June 2014

Wolters Kluwer Law & Business White Paper

Employer Shared Responsibility Mandate—To Pay or Play? That is the Question

Inside

Executive Summary....1
Introduction....1
Background....2
Code Sec. 4980H....2
Reporting Requirements....2
Change to Effective Date—Transition Relief....2
Understanding the Mandate: Key Terms....2
Large Employers....2
FTEs....3
Affordable Health Care....3
Safe Harbors....3
Minimum Value....4
Premium Subsidy or Credit....4
The Penalty....4
Transition Relief Rules....4
  Transition rules for 2014:....4
  Transition rules for 2015:....5
  Transition rules for 2016:....5
Calculating the Penalties—Pay or Play. Is it worth it?....5
Examples....5
Employer Checklist....6
  Are you a large employer?....6
The "100" Factor—No Cause for Alarm....7
Conclusion....7

By Lisa Weder
Legal Analyst, Health Reform KnowlEDGE™ Center

Wolters Kluwer
Law & Business

Executive Summary

The Employer Shared Responsibility, or Employer Mandate, was enacted by the Patient Protection and Affordable Care Act (ACA) (P.L. 111-148) in March 2010. This Mandate requires large employers to offer affordable health insurance that meets the minimum value of coverage deemed necessary by the ACA.

Final regulations implementing the Mandate provisions were released by the IRS in February 2014. These regulations (T.D. 9655) define a large employer, provide guidance regarding when the Mandate penalty applies, and discusses the transition relief for the next two years.

The Employer Mandate has also been termed the "Pay or Play" Mandate by the general public as employers are faced with the decision to either play along and comply with the Mandate requirements or pay the penalty for non-compliance, which is the subject of this White Paper.

The analysis, supplemented by numerous examples and an employer checklist, highlights the intricate details of the Employer Mandate and what will lead to compliance or the Mandate penalty.

Introduction

Employers have many items to consider when offering benefits to their employees. Some benefits incur costs while some provide tax deductions or tax credits. Employee health insurance premiums paid by employers are provided tax-free to employees and are a deduction for the business; however, with the passing of the Patient Protection and Affordable Care Act (ACA) (P.L. 111-148), enacted in March 2010, employer-sponsored health insurance is an employee benefit which now incurs a penalty to large employers if not offered to full-time employees and their dependents. The Employer Shared Responsibility, more commonly known as the Employer Mandate (the Mandate), provisions were added as Code Sec. 4980H to the Internal Revenue Code (the Code) by sec. 1513 of the ACA. In February 2014, the IRS and Treasury implemented Final regulations (T.D. 9655) on the provisions to serve as further guidance for employers to determine whether the penalty applies to, and whether their employees' status qualify them as "applicable large employers." The Mandate has been termed the "Pay or Play" Mandate, meaning an employer either plays along and complies with the regulations or pays the price of non-compliance. Incidentally, these regulations are also providing guidance as to whether the costs associated

©2014 CCH Incorporated. All Rights Reserved.

with the penalty outweigh the costs of providing health care coverage.

Background

Code Sec. 4980H

Code Sec. 4980H outlines the Mandate and the conditions under which large employers will face monthly penalties. Subsections (a) and (b) of Code Sec. 4980H state that an applicable large employer will incur a monthly penalty fee if it either (1) does not offer full-time employees and their dependents an opportunity to enroll, or (2) does offer an opportunity to enroll in minimum essential health coverage under an eligible employer-sponsored plan for any month, and at least one full-time equivalent employee (FTE) has been certified as enrolled in that month for purchasing individual coverage on a Health Insurance Exchange or Marketplace (Marketplace) (a "qualified plan") (*see* sec. 1411 of the ACA). Both situations utilize slightly varying calculations to arrive at the penalty, which will both be discussed below.

The Mandate stipulates that any business with more than 50 FTEs must offer *affordable* health insurance coverage with *minimum value* to these employees and their dependents up to age 26, and that an employee will not be eligible for a premium tax credit if the employer has offered the employee health coverage meeting these requirements. When an employee claims a premium tax credit or is paying a Marketplace insurance company, this acts as a trigger to the IRS, which will notify the employer of the employee's certification for the credit and that the employer now owes the penalty fee. The penalty payment is not deductible as a business expense and therefore the penalty is not included on employers' tax returns. (For more information on employer-provided coverage, *see* Code Sec. 5000A(f)(2).)

Reporting Requirements

While employers cannot deduct the penalty on their tax returns, there are certain reporting requirements enacted by the ACA under Code Sec. 6056. Code Sec. 6056 requires employers to report to the IRS information about the types of health care plans they offered to FTEs in order to properly administer the Mandate's provisions. Large employers must also provide compensation statements to their employees to assist the employees in determining whether they can claim their premium tax credit received each month on their individual tax returns under Code Sec. 36B (for more on Code Sec. 6056, see the following article: Final large employer and insurance provider reporting regulations allow combined reporting).

Change to Effective Date—Transition Relief

The Mandate's provisions as enacted by the ACA were to be implemented January 1, 2014; however, in response to a number of changes received from comments regarding proposed regulations issued during 2011 and 2012, the effective date, key terminology, and penalty arrangements changed. On February 10, 2014, the IRS and Treasury issued final regulations delaying implementation until January 1, 2015, and thus, no penalties will be assessed to large employers in 2014. The Mandate will be phased in during 2015 and 2016 based on employer size (for further detail, see the section *Large employers*).

Understanding the Mandate: Key Terms

To understand the Mandate, it is imperative to be familiar with the definitions used in its requirements, the different employer and employee situations to which the Mandate applies, and the fact that the Final rules are different for 2015 and 2016. It is important to note that other sections of the Code, Code Secs. 5002A and 36B specifically, contribute to interpretation of these definitions and are noted.

Large Employers

Generally, the Employer Mandate requires that any business with more than 50 full-time employees or full-time equivalent (FTEs) employees, referring to a combination of full-time and part-time employees that totals 50, on business days for the prior calendar year is an "applicable large employer." What does this exactly mean?

There are transition rules in effect for 2014 through 2016 that determine whether an employer is an applicable large employer for each affected year. In 2014, an "applicable large employer" is one with at least 50 but fewer than 100 FTEs for the preceding calendar year or for at least six consecutive months of 2014, to account for large employer status in 2015. In 2015, the definition changes to employers with 100 or more FTEs for

©2014 CCH Incorporated. All Rights Reserved.

the calendar year, and in 2016, it changes to employers with 50 to 99 FTEs for the calendar year.

Where several employers or corporations act as one large employer, the final rules address them as applicable large employer *members* (79 FR 8553). In this situation, if an employee worked for more than one large employer member of the same applicable large employer during a calendar month, the penalty for a calendar month applies to the employer member for whom the employee worked the greatest number of hours for that calendar month.

"Applicable large employer" also applies to unique situations such as where a U.S. employer has employees working abroad or a foreign employer utilizes U.S. workers, according to the IRS. Both scenarios take into account whether work was performed in the United States. In the former scenario, if the U.S. employer has 50 FTEs working in the United States and other employees working abroad, then the employer is subject to the Mandate's rules. In the latter scenario, if a foreign employer has less than 50 FTEs working in the United States, it is not subject to the Mandate's rules.

The IRS defines "applicable large employer" to include for-profit, non-profit, and government entity employers, including colleges and schools.

Further clarification of applicable large employers is found under Code Sec. 4980H(c). T.D. 9655 provides rules applying to employers not in existence during the preceding year.

FTEs

Since an employer's headcount is the defining measure as to whether an employer is an applicable large employer, it is important to clear up any assumptions on the use of the term, "full-time employee." Many people assume that being full-time means 40 hours or more per week, when in fact full-time is defined by working at least 30 hours per week (79 FR 8544). Both part-time employees and full-time employees may be combined as the required 50 FTEs. The number of part-time equivalents is determined by their hours of service.

Employees whose positions last for six months or less generally are not considered FTEs; however, teachers who typically do not work in the summers are considered full-time. The 50 FTE requirement does not apply to seasonal workers regardless of hour counts according to Code Sec. 4980H(c)(2)(B), which states that any employer's workforce in excess of 50 employees who work for 120 days or less during the calendar year are seasonal workers. This includes extra workforce support during holiday periods in retail stores. Finally, "full-time employee" does not include volunteers' hours worked for a government or tax-exempt entity, such as volunteer firefighters, and will not cause them to be considered FTEs.

To learn more about the challenges in defining FTEs, see the following article: Final rules give employers some breathing room to determine who is a full-time worker for mandate purposes, expert says.

Many people assume that being full-time means 40 hours or more per week, when in fact full-time is defined by working at least 30 hours per week.

Affordable Health Care

Code Sec. 36B(c)(2)(C)(i) states that coverage must be affordable, but how does the employer know whether the coverage is affordable for employees? Coverage is deemed affordable if the employee's required contribution to the plan does not exceed 9.5 percent of the employee's household income for the tax year. However, most employers are generally not aware of employees' total household income. To remedy this, IRS Notice 2011-73 proposed, and the Final rules adopted, three safe harbor rules for employers to deduce the percentage of employees' income, such as using their wages as reported in Box 1 of Form W-2 instead. The percentage applies to the self-only portion (no dependents) of the lowest cost-option premium offered to the employee. (*See also* Code Sec. 5000A(e)(1)(B) for employee premium contribution information.)

Safe Harbors

Notice 2011–73 provided three safe harbors for an employer to determine whether coverage is affordable to an employee since an employer could not really know what the employee's total household income would be. The three optional safe harbors are based on job categories, salary versus hourly paid employees, and geographical location. The three safe harbor measures are: (1) the

©2014 CCH Incorporated. All Rights Reserved.

employee's wages reported on Box 1 of Form W-2; (2) the employee's rate of pay not to exceed 9.5 percent of hourly or salary pay; and/or (3) the employee's required contribution for the least expensive coverage option that does not exceed 9.5 percent of the federal poverty line divided by 12.

An employer may choose one or more safe harbors for all of its employees or any reasonable category of employees, so long as it is applied uniformly and consistently. Employers may use the rate of pay safe harbor even if the employee's hourly rate is decreased during the calendar year.

The safe harbors only apply for purposes of the assessable penalty payment—they do not affect an employee's eligibility for a premium tax credit other than the fact that an employee may only obtain the tax credit if the coverage offered is not considered affordable. But an employer's health coverage offer meeting the safe harbor requirements is considered affordable even if it is not truly affordable to the employee. A detailed discussion of the safe harbors is included in T.D. 9655.

Minimum Value

If an employer-sponsored plan pays at least 60 percent of the cost of covered services, then the plan is deemed to have minimum value. If the employer plan does not provide minimum value, the employee is eligible to receive coverage in another qualified plan that is supported by a premium tax credit. A minimum value calculator is provided by the IRS and HHS. Minimum value is also defined in Code Sec. 36B(c)(2)(C)(ii).

Premium Subsidy or Credit

Under Code Sec. 4980H, an employer is liable for the Mandate penalty when an employee purchases coverage on a Marketplace and receives a premium tax credit. A premium tax credit refers to a refundable tax credit that allows low-to-moderate income employees to afford health coverage through a Marketplace. An employee may pay the credit in advance to the health insurance company or claim it as a lump sum on his or her tax return. There are six requirements that constitute eligibility for the tax credit, and not receiving affordable, minimum value employer-provided health insurance is one of them.

> ***Note.*** An employee seeking coverage for only his or her dependents and who receives a premium tax credit will not result in a penalty for the employer (Code Sec. 36B).

The Penalty

Most large companies won't be affected by the Mandate because they typically offer health coverage. According to the U.S. Treasury, about 96 percent of companies employ less than 50 employees, which exclude them from the Mandate and its penalties. "[T]he companies most concerned with the employer Mandate remain those where the difference between full- and part-time work is fluid, such as firms with employees who work sporadic or fluctuating hours or who work seasonally … Those are the employers who could appreciate this transition period," said Nancy Daas, a partner at Chicago-based CMC Advisory Group, a benefits consultancy. (For more information on the Mandate's impact, see the following article: ACA Mandate penalties may not be necessary, after all.) While a majority of large companies will not be impacted by the Mandate, it is necessary to understand the transition relief and safe harbor rules in order to know whether a company has cause for concern.

Transition Relief Rules

The Mandate's various transition relief and safe harbor rules may (1) affect whether an employer offers health insurance and (2) help to determine whether an employer is an applicable large employer. The Final rules did not approve all proposed regulations, holding to statutory definitions. The following transition relief rules specifically relate to adopted relief rules concerning employers:

Transition rules for 2014:

- T.D. 9655 adopted Notice 2013-45, issued July 9, 2013, which suggested that employers would need time to become familiar with the applicable large employer determination method (discussed below), reporting requirements, and assemblage of data in 2014. Because of this, no penalty payments will be assessed for 2014. However, in order to know whether these penalties will apply in 2015, employers need to factor the number of FTEs and their hours of service on business days during 2014 to determine whether they are considered applicable large employers for 2015.
- For 2014, employers with at least 50 but fewer than 100 FTEs (including full-time equivalents) that meet conditions in the final regulations will not be subject to any penalty payments for 2015 (or for the 2015 plan year in the case of an employer with a non-calendar-year health plan). Rather than

©2014 CCH Incorporated. All Rights Reserved.

being required to use the full 12 months of 2014 to measure if it has 100 FTEs (including full-time equivalents), an employer may measure during any consecutive six-month period (as chosen by the employer) during 2014.

- Newly designated applicable large employers that do not offer health coverage during the prior calendar year, but that offer coverage on or before April 1 of the year in which it is newly designated, will not be penalized under Code Sec. 4980H (79 FR 8548).

Transition rules for 2015:

- Employers with plan years that do not start on January 1 will be able to begin compliance with the Mandate at the start of their plan years in 2015 rather than on January 1, 2015.
- For offers of coverage to dependents for 2015, the transition relief from the penalty applies to dependents who were not offered coverage from the employer in both the 2013 and 2014 plan years, and the employer takes steps during the 2014 or 2015 plan year (or both) to extend coverage to these dependents.
- The assessable penalty payment for any calendar month is capped at the number of the employer's FTEs for the month (minus up to 80) multiplied by 1/12 of $2,000. This cap ensures that the payment for an employer that offers coverage can never exceed the penalty payment the employer would owe if it did not offer coverage.
- The penalty rules apply to employers with 100 or more FTEs effective for the first plan year beginning on or after January 1, 2015. The penalty is $2,000 for each FTE excluding the first 80 employees. This transition relief amount is applicable only to 2015.
- Large employers are required to offer coverage to only 70 percent of their FTEs in 2015 in order to avoid the penalty. But for 2015, if at least one FTE receives a premium tax credit, the employer will be liable for the Mandate payment, calculated by the number of FTEs who receive a premium tax credit for the month multiplied by 1/12 of $3,000.

Transition rules for 2016:

- The penalty rules apply to employers with 50 to 99 for plan years beginning January 1, 2016. For plan years beginning in 2016 and beyond, employers exclude 30 employees from the penalty calculation.
- Large employers are required to offer coverage to 95 percent in 2016 (and beyond) in order to avoid the penalty.

Calculating the Penalties—Pay or Play. Is it worth it?

So, how does a large employer weigh the health insurance costs per full-time employee versus the cost of incurring a penalty if health insurance is not offered? Mark Luscombe, a Principal Analyst with Wolters Kluwer CCH Tax & Accounting North America says that, "there has been discussion that paying the Mandate's penalty may be a less expensive option for some businesses than providing health insurance." It is clear that some businesses are looking for ways around the law and are changing their employee hours or seeking other ways to avoid providing health insurance and the penalty. During a recent conversation with one of the my relatives, who had worked as an office assistant for 30 hours per week for over 20 years, she revealed that her employer recently changed her hours. Since the enactment of the final rules, her employer told her that 30 hours is no longer considered part-time and that she may work only 29 hours. Clearly, the employer decided that providing coverage was too costly, but was he certain of that? Perhaps a calculation or estimator tool would have prevented his employee from losing time paid each week.

Paying the Mandate's penalty may be a less expensive option for some businesses than providing health insurance.

Examples

As noted earlier, Code Sec. 4980H(a) and (b) factor calculations differently. Under subsection (a), the large employer penalty is assessed on a monthly basis and is calculated by multiplying the penalty payment by the number of employees employed as FTEs for each month when an employer does not offer minimum essential health care coverage, and at least one employee receives the premium credit ($2,000 × amount of FTEs). In the case of subsection (b), the penalty is based on large employers who do offer coverage and more than one employee qualifies for premium tax credits and is calculated by multiplying the number of FTEs each month by 1/12 of $3,000, or $250.

©2014 CCH Incorporated. All Rights Reserved.

Example 1: Let's take a look at a sample calculation from the Code Sec. 4980H(a) monthly perspective accounting for transition relief rules in 2015:

> In 2015, Company A fails to offer minimum value coverage and has 100 FTEs, and 10 claimed a premium tax credit for the year for enrolling in a state exchange plan. For 20 of its FTEs (transitional relief) (100 FTEs – 80 = 20), Company A owes $2,000 per employee (assuming no inflation adjustment of the $2,000 for 2016), for a total *monthly* penalty payment of $40,000 ($2,000 × 20 FTEs).

Example 2: The same example could be translated in annual terms for another cost perspective:

> In 2015, Company A fails to offer minimum value coverage and has 100 FTEs, 10 received a premium tax credit for the year for enrolling in a state exchange plan. For 20 of its FTEs (100 FTEs – 80 = 20), Company A owes $2,000 per employee (assuming no inflation adjustment of the $2,000 for 2016), for a total *annual* penalty payment of $480,000 ($2,000 × 20 FTEs × 12 months).

Example 3: Here's a sample calculation from the Code Sec. 4980H(b) perspective, accounting for 2015's transition relief rules:

> In 2015, Company A offers minimum value coverage and has 100 FTEs, 10 claimed a premium tax credit for the year for enrolling in a state exchange plan. For 20 of its FTEs (transitional relief) (100 FTEs – 80 = 20), Company A owes $250 per employee, for a total *monthly* penalty payment of $5,000 ($250 × 20 FTEs).

Employer Checklist

The following checklist is designed to help an employer determine if it is an applicable large employer and whether it is at risk for the Mandate penalty if it does not offer minimum essential health coverage.

Are you a large employer?

- ☐ Did you employ at least 50 but less than 100 FTEs for all of calendar year 2014, or for at least 6 consecutive months of 2014?
  - If yes, then there's no penalty and you are not deemed a large employer for 2015. You will, however, be deemed a large employer effective January 1, 2016 (see the discussion on *Large employers* for further details).
- ☐ For 2015, did you employ at least 100 FTEs and offer coverage to at least 70 percent (95 percent for 2016) of them, but have one or more FTEs who received a premium tax credit?
  - If so, the penalty is calculated for each month and is factored as: Number of FTEs receiving a premium tax credit multiplied by 1/12 of $3,000.
  - The penalty amount for any calendar month is capped by the amount of FTEs for the month, minus up to 80, multiplied by 1/12 of $2,000.

If you are deemed a large employer, you must comply with the Employer Mandate requirements. Continue to the next set of questions to help determine your risk for incurring the Mandate penalty.

- ☐ Do you offer employer-sponsored health insurance coverage to the FTEs?
  - If no, then you are subject to a $2,000 penalty per employee, per month, excluding the first 80 employees in 2015 and excluding 30 employees in 2016.
- ☐ Did at least one employee receive a premium tax credit or cost-sharing reduction payment because the coverage is not affordable or of minimum value?
  - If yes, the $2,000 penalty applies.
- ☐ Does the employee's share of the premium for self-only coverage (not family coverage) exceed 9.5 percent of the employee's annual household income as reported on his W-2?
  - If no, then the coverage is deemed affordable (see the discussion on *Safe harbors* for further details).
- ☐ Does the offered plan pay at least 60 percent of the costs of the plan's covered services (Code Sec. 5000A(f)(2)?
  - If yes, then the plan is deemed to have minimum value and you have met that portion of the criteria for complying with the Mandate (Code Sec. 36B(c)(2)(C)(ii)).
- ☐ For 2015, will you offer health coverage to less than 70 percent (95 percent for 2016 and beyond) of FTEs/dependents and at least one of the FTEs received a premium tax credit?
  - If yes, the penalty applies. This is calculated as: FTE total for the month, minus 80, multiplied by 1/12 of $2,000.

©2014 CCH Incorporated. All Rights Reserved.

- ☐ Did you offer health coverage for some months but not others during the calendar year?
  - If yes, the penalty is assessed for each month that coverage was not offered. For 2015, this is calculated as: Total amount of FTEs for that month, minus 80, then multiplied by 1/12 of $2,000.
  - For 2016: Total amount of FTEs, minus 30, then multiplied by 1/12 of $2,000.

The "100" Factor—No Cause for Alarm

The Employer Mandate's penalty payment is in itself considered or qualified as an excise tax; however, there are practitioners (and employers) who may be confusing the Mandate with other Title 26 health care coverage requirements found in such programs as the Employee Retirement Income Security Act of 1974 (ERISA)'s health care continuation coverage (COBRA), or Code Sec. 4980B's coverage of group health plans. It seems that this confusion is creating an alarmist atmosphere in the industry. Code Secs. 4980B, 4980D, 4980E, and 4980G all impose long-existing excise tax of $100 per day for failure to comply with coverage requirements. What practitioners and employers should understand is that these statutes do not require employers to offer health benefits, though they do relate to health coverage plans. It is the plans themselves that are the focus. But if an employer should offer benefits, that employer must comply with federal requirements such as reporting and privacy disclosure requirements, health savings account contributions, claims payment policies, procedures for appealing denied benefit claims, and COBRA requirements. If an employer's plan does not comply with these requirements for any length of time, then the employer must pay a $100-per-day, per individual, excise tax. The excise tax may also be imposed upon the plan itself and also be imposed along with the Mandate's penalty. Unlike the Mandate, these $100-per-day penalties apply to *all* employers, of any size, that currently provide health care coverage; not just applicable large employers. In further contrast, if a large employer does not offer affordable, minimum value coverage to dependents, employers are subject to the calculations mandated in Code Sec. 4980H(a) and (b), described above. In fact, law firms have attested to the fact that the excise taxes are independent of the so-called pay or play rules. The only common thread between this excise tax penalty and the Mandate is that the Mandate created new plan requirements, such as dependent coverage, that large applicable employers must comply with and that requirements for both must be reported on Form 8928.

Note. The excise tax penalty concerns violations of plan details versus the issue of offering opportunities for health care.

Example. Let's take a look at the same sample calculation previously discussed using the Code Sec. 4980H(a) monthly penalty but assume that Company A has violated health savings account contribution rules (Code Sec. 4980G) over five business days, resulting in an excise tax penalty:

Unlike the Mandate, these $100-per-day penalties apply to all employers, of any size, that currently provide health care coverage; not just applicable large employers.

In 2015, Company A fails to offer minimum value coverage and has 100 FTEs. 10 claimed a premium tax credit for the year for enrolling in a state exchange plan. Over a period of five business days, Company A did not comply with health savings account contribution requirements ($100 × 5 = $500). For 20 of its FTEs (100 FTEs - 80 = 20), Company A owes $2,000 per employee (assuming no inflation adjustment of the $2,000 for 2016), for a total *monthly* penalty payment of $40,500 ($2,000 × 20 FTEs = $40,000 + $500 = $40,500).

Conclusion

Which is more costly? Providing health care coverage to FTEs or paying the Mandate penalty? The Employer Shared Responsibility Mandate is no doubt an intricate web of situational components, but it is incumbent upon employers to be proactive and understand its basic implications, definitions, and calculations, in order to ascertain which costs to undertake. The final regulations in T.D. 9655 and workflow solutions such as Wolters Kluwer Health Reform KnowlEDGE™ Center, which includes a new *Employer Mandate: Pay or Play Estimator*, will aid employers facing this complex decision.

Wolters Kluwer Law & Business connects legal and business communities with timely, specialized expertise and information-enabled solutions to support productivity, accuracy and mobility. Serving customers worldwide, our products include those under the Aspen, CCH, ftwilliam, Kluwer Law International, LoislawConnect, MediRegs, and TAGData names.