

IRS Proposed Premium Tax Credit Regulations Signal Direction of Future Guidance on Employer Pay-or-Play Penalties

August 25, 2011

The Internal Revenue Service has issued proposed regulations implementing health insurance premium tax credits. The proposed regulations clarify the eligibility criteria for health insurance premium tax credits. In addition the proposed regulations provide guidance regarding determining the affordability of employer-sponsored coverage and calculating the premium tax credit. The preamble to the proposed regulations offers previews of anticipated future guidance relating to the employer affordable coverage mandates and pay-or-play penalties. Health insurance premium tax credits will go into effect concurrent with the establishment of the state insurance exchanges and employer pay-or-play mandate in 2014.

On August 12, 2011, the Internal Revenue Service issued proposed regulations implementing health insurance premium tax credits under Code Section 36B of the federal Patient Protection and Affordable Care Act. The tax credits are designed to enable low income individuals to purchase insurance on state-based Affordable Insurance Exchanges (Exchanges), which are scheduled to be up and running by January 2014, assuming they are not struck down by the Supreme Court of the United States as unconstitutional. As set forth in the proposed regulations, the Exchange determines whether an individual meets the income and other requirements for the tax credit based in part on the availability of affordable employer-sponsored group health plan coverage. Each month, the credits will be paid directly to the insurer that provides coverage to the eligible individual through the Exchange. This credit will reduce the premium amount owed by the individual.

Under the employer pay-or-play mandates that will take effect in 2014, assuming they are not struck down by the Supreme Court as unconstitutional, if an employer offers coverage to all full-time employees, penalties will be assessed if any full-time employee with a household income below 400 percent of the federal poverty line opts out of the employer's group health plan to obtain coverage through the Exchange and, for this particular employee, the available employer-sponsored plan coverage is unaffordable. Employer group health plan coverage is considered unaffordable if it requires an employee premium contribution that exceeds 9.5 percent of the employee's household income or provides coverage where the group health plan's share of the total cost of benefits is less than 60 percent. The penalty is equal to \$3,000

for each full-time employee per year who meets the criteria above (but not more than the penalty that would have applied if the employer had not provided any group health plan coverage).

Below is a brief description of the major provisions of the proposed premium tax credit regulations.

- **Eligibility:** An individual is eligible for the credit if the individual is a taxpayer who has purchased coverage on the Exchange and is not eligible for “minimum essential coverage” other than through coverage in the individual market (*i.e.*, not eligible for minimum essential coverage under an employer or government group health plan). The proposed regulations define an eligible taxpayer to mean an individual lawfully present in the United States with household income between 100 percent and 400 percent of the federal poverty line. This amount differs based on the taxpayer’s state of residence and family size. An eligible taxpayer cannot be claimed as a dependent by another taxpayer and must file a joint tax return if married.
- **Minimum Essential Coverage—Employer-Sponsored Coverage:** The proposed regulations clarify that an individual who has the opportunity to enroll in minimum essential coverage through an affordable employer-sponsored group health plan that meets the minimum value requirements for coverage generally will not be eligible for the premium tax credit, regardless of whether the individual actually enrolls in such employer-sponsored group health coverage. The exception to this rule is COBRA; an individual must actually enroll in COBRA coverage in order to be considered eligible for minimum essential coverage under an employer group health plan. The proposed regulations provide that employer-sponsored coverage will be treated as affordable if an individual actually enrolls in such coverage, even if the coverage does not meet affordability and minimum value requirements. In addition, the proposed rules clarify that when determining the affordability of coverage for a spouse or dependent under an employer group health plan, the test for premium tax credit eligibility is based on the cost of self-only coverage. However, for purposes of the individual mandate, the preamble to the proposed regulations indicate that future guidance will base affordability on the cost of family coverage.
- **Affordability Safe Harbors:** The Exchange determines whether an individual is eligible for the premium tax credit at the time of enrollment in coverage purchased through the Exchange. Recognizing that a taxpayer’s household income can change in the middle of a year, the proposed regulations provide a safe harbor so that a taxpayer will not lose eligibility for the

credit upon a mid-year household income increase. Under the safe harbor, an employer-sponsored group health plan is evaluated at the time of enrollment, and a plan that is then determined to be unaffordable is treated as unaffordable for the whole plan year. The preamble to the proposed regulations anticipate that future guidance will provide that employers will not be subject to a penalty if the Employer in fact provides affordable coverage but, based on an earlier estimate of household income, the Exchange determined that the employer's group health plan coverage was unaffordable.

- **Computing the Premium Tax Credit:** The premium tax credit amount is the lesser of the premium for the Exchange plan purchased by the taxpayer or the excess of the premium for the "benchmark plan" over a percentage of the taxpayer's household income determined under health care reform rules. The benchmark plan is the second lowest cost plan at the silver level (as determined under the rules relating to the Exchanges) that would cover the taxpayer and any family members enrolled in the Exchange plan. The proposed regulations describe procedures for determining the applicable benchmark plan and for calculating the premium tax credit when family members enroll in different Exchange plans.
- **Reconciling the Credit and Advance Credit Payments:** The premium credit is computed using the household income and family size for the taxable year, but premium assistance amounts for different coverage months may be based on different benchmark plans depending on the taxpayer's family size. For example, the amount of the credit that should be provided to a taxpayer may change in the middle of a tax year in the event of a marriage, divorce or other change in income tax filing status. Thus, the proposed regulations provide rules for reconciling the credits actually provided for a tax year with the amount of the credit that should have been available to the taxpayer. All individuals who receive premium tax credits must file an income tax return, even if the individual would generally be exempt from filing due to low gross income.

The preamble to the proposed regulations offers previews of anticipated future guidance relating to the employer affordable coverage mandates and pay-or-play penalties. In addition to the affordability safe harbor described above, the proposed regulations suggest future guidance will offer a safe harbor for employers wishing to avoid the penalty for providing unaffordable coverage to an employee who ultimately purchases coverage on an Exchange and receives the premium tax credit. Although the availability of the credit is based on household income, under the safe harbor, an employer will be permitted to assume that an employee's household income is the same as the employee's W-2 wages from the employer. Therefore, if an employer sets the employee portion of the cost of self-only coverage based on W-2 wages, the preamble indicates that the employer will not be subject to a penalty if the coverage turns out to be

unaffordable because the employees' household income is lower than W-2 wages. The preamble acknowledges that this safe harbor could result in an employee receiving the premium credit without a penalty applying to the employee's employer but recognizes that this is not likely to happen.

The preamble also indicates that future guidance relating to the individual mandate requirement will clarify that a self-insured employer group health plan can be considered minimum essential coverage. Health care reform provisions currently define minimum essential coverage to include an employer-sponsored plan only if it is a government plan or an insured plan (including a grandfathered plan offered in the group market).

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