



# Health Care Reform

## LEGISLATIVE BRIEF

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## Proposed Rules Released on Employer Penalties

Beginning in 2014, large employers are subject to “pay or play” requirements under the Affordable Care Act (ACA). The “pay or play” rules impose penalties on certain large employers that do not offer health coverage to their full-time employees, or that offer coverage that is either unaffordable or does not provide minimum value. These penalties are also known as “shared responsibility payments.”

On Jan. 2, 2013, the Internal Revenue Service (IRS) published [proposed regulations](#) that address numerous issues regarding ACA’s “pay or play” requirements. The regulations are not final. However, employers may rely on the proposed regulations until final regulations or other applicable guidance is issued.

The proposed regulations incorporate guidance that was previously provided by the IRS on ACA’s shared responsibility requirements, with some modifications. Specifically, the regulations include the provisions of [Notice 2012-58](#) as well as many of the provisions of [Notices 2011-36](#), [2011-73](#) and [2012-17](#).

The proposed regulations also contain guidance on additional issues associated with ACA’s shared responsibility requirements. To highlight key aspects, the proposed regulations:

- Provide transition relief for non-calendar year plans;
- Expand the safe harbor options for determining whether an employer’s health coverage is affordable; and
- Clarify how the shared responsibility penalty applies to members of a controlled group.

This Clarke & Company Benefits, LLC Legislative Brief summarizes the proposed regulations. Please read below for more information. The IRS also issued [Questions and Answers](#) on the employer shared responsibility rules on Dec. 28, 2012.

### EMPLOYERS SUBJECT TO “PAY OR PLAY” RULES

As of Jan. 1, 2014, employers with **50 or more full-time employees** (or an equivalent combination of full-time and part-time employees) will be subject to ACA’s “pay or play” rules, which are found in Internal Revenue Code section 4980H. ACA defines a full-time employee as an individual who is employed on average at least 30 hours per week.

The proposed regulations contain detailed guidance on how employers should determine if they are subject to ACA’s shared responsibility provisions, including information on the following topics.

#### ***Common Law Standard***

The regulations clarify that a common law standard applies to define employee and employer. Under this standard, an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services with respect to the result to be accomplished, along with the details and means by which it is done.

Leased employees are not considered employees of the service recipient for purposes of the employer penalties.

#### ***Prior Year Data and Transition Rule***

The proposed regulations provide that an employer determines its status as a large employer for a year by looking back to employees’ actual hours of service in the prior year. The proposed regulations provide additional information



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on how to determine the number of employees for a year, including information about how to take account of salaried employees who may not clock their hours and a rule for seasonal workers.

Under a special transition rule, the proposed regulations allow an employer to ascertain its large employer status for 2014 by determining whether it employed an average of at least 50 full-time employees (including full-time equivalents) on business days during **any consecutive six-month period** in 2013. For example, an employer could use the period from March through August 2013, and then have from September through December 2013 to analyze the results and determine whether it needs to make changes to its health coverage.

## **Controlled Group Rules**

Under the proposed regulations, companies that have a common owner or are otherwise related generally are combined together for purposes of determining whether or not they employ at least 50 full-time employees (or an equivalent combination of full-time and part-time employees). If the combined total meets the large employer threshold, each separate company is subject to ACA's shared responsibility rules – even companies that do not have enough employees on their own to meet the threshold.

## **POTENTIAL "PAY OR PLAY" PENALTIES**

Under the proposed regulations, a large employer is liable for a "pay or play" penalty if:

- The employer does not offer health coverage or offers coverage to less than **95 percent** of its full-time employees (and dependent children), and at least one full-time employee receives a premium tax credit to help pay for coverage on an ACA insurance exchange (Exchange); or
- The employer offers health coverage to at least 95 percent of its full-time employees (and dependent children) but at least one full-time employee receives a premium tax credit to help pay for coverage on an Exchange. This may occur because the employer did not offer coverage to the employee or because the coverage that was offered was unaffordable or did not provide minimum value.

The proposed regulations provide that, under ACA's penalty rules, employers are required to provide coverage to dependent children up to age 26, but are not required to provide coverage to dependent spouses. The proposed regulations include a transition rule for 2014 plan years for employers that do not currently offer dependent coverage.

In 2014, the monthly penalty assessed on employers that do not offer coverage to substantially all of their full-time employees will be equal to the number of full-time employees (minus 30) multiplied by 1/12 of \$2,000. In 2014, the monthly penalty assessed on employers that offer health coverage to at least 95 percent of their full-time employees will be 1/12 of \$3,000 for each full-time employee who receives a premium tax credit for any applicable month. However, the total penalty for the employer would be limited to the total number of the company's full-time employees (minus 30) multiplied by 1/12 of \$2,000 for any applicable month.

## **TRANSITION RELIEF FOR NON-CALENDAR PLANS**

The proposed regulations provide transition relief for employers that, as of Dec. 27, 2012, offer health coverage under plans that operate on a non-calendar year basis. The regulations call these health plans "fiscal year plans." The proposed regulations note that this transition relief is provided because employers with fiscal year plans may have difficulty complying the ACA's "pay or play" rules on Jan. 1, 2014. There are two components to the transition relief for fiscal year plans.

First, the transition relief applies with respect to employees who would be eligible for employer-sponsored coverage as of the first day of the fiscal plan year starting in 2014 under the plan's eligibility terms as in effect on Dec. 27, 2012. If these employees are offered affordable, minimum value coverage no later than the first day of the plan year starting in 2014, the employer will not be assessed a shared responsibility penalty with respect to these employees for any period in 2014 prior to the beginning of the plan year that starts in 2014 and runs into 2015.

Second, transition relief applies to employers that have a significant percentage of their employees who are eligible for or covered under one or more fiscal year plans with the same plan year. If an employer has at least one-quarter of

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its employees covered under a fiscal year plan (or if the employer offered coverage under the plan to at least one-third of its employees during the most recent open enrollment period before Dec. 27, 2012), the employer will not be subject to a shared responsibility payment with respect to any of its full-time employees until the first day of the plan year starting in 2014, provided that those full-time employees are offered affordable coverage that provides minimum value no later than that first day.

For example, if during the most recent open enrollment period before Dec. 27, 2012, an employer offered coverage to at least one-third of its employees under a plan with a plan year starting July 1, 2013, the employer could avoid liability for a shared responsibility payment if, by July 1, 2014, it expanded the plan to offer coverage satisfying ACA's shared responsibility provisions to the full-time employees who had not been offered coverage.

## **AFFORDABILITY SAFE HARBOR**

In general, an employer's coverage is considered unaffordable under ACA if the employee's required contribution for self-only coverage exceeds 9.5 percent of the employee's annual household income for the calendar year. The IRS recognizes that an employer will generally not know an employee's household income. Thus, in Notice 2011-73, the IRS outlined a safe harbor under which an employer could determine affordability based on whether the employee's required contribution exceeds 9.5 percent of his or her Form W-2 wages.

The proposed regulations provide additional guidance on the Form W-2 safe harbor and establish two additional safe harbors for determining affordability – the rate of pay safe harbor and the federal poverty line (FPL) safe harbor.

- **Rate of Pay Safe Harbor** – Under this safe harbor, affordability is determined based on an employee's rate of pay. For salaried employees, the employer would use the employee's monthly salary to determine affordability. For hourly employees, the employer would multiply the employee's hourly rate of pay by 130 hours per month and determine affordability based on the resulting monthly wage amount. The employee's monthly contribution amount (for self-only coverage) is affordable if it is equal to or lower than 9.5 percent of the computed monthly wages.
- **FPL Safe Harbor** – This safe harbor determines affordability based on the FPL for a single individual. If the employee's cost for self-only coverage under the employer's health plan does not exceed 9.5 percent of the FPL for a single individual, the coverage is considered affordable.

## **CONTROLLED GROUP RULES**

The proposed regulations provide that all members of a controlled group are combined for purposes of determining whether any member of the group is a large employer subject to ACA's shared responsibility provisions. However, the proposed regulations clarify that controlled group members are treated separately for purposes of determining whether an employer owes a penalty and the amount of the penalty. Thus, employers will not automatically be subject to a "pay or play" penalty just because an employer in their controlled group is subject to the penalty. Also, the penalty is computed separately for each member, taking into account that member's offer of coverage (or lack thereof) and based on that member's number of full-time employees.

## **EFFECTIVE DATE**

Section 4980H is effective for months after Dec. 31, 2013. Employers may rely on the proposed regulations for guidance until final regulations or other guidance is issued. If future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will not be applied retroactively and employers will be provided with sufficient time to come into compliance with the final regulations.