PPi Benefit Solutions

HEALTH CARE REFORM

Employer Mandate: Penalties

All applicable large employers are at risk for employer mandate penalties, including for-profit, non-profit, private employers, churches, government entities and Indian tribal government employers.

PPACA requires applicable large employers – those with 50 or more full-time employees (FTEs) and full-time equivalents – to offer affordable minimum value coverage to substantially all FTEs (those working 30 hours or more per week) and their dependents, or risk a penalty. The requirement, known as the employer mandate, is generally effective Jan. 1, 2015 (although a delayed effective date may apply for employers with 50–99 FTEs and full-time equivalents and for employers that sponsor non-calendar-year plans, if certain requirements are met).

The employer mandate consists of two potential penalties: Penalty A and Penalty B. Depending on the situation, only one will actually apply to an employer. Special rules – further described below – apply for employers that are part of a controlled group (i.e., share common ownership or control). In addition, although generally expressed as an annual amount, both penalties are calculated on a monthly basis.

Penalty A

Penalty A, generally viewed as the more severe penalty, is an annual penalty equal to $2,000 times the total number of FTEs (minus the first 30, although – for 2015 only – it is minus the first 80). Penalty A is triggered if the employer fails to offer minimum essential coverage (MEC) to substantially all FTEs and their dependents, and at least one FTE qualifies for a premium tax credit or cost-sharing reduction through a state health insurance exchange. To avoid Penalty A, employers must understand the meanings of "MEC," "substantially all" and "dependent."

Minimum Essential Coverage

"MEC" is defined very broadly as an "eligible employer-sponsored plan," which includes fully insured group coverage offered in the small or large market, as well as many self-insured plans. Importantly, though, MEC does not include HIPAA-excepted benefits, such as health FSAs, disability coverage, accidental death and dismemberment coverage, and limited-purpose or stand-alone dental or vision coverage.

Substantially All

"Substantially all" generally means 95 percent of all FTEs (or five FTEs, if greater than 95 percent). That is, an employer must offer MEC to no fewer than 95 percent of its FTEs (or five FTEs, if greater). For 2015 only, "substantially all" means 70 percent of all FTEs (instead of the greater of 95 percent or five FTEs).

Dependent

"Dependent" means a child of an employee who has not attained age 26. This includes biological and adopted children, but does not include step and foster children. Dependent status applies for the entire calendar month during which the child attains age 26. Importantly, the term does not include a spouse (whether same or opposite-sex) or domestic partner (DP). Thus, an employer need not offer coverage to employees' spouses or DPs to avoid employer mandate liability. But keep in mind that for fully insured plans, state law may prohibit an employer from excluding spouses from coverage. Ask your advisor if you are unsure about your state's requirements.

If an employer is offering MEC to substantially all FTEs and their dependent children for each month of the year, then the employer will not be subject to Penalty A. However, there is a temporary transition rule that applies to employers currently (A) not offering dependent coverage, (B) offering dependent coverage that is not minimum essential coverage or (C) offering coverage to some, but not all, dependents. Such employers may qualify for transition relief, presuming they take steps during the plan years beginning in 2014 or 2015 (or both) to expand dependent coverage availability. Employers should consult their advisors for help if this situation may apply.

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Penalty B

Penalty B is an annual penalty equal to $3,000 times the actual number of FTEs that do qualify for a premium tax credit or cost-sharing reduction. Penalty B is triggered if the employer offers MEC to substantially all FTEs and their dependents, but the coverage is either not of minimum value (MV) or is not affordable. To avoid Penalty B, employers must understand the meanings of "MV" and "affordable."

Minimum Value

"MV" means that the plan will pay at least 60 percent of the costs incurred by the participant and his or her beneficiaries. In other words, the employee cannot be responsible for more than 40 percent of the benefit costs that he or she incurred under the plan. Importantly, employer contributions to a health savings account (HSA) and an integrated health reimbursement arrangement (HRA) (so long as HRA reimbursements are not limited only to premiums) are included in the plan's share of costs for purposes of the MV calculation. Overall, there are several methods to determine minimum value.

MV Calculator: This tool is available through the U.S. Department of Health and Human Services (HHS) website, and allows employers to enter details of the plan and calculate MV. The MV calculator is similar to the actuarial value (AV) calculator developed by HHS to determine the AV of qualified health plans offered through the state health insurance exchanges, although the AV calculator cannot be used to determine MV.

Design-based MV Safe Harbor Checklist: This tool provides several examples of plan designs that would satisfy the 60 percent threshold if measured using the MV calculator. Proposed plan designs for the checklist include plans with a:

1. $3,500 integrated medical/drug deductible, 80 percent plan cost-sharing and a $6,000 out-of-pocket (OOP) maximum limit for employee cost-sharing
2. $4,500 integrated medical/drug deductible, 70 percent plan cost-sharing, $6,400 OOP maximum limit and a $500 employer contribution to an HSA
3. $3,500 medical deductible, $0 drug deductible, 60 percent plan medical cost-sharing, 75 percent drug cost-sharing, a $6,400 OOP maximum limit and drug copays of $10/$20/$50 for first, second and third prescription drug tiers, with 75 percent coinsurance for specialty drugs

Future guidance will further expand the safe harbor plan design list and will hopefully include additional common plan design features, such as copayments for office visits or other services.

Actuarial Certification: Employers may always seek certification by an actuary to determine MV. Certification is particularly recommended where the plan has nonstandard features, such as limits on the number of physician visits or covered days in a hospital.

Affordable

"Affordable" generally means that the employee's cost for single-only coverage does not exceed 9.5 percent of that employee's household income. However, since employers may not know an employee's total household income, there are three available safe harbors for determining whether coverage is affordable.

Form W-2 Safe Harbor: Under the Form W-2 safe harbor, coverage is affordable if the employee's cost for single-only coverage does not exceed 9.5 percent of that employee's Form W-2 wages (as reported in Box 1). So, on an employee-by-employee basis, the employer would compare the employee's current, expected Form W-2 wages to the amount of the employee's required premium contribution for the current year.

> ***Example 1:*** *For 2015, Employee A's Form W-2 wages are $30,000, and the employee's required premium contribution for 2015 is $1,500. Because the employee contribution for 2015 is less than 9.5 percent of Form W-2 wages ($1,500 is 5 percent of $24,000), the coverage is affordable for Employee A for 2015.*

While the actual application of the safe harbor would generally be performed retroactively at the end of the calendar year, an employer could use the safe harbor prospectively at the beginning of the calendar year by setting the employee contribution such that the contribution would not exceed 9.5 percent of employees' Form W-2 wages. Setting the safe harbor contributions prior to having actual Form W-2 data available can make this approach tricky to implement, particularly where Form W-2 wages fluctuate dramatically during the year. But it is a good option for employers with stable compensation costs.

> ***Example 2:*** *For 2015, Widgets, Inc. sets the employee premium contribution such that employees, regardless of actual wages, will pay only 9 percent of wages that are reported in Form W-2 Box 1 (i.e., all employees pay 9 percent of their wages, deducted from their salary each pay period). Since each employee will pay less than 9.5 percent of their Form W-2 wages, the coverage is affordable for all employees for 2015.*

Rate of Pay Safe Harbor: Under the rate of pay safe harbor, coverage is affordable if the employee's cost for single-only coverage does not exceed 9.5 percent of that employee's rate of pay. For an hourly employee, the employer uses an assumed rate of 130 hours per calendar month multiplied by the hourly employee's rate of pay (regardless of whether the employee actually works more or less than 130 hours). For a non-hourly (salaried) employee, the employer uses the employee's monthly salary, as of the first day of the coverage period.

Example 3: For 2015, Widgets, Inc. has 100 hourly employees, paying each one $10 per hour for each calendar month of the year, and 100 non-hourly employees with a monthly salary of $3,000. Under the rate of pay safe harbor, Widgets, Inc. assumes a monthly income of $1,300 ($10 times 130 hours) for each hourly employee. To satisfy the safe harbor for the non-hourly employees, Widgets, Inc. would set the employee monthly contribution amount at a rate that does not exceed 9.5 percent of $1,300 (or $123.50). Similarly, the employer would set the employee monthly contribution for the salaried employees at a rate that does not exceed 9.5 percent of $3,000 (or $285). If Widgets, Inc. does so, the coverage would be treated as affordable for both hourly and salaried employees for 2015.

Special rate of pay safe harbor rules apply where the employee's rate of pay increases or decreases during a month or year. Employers should consult their advisors for help in those situations.

Federal Poverty Line (FPL) Safe Harbor: Under the FPL safe harbor, coverage is affordable if the employee's monthly cost for single-only coverage does not exceed 9.5 percent of the FPL for a single individual divided by 12 (to convert the FPL from an annual to a monthly amount). By using the FPL safe harbor, the employer may ignore employees' actual wages (thus avoiding troublesome issues such as fluctuation in hours, increase or decrease in rates of pay, etc.). Importantly, to allow time for planning, employers may use the FPL guidelines in effect six months prior to the beginning of the plan year.

Example 4: *Assume that the FPL for 2015 for an individual is $11,670. Widgets, Inc. sets the monthly employee contribution for single-only coverage for each calendar month of 2015 at $92. Since $92 does not exceed 9.5 percent of the FPL (9.5 percent of $11,670 divided by 12 would be $92.39), the coverage would be treated as affordable for all employees for 2015, regardless of the number of actual hours worked by any employee.*

In summary, employers may (but are not required to) rely on any one of the three safe harbors in determining whether coverage is affordable. Employers may also use different safe harbors for different classes of employees, so long as the classes are based on a business purpose (such as different geographic locations, job types, nature of compensation, etc.). Also, generally speaking, employer HSA contributions and wellness program premium discounts are not included in determining affordability. Contributions to integrated HRAs may only be included if HRA funds can be used to pay premiums (in that case, the HRA contributions could not also count toward satisfying MV, described above).

Application of Penalties to Controlled Groups

The employer mandate incorporates the controlled group rules found in Internal Revenue Code Section 414. Under Section 414, if two or more companies have sufficient common ownership or are under common control, they are treated as a single employer. A discussion of Section 414 is beyond the scope of this paper, but the most basic controlled group would be where a parent company owns 80 percent or more of one or more subsidiaries (known as a parent-subsidiary controlled group).

As it relates to the employer mandate penalties, the coverage tests and penalty assessments are calculated and imposed separately on each company within the controlled group (referred to as "controlled group members"). In other words, the penalties apply on a member-by-member basis, such that the parent company would not be liable for the subsidiary company's failure to offer affordable coverage to subsidiary employees (and vice versa). Accordingly, each controlled group member is responsible for ensuring that it offers affordable, MV coverage to substantially all of its FTEs and their dependents, or it will pay a penalty for its own failure.

Along those lines, if an FTE is working for multiple controlled group members, the member for whom the FTE has the greatest number of hours of service is the member with employer mandate responsibility. However, an offer of coverage by one controlled group member is treated as an offer of coverage by all controlled group members for that month.

Lastly, with respect to the 30- or 80-employee reductions in calculating Penalty A, the reduction is allocated ratably among controlled group members based on the number of FTEs employed by each member (and the ratable share can be rounded up one FTE).

Example 5: *In 2016, Parent P wholly owns Subsidiary S. P employs 200 FTEs, and S employs 100 FTEs. For 2016, P offers affordable MV coverage to all 200 of its FTEs, but S fails to offer any coverage to its 100 FTEs, and one of S's FTEs qualifies for a premium tax credit. Therefore, Penalty A applies to S for 2016. The amount of the penalty is $2,000 times the total number of FTEs (100) minus 30. The 30-employee reduction is shared, however, between P and S. As a result, S's reduction is 10 (100 of 300 total employees, resulting in one-third of 30). Thus, the total penalty for S is $2,000 times 90, or $180,000.*

Payment and Tax Treatment of Penalties

Employers and controlled group members are responsible for reporting and paying employer mandate penalties in the year following the compliance year (i.e., 2015 penalties will be reported and paid in 2016). (A full discussion of reporting is beyond the scope of this paper.) Finally, employers should note that employer mandate penalty payments are not tax deductible.

Additional Resources

Final Regulations
IRS FAQ

About PPI Benefit Solutions

PPI Benefit Solutions helps smaller, mid-sized employers relieve the day-to-day challenges of managing an employee benefits program. With over 40 years of benefits administration experience working with nonprofit organizations, PPI leverages strategic relationships with a broad array of nationally recognized insurance carriers and powerful, web-based technology to provide a single solution for multiple carrier enrollments and eligibility processing, true premium billing, COBRA Administration, and member advocacy services, all at little or no cost to the employer. Working exclusively through brokers, PPI serves over 1,300 clients and nearly 100,000 employees.

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