Health Care Reform Advisory: The “Employer Responsibilities” Requirement of The Patient Protection and Affordable Care Act: A View from the Weeds

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The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (together, the “Act”), adds a new federal requirement, referred to as “employer responsibility,” that takes effect in 2014. Under the Act’s employer responsibility provisions, “applicable large employers” must pay a non-deductible excise tax penalty if any of their full-time employees are certified as having purchased health insurance through a state exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee. Colloquially referred to as a “free rider surcharge” (since it is imposed only when the government subsidizes coverage for employees of an employer), this provision is more complex and nuanced than it might at first appear. This client advisory explains the key features of employer responsibility and considers some implications for plan design.

Definition: “applicable large employer”

An employer (including any predecessor employer) is an “applicable large employer” if it employed an average of at least 50 full-time employees during the preceding calendar year. An employer is not an applicable large employer, however, if the employer’s workforce exceeds 50 full-time employees for 120 days or less during the calendar year and the employees that cause the employer’s workforce to exceed 50 full-time employees are “seasonal workers.” The Act defines a “seasonal worker” narrowly to mean “a worker who performs labor or services on a seasonal basis” (as defined by the Secretary of Labor). [1]

The determination of an employer’s status as an “applicable large employer” is made on a controlled group basis applying the aggregation rules of Code §§ 414(b), (c), (m), and (o), and it is based on full-time equivalent employees. An employee who in any month works an average of at least 30 hours or more per week is counted as one employee. All other employees are counted on a pro-rated basis. The particulars of these calculations will be established by regulation. As explained below, the amount of any excise tax penalty is determined based only on “full-time” employees. The number of full-time equivalent employees is important only for the purpose of establishing whether an employer is an applicable large employer.

Definition: “minimum essential coverage”

“Minimum essential coverage” includes coverage under government sponsored programs, eligible employer-sponsored plans, plans in the individual market, certain grandfathered group health plans, and other coverage as recognized by regulation. “Government sponsored programs” include:

- Medicare
- Medicaid
- Children’s Health Insurance Program
- Coverage for members of the U.S. military
- Veterans’ health care
- Health care for Peace Corps volunteers.

“Eligible employer-sponsored plans” include governmental plans, church plans, “grandfathered plans,” and other group health plans offered in the small or large group market within a state. The term “eligible employer-sponsored plan” is, essentially, content-less; the term is defined by what it is not. Specifically, “minimum essential coverage” does not include “excepted benefits” under 42 U.S.C. 300gg-91(c)(1), which consist of: (i) coverage only for accident, or disability income insurance, or any combination thereof; (ii) coverage issued as a supplement to liability insurance; (iii) liability insurance, including general liability insurance and automobile liability insurance; (iv) workers’ compensation or similar insurance; (v) automobile medical payment insurance; (vi) credit-only insurance; (vii) coverage for on-site medical clinics; (viii) other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits; and (ix) any of the following if provided under a separate policy, certificate, or contract of insurance: limited scope dental or vision benefits; benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof; other limited benefits similar to those above, to the extent specified in regulations; coverage only for a specified disease or illness; hospital indemnity or other fixed indemnity insurance; or Medicare supplemental health insurance, coverage supplemental to TRICARE, or similar coverage supplemental to coverage under a group health plan.

Thus, whatever major medical-like coverage an employer chooses to offer constitutes minimum essential coverage, provided, of course that it otherwise satisfies the Act’s substantive group market and health insurance reforms as modified by the grandfathered plan rules. With the exception of the rules prohibiting discrimination in favor of highly compensated employees and cost reporting and limits on insurance companies’ profits, self-funded plans are treated in much the same way as their fully insured counterparts for purposes of the Act’s employer responsibility requirements. Unlike self-funded plans, however, fully insured plans must comply with state law, and those fully insured arrangements offered through a state exchange, *e.g.*, in the small group market in 2014 and later years, will be required to include an “essential health benefits package.” There is otherwise no separate requirement that “minimum essential coverage” include an “essential health benefits package.”

Excise Tax Penalties

There are two prongs to the excise tax penalty. Which prong applies depends on whether an applicable large employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan. In each case, whether an excise tax penalty is due, and if so in what amount, is determined on a monthly basis.

Prong One: Employer makes no offer of minimum essential coverage

For any month in which:

1. An applicable large employer fails to offer its full-time employees and their dependents the opportunity to enroll in minimum essential coverage; and
2. At least one of its full-time employees enrolls in health insurance coverage purchased through a state exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee or employees

the penalty is the product of the number of the employer's full-time employees (over a 30-employee threshold) multiplied by one-twelfth of $2,000 (or $166.67). This determination is made without regard to the number of the employer's full-time employees who are receiving a premium tax credit or cost-sharing reduction. For years after 2014, this $2,000 amount is indexed in a manner to be specified in guidance issued by the Secretary of Health and Human Services (HHS).

Prong Two: Employer offers minimum essential coverage

Where an applicable large employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage, different rules apply. The employer in this instance is subject to the excise tax penalty if:

1. At least one of its full-time employees enrolls in health insurance coverage purchased through a state exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to such employee or employees; and
2. The coverage is "unaffordable" or the plan's share of the total allowed cost of benefits is less than 60% (the 60% threshold is *not* a requirement of minimum essential coverage for this purpose).

Employer-provided health insurance coverage is deemed "unaffordable" if the premium required to be paid by the employee exceeds 9.5 % of the employee's household income. This percentage is indexed to reflect increases in the per capita growth in premiums as determined by the Secretary of HHS. To demonstrate that coverage is unaffordable, the employee must obtain an affordability waiver from the state exchange. Special rules apply where an employer requires salary reduction contributions and employee reimbursements. An individual may not, for example, purchase coverage through the exchange, apply for the premium tax credit, and pay for the individual's portion of the premium using salary reduction contributions under the cafeteria plan of the individual's employer.

What constitutes the "total allowed cost of benefits" for purposes of the 60% threshold is not yet entirely clear. It most likely refers to the actuarial value of **all** benefits provided under the plan, without regard to co-pays, deductibles, co-insurance, and employee premium contributions, and it will almost assuredly require an actuarial calculation. What is clear is that it is not the same as the aggregate premium cost (*e.g.*, the COBRA rate less 2%).

The excise tax penalty under this second prong for any month is the product of the number of employees who receive a premium tax credit or cost-sharing reduction for health insurance purchased through an exchange multiplied by one-twelfth of $3,000 (or $250), excluding the first 30 employees. The penalty in any month is capped, however, at an amount equal to the number of full-time employees during the month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) in excess of 30, multiplied by one-twelfth of $2,000. As a result, the excise tax penalty imposed on an "offering" employer can never exceed the penalty imposed on a "non-offering" employer. For years after 2014, this $3,000 amount is indexed in a manner to be specified in guidance issued by the Secretary of HHS.

A Medicaid-eligible individual can at any time choose to drop employer coverage and enroll in Medicaid. No penalty is imposed on an employer with respect to these individuals.

Excise Tax, Employer Subsidies and Plan Design Implications

Only employees with household incomes of up to 400% of the federal poverty level (FPL) are eligible for a premium tax credit and cost-sharing reductions for health insurance purchased through a state exchange. Thus, in the absence of an employer offer of minimum essential coverage, any employee of the employer with a household income at or below 400% of the FPL is eligible for subsidized coverage from a state-based exchange. But where an employee is offered minimum essential coverage under his or her employer's plan, the individual is ineligible for a premium tax credit and cost sharing reductions for health insurance purchased through a state exchange, *unless* (i) the coverage under the employer's plan is unaffordable or (ii) the coverage consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60 percent, but only if the employee declines to enroll in the coverage and purchases coverage through the exchange instead.

These rules have important consequences for plan sponsors. Whether an employer is subject to the excise tax is determined under the "offer for coverage" prong described above, irrespective of whether the employer contributes 60% or more of the total allowed cost of benefits. What changes is the cohort of individuals eligible to purchase coverage through a state exchange with respect to whom a premium tax credit or cost-sharing reduction is allowed or paid. If the employer's contribution meets the 60% threshold, not only must an employee have household income between 100% and 400% of the FPL, he or she must also establish that the coverage is unaffordable. Where the employer contribution does not satisfy the 60% threshold, however, then that same employee is subsidy-eligible irrespective of the percentage of household income which the employee premium represents.

There is, thus, a relationship among the prongs of the excise tax penalty, the 60% threshold for employer contributions to the total allowed cost of benefits under the plan, and the rules governing eligibility for a premium tax credit or cost-sharing reduction. It may be advantageous for some employers to offer minimum essential coverage with only a small (*i.e.*, something less than 60%) employer contribution, particularly where the portion of the workforce with household incomes at or below 400% of the FPL is relatively low. On the other hand, employers with a large proportion of minimum wage employees would not benefit from this strategy. Where an employer does meet or exceed the 60% threshold, not only is it more difficult for its employees to qualify for the tax subsidy (because of the need to establish that the employer's coverage is unaffordable), but the richer the employer coverage is, the less likely it is that an employee will exceed the 9.5% of household income bar. Taken to its extreme, an employer that offers fully paid coverage (no employee premiums, co-pays, deductible or co-insurance) would never have any excise tax exposure.

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Endnotes

[1] See 29 C.F.R. § 500.20(s)(1) (defining a seasonal employee to include "retail workers employed exclusively during the holiday season and workers whose employment is, ordinarily, the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year").

For further information regarding this or any issue related to Health Care Reform, please contact one of the professionals listed below or the Mintz Levin attorney who ordinarily handles your legal affairs.

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