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Pay or Play Penalty—Offer of Coverage

The Affordable Care Act (ACA) imposes a penalty on applicable large employers (ALEs) that do not offer health insurance coverage to substantially all full-time employees and dependents. Penalties may also be imposed if coverage is offered, but is unaffordable or does not provide minimum value. The ACA's employer penalty rules are often referred to as "employer shared responsibility" or "pay or play" rules.

> The employer penalty provisions were set to take effect on Jan. 1, 2014. However, in July 2013, the Treasury announced that **the employer penalties and related reporting requirements would be delayed for one year, until 2015.** Therefore, no penalties will apply to any employers for 2014. Smaller ALEs may also be eligible for an additional one-year delay.

On Feb. 12, 2014, the Internal Revenue Service (IRS) published **final regulations** on the employer shared responsibility rules. These regulations finalize provisions in proposed regulations released on Jan. 2, 2013. Under the final regulations, **ALEs that have fewer than 100 full-time employees (including full-time equivalents, or FTEs) generally will have an additional year, until 2016, to comply with the pay or play rules.** ALEs with 100 or more full-time employees (including FTEs) must comply with the pay or play rules starting in 2015.

The employer shared responsibility rules impose specific requirements on the "offer of coverage" that an ALE must provide to its full-time employees (and dependents). This Legislative Brief provides an overview of the requirements related to the ALE's offer of coverage.

OVERVIEW OF EMPLOYER PENALTIES

Beginning in 2015, an ALE may be subject to a penalty if it:

- Fails to offer to substantially all full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan for any month; or
- Offers eligible employer-sponsored coverage that is not affordable or does not provide minimum value.

An ALE is an employer with, on average, **at least 50 full-time employees, including FTEs**, during the preceding calendar year. Full-time employees are those working an average of **30 or more hours per week** (or 130 hours in a calendar month).

Regardless of whether or not an ALE offers coverage, a penalty will be assessed ***only if*** at least one of its full-time employees receives a premium tax credit or cost-sharing reduction for coverage purchased through an Exchange. Beginning in 2014, low-income individuals who are not offered employer-sponsored coverage and who are not eligible for Medicaid or other programs may be eligible for premium tax credits or cost-sharing reductions for coverage purchased through an Exchange.

The final rules **delay implementation for ALEs that have fewer than 100 full-time employees** (including FTEs). These medium-sized ALEs will generally have an additional year, until 2016, to comply with the pay or play rules. However, an ALE must certify that it meets certain eligibility conditions to qualify for this delay.

OFFER OF COVERAGE

In general, the employer shared responsibility rules require an ALE to offer an effective opportunity to accept coverage **at least once during the plan year**. If an employee has not been offered an effective opportunity to accept coverage, the employee will not be treated as having been offered the coverage for purposes of the employer shared responsibility provision.

The employee must also have, at least once during the plan year, an effective opportunity to decline an offer of coverage that is not minimum value coverage or that is not affordable. However, an effective opportunity to decline is not required for an offer of coverage that provides minimum value and is either:

- Affordable (determined based on the federal poverty level safe harbor); or
- No cost to the employee.

Thus, an employer may not render an employee ineligible for subsidized coverage by providing an employee with mandatory coverage (that is, coverage which the employee is not offered an effective opportunity to decline) that does not meet minimum value. The final regulations also clarify that an employee's election of coverage from a prior year that continues for every succeeding plan year unless the employee affirmatively elects to opt out of the plan constitutes an offer of coverage for purposes of the employer shared responsibility rules.

For an employee to be treated as having been offered coverage for a month (or any day in that month), the coverage offered, if accepted, must be applicable for that month (or that day). If an ALE fails to offer coverage to a full-time employee for any day of a calendar month during which the employee was employed, the employee is treated as not being offered coverage during that entire month. However, a full-time employee who terminates employment in a calendar month will be treated as having been offered coverage during that month as long as the employee would have been offered coverage for the entire month if he or she had been employed for the entire month.

If an employee enrolls in coverage but **fails to pay his or her share of the premium on a timely basis**, the employer is not required to provide coverage for the period for which the premium is not paid in a timely fashion, but will still be treated as having offered that employee coverage for the remainder of the coverage period (typically the remainder of the plan year) for purposes of the employer shared responsibility rules.

Minimum Essential Coverage

For purposes of the employer shared responsibility rules, an ALE is not treated as having offered coverage to an employee unless the coverage qualifies as **"minimum essential coverage"** (MEC). The definition of MEC under the ACA is very broad, and includes coverage under an eligible employer-sponsored plan. An eligible employer-sponsored plan is, with respect to any employee:

- Group health insurance coverage offered by (or on behalf of) an employer to the employee that is either:
    - A governmental plan;
    - Any other plan or coverage offered in the small or large group market within a state; or
    - A grandfathered health plan offered in a group market; or
- A self-insured group health plan under which coverage is offered by (or on behalf of) an employer to the employee.

In general, most employer-sponsored coverage will qualify as MEC. However, MEC does not include coverage consisting solely of excepted benefits (as defined by HIPAA). MEC also does not include specialized coverage, such as coverage only for vision or dental care, workers' compensation, disability policies or coverage only for a specific disease or condition.

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BK 5/14

Minimum Value

If the coverage offered by an ALE fails to provide minimum value (MV), an employee may be eligible for a subsidy to purchase Exchange coverage (and thus, the ALE may be subject to a penalty). A plan fails to provide MV if the plan's share of the total allowed costs of benefits provided under the plan is less than **60 percent** of those costs. MV is calculated by dividing the cost of essential health benefits (EHBs) the plan would pay for a standard population by the total cost of EHBs for the standard population (including amounts the plan pays and amounts the employee pays through cost-sharing) and then converting the result to a percentage.

On Feb. 25, 2013, HHS issued a final rule establishing the following four approaches for determining MV:

- ***Approach One: Calculator—***HHS has released an MV Calculator that permits an employer to enter information about its health plan's benefits, coverage of services and cost-sharing terms to determine whether the plan provides minimum value.
- ***Approach Two: Checklists—***HHS and the IRS will provide an array of design-based safe harbors in the form of checklists that employers can use to compare to their plan's coverage. If a plan's terms are consistent with or more generous than any one of the safe harbor checklists, the plan would be treated as providing minimum value. In May 2013, the IRS specified three safe harbor plan designs that satisfy minimum value and stated that they expect to release more in future guidance.
- ***Approach Three: Actuarial Certification—***An employer-sponsored plan may seek certification by an actuary to determine the plan's minimum value if the plan contains nonstandard features that preclude the use of the MV Calculator and safe harbor checklists.
- ***Approach Four: Metal Level—***Any plan in the small group market that meets any of the "metal levels" of coverage (that is, bronze, silver, gold or platinum) provides minimum value.

Affordability

An employee may also be eligible for a subsidy through an Exchange (and thus, an ALE may be subject to a penalty) if the coverage offered by the ALE is not affordable. Coverage for an employee under an eligible employer-sponsored plan is affordable if the employee's required contribution for self-only coverage does not exceed **9.5 percent** of the taxpayer's household income for the taxable year.

The final regulations provide safe harbor approaches for assessing whether an employer's coverage is affordable. Although the ACA measures affordability based on household income, these safe harbors allow an employer to measure affordability based on:

- The employee's **W-2 wages** from that employer that are required to be reported in Box 1;
- The employee's **rate of pay**. For salaried employees, the employer uses 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; or
- The **federal poverty level (FPL) for a single individual** in effect within six months before the first day of the plan year.

Eligibility for premium tax credits or cost-sharing reductions will still be based on household income. However, the employer will not be subject to a penalty for that employee, even if he or she ultimately receives a subsidy.

EMPLOYEES WHO HAVE OTHER COVERAGE

The final rules did not exempt an ALE from liability for failing to offer coverage to full-time employees who have coverage from other sources (such as Medicare, Medicaid or a spouse's employer). The IRS noted that this type of

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rule would be inconsistent with the employer shared responsibility rules and would require the employer to verify alternative coverage in a manner not contemplated by the ACA (for example, requiring an employer to question its employees as to Medicaid eligibility or a spouse's eligibility for and purchase of employer-sponsored coverage).

However, an employee who is eligible for Medicare or Medicaid is not eligible for a subsidy to purchase coverage through an Exchange. If no full-time employee receives a subsidy (for example, because all of an ALE's full-time employees are eligible for Medicare or Medicaid), the employer will not be subject to an employer shared responsibility penalty. In addition, employees who are eligible for Medicare or Medicaid cannot trigger a penalty under the employer shared responsibility rules because they are not eligible for a subsidy.

MINIMUM PARTICIPATION REQUIREMENTS

Many employers expressed concern about potential liability under the employer shared responsibility rules for ALEs that cannot obtain or maintain coverage for its employees because the employer cannot satisfy a health insurance issuer's minimum participation requirements. In the large group market, a minimum participation requirement cannot be used to deny guaranteed issue.

For small employers, such as relatively small ALEs, final regulations issued by HHS provide that an issuer must guarantee issue coverage to a small employer during an annual, month-long open enrollment period, regardless of whether the small employer satisfies any minimum participation requirement. HHS regulations generally define a small employer as one that has at least one, but not more than 100, employees. For plan years beginning before Jan. 1, 2016, states may set the upper limit at 50 employees.

APPLICATION TO COMMONLY OWNED COMPANIES

The final regulations address how the ACA's pay or play rules apply to companies that are treated as a single employer under Internal Revenue Code (Code) sections 414(b), (c) or (m) because they form a controlled group of businesses or an affiliated service group. To determine whether a company is an ALE, aggregation rules apply for companies that are related or commonly owned. *Under these rules, all employees of a controlled group of businesses or an affiliated service group are taken into account to determine whether an employer is subject to the pay or play rules.* If the combined total meets the ALE threshold, each separate member of the group is subject to the pay or play rules, even those companies that on their own do not have enough employees to meet the threshold.

For a full-time employee who is employed by two or more companies that are treated as a single employer under the Code's aggregation rules, the final regulations provide that an offer of coverage by one company to an employee is treated as an offer of coverage by all other members of the controlled group or affiliated service group. Thus, if one member of the group offers coverage to the employee for a calendar month, every other member of the same applicable large employer group is considered to have made the same offer of coverage to that employee for purposes of determining liability under the employer shared responsibility rules, if any, of each member.

For example, in the case of a group of ALEs operating a single plan intended to offer coverage to employees of all the ALE members, any employee offered coverage under the plan would be treated as receiving an offer of that coverage from each ALE member.

APPLICATION TO MULTIEMPLOYER AND SINGLE EMPLOYER TAFT-HARTLEY PLANS, MULTIPLE EMPLOYER WELFARE ARRANGEMENTS (MEWAS) AND OTHER SIMILAR ARRANGEMENTS

The final regulations provide clarification of whether an offer of coverage under a multiemployer or single employer Taft-Hartley plan, if the employer contributed to the plan on behalf of the employee, constitutes an offer of coverage by the employer for purposes of the employer shared responsibility rules. In general, an offer of coverage includes an offer of coverage made **on behalf of an employer**. This includes an offer made by a multiemployer or single employer Taft-Hartley plan or a MEWA to an employee on behalf of a contributing employer of that employee.

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Under this same reasoning, if certain conditions are met, an offer of coverage to an employee performing services for an employer that is a client of a **professional employer organization** (PEO) or other **staffing firm** (in the typical case in which the PEO or staffing firm is not the common law employer of the individual) made by the staffing firm on behalf of the client employer under a plan established or maintained by the staffing firm is treated as an offer of coverage made by the client employer for purposes of the employer mandate. For this purpose, an offer of coverage is treated as made on behalf of a client employer only if the fee the client employer would pay to the staffing firm for an employee enrolled in health coverage under the plan is **higher** than the fee the client employer would pay to the staffing firm for the same employee if the employee did not enroll in health coverage under the plan.

DEMONSTRATING THAT AN OFFER OF COVERAGE WAS MADE

The final regulations do not apply any specific rules for demonstrating that an offer of coverage was made. The otherwise generally applicable substantiation and recordkeeping requirements in Internal Revenue Code (Code) section 6001 apply, including the recordkeeping requirements in IRS Rev. Proc. 98–25.

In addition, the offer generally can be made electronically. The IRS has provided a safe harbor method for use of electronic media in 26 CFR § 1.401(a)–21.

TRANSITION RELIEF FOR JANUARY 2015

In general, the employer shared responsibility rules provide that if an ALE fails to offer coverage to a full-time employee for any day of a calendar month, that employee is treated as not offered coverage during that entire month. However, many employers offer coverage for a new year effective as of the first day of the **first pay period** beginning on or after the first day of the year. As a result, questions have arisen as to whether a full-time employee will be treated as having been offered coverage for January 2015 (the first month in which the employer shared responsibility rules apply) if the offer of coverage applies no later than the first day of the first payroll period that begins in that month.

Thus, the final regulations provide transition relief from this requirement for January 2015. Solely for purposes of January 2015, if an ALE offers coverage to a full-time employee no later than **the first day of the first payroll period that begins in January 2015**, the employee will be treated as having been offered coverage for January 2015. This transition relief applies only for January 2015.

MORE INFORMATION

Please contact Loudoun Insurance Group LLC for more information on the ACA's pay or play rules.

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BK 5/14