Employer Penalty Provisions:

Further Details on the Proposed Regulations and Q&As

Mike Holland | Innovative Insurance | (203) 292-5905 | mike@innovativeinsurance.net

Issued date: 01/31/13

The IRS issued proposed regulations, together with Q&As, on the employer penalty provisions that provide additional information and greater clarity on how these provisions will apply. Employers may rely on the proposed regulations for guidance pending the issuance of final regulations or other guidance. If the final regulations are more restrictive than the guidance in the proposed regulations, the final regulations will be applied prospectively, and employers will be given sufficient time to come into compliance with the final regulations.

Background

Beginning January 1, 2014, there are two potential employer penalties under health care reform related to offering group medical coverage. The "No Coverage" penalty applies if a large employer (average of 50 or more full-time employees (including full-time equivalents) in the preceding calendar year) does not offer all (or substantially all) full-time employees and their dependents minimum essential coverage and one full-time employee receives a subsidy in the Exchange. This penalty is $2,000 multiplied by the number of full-time employees in excess of 30. The "Offer Coverage" penalty applies if a large employer does offer minimum essential coverage to all (or substantially all) full-time employees, but that coverage is either unaffordable, or does not provide a minimum value, and one full-time employee receives a subsidy in the Exchange. This penalty is $3,000 multiplied by the total number of full-time employees who receive the government subsidy in the Exchange, with a maximum penalty of the "No Coverage" penalty.

Below you will find a summary of the key provisions contained in the proposed regulations.

Transition Relief

Non-Calendar Year Plans: An employer with a non-calendar year plan ("fiscal year plan") may be eligible for transitional relief that would delay the potential for a penalty until the first day of the fiscal plan year that begins in 2014 (as opposed to January 1, 2014). This relief is not afforded to a calendar year plan. The relief applies in the following scenarios:

a. For any employees who are eligible for coverage under the terms of an employer's plan as of December 27, 2012 (regardless of whether they take the coverage), the employer will not be subject to a potential penalty as to those employees until the first day of the plan year that begins in 2014.

b. Additionally, with respect to any other employees, as of December 27, 2012, if at least 25% of all employees (full-time and part-time) are covered by the employer's plan, or at least 33% of all employees are offered coverage under the plan, the employer will not be subject to a potential penalty as to any full-time employee until the first day of the fiscal plan year that begins in 2014.

This document is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws or regulations, or to address specific client situations. You should not act or rely on any information contained herein without seeking the advice of an attorney or tax professional.

Thus, if at open enrollment an employer offers coverage under a fiscal plan year with the plan year starting July 1, 2013 to at least 33% of its employees, the employer can avoid liability for an employer penalty if, by July 1, 2014, the employer expands the plan to offer coverage satisfying the employer penalty provisions to the full-time employees who had not been offered coverage.

Dependent Coverage: For employers that do not currently cover dependent children, transition relief is available to provide these employers sufficient time to implement the change requiring coverage of dependent children in order to avoid penalty exposure beginning in 2014. Any employer that "takes steps" during its plan year that begins in 2014 toward satisfying the requirement to offer coverage to full-time employees' dependents will not be liable for any penalty solely on account of a failure to offer coverage to the dependents for that plan year. Coverage for dependents will need to be offered beginning with the 2015 plan year in order to avoid a potential penalty for not offering coverage to full-time employees (and their dependents).

Large Employers: Some employers will be close the 50 full-time employee threshold and will need to calculate whether they are subject to the employer penalty provisions. Specifically for 2014, an employer has the option to determine its status as a large employer by determining whether it employed on average at least 50 full-time employees on business days during any consecutive 6-month period in 2013 (rather than the entire calendar year). This will provide these employers with 6 months to analyze their results, determine whether they need to offer a plan, and choose a plan if necessary.

Mid-Year Change to Non-Calendar Year Cafeteria Plans: In 2014, employees may either wish to enroll in the Exchange and discontinue employer health plan coverage or choose to enroll in the employer's health plan in order to avoid the individual tax for not having health insurance coverage. The existing election rules for cafeteria plans will not allow an individual to make these mid-year election changes. The regulations propose transition relief to allow employers to amend fiscal year cafeteria plans to permit either or both of the following election changes: an employee who elected to salary reduce through the cafeteria plan is allowed to prospectively revoke or change his/her election once during that plan year, without regard to whether the employee experienced a change in status event; and an employee

This document is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws or regulations, or to address specific client situations. You should not act or rely on any information contained herein without seeking the advice of an attorney or tax professional.

who failed to make a salary reduction election through the cafeteria plan with a fiscal plan year beginning in 2013 is allowed to make a prospective salary reduction election on or after the first day of the 2013 plan year of the cafeteria plan, without regard to whether the employee experienced a change in status event. These changes must be incorporated into the written cafeteria plan document; the amendment may be made retroactively as long as it's not made later than December 31, 2013 and is effective the first day of the 2013 fiscal plan year.

Shorter Measurement Period: Solely for the purpose of stability periods beginning in 2014, employers may adopt a transition measurement period that is shorter than 12 months, but not less than 6 months, that begins no later than July 1, 2013 and ends no earlier than 90 days before the first plan year beginning on or after January 1, 2014.

Measurement and Stability Periods

Change in Employment Status: A new variable hour or seasonal employee who has a change in employment status (where such change would have resulted in the employee being reasonably expected to work at least 30 hours per week had the employee begun employment in such position) during an initial measurement period is treated as a full-time employee as of the first day of the 4th month following the change in employment status or, if earlier and the employee averages more than 30 hours of service per week during the initial measurement period, the first day of the first month following the end of the initial measurement period. This does not apply to ongoing employees.

Rehired Employees/Employees Resuming Service: Solely for purposes of determining the full-time employee status for employers using the look-back measurement method, under the proposed regulations, if the period for which no hours of service is credited is at least 26 consecutive weeks, an employer may treat an employee who has an hour of service after that period, for purposes of determining the employee's status as a full-time employee, as having terminated employment and having been rehired as a new employee of the employer. The employer may also choose to apply a rule of parity for periods of less than 26 weeks, where the employee may be treated as having terminated employment and having been rehired as a new employee if the period with no credited hours of service (of less than 26 weeks) is at least 4 weeks long and is longer than the employee's period of employment immediately preceding that period with no credited hours of service.

Special Unpaid Leave: The proposed regulations suggest a method for averaging hours when applying the look-back measurement method to measurement periods that include unpaid leave which is due to FMLA, USERRA or jury duty. Here, the employer would determine the average hours of service per week for the employee during the measurement period excluding the special unpaid leave period and use that average as the average for the entire measurement period. The employer may also choose to treat employees as credited with hours of service for special unpaid leave at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not special unpaid leave.

Changing the Measurement Period: A large employer may change its standard measurement period and stability period for subsequent years, but generally may not change the standard measurement period or stability period once the standard measurement period has begun.

Anti-Abuse Rules: For employers of employees whose compensation is not based primarily on hours of service, or whose active work hours may be subject to safety-related regulatory limits (such as salespeople paid on commission basis, adjunct faculty, or airline pilots whose flying hours are subject to limits) until further guidance is issued, employers must use a reasonable method of crediting hours of service. Methods of crediting hours that take into account only some of an employee's hours of service, or that would characterize a full-time employee as part-time would not be reasonable. It should also be noted that a change in plan year is not permitted if a principal purpose of the change is to circumvent the employer penalty provisions.

Hours Worked: Hours worked includes not only hours when work is performed, but also hours for which an employee is paid or entitled to payment even when no work is performed. For employees paid on an hourly basis, employers must calculate actual hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. For employees not paid on an hourly basis, employers may calculate the number of hours of service under any of the

This document is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws or regulations, or to address specific client situations. You should not act or rely on any information contained herein without seeking the advice of an attorney or tax professional.

following methods: actual hours of service, days-worked equivalency, or weeks-worked equivalency. Employers may apply different methods for different classifications of non-hourly employees, as long as the classifications are reasonably and consistently applied. Additionally, the method of calculation may be changed for each calendar year.

Temporary Staffing Agencies: At this time there are no special rules for temporary staffing agencies. Employees of a temporary staffing agency are not presumed to be variable hour employees. It is anticipated that final regulations will contain an anti-abuse rule to address various structures being considered under which employers might use temporary staffing agencies to evade the employer penalty.

Offering Coverage

The regulations clarify that if a large employer fails to offer coverage to a full-time employee for any day of a calendar month during which the employee was employed by the employer, the employee is treated as not being offered coverage during that entire month. However, in a calendar month when a full-time employee terminates employment, if the employee would have been offered coverage for the entire month if the employee had been employed for the entire month, the employee is treated as having been offered coverage during that month. There are no new specific rules to demonstrating that an offer of coverage was made. An employee must have an effective opportunity to accept coverage, and to decline coverage that is not minimum value or is not affordable. An employer cannot make someone ineligible for a premium tax credit by providing the employee with mandatory coverage that does not meet minimum value. Further, if an employee enrolls in coverage but fails to pay the employee's 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 timely paid, and that employer is treated as having offered that employee coverage for the remainder of the coverage period. The proposed regulations adopt the COBRA rule providing a 30-day grace period for payment of premiums.

Definitions

Substantially All: The requirement to offer minimum essential coverage to substantially all full-time employees and their dependents in order to avoid the No Coverage penalty will require an offer of such coverage to at least 95% of all

This document is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws or regulations, or to address specific client situations. You should not act or rely on any information contained herein without seeking the advice of an attorney or tax professional.

full-time employees and their dependents (or, if greater, to 5 full-time employees).

Dependents: For purposes of the requirement to offer coverage to dependents as a condition of avoiding the penalty, the regulations define "dependents" as the employee's children up to age 26, and not any spouse.

Variable Hour Employees: A variable hour employee means an employee if, based on the facts and circumstances at the employee's start date, a large employer cannot determine whether the employee is reasonably expected to be employed on average at least 30 hours of service per week during the initial measurement period because the employee's hours are variable or otherwise uncertain.

Controlled Groups

Commonly owned employers must be aggregated for purposes of determining whether they are subject to the penalty rules, but the actual penalty assessment will be done on an employer-by-employer basis, based on whether the individual employer provides the required coverage or not. Further, the 30-employee reduction in the No Coverage penalty is determined on an aggregated basis; the reduction is allocated among each individual employer ratably on the basis of the number of full-time employees employed by each.

Employers and Employees

New Employers: An employer not in existence during an entire preceding calendar year is a large employer for the current calendar year if it is reasonably expected to employ an average of at least 50 full-time employees on business days during the current calendar year.

Number of Full-Time Employees: In determining the number of full-time employees for each calendar month, fractions are taken into account. However, the number may be rounded down. Thus, if an employer calculates it has 49.9 full-time employees (including full-time equivalents) for the preceding year, it would be rounded down to 49 full-time employees and the employer would not be a large employer in the current calendar year.

Overseas Employees: Employees working overseas generally will not have hours of service and will not qualify as full-time employees either for purposes of determining an employer's status as a large employer or for purposes of determining and calculating any potential liability. This rule applies without regard to the residency or citizenship of the individual.

Teachers: Any employee of an educational organization who works full-time during the active portions of the academic year is treated as a full-time employee, not a seasonal employee. (Note that the term "seasonal employee" has not yet been defined and employers should use a reasonable, good faith interpretation of the statutory definition of seasonal worker.)

Affordability Safe Harbors

The proposed regulations provide 3 safe harbors. The employee's monthly contribution amount for self-only premium of the employer's lowest cost coverage that provides a minimum value is "affordable" if it is equal to or lower than 9.5% of any of the following:

a. The employee's Form W-2 wages (Box 1). Application is determined after the end of the calendar year and on an employee-by-employee basis.

b. The employee's computed monthly wages. For hourly employees, this is the employee's applicable hourly rate of pay multiplied by 130 hours.

c. The Federal Poverty Level for a single individual.

Payment of the Employer Penalty

The IRS will contact employers to inform them of their potential liability and provide them an opportunity to respond before any liability is assessed or notice and demand for payment is made. The contact for a given calendar year will not occur until after employees' individual tax returns are due for that year claiming premium tax credits and after the due date for employers that meet the 50 full-time employee threshold to file the information returns identifying their full-time employees and describing the coverage that was offered (if any). If it is determined that an employer is liable for an employer penalty payment after the employer has responded to the initial IRS contact, the IRS will send a notice and demand for payment. That notice will instruct the employer on how to make the payment. Employers will not be required to include the employer penalty payment on any tax return they file.

This document is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws or regulations, or to address specific client situations. You should not act or rely on any information contained herein without seeking the advice of an attorney or tax professional.

Additional Guidance To Come

The proposed regulations refer to a number of issues that will be addressed in subsequent guidance, including the following:

- Further guidance on minimum essential coverage and employer sponsored coverage
- Additional guidance on the minimum value standard
- Information reporting requirements by large employers
- Process for advising large employers where an employee is certified to receive a subsidy on the Exchange

This document is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws or regulations, or to address specific client situations. You should not act or rely on any information contained herein without seeking the advice of an attorney or tax professional.