VENABLE LLP

Employee Benefits and Executive Compensation Alert

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Limited Relief for Employers under Health Care Reform's "Play-or-Pay" Rules

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Proposed regulations issued by the Internal Revenue Service on December 28, 2012 provide some relief to large employers subject to the employer-sponsored coverage mandate under health care reform. The employer mandate is described in detail in our prior alert that can be accessed at the following link: **Don't Play and Also Pay: Navigating the Employer-Sponsored Health Coverage Mandate**. Although issued as proposed regulations, employers may rely on these rules pending the issuance of final regulations or other applicable guidance. Below are highlights of some of the key changes to the employer mandate incorporated in the proposed regulations.

Key Changes Relating to the Implementation of the No Coverage Penalty

In the event that an employer becomes subject to the no coverage penalty, the employer is generally required to pay a monthly penalty of $166.67 (adjusted for inflation) multiplied by its total number of full-time employees (excluding the first 30). The new guidance reduces this potential burden in two key ways.

First, the statute states that the no coverage penalty applies if a large employer "fails to offer to its full-time employees (and their dependents)" health coverage. Therefore, the statute could have been interpreted by the IRS to mean that the no coverage penalty was triggered where an employer failed to offer coverage to even just one of its full-time employees. The proposed regulations indicate that the IRS has adopted a more liberal approach—thereby reducing the risk to an employer of triggering the no coverage penalty by providing that the penalty applies only if an employer fails to offer coverage to more than 5% (or, if greater, five) of its full-time employees. Thus, provided at least 95% of full-time employees (and their children)[1] are offered coverage, the no coverage penalty will not apply. This clarification provides employers with a much needed "margin for error" in applying the complex IRS rules defining full-time employees for penalty purposes. Notably, however, if one of these full-time employees who were not offered employer-sponsored coverage purchases health insurance through a state-based or federally-facilitated exchange, the unaffordability penalty may be triggered.

Second, the proposed regulations clarify that the no coverage penalty is not calculated on a controlled group basis. Instead, the penalty is applied company-by-company. Thus, if a company within a controlled group becomes subject to the no coverage penalty, the penalty will be calculated based only on that company's full-time employee count (minus its allocable share of the 30-employee reduction). While the determination of whether an employer is "large" for purposes of the employer mandate (and thus subject to the mandate) continues to apply on a controlled group basis, this change provides significant relief to companies that are part of large controlled groups. The change also provides a planning opportunity for employers who wish to limit their potential overall exposure to the no coverage penalty.

The new guidance also provides significantly more detail on how the IRS will implement its existing guidance defining a "full-time" employee for purposes of applying the no coverage penalty. The regulations incorporate and refine the prior guidance on a safe-harbor for determining full-time status based on a "look back" measurement period. They provide detailed rules on how hours and leaves will be calculated, as well as how breaks in service will be treated. These rules require employers to make nuanced plan design decisions. To ensure consistent application, these decisions will likely need to be captured in plan documents or policies.

New Safe Harbors Apply to the Unaffordability Penalty

Even if an employer offers health coverage to its full-time employees (and their children), it can be subject to penalties if that coverage is deemed "unaffordable" or does not provide "minimum value." Specifically, the employer is required to pay a monthly penalty of $250 (adjusted for inflation) multiplied by the number of full-time employees who purchase health insurance through a state-based or federally-facilitated exchange and receive a government subsidy. Generally, coverage is defined as “affordable” if the required employee contribution towards self-only coverage is not more than 9.5% of the employee’s household income. A plan fails to provide minimum value if the plan’s share of the total allowed costs of benefits provided under the plan is less than 60% of those costs. The proposed regulations do not address minimum value, and the IRS plans to propose additional guidance on minimum value in the future.

The proposed regulations do, however, set out three basic safe harbors on which employers can rely in setting employee premiums for self-only coverage at an affordable level without knowing the employee’s “household income.” First, under the W-2 safe harbor, the premium for self-only coverage is affordable unless it exceeds 9.5% of the Box 1 wages reported by the employer for the employee for a given year (or shorter period if the employee was not covered for the full year). Second, a new safe harbor allows an employer to measure the 9.5% against the employee’s rate of pay. Specifically, coverage is deemed affordable if monthly premiums do not exceed 9.5% of the employee’s hourly rate of pay times 130 (or, if salaried, the employee’s monthly salary). Finally, coverage is deemed affordable if it does not exceed 9.5% of the federal poverty line for a single individual.

Transitional Relief

The new proposed regulations will be particularly welcomed by sponsors of non-calendar year plans, in that they provide that, in most cases, the employer penalties will not apply prior to the beginning of the first plan year beginning in 2014. The transitional relief also provides special rules relating to the use of “look back” periods for the 2014 plan year. These rules allow employers some flexibility to shorten their 2013 “look back” periods.

The proposed regulations discussed above are just one small piece of the significant body of guidance relating to the implementation of health care reform issued in the closing weeks of 2012. Please join Venable as we discuss this and other guidance in more detail at the *Changing Landscape for Employer Health Plan* events later this month. Please **click here** for more information and to register.

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[1] - The proposed regulations require that employer plans offer coverage to dependents—specifically children of employees—to avoid running afoul of the no coverage penalty. In contrast, coverage does not need to be offered to spouses. The proposed regulations define an employee’s dependents for this purpose as employee’s children who are under 26 years of age. (There is a transitional rule that provides some relief to plans that do not currently offer dependent coverage until plan years that begin in 2014.) It is important to note, that the unaffordability penalty, however, remains triggered only if the employee’s required contribution for self-only coverage is more than 9.5% of his or her household income for the taxable year.