Labor and Employment Alert: Implications of the Delay of the Pay or Play Penalties

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Summary: The postponement of the pay or play penalties and related reporting from 2014 to 2015 gives employers a welcome opportunity to reassess their compliance strategies and plan for a more measured implementation of new systems. However, the pay or play penalties are related to the availability of federal premium assistance for the purchase of health insurance on an exchange. The absence of pay or play penalties and related reporting in 2014 may increase the number of employees buying health insurance on an exchange with federal premium assistance in 2014.

Pay or play penalties and related reporting postponed from 2014 to 2015

Background

The pay or play penalties only apply to "applicable large employers." An "applicable large employer" is an employer with at least 50 full-time and full-time equivalent employees in the preceding calendar year. In the case of a controlled group of corporations or trades or businesses under common control, "applicable large employer" status is determined on the basis of the number of employees in the controlled group but penalties are applied separately to each member of the group.

An applicable large employer member is subject to two mutually exclusive types of play or pay penalties (both of which have been postponed from 2014 to 2015):

- No-offer penalty – Imposed on an applicable large employer member when it fails to offer health coverage to substantially all of its full-time employees (and their children) and one or more of its full-time employees buys health insurance on an exchange with premium assistance. On an annual basis, the no-offer penalty equals $2,000 times [the number of full-time employees employed by the member minus the member's ratable share of 30].

- Unaffordable/inadequate coverage penalty – Imposed when an applicable large employer member offers medical coverage that is unaffordable or inadequate and one or more of its full-time employees buys health insurance on an exchange with premium assistance. Coverage is unaffordable if the employee contribution for single coverage exceeds 9.5% of the employee's household income. Coverage is inadequate (i.e., the coverage does not provide minimum value) if the coverage is not expected to cover at least 60% of average out-of-pocket medical costs in a standard population. On an annual basis, the unaffordable/inadequate coverage penalty equals $3,000 times the number of the member's full-time employees who are getting premium assistance (but not to exceed the no-offer penalty).

A full-time employee is an employee who works an average of at least 30 hours per week (130 hours per month). The IRS proposed that an employee's full-time or part-time status be determined on the basis of a measurement period of up to 12 months and then applied (regardless of fluctuations in schedule) during a prospective stability period of up to 12 months. This methodology was proving to be one of the more challenging aspects of implementation despite some transitional rules.

What does the delay mean to employers?

To the extent you are in the process of implementing new workforce tracking systems and/or planning to expand eligibility for health benefits in 2014, the postponement of the pay or play penalties gives you options. You can take a moment to reevaluate your chosen strategies and decide how best to use the one-year reprieve. The decision may be to forge ahead so as to use 2014 as a dry run (test systems and fix glitches) in preparation for the application of the pay or play penalties in 2015. Or, you may decide to hold off on implementing changes so as to avoid 2014 expenses and sequential adjustments of systems as governmental requirements evolve. Still, given the significant likelihood that the IRS will go forward with a look-back measurement method of identifying full-time employees (potentially without transitional rules) in 2015, you may want to try cumulating hours of variable-hour employees in a measurement period ending in 2014.

The postponement of the pay or play penalties includes a postponement of related reporting. All applicable large employer members – even those that offer affordable, adequate coverage to all of their full-time employees – were expecting to have to report employees' full-time status and their eligibility for and enrollment in health coverage. Because of the postponement of the pay or play penalties, employers will not have to report 2014 data in 2015. However, watch for guidance later this year on reporting 2015 data in 2016.

While the postponement of the pay or play penalties and related reporting is quite a relief for many employers, remember that other aspects of the Affordable Care Act are not postponed. For example:

- As of the first day of the first plan year starting on or after January 1, 2014:
  - All remaining preexisting condition limitations must be eliminated.
  - All remaining annual dollar limits on essential health benefits must be eliminated.
  - Waiting periods cannot exceed 90 days.
  - For non-grandfathered plans, in-network out-of-pocket maximums must be limited to $6,350 single and $12,700 family.

- You still must distribute the Notice of Coverage Options before October 1, 2013 (more information available in our May 21, 2013 Client Alert: Notice of Coverage Options).
- You still need to pay the Patient–Centered Outcomes Research Fee. For many health plans, the first payment is due July 31, 2013. See the reminder below for more details.

What does the delay mean to employees?

Federal premium assistance for the purchase of health insurance on an exchange will be available to employees on an honor system in 2014.

An employee with income between 100% and 400% of the Federal Poverty Level is eligible for federal premium assistance to buy health insurance on an exchange – but only if his or her employer does not offer affordable, adequate health coverage. In other words, an employee's eligibility for employer-sponsored coverage that meets the government's standards for affordability and adequacy is supposed to block an employee from getting potentially significant amounts of federal premium assistance – even if the federal premium assistance would have resulted in better coverage at a lower cost to the employee.

The postponement of the pay or play penalties and the related reporting do not change the *rules* on access to federal premium assistance. However, it does change the *enforcement* of the rules in 2014. If an employee applies for federal premium assistance, the exchange application will ask whether the employee is eligible for affordable, adequate employer-sponsored health coverage. If the employee states that his or her employer does not offer affordable, adequate coverage, the employee will be enrolled in the coverage with potential federal premium assistance (subject to subsequent random verification).

A federally-facilitated exchange (like Ohio's exchange) will make inquiries to a random sample of employers, asking the employer to confirm the employee's statement as to access to affordable, adequate employer-sponsored health coverage. If an employer responds to an inquiry from an exchange, the exchange will make a determination considering the information provided by the employee and the employer. If an employer fails to respond to an inquiry from an exchange, the exchange will simply accept the employee's statement at face value. (Note that there does not appear to be any penalty associated with an employer's failure to respond to an exchange's inquiry.) Since the exchange will make inquiries to only a random sample of employers, there will be no follow-up for many individuals, meaning that individuals who are technically ineligible for federal premium assistance may, nevertheless, obtain it in 2014.

One aspect of enforcement is still in place: An employee's access to federal premium assistance will still be subject to post-year-end reconciliation based on the employee's actual household income. If actual household income (as reported on the employee's tax return) is more than the amount the employee stated in the application as his or her expected household income, the employee may have to repay some or all of the federal premium assistance obtained (and that could be quite expensive).

Other Employee Benefit News

Reminder of the Patient-Centered Outcomes Research (PCOR) fee due date

If you have a group health plan with a plan year end between October 1, 2012 and December 31, 2012, your first payment of the PCOR fee is due July 31, 2013. The PCOR fee for plan years ending in 2013 is due July 31, 2014.

Use IRS Form 720 to pay the PCOR fee. The IRS instructions to Form 720 (pages 8-9) include an explanation of the calculation of the PCOR fee. See our April 18, 2012 Client Alert: Health Plans Must Pay PCOR Fee for more details.

The demise of (part of) the Defense of Marriage Act (DOMA)

As of the writing of this Client Alert, the IRS had not as yet published guidance on the implementation of federal recognition of same sex marriage in the wake of the Supreme Court's decision in *U.S. v. Windsor*.

If you currently make health coverage available to employees' same sex domestic partners, check your database of enrolled domestic partners to see whether you have distinguished between: (a) same sex spouses (legally married in a jurisdiction that recognizes same sex marriage); or (b) other (unmarried) same sex domestic partners. If you have not to date distinguished between same sex spouses and unmarried same sex domestic partners, be prepared to collect information on marital status from employees who have enrolled same sex partners; some will be same sex spouses and some will not. No matter what guidance the IRS ultimately provides, the tax treatment of health benefits for same sex spouses will not be the same as the tax treatment of health benefits for other same sex domestic partners. Plus, the same sex spouses of your employees will have all of the rights formerly reserved to opposite sex spouses. While your company's policy may be to treat the unmarried same sex partners of employees as if they were spouses to the extent possible, there are unavoidable legal distinctions.

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This alert is a summary and cannot include all details that may be relevant to your situation. As always, please contact us if you want more information on these developments or other employee benefits matters.