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Meeting the government’s is critical.”

## **Employer Compliance Alert**

### **Health Care Reform Update: IRS Proposes Regulations on Employer Penalty**

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The Internal Revenue Service has released proposed regulations on the health care reform employer "shared responsibility" penalty provision. This is the penalty on "large" employers (those with at least 50 full-time or full-time equivalent employees) that do not provide affordable minimum essential coverage for full-time employees and their dependents and have at least one full-time employee who receives subsidized Exchange coverage (new Internal Revenue Code section 4980H, enacted as part of the Patient Protection and Affordable Care Act of 2010 as amended by the Health Care and Education Reconciliation Act of 2010). The IRS also posted on its website a set of related questions and answers.

#### **Employers Affected**

An employer meets the penalty provision's large employer threshold if it employed, on average, at least 50 full-time or full-time equivalent employees in the prior calendar year. Thus, for 2014, the first year the penalty is effective, an employer would consider the average number of such employees it had during 2013 to determine whether it is a covered large employer. The proposed regulations include a transition rule under which employers may use any consecutive six-month period in 2013, instead of the full year, to calculate the average number of employees.

A full-time employee is one who is employed by the employer an average of 30 hours per week. Part-time employees count, too, taking into account the number of full-time equivalents: For a given month, add the number of hours for all part-time employees (counting no more than 120 hours for any one employee) and divide by 120. Count all hours worked and all hours for which payment is made or due for

vacation, illness, holiday, incapacity, layoff, jury duty, military duty, or leave of absence. Notice 2011-36 had limited the period of leave that must be included to 160 hours but the proposed regulations eliminate this limitation.

The proposed regulations clarify that the IRS's safe harbor for determining full-time status (i.e., using the look-back/stability period approach) will not apply for purposes of determining whether an employer meets the threshold of 50 full-time employees. Instead, whether an employer is a large employer for a given year will be determined by calculating employees' actual hours of service in the immediately preceding year. Equivalency rules may be used for employees not paid on an hourly basis. An entity not in existence in the preceding year may be a large employer in its first year if it is reasonably expected to employ an average of at least 50 full-time employees during its first year. Special hours-counting rules are proposed for educational institutions, employees paid on a commission basis, and other circumstances.

Whether a worker is an employee of a particular employer will be based on the long-standing common law principle that, if a service recipient has the right to direct and control how a worker performs services, that service recipient is the worker's employer. The proposed regulations also reiterate that controlled group rules apply for purposes of identifying the employer. Thus, all common law employees of all entities that are part of the same controlled group or affiliated service group must be counted to determine whether the threshold of 50 full-time employees is met.

### **Assessable Penalty for Affected Employers**

For a given month beginning after 2013, if an employer does not offer minimum essential coverage to "substantially all" of its full-time employees and their dependents and a full-time employee obtains subsidized Exchange coverage, the employer must pay a penalty equal to \$166.67 multiplied by the number of its full-time employees in excess of 30. Under the proposed regulations, "substantially all" means all but five percent of full-time employees or, if greater, five full-time employees. The proposed regulations define "dependent" as a child, within the meaning of Code 152(f)(1), who is under age 26. (Thus, a spouse is not a dependent.) The proposed regulations offer transitional relief (only for 2014) for employers that do not currently provide dependent coverage. Any employer that takes steps during its plan year that begins in 2014 toward offering dependent coverage will not be liable for penalties solely on account of its failure to offer dependent coverage for that plan year. The proposed rules also explain that the 30-employee reduction used when calculating this penalty is applied on a controlled group basis so that each member company reduces its number of full-time employees by a ratable share of 30.

If an employer offers minimum essential coverage to substantially all of its full-time employees and their dependents, but a full-time employee nevertheless obtains subsidized Exchange coverage (i.e., because the employer's coverage fails to meet the minimum value or affordability test), the employer must pay a penalty equal to the lesser of the penalty determined in the preceding paragraph or \$250 multiplied by the number of full-time employees who are certified as having subsidized Exchange coverage for the month.

Since no penalty is triggered unless at least one full-time employee obtains subsidized

Exchange coverage, it is important to know whether a full-time employee can obtain subsidized Exchange coverage. An employee can obtain subsidized Exchange coverage only if his or her household income is between 100 percent and 400 percent of the federal poverty line, he or she enrolls in Exchange coverage and is not eligible for Medicaid (or other government coverage), and either no employer coverage is offered or the employer coverage offered fails to meet either a minimum value test or an affordability test:

- Employer coverage meets the minimum value test if it covers at least 60 percent of the total allowed cost of benefits that are expected to be incurred under the plan. The Department of Health and Human Services is working with IRS to develop a calculator that employers may use to determine whether this test is met.
- Employer coverage meets the affordability test if the employee is required to pay no more than 9.5% of his household income for self-only coverage. Since employers have no practical way of knowing what an employee's household income is, the IRS previously stated that employers could use an employee's W-2 reported wages as a safe harbor. The proposed regulations explain how that safe harbor would apply, including how it would apply to partial years worked. The W-2 safe harbor will be very useful to most employers, but the proposed regulations also offer two additional safe harbors that employers may use to determine affordability: one based on monthly rate of pay (i.e., coverage is affordable if the employee's monthly cost for self-only coverage does not exceed 9.5% of his monthly rate of pay) and the other based on eligibility for Medicaid (i.e., coverage is affordable if the employee's cost for self-only coverage does not exceed 9.5% of the federal poverty line for a single individual).

If an employee elects coverage under an employer's group health plan, the employee cannot qualify for subsidized Exchange coverage even if the employer coverage fails the minimum value or affordability test. However, providing mandatory group health coverage that fails the minimum value or affordability test will not prevent an employee from obtaining subsidized Exchange coverage.

The proposed regulations retain the look-back/stability period safe harbor method provided in prior guidance for determining which employees are full-time for purposes of the penalty calculation. Thus, an employer can use a look-back period of up to 12 months to determine whether an on-going employee (i.e., one employed for at least the length of the look-back measurement period selected) is a full-time employee. If an employer uses a look-back/stability period for its on-going employees, it also can use the look-back/stability period for new and seasonal employees. The proposed regulations include additional special rules for a new variable-hour employee or seasonal employee whose status changes during the look-back measurement period, for rehired employees and employees returning from unpaid leaves of absence, for employees of temporary agencies, and for other special circumstances.

The proposed regulations assure that an employer will (a) receive certification of an employee's receipt of subsidized Exchange coverage and (b) have an opportunity to respond regarding application of the penalty before IRS actually assesses a penalty

in connection with that employee.

Recordkeeping obviously is important both for compliance (existing law already requires substantial recordkeeping for tax purposes) and to substantiate any defense to a penalty.

### Opportunity to Comment on Proposed Regulations

Employers and other stakeholders can help shape final regulations at a public hearing on April 23, 2013, and by submitting written comments by March 18, 2013. In addition, the government also requests comments on the new Code Â§ 6056 employer-reporting requirements and the 90-day waiting period rule.

Please contact your UBA Partner Firm if you have any questions about health care reform.

**Jackson Lewis LLP**

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