# Employer Mandate: What Are the Penalties and When Do They Apply?

Beginning in 2015, employers who employed an average of 50 full-time equivalent (FTE) employees during the previous calendar year (applicable large employers) must offer health coverage that meets minimum essential coverage requirements or pay an assessable payment (penalty). The employer mandate penalty actually consists of two separate taxes. Both taxes hinge on whether an employer offers eligible employer-sponsored health coverage to full-time employees, but the nature of the penalty will depend on the cost to employees and the terms of coverage.

## Effective Dates

The employer mandate was originally scheduled to be effective for months after Dec. 31, 2013. However, on July 9, 2013, the IRS issued Notice 2013-45, which provides a one-year delay for employers subject to PPACA's employer mandate and information reporting requirements. Under the original schedule, there was transitional relief available for non-calendar-year plans. Under that transitional relief, a large employer who currently offers a non-calendar-year plan would generally not be liable for tax penalties for the months prior to the first day of its plan year beginning in 2014. This transition relief was introduced so that a large employer would not have to make midyear changes to a non-calendar-year plan in order to meet the law's coverage requirements. As large employers now have a year longer to adopt plans compliant with the employer mandate, it is unlikely that similar transition relief will be available for non-calendar year plans in 2015.

## Penalties Under the Employer Mandate

Under Internal Revenue Code (IRC) Section 4980H(a) (subsection (a) penalty), the employer is subject to a $2,000 per employee penalty (less the first 30 employees) if it fails to offer its full-time employees and their dependents the opportunity to enroll in minimum essential coverage and the full-time employee is certified as having received a premium tax credit or cost-sharing reduction. While commonly controlled entities are aggregated for purposes of determining whether the employer mandate is applicable, there is no aggregation used in determining the penalty itself. However, while aggregation is not generally used in determining the penalty itself, the 30-employee reduction mentioned above is only allowed once per controlled group, so the reduction would be allocated ratably among the applicable members of the controlled group.

Under Section 4980H(b), the employer is subject to a $3,000 penalty for each employee who receives a premium tax credit or cost-sharing reduction if the employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage that is either unaffordable or does not provide minimum essential value and the full-time employee is certified as having received a premium tax credit or cost-sharing reduction.

## Employers Must Offer Minimum Essential Coverage to Full-time Employees and Their Dependents

The subsection (a) penalty applies to applicable large employers if the employer fails to offer adequate coverage and at least one employee enrolls for subsidized exchange coverage. If, however, the employer offers minimum essential coverage to substantially all full-time employees, it will not be liable for this penalty.

To fulfill the mandate, each month, applicable large employers must offer minimum essential coverage to 95 percent of its full-time employees (that is, all but the greater of 5 percent of the company's full-time employees or five full-time employees) and their dependents. The proposed regulations apply this 95 percent rule separately to each company that is a member of a controlled group. Notably, coverage does not need to be offered to a spouse of a full-time employee. Rather, the proposed regulations define "dependent" as the child of the employee who has not attained age 26.

Most employer-provided group health coverage will meet the very broad definition of "minimum essential coverage." The definition includes any coverage under an "eligible employer-sponsored plan" — a term that means


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a group health plan or group health insurance coverage that is (a) a governmental plan, or (b) any other plan or coverage offered in a state's small or large group market, offered by an employer to an employee. Minimum essential coverage does not include certain excepted benefits.

**Excepted benefits include, for example, health flexible savings accounts that do not accept employer contributions, disability coverage, accidental death and dismemberment coverage, and dental-only and vision-only coverage.**

## Employers Must Offer Coverage That Satisfies the Minimum Value Requirements

If a large employer offers employees the opportunity to enroll in minimum essential coverage, but such coverage fails to satisfy the minimum value requirement, then employees will be eligible to enroll in another health plan and may be eligible to receive federal subsidies to pay for that coverage. In this case, if one or more full-time employees enroll in another health plan for which federal subsidies are allowed or paid, the employer will be required to pay the penalty associated with Section 4980H(b).

An employer-sponsored plan provides minimum value if the plan's share of the total allowed costs of benefits provided under the plan is at least 60 percent of such costs. The Internal Revenue Service (IRS) and the Department of Health and Human Services (HHS) have provided preliminary guidance on how minimum value will be determined and anticipate allowing three separate approaches:

- **Minimum value (MV) calculator:** HHS and the IRS intend to develop an MV calculator for use by self-insured plans and insured large group plans that will be available through the HHS website. The MV calculator would be similar to the actuarial value calculator developed by HHS to determine the value of qualified health plans offered in the individual and small group markets through an exchange.
- **Safe-harbor checklist:** This approach would provide an array of safe harbor checklists that plans may compare to their own coverage. The checklists would be used to make minimum value determinations for plans that cover all of the four core categories of benefits and services and have specified cost-sharing amounts.
- **Actuarial certification:** Plans with nonstandard features of a certain type and magnitude would have the option of engaging a professional actuary to determine the plan's minimum value without the use of a calculator.

## Employers Must Offer Coverage That Satisfies the Affordability Requirements

If a large employer offers employees the opportunity to enroll in minimum essential coverage, but such coverage fails to satisfy the affordability requirement, then employees will be eligible to enroll in another health plan and may be eligible to receive federal subsidies to pay for that coverage. In this case, if one or more full-time employees enroll in another health plan for which federal subsidies are allowed or paid, the employer will be required to pay the penalty associated with Section 4980H(b).

**Significance of Affordability: Whether an applicable large employer's health coverage is affordable to its full-time employees is essential in determining whether an employee can receive a premium tax credit and, in turn, whether the employer is subject to an assessable payment under IRC Section 4980H(b).**

Proposed regulations jointly released by the Department of the Treasury and the IRS on Jan. 2, 2013, announced three safe harbors that employers can use to assess affordability. Under these safe harbors, an employer can elect to determine affordability based on a criterion other than the employee's household income, which was originally identified in the mandate. Use of the safe harbors is optional, and an applicable large employer may choose to apply the safe harbors for any reasonable category of employees, provided it does so uniformly and consistently for all employees in a category. If the employee's coverage is affordable using a safe harbor, the employer will not be liable for a shared responsibility tax.

## Form W-2 Safe Harbor

To qualify for the W-2 safe harbor, the employee's required contribution must remain a consistent amount or a consistent percentage of all Form W-2 wages during the calendar year (or for plans with fiscal-year plan years, within the portion of each plan year during the calendar year) so that an applicable large employer is not permitted to make discretionary adjustments to the required employee contribution for a pay period.

Application of this safe harbor is determined after the end of the calendar year and on an employee-by-employee basis, taking into account the employee's annual W-2 wages (as reported in Box 1) and the employee contribution for the full calendar year for the employer's lowest-cost self-only coverage that provides minimum value. Therefore, the employer determines if it met the affordability safe harbor for 2015 by looking at that employee's W-2 wages for 2015 and comparing 9.5 percent of that amount to the employee's required 2015 employee contribution. If the employee's contribution is less than 9.5 percent of his or her wages, affordability is satisfied.

## Rate of Pay Safe Harbor

Under the rate of pay safe harbor, an employer can compare the employee's monthly contribution amount to an employee's projected monthly income (based on the employee's rate of pay at the beginning of the plan year). Unlike the W-2 safe harbor, the rate of pay safe harbor is easy to apply prospectively and avoids the need to analyze each employee's Form W-2 after the end of the year. An employer may use this safe harbor only if, with respect to the employees for whom the employer applies the safe harbor, the employer does not reduce the hourly wages of hourly employees or the monthly wages of salaried employees during the year.

The rate of pay safe harbor entails a three-step process for hourly employees:

- **Step 1:** Determine the hourly wage rate for each hourly employee who is eligible to participate in the health plan as of the beginning of the coverage period.
- **Step 2:** Multiply that rate by 130 hours per month.
- **Step 3:** Compare the employee's monthly contribution amount (for the self-only premium of the employer's lowest-cost coverage that provides minimum value) to the monthly wage.

For salaried employees, steps 1 and 2 are not necessary — the employer simply uses the employee's monthly salary (using any reasonable method to convert payroll periods to a monthly salary). The coverage will satisfy affordability if the employee's monthly contribution is less than or equal to 9.5 percent of the monthly wage.

## Federal Poverty Line Safe Harbor

If an employer's offer of coverage is affordable to all employees who earn more than 100 percent of the federal poverty line, then the affordability standard is satisfied. This safe harbor is the easiest to apply since the employer has to do just one calculation and can ignore employees' actual wages. Employer-provided coverage offered to an employee is affordable if the employee's monthly cost for self-only coverage under the plan does not exceed 9.5 percent of the federal poverty line for a single individual divided by 12 (to convert the poverty level from an annual to a monthly amount).

## Controlled Group Rules

PPACA and its regulations apply the IRS "controlled group" rules found in IRS Code § 414 (b) and 414(c). The controlled group rules essentially state that all employees of all corporations which are members of a controlled group of corporations and all employees of businesses which are under common control, are to be treated as employed by a single employer.

Generally, there are three types of controlled groups:

1. parent-subsidiary groups (one business owns 80 percent or more of another business or businesses);

2. brother-sister groups (five or fewer common owners; the common owners must own at least 80 percent of each business; and the combined identical ownership must be 50 percent or more); and

3. combined ownership groups (each organization is a member of either a parent-subsidiary or brother-sister group and at least one corporation is: the common parent of a parent-subsidiary and a member of a brother-sister group).

Accordingly, any of the organizations that are controlled groups are treated as a single employer under PPACA.

Although the proposed regulations use a controlled group standard to determine if the employer is an applicable large employer such that the employer mandate rules would apply, the coverage tests and the penalty assessments are to be calculated and imposed separately on each company within the group. Accordingly, each company within a given controlled group is considered separately responsible for complying with the employer mandate and only with respect to its own full-time employees and their dependents. For example, a company that is considered a "large" employer only needs to offer coverage to 95 percent of its full-time employees (that is, all but the greater of 5 percent of the company's full-time employees, or five full-time employees total) and their dependents, each month, in order to fulfill the employer mandate. However, the regulations apply this new 95 percent rule separately to each company which is a "member" (i.e. a separate EIN) of a controlled group.

This same entity-by-entity approach carries through to the calculation and imposition of the assessable payment. Therefore, one member's failure to provide adequate coverage will not affect other controlled group members. The regulations further provide the 30-employee reduction that applies when calculating the subsection (a) penalty is allocated ratably among member employers. If an employer has more than 30 employer members, such that the pro-rata share of the 30-employee reduction would be more than zero but less than one for some employer members, the number is rounded up to one.

## Penalty Collection and Record Keeping

Each individual entity within a controlled group is independently responsible for their penalty under 4980H. Any penalty under this section is payable upon notice and demand in a similar manner to a tax. Finally, please note that penalties assessed under 4980H are not deductible. Consistent with this section of PPACA, employers are required to maintain records in accordance with the IRC. Records are especially important in substantiating employee eligibility using measurement periods and if an employer is using a safe harbor to avoid the penalty.

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