



For your information

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IRS issues proposed regulations on the shared responsibility penalty

Last Friday, the IRS released [proposed regulations](#) that address [numerous issues](#) regarding assessment of the shared responsibility penalties under the Affordable Care Act. Beginning in 2014, an "applicable large employer" (one that employed at least 50 full-time employees, or FTEs, during the preceding calendar year) may be subject to one of two shared responsibility penalties if it has any FTEs who are enrolled in coverage offered through a public Exchange and who receive a premium tax credit or cost-sharing assistance. The penalties are as follows:

- Employers that fail to offer health coverage to FTEs and their dependents may be subject to a penalty equal to the number of FTEs it employed during the year (minus 30) multiplied by \$2,000 (the "play or pay" penalty).
- Employers that offer health coverage to FTEs that is unaffordable or fails to provide minimum value may be subject to a penalty equal to the number of FTEs who enroll in Exchange coverage and receive a premium tax credit multiplied by \$3,000 (the "play and pay" penalty).

The proposed regulations condense previous guidance on the shared responsibility penalty and address comments and suggestions from taxpayers. Among other things, the proposed regulations incorporate and modify the safe harbor guidance concerning FTE calculations. Additional highlights include the following:

- **Clarification that an applicable large employer must offer coverage to "substantially all" FTEs and their dependent children up to age 26 in order to avoid potential liability for the play or pay penalty.** However, there is no requirement that the employer offer coverage to employees' spouses. The proposed regulations also quantify the "substantially all" standard and provide that if an employer offers health coverage to all but 5% of its FTEs (or, if greater, five employees), it will be treated as offering coverage to its FTEs. Coverage generally will be considered offered to an employee only if it is also offered to the employee's dependents. However, the proposed regulations include a transition rule for employers that do not currently offer dependent coverage. Employers that take steps during the 2014 plan year to offer dependent coverage will not be subject to the play or pay penalty solely for failing to satisfy this requirement.
- **Clarification that the shared responsibility requirements are generally applied separately to each member of the controlled group.** The proposed regulations provide that although all members of a controlled group are treated as a single entity for purposes of determining whether any member of the group is an "applicable large employer" subject to the shared responsibility

provisions (i.e., employed at least 50 FTEs during the preceding calendar year), each member is treated as a separate entity for purposes of determining liability for, and the amount of, any shared responsibility penalty. Thus, employers that offer health coverage to their FTEs and dependents will not be subject to the play or pay penalty simply because other employers in their controlled group do not offer coverage. An employer that does not offer coverage will be subject to a penalty based on the number of its own FTEs and not on the number of FTEs employed by the entire controlled group.

- **Expansion of safe harbors for determining whether the employer's health coverage is affordable for purposes of the play and pay penalty.** Generally, an employer's health coverage will be considered unaffordable for purposes of the play and pay penalty if the required employee contribution for the lowest cost self-only coverage option exceeds 9.5% of the employee's annual household income for the calendar year. Recognizing that an employer will generally not know the employee's household income, the IRS previously set out a safe harbor under which an employer could determine affordability based on whether the required employee contribution for self-only coverage exceeded 9.5% of the employee's Form W-2 wages (i.e., amount reported in Box 1 of the employee's Form W-2).

The proposed regulations set out two additional safe harbor options – one for the rate of pay and one for the federal poverty line (FPL). Under the rate of pay safe harbor, affordability is based on a salaried employee's monthly salary; for an hourly employee, the hourly rate of pay times 130 hours per month would be the monthly wage. If the employee's required monthly contribution for self-only coverage does not exceed 9.5% of the monthly wages, the employer coverage would be affordable. Under the FPL safe harbor, affordability is based on the FPL for a single individual. If the employee contribution for self-only coverage does not exceed 9.5% of the FPL, the employer coverage would be deemed affordable for all employees.

- **Special transition relief for non-calendar year plans in existence as of December 27, 2012.** The shared responsibility provisions generally are effective on January 1, 2014. The preamble to the proposed regulations notes that non-calendar year plans might have difficulty complying with the requirements. Thus, the proposed regulations provide that if an employer with a non-calendar year plan in existence on December 27, 2012 offers employees affordable coverage that satisfies the minimum value requirement by the first day of the plan year starting in 2014, it would not be assessed a shared responsibility penalty for any period in 2014 prior to the beginning of the 2014-2015 plan year.

In addition, the preamble states that during the 2013-2014 plan year, an employer may permit participants who pay for health coverage through a cafeteria plan to make one mid-year election change to drop the coverage to enroll in Exchange coverage. Employers may also permit employees who previously declined employer coverage to enroll in that coverage through the cafeteria plan, even if they had experienced no change in status event. The cafeteria plan must be amended to permit these election changes by December 31, 2014.

The proposed regulations contain much more important guidance. We will be providing a more detailed analysis of the regulations shortly.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.
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