HEALTH CARE REFORM
WHETHER TO PLAY OR PAY
(Executive Summary)

Dated: January 11, 2013

Starting in 2014, "large employers" will be subject to the employer shared responsibility provisions under the Patient Protection and Affordable Care Act ("ACA"). This is sometimes known as the employer coverage mandate or the "play or pay" provisions. In November 2012, we provided a detailed summary of these play or pay provisions based on the guidance issued up to that point. On December 28, 2012, the Treasury Department and the IRS issued proposed regulations that further clarify these play or pay provisions and which modify portions of our prior summary.

The following, in question and answer format, is an Executive Summary of the play or pay provisions as updated by the proposed regulations. We have also provided a more detailed set of questions and answers summarizing the guidance to date and replacing our prior detailed summary.

Of course, the rules regarding the play or pay provisions are complex and both this Executive Summary and the detailed summary are intended as just a very general guide. We are here to assist with the details as they apply to any specific employer.

Under the play or pay provisions, if large employers do not offer affordable health coverage that provides a minimum level of coverage to their full-time employees, they may be subject to a play or pay penalty if at least one of their full-time employees receives a premium tax credit for purchasing individual coverage on one of the new Affordable Insurance Exchanges ("Exchange").

1. What is a large employer?

Answer: To be subject to the play or pay penalties for a year, an employer must be a large employer. A large employer is one who has, on average, at least 50 full-time employees or a combination of full-time and full-time equivalent employees during the ***prior*** calendar year. ACA defines a full-time employee as an individual employed on average for at least 30 hours of service per week or 130 hours a month. Full-time equivalent employees are determined in a calculation that takes into account the hours of part-time employees for each month and divides by 120.

Employers will then average their number of full-time and full-time equivalent employees across the months in the year to see whether they meet the large employer threshold. Our more detailed summary provides further guidance on how to determine the average number of full-time employees and full-time equivalent employees for a year. That detailed summary includes information about the definition of hours of service, how to account for salaried employees who may not clock their hours, and the special rule for seasonal workers.

In determining whether an employer is a large employer, all related entities in a controlled group or affiliated service group will be considered as a single employer. These are the same standards that apply for other tax and employee benefit purposes. If the combined total of full-time and full-time equivalent employees for the group meets the 50 employee threshold, then each separate employer is a large employer even if an individual employer of the group does not employ enough employees to meet this large employer threshold.

Importantly, the proposed regulations clarify that while the rules for combining related employers apply for the purposes of determining whether an employer is a large employer, ***the actual calculation and assessment of any play or pay penalty will be done on an employer by employer basis and not a group-wide basis***.

2. Under what circumstances will a large employer owe a play or pay penalty?

Answer: A large employer will owe the play or pay penalty only if:

(a) The employer either does not offer health coverage or offers coverage to less than 95% of its full-time employees, and at least one of the full-time employees receives a premium tax credit to help pay for coverage on an Exchange;

OR

(b) The employer offers health coverage to at least 95% of its full-time employees, but at least one full-time employee receives a premium tax credit to help pay for coverage on an Exchange, which may occur because the employer did not offer coverage to that employee or because the coverage the employer offered that employee was either unaffordable to the employee or did not provide minimum value.

After 2014, the rule in paragraph (a) applies to employers that do not offer health coverage or that offer coverage to less than 95% of their full time employees ***and the dependents of those employees.***

3. When can an employee receive a premium tax credit?

Answer: Premium tax credits are generally available to help pay for coverage for employees who:

a) are between 100% and 400% of the federal poverty level and enroll in coverage through an Exchange,
b) are not eligible for coverage through a government-sponsored program like Medicaid or CHIP, and
c) are not eligible for coverage offered by an employer or are eligible only for employer coverage that is unaffordable or that does not provide minimum value.

4. How does an employer know whether the coverage it offers is affordable?

Answer: If an employee's share of the premium for self-only coverage would cost the employee more than 9.5% of that employee's annual household income, then the coverage is not considered affordable for that employee. If an employer offers multiple healthcare coverage options, the affordability test applies to the lowest-cost self-only coverage option available to the employee that also meets the minimum value requirement.

Because employers generally will not know their employees' household incomes, employers can take advantage of one of the safe harbors set forth in the proposed regulations that are explained more fully in our detailed summary.

5. How does an employer know whether the coverage it offers provides minimum value?

Answer: A minimum value calculator will be made available by the IRS and the Department of Health and Human Services (HHS). Employers can input certain information about the plan, such as deductibles and co-pays, into the calculator and get a determination as to whether the plan provides minimum value by covering at least 60% of the total allowed cost of benefits that are expected to be incurred under the plan. There will be other methods such as checklists or an actuarial certification that can be used to determine minimum value.

6. For purposes of the play or pay penalty, is there a method to ascertain whether an employee will be a full-time employee for a given month before the month is over and the work has been done?

Answer: Yes. The proposed regulations provide a method for employers to determine in advance whether or not an employee is to be treated as a full-time employee based on the hours of service credited to the employee during a previous period. Using this look-back method to measure hours of service, the employer will know the employee's status as a full-time employee at the time the employer would offer coverage. These rules are very complex and have differing provisions for ongoing employees, new employees expected to work full time, and new employees who are variable hour or seasonal employees. Our more detailed summary provides further guidance on these rules. Importantly, to take

advantage of these rules an employer will have to have measurement periods in 2013 in order to determine full-time employees for 2014.

7. If an employer fails to offer coverage to at least 95% of its full-time employees (or for periods after 2014, 95% of full-time employees and their dependents) how is the play or pay penalty calculated?

Answer: In our more detailed summary, we term this penalty the "No Offer Penalty." The No Offer Penalty is equal to the number of full-time employees the employer employed for the year (minus 30) multiplied by $2,000, as long as at least one full-time employee receives the premium tax credit. This applies only to full-time employees and not full-time equivalent employees. For an employer who offers coverage for some months but not others during the calendar year, the payment is computed separately for each month for which coverage was not offered.

In instances of related groups of employers the thirty employee credit is allocated among employers in the group based on their number of full-time employees. Also, as mentioned earlier, while the determination of whether an employer is a large employer is based on all related employers, the No Offer Penalty, as well as the Inadequate Coverage Penalty described below, are calculated and assessed on an employer by employer basis.

8. If an employer offers coverage to at least 95% of its employees, and, nevertheless, owes the play or pay penalty how is the amount of the payment calculated?

Answer: For an employer who offers coverage to at least 95% of its full-time employees in 2014 (or 95% of its full-time employees *and dependents* for subsequent years), but has one or more full-time employees who receive a premium tax credit, the payment is computed separately for each month. That penalty could be due to the fact that the coverage offered is unaffordable, does not provide a minimum value or the employee could be one of the 5% or less of employees not offered coverage. In our detailed summary we term this the "Inadequate Coverage Penalty." The amount of this penalty for the month equals the number of full-time employees who receive a premium tax credit for that month multiplied by 1/12 of $3,000. The amount of the payment for any calendar month is capped at the number of the employer's full-time employees for the month (minus up to 30) multiplied by 1/12 of $2,000. (The cap ensures that the payment for an employer who offers coverage can never exceed the payment that employer would owe if it did not offer coverage).

9. How will an employer know that it owes play or pay penalty and how will it pay that penalty?

Answer: The IRS will contact employers to inform them of their potential liability and provide them an opportunity to respond before any liability is assessed. If it is determined that an employer is liable for a play or pay penalty after the employer has responded to the initial IRS contact, the IRS will send a notice and demand for payment. That notice will instruct the employer on how to make the payment. Employers will not be required to include the play or pay penalty on any tax return that they file.

10. Are there any transition rules or relief for 2014?

Answer: Yes. Our detailed summary describes the 2014 transition rules and relief including rules for fiscal year plans, use of less than a full calendar year in determining whether an employer is a large employer and an abbreviated measurement period for determining full-time employee status for the play or pay penalty calculation.

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