Tax Strategy: 2014 Affordable Care Act Provisions Begin to Get Noticed

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Major new requirements and obligations under the Affordable Care Act go into effect in 2014. Many individuals and employers are only vaguely aware of them; fewer still appear to be aware of how to react. The Internal Revenue Service itself seems to be engaged in issuing just-in-time guidance that is critically needed by individuals and employers to start making preparations now, for the changes that will take place in 2014. In some cases, steps may be taken to minimize the cost of compliance; in other situations, simply preparing the resources necessary to cover the additional costs that may be imposed is critical.

A review of recent IRS guidance on certain ACA provisions is an important step in preparing for the change coming in 2014. Recent guidance has clarified dozens of rules involving the individual mandate, the Section 38B health insurance premium credit, the employer mandate, essential health benefits, and health coverage notices, among other issues. This month's column takes a look at these developments from that perspective.

Individual mandate

The IRS issued both proposed regulations and questions and answers this year on the shared responsibility payment, a.k.a. the individual mandate (NPRM REG-148500-12). Under the individual mandate, which starts in January 2014, a non-exempt individual must maintain minimum essential coverage or make a shared responsibility payment on their federal income tax return. The regulations clarify the statutory categories of individuals who are exempt from the shared responsibility payment. This group includes, among others, those for whom coverage is unaffordable, and taxpayers with income below the income tax filing thresholds. These individuals, if not Medicaid or Medicare eligible, are generally expected to apply for the Code Sec. 36B premium tax credit. Hardship cases and individuals who experience short coverage gaps (less than three consecutive months) are also among the exceptions.

Coverage is deemed not affordable under the individual mandate if the required contribution for minimum essential coverage exceeds 8 percent of the taxpayer's household income for 2014. For an individual with employer coverage, the test applies to the cost of the lowest self-only coverage.

Affordability for purposes of the individual mandate should not be confused with affordability related to the employer mandate, which is dependent upon whether an employee is eligible for a Code Section 36B premium tax credit when purchasing insurance through an exchange. There, the standard for determining the penalty imposed on the employer is whether the cost of employer coverage is greater than 9.5 percent of household income.

Premium tax credit

The IRS issued final regulations on the health insurance premium tax credit under Code Sec. 36B in early 2013 that added to 2012 final regulations (TD 9611). Those later final rules retain a controversial provision that bases the affordability of minimum essential coverage for family members ("related individuals") on the employee's cost of self-only coverage. Furthermore, starting in 2014, premiums cannot be set based on health status (known as community rating) or provision of essential health benefits.

Beginning in 2014, individuals who obtain health insurance coverage through an Affordable Insurance Exchange may qualify for a refundable Code Sec. 38B premium tax credit. The credit will be given to qualified individuals who are not eligible for affordable coverage and whose household income falls within specified thresholds, based on the federal poverty level. The taxpayer's household income generally must be between 100 percent and 400 percent of the FPL. Initial eligibility for the premium assistance credit is generally based on the individual's income for the tax year ending two years prior to the enrollment period. Household income is modified adjusted gross income that includes, in addition to AGI, Section 911 foreign-based income, tax-exempt income and otherwise excluded Social Security benefits. An individual may apply for and be approved in advance for a premium assistance credit.

The Code Sec. 36B premium tax credit plays a role in both the individual mandate and the employer mandate. The Code Sec. 36B credit is not available if the individual is eligible for MEC through an employer-sponsored plan that is deemed affordable and that provides minimum value. Coverage is considered affordable if the employee's required contribution to the plan for self-only coverage does not exceed 9.5 percent of the taxpayer's household income. Providing minimum value requires that the plan's share of the employee's health costs be at least 60 percent of total costs.

Employer mandate

The IRS in early January issued comprehensive proposed reliance regulations on the employer shared responsibility provisions, a.k.a. the "employer mandate" (NPRM REG-138006-12). This guidance includes definitions; rules for determining status as an applicable large employer; rules for determining full-time employees; and rules for determining the scope and extent of assessable payments. The proposed reliance regulations assist in planning properly within the context of eligibility and plan design.

Assessment payment liability. Under Code Section 4980H, an applicable large employer is subject to a shared responsibility payment (an assessable payment) for months beginning after Dec. 31, 2013, if any full-time employee of the organization is certified to receive an applicable premium tax credit or cost-sharing reduction, and either:

1. The employer does not offer to its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan (Code Sec. 4980H(a)); or,

2. The employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan that, with respect to a full-time employee who has been certified for the advance payment of an applicable premium tax credit or cost-sharing reduction, either is unaffordable relative to an employee's household

income or does not provide minimum value (Code Section 4980H(b)). The proposed regulations stress that an employer must be notified if one of its employees is determined to be eligible for a premium assistance credit or reduced cost-sharing and be provided with an appeals process.

The Code Sec. 4980H(b) penalty applies to coverage that is "unaffordable," meaning that the coverage costs more than 9.5 percent of the employee's household income. Since employers may not be able to determine household income, the proposed regs provide three affordability safe harbors: the Form W-2 safe harbor (based on employee wages); the rate-of-pay safe harbor (based on hourly or monthly pay rates); and the federal poverty line safe harbor. Most employers should make a decision in 2013 on which safe harbor might be appropriate while there is still time to evaluate what works best within a particular employee population.

Amount of the penalty. For employers that do not offer minimum essential coverage (Code Sec. 4980H(a)), the assessable payment for a month is equal to the number of full-time employees (regardless of the number of employees receiving a premium assistance credit, as long as at least one qualifies for the credit) over a 30-employee threshold during the applicable month, multiplied by one-twelfth of $2,000. Critics predict that employers who may be subject to this penalty will decrease full-time employees, likely those earning lower wages, and freeze hiring in general. Others are calculating whether paying the penalty will eventually be more cost-efficient than continuing offering coverage to the degree that will now be required.

For employers that offer minimum essential coverage but have one or more employees who enroll in an exchange and qualify for a credit (Code Sec. 4980H(b)), the penalty generally will not be nearly as high as if no MEC plan were offered. The employer in that situation must pay one-twelfth of $3,000 multiplied by the number of such employees qualifying for the credit. This amount is further capped to be no more in amount than would be imposed on an employer that did not offer minimum essential coverage.

Applicable large employer. An applicable large employer is an employer that employed an average of at least 50 full-time employees during the preceding calendar year, including full-time equivalent employees. For 2014, 2013 becomes the critical applicable year to evaluate the current workforce for "large employer" status, particularly for those employers that are borderline in connection with the 50-full-time-employee all-or-nothing floor.

The statute defines a full-time employee as an employee who on average was employed for at least 30 hours of service per week. One hundred and thirty hours of service in a calendar month is also treated as full-time. The proposed reliance regs determine FTEs by calculating the aggregate hours of service worked in a month by non-full-time employees (up to 120 hours per employee) and dividing the total by 120.

A new employer is an applicable large employer if it reasonably expects to employ an average of at least 50 full-time employees (including full-time equivalents) during the current calendar year. The IRS explained that it declined to exempt new employers from any assessable payment, but has requested comments on whether to provide safe harbors or presumptions to help new employees determine their status.

Determination of hours of service for employees employed on a non-hourly basis may be determined under several methods under proposed regulations that use daily or weekly equivalencies, unless it understates actual hours to the extent that an employee is not treated as full-time. Full-time status, in turn, for ongoing employees generally may be determined under

a measurement period looking back to not less than three but not more than 12 consecutive months.

All entities treated as a single employer under Code Section 414 are treated as a single employer for determining whether the group is an applicable large employer. However, if the group is an applicable large employer, the penalty provisions apply to each company separately. Of particular note, the IRS has recognized that the application of Code Section 4980H to temporary staffing agencies may be particularly challenging, and has requested comments on possible rules. However, it is also aware that staffing agencies might be used to evade Code Section 4980H and it has promised anti-abuse rules targeted toward such maneuvers.

Essential health benefits

Frequently asked questions on rules describing standards for essential health benefits for individual and small group plans are available online (FAQs Part XII, on www.hhs.gov or www.irs.gov). Beginning in 2014, all non-grandfathered health insurance coverage in the individual and small group markets must cover EHB and do so without annual limits.

Under the Patient Protection and Affordable Care Act, EHBs include ambulatory patient services, emergency services, hospitalization, maternity and newborn care, mental health and substance use disorder services, prescription drugs, rehabilitative services, laboratory services, preventive services, and pediatric services.

Final rules also address actuarial value levels in the individual and small group markets. Beginning in 2014, plans that cover EHB must cover a certain percentage of costs, known as "actuarial value." The levels are 60 percent for a bronze plan, 70 percent for a silver plan, 80 percent for a gold plan, and 90 percent for a platinum plan.

Health coverage notices

In late January, the Treasury, the U.S. Department of Health and Human Services, and the U.S. Department of Labor announced in the frequently asked questions postponement of the March 1, 2013, effective date for the requirement that employers notify their employees and new hires of coverage available through a health insurance exchange. The delay is intended to coincide with an anticipated release of a model notice with generic language.

Conclusions

Opinions may be split on the ultimate value of the provisions within the Affordable Care Act, let alone the impact they may have on the economy during this year and next. Employers and employees, irrespective of the macro-economic consequences, however, must start to pay attention to an immediate future that includes the "individual mandate" and the "employer mandate" on their own "micro" levels. Reviewing the rules, as they have been recently developed by IRS guidance, can save costs in some instances, and serve to reduce costly surprises in others. They are worth a careful look in either case.