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Management Alert

Fiscal Cliff NO. 4: Will the Fiscal Cliff Negotiations Impact Whether an Employer Owes a Penalty Under Health Care Reform?

This is the fourth in our series of alerts discussing the legal ramifications of the rapidly approaching spending cuts and tax increases, more commonly referred to as the "fiscal cliff."

In this alert, we address the potential impact of a fiscal cliff deal (or of the failure to reach a deal) on the Affordable Care Act. More specifically, some Washington, D.C. insiders have speculated that a fiscal cliff deal could scale back the tax credits available under the Affordable Care Act for low-income individuals seeking health coverage through the state-based exchanges. To understand the implications for employer-sponsored benefit plans, it is important to first put the tax credit in context.

Background on the Employer Mandate

Starting in 2014, the Affordable Care Act requires large employers (generally, those with at least 50 employees) to either offer affordable coverage to full-time employees or pay a penalty. One of two penalties could apply under the law:

- If an employer fails to offer coverage to all full-time employees, and at least one full-time employee purchases coverage through the state-based exchanges and receives a government tax credit, the employer will be penalized **$2,000 multiplied by all full-time employees (subtracting out 30 full-time employees).**
- If the employer offers coverage, but the employer charges an unaffordable premium or the plan's reimbursement rate for benefits is too low, and at least one full-time employee purchases coverage through the state-based exchanges and receives a government tax credit, the employer will be penalized **$3,000 multiplied only by those employees receiving a government tax credit.**
    - The premium will be considered unaffordable for any employee that must pay more than 9.5% of household income toward the cost of coverage.
    - The plan's reimbursement rate will be considered too low if the plan pays less than 60% of the actuarial value of benefits.

Background on Tax Credits Through Health Insurance Exchanges Under the Employer Mandate

Notably, the employer will never be subject to the employer mandate under the Affordable Care Act unless an employee receives a government tax credit through the health insurance exchange. Under current law, the Affordable Care Act's tax credits serve to limit the amount certain individuals must pay toward the cost of health care coverage through the exchanges. The tax credits operate on a sliding scale, phasing out for higher-income individuals as follows:

Income Level (as a % of the Federal Poverty Level)	Individual Required Contribution Toward Premium (as a % of Income)
100%-133%	2%
133%-150%	3%-4%
150%-200%	4%-6.3%
200%-250%	6.3%-8.055
250%-300%	8.05%-9.5%
300%-400%	9.5%

As a point of reference, here's a breakdown of the Federal Poverty Level in 2012:

Family Size	Federal Poverty Level	133% of FPL	250% of FPL	400% of FPL
1	$11,170	$14,856	$27,925	$44,680
2	$15,130	$20,123	$37,825	$60,520
3	$19,090	$25,390	$47,725	$76,360
4	$23,050	$30,657	$57,625	$92,200
5	$27,010	$35,923	$67,525	$108,040
6	$30,970	$41,190	$77,425	$123,880

So, for example, an individual who has no other members of his or her household and earns more than 400% of the federal poverty level (in 2012, $44,680) would never be eligible for a tax credit under the health insurance exchange. As a result, this employee would not ever trigger an employer mandate penalty for the employer.

Potential Changes to Tax Credits in Fiscal Cliff Negotiations

There is some speculation that a fiscal cliff deal could lop-off the tax credits for individuals at or above either 300% or 350% of the Federal Poverty Level. This would be significant because it would reduce the number of employees potentially eligible for a tax credit, thereby reducing the number of individuals that could trigger a penalty for employers.

Strategies for Dealing with Employer Mandate

Employers are already developing strategies for dealing with the employer mandate. Most notably, the Affordable Care Act "looks back" to hours worked during the prior year for purposes of determining who is a full-time employee. So, many employers have started measuring employee hours already, or will begin doing so on January 1, 2013. (Click *here* for more information on measuring employee hours under the Affordable Care Act.) Further, employers are considering different strategies for 2014:

- ***Decide Whether to Play or Pay.*** Many employers already offer generous health benefit coverage. These employers may decide to "play" and avoid the penalty. To effectively take this approach, however, employer should still assess whether the coverage is sufficient to avoid paying a penalty under the mandate and whether the coverage is offered to all full-time employees as defined under the Affordable Care Act (generally, individuals working at least 130 hours per month).

  Some employers are considering the "pay" option instead and would allow employees to seek coverage through the exchanges (which, in some instances, will be subsidized by federal tax credits). Under this approach, employees could not pay for the exchange coverage on a pre-tax basis through the employer's cafeteria plan so would need to pay for the coverage on an after-tax basis.

- ***Design a Hybrid Approach.*** There is likely a middle ground between "paying" and "playing." Employers may choose to offer coverage to all full-time employees but set the employee premium contribution at a level that would be unaffordable for certain low-wage workers (e.g., all workers making less than $40,000 per year). Note that this would not necessarily be a discriminatory arrangement -- the same premium would be charged to the entire workforce. For certain workers, however, under this scenario, the premium cost would exceed 9.5% of that individual's household income. This scenario has some potential upside in that the employer would only pay the $3,000 nondeductible excise tax for those individuals who actually go to the health insurance exchanges and receive a tax credit (this $3,000 penalty may or may not be less than the cost of providing coverage), and the employees would still qualify for federal assistance in purchasing coverage through the exchanges.

- ***Hire More Part-Time Employees.*** As mentioned above, employers do not have to provide health coverage to part-time employees (as defined by the Affordable Care Act). So, an employer could avoid or reduce the amount of the tax under the employer mandate to the extent its workforce is made up of part-time employees. Whether or under what circumstances this approach might raise retaliation concerns or serve to promote collective bargaining demands is beyond the scope of this alert. Employers considering this option should consult with our *ERISA and Employee Benefits Litigation experts*.

Other Potential Benefit Implications

While this alert focuses on the implications of the fiscal cliff negotiations on the employer mandate under the Affordable Care Act, there are other potential employer-provided benefit implications, as described below:

- ***Taxation of Over-the-Counter Drugs***
  The Affordable Care Act prohibited health reimbursement plans (HSAs, FSAs, HRAs, etc.) from reimbursing participants for over-the-counter drugs. At present, there is some level of bi-partisan consensus that plans should be permitted to reimburse participants on a tax-free basis for these purchases, so a change could come out of the fiscal cliff negotiations.

- ***Education Exclusion Assistance***
  If Congress fails to take action, the tax exclusion for employer-provided education assistance will expire at the end of this year. Congress regularly renews this provision, so many hope that it will be further extended with any year-end deal.

- ***Adoption Assistance Exclusion***
  As with the education assistance exclusion, if Congress fails to take action, the tax exclusion for employer-provided adoption assistance will expire at the end of this year, so many hope it will be further extended with any year-end deal.

- ***Transit Pass Tax Benefit***
  Under current law, employees can exclude up to $230 per month from income for employer-provided transit passes (i.e., the same amount employees can exclude for employer-provided parking benefits). If Congress fails to act, the permitted exclusion for transit passes (but not for parking benefits) will shrink from $230 to $125 per month.

- ***Employer Child Care Tax Credit***
  The employer-provided child care tax credit, which allows employers to take a tax credit for expenses incurred in providing qualifying child care services for children of employees, is also set to expire at the end of 2012.

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