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"Pay or Play" Penalty – Coverage for Substantially All Full-time Employees and Dependents

Effective Jan. 1, 2014, the Affordable Care Act (ACA) imposes a penalty on large employers that do not offer minimum essential coverage to full-time employees and their dependents. Large employers that offer this coverage may still be liable for a penalty if the coverage is unaffordable or does not provide minimum value.

ACA's employer penalty is referred to as an employer shared responsibility payment. It requires large employers to either "play" by offering health coverage that meets certain standards to full-time employees and their dependents OR "pay" a substantial excise tax. ACA's pay or play penalty provisions are contained in Internal Revenue Code section 4980H.

On Jan. 2, 2013, the Internal Revenue Service (IRS) released long-awaited proposed regulations on ACA's employer shared responsibility provisions. Although the proposed regulations are not final, employers may rely on them until further guidance is issued.

The IRS' proposed regulations address who a large employer must offer coverage to in order to avoid an ACA penalty. Under the proposed regulations, the requirement to offer coverage to full-time employees is relaxed to a "substantially all" standard. Also, the proposed regulations identify the dependents who must be offered coverage to avoid an ACA penalty.

EMPLOYER PENALTIES

Under the proposed regulations, the amount of the excise tax generally depends on whether or not an employer offers coverage to substantially all full-time employees and their dependents.

- In 2014, the monthly penalty assessed on employers that do not offer coverage to substantially all full-time employees and their dependents will be equal to the number of full-time employees (minus 30) multiplied by 1/12 of $2,000. This penalty is called the **4980H(a) penalty**.
- In 2014, the monthly penalty assessed on employers that offer health coverage to substantially all full-time employees and their dependents will be 1/12 of $3,000 for each full-time employee who receives a premium tax credit or cost-sharing reduction under an insurance exchange for any applicable month. However, the total penalty would be limited to the total number of full-time employees (minus 30) multiplied by 1/12 of $2,000 for any applicable month. This penalty, which is called the **4980H(b) penalty**, is triggered when a full-time employee is not offered coverage or when the coverage is unaffordable or does not provide minimum value.

SUBSTANTIALLY ALL

Under the proposed rules, the 4980H(a) penalty will not apply to a large employer that intends to offer coverage to all of its full-time employees but fails to offer coverage to a few of these employees, regardless of whether the failure to offer coverage was inadvertent.

The proposed regulations provide that an employer will satisfy the requirement to offer minimum essential coverage to "substantially all" of its full-time employees and their dependents if it offers coverage to **at least 95 percent** of its full-time employees and dependents.

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Under the regulations, an employer will not be liable for a penalty for a calendar month if it offers coverage to all but 5 percent (or, if greater, five) of its full-time employees and dependents for that month. According to the IRS, the alternative margin of five full-time employees is designed to accommodate relatively small employers because a failure to offer coverage to a handful of full-time employees might exceed 5 percent of the employer’s full-time employees.

DEPENDENTS

The proposed regulations define “dependents” for purposes of ACA’s employer penalty to include only an employee’s child (that is, son, daughter, stepchild, adopted child or child placed for foster care) under the age of 26. Employers may rely on employees’ representations regarding the identity and ages of their children.

Under the proposed regulations, “dependent” does not include an employee’s spouse. Thus, an employer is not required to offer minimum essential coverage to employees’ spouses in order to avoid ACA’s pay or play penalty.

In addition, the proposed regulations contain a transition rule for employers that currently offer coverage only to employees. Any such employer that takes steps during its 2014 plan year to satisfy ACA’s requirement to offer coverage to full-time employees’ dependent children will not be liable for a penalty based solely on the failure to offer coverage to dependent children for that plan year.

MORE INFORMATION

Please contact your Clarke & Company Benefits, LLC representative for more information on ACA’s pay or play penalty.