least for the first three months following an employee's date of hire, an employer that sponsors a group health plan will not be subject to ACA's shared responsibility penalty because it did not offer plan coverage to the employee during that three-month period.)
- An individual who may enroll in continuation coverage under federal law (COBRA) or a state law that provides comparable continuation coverage is eligible for minimum essential coverage only for months that the individual is enrolled in the coverage.
- An individual who is enrolled in employer-sponsored coverage is not eligible for the premium tax credit, regardless of whether the plan meets the affordability and minimum value requirements.
- Individuals who are automatically enrolled in employer-sponsored coverage will be given a period of time to decline enrollment to maintain their eligibility for the tax credit.

EEM 5/12

Affordability Determination

ACA provides that employer-sponsored coverage is not considered affordable if the employee's cost for coverage exceeds **9.5 percent** of the employee's household income for the tax year. The IRS has indicated that it intends to issue guidance that would permit employers to use an employee's Form W-2 wages (instead of household income) to determine the affordability of employer coverage.

The final regulations provide that employer contributions to **health savings accounts (HSAs)** do not affect the affordability of employer-sponsored coverage because HSA amounts may generally not be used to pay for health insurance premiums. Contributions to **health reimbursement arrangements (HRAs)** that may only be used to reimburse medical expenses also do not affect the affordability of employer-sponsored coverage. The regulations do not address how HRA contributions that can be used to offset the employee's cost of coverage are treated for purposes of determining the affordability of employer-sponsored coverage. The IRS states that this type of HRA contributions, as well as **wellness incentive programs that increase or decrease an employee's share of premiums**, may be addressed in future guidance.

Minimum Value Determination

ACA provides that a plan fails to provide minimum value if the plan's share of total allowed costs of benefits provided under the plan is less than **60 percent** of those costs. In Notice 2012-31, the IRS outlined three potential approaches for determining whether an employer-sponsored plan provides minimum value and requested comments. According to the IRS, all comments received will be considered in separate guidance on determining minimum value.