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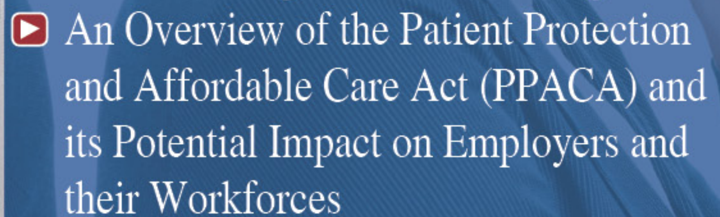
COORDINATED BENEFITS COMPANY, LLC

THE EMPLOYER'S GUIDE TO "Play or Pay"



An Overview of the Patient Protection and Affordable Care Act (PPACA) and its Potential Impact on Employers and their Workforces

The Patient Protection and Affordable Care Act (PPACA) has been referred to as the most sweeping overhaul of the U.S. health care system in the last half-century. Many major provisions of PPACA will be phased in by January of 2014, while the remaining provisions are expected to be phased in by 2020.

One of PPACA's main goals is to reduce the number of Americans without health coverage. As a result, most Americans will be required to purchase some type of health insurance or, alternatively, pay a penalty. In support of this requirement, legislation will make it easier for individuals to obtain coverage by:

- The creation of insurance exchanges (also called health insurance marketplaces).
- Incenting employers to provide coverage to all full-time employees.
- Reducing the barriers to purchasing health coverage for individuals with medical problems.

Employers will have a number of obligations and opportunities as PPACA's core provisions are implemented in 2014 and 2015.

- Beginning in 2015, employers who have 50 or more full-time employees or full-time equivalent employees (FTEs) must provide health coverage that meets minimum requirements or pay a penalty. (This requirement is often called "play or pay" or "employer-shared responsibility.")
- Beginning in 2014, exchanges are to be in effect in each state to make purchasing medical coverage simpler for individuals and small employers.
- Beginning in 2014, the individual mandate begins, requiring most people to have some type of medical coverage in effect or pay a penalty.

PPACA is complex and each employer will need to base its decisions upon its own particular situation and needs. This guide is intended to help employers better understand their options and the implications of their various PPACA-related decisions.

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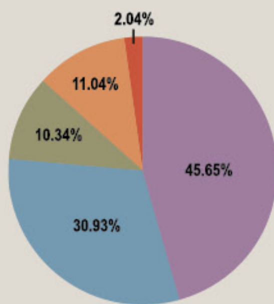
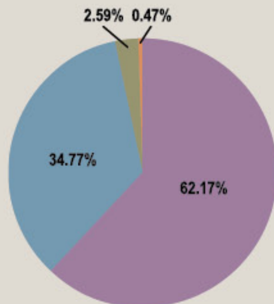
Employers continue to be firmly committed to the value of providing health benefits (76.58%) to active employees and their dependents and believe good benefits help attract and retain employees (more than 96%).

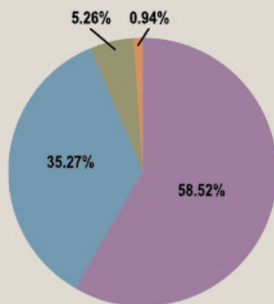
Our organization should provide health care benefits to both our employees and their dependents



Good benefits help attract employees



Good benefits increase employee retention



Play or Pay: The Facts about Paying the Penalties

With every day that goes by, the nation's employers move a step closer to having to make play or pay decisions. Many employers have less than a year to prepare for the arrival of this core provision of PPACA. Their decisions are far from easy… the ensuing financial, legal and competitive implications are profound… and the clock is ticking.

Some employers believe that the play or pay mandate will raise their costs and force them to make workforce cutbacks. As a result, they're considering the "pay" option—i.e., eliminating their health care coverage altogether and paying the penalty on their full-time employees. Other employers are leaning toward "play," which means they'll offer employees medical coverage that meets the requirements of PPACA. While employers should look carefully at both options and do their best to calculate the outcomes of each, the actual solutions implemented by many likely will be creative combinations of approaches (making some reductions to benefits while enhancing others). After all, as with many other workforce-related decisions employers make, their main objective will be to remain financially competitive while still being able to attract and retain the employees they require.

When considering the financial implications of play or pay decisions, keep in mind the fact that PPACA actually calls for two potential penalties for large employers with 50 or more employees: one penalty for not offering "minimum essential" coverage, and the other penalty for offering coverage that's considered inadequate because it isn't "affordable" and/or doesn't provide "minimum value."

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Here's a closer look at each of these penalties along with some of the key questions and answers that can help employers determine whether they will play or pay:

PENALTY #1: MINIMUM ESSENTIAL COVERAGE

- **A large employer must offer minimum essential coverage to at least 95% of its full-time employees (and their dependents) or pay a $2,000 penalty on each of its full-time employees, if even one employee receives a premium tax credit (sometimes referred to as the premium subsidy). When applying this penalty, 30 employees may be excluded (the "30 Free Employees Rule").**

Which full-time employees must be offered coverage to avoid this penalty?

Employees who average 30 or more hours per week are considered full-time under PPACA. When determining who needs to be offered coverage, employers may simply measure an employee's hours on a current, month-by-month basis. For employers with stable employee populations that largely work predictable hours, this approach may work fine. Alternatively, employers have the option of using lookback measurement periods to get smoother, more predictable results. This option can help avoid complications that might arise when employees alternate between working more or less than 30 hours per week; it might also reduce the risks that employees will unexpectedly exceed 30 hours because of overtime or a change in job or schedule.

What dependents must be offered coverage?

Coverage must be offered to the dependent children of full-time employees until the children reach age 26. The usual IRS definition of "child" applies, meaning that natural, adopted, step and foster children are included, and employers cannot impose other requirements, such as financial dependence or that the child live with the employee.

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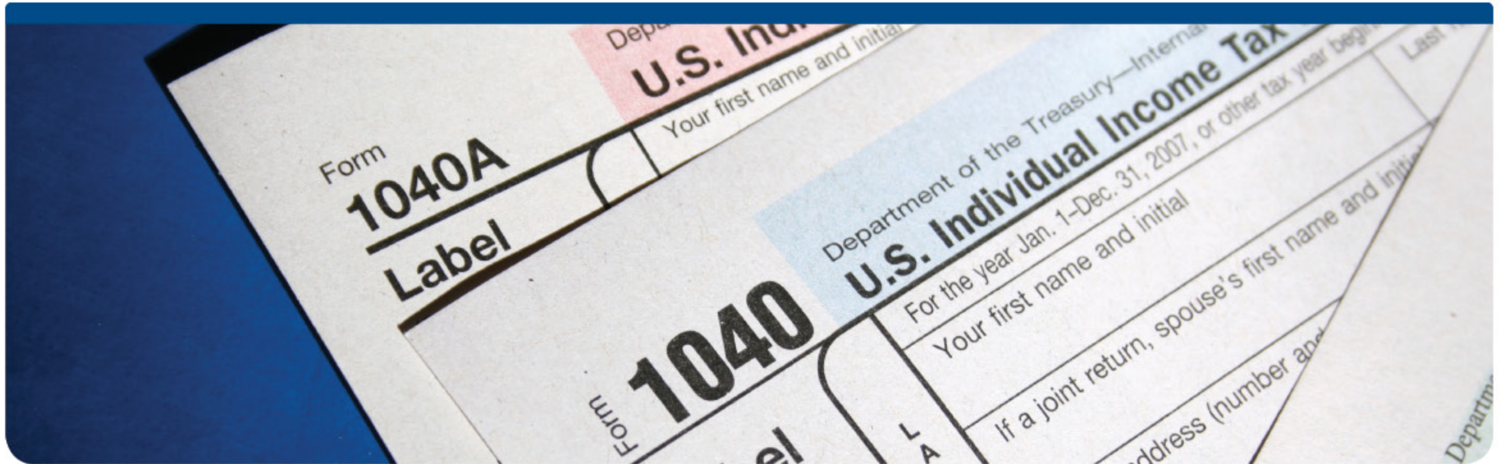


Must spouses be offered coverage?

No. The IRS definition of "dependents" includes children, but not spouses. (Think about your federal income tax return, which separates a spouse from dependents.)

How is the minimum essential coverage penalty calculated?

The penalty is calculated monthly at the rate of $166.67 for each full-time employee, less "30 free employees." (Although the penalty is calculated monthly, it will be paid annually.)

EXAMPLE: Dave's Donuts does not offer medical coverage to its employees. Dave has 60 full-time employees and 12 part-time employees. Two employees purchase coverage through an exchange. Dave's Donuts will owe a penalty of $5000.10/month: 60 full-time employees, minus "30 free employees," multiplied by $166.67 (part-time employees are not counted for purposes of this penalty).

What happens if an employer is part of a controlled or affiliated service group?

If some employers in the group offer minimum essential coverage to 95% of their full-time employees and others do not, only those employers who do not offer coverage must pay the $2,000 penalty on their own employees. Also, the employers who are part of a controlled or affiliated service group share the "30 free employees" pro rata. If one employer doesn't need the free employees because it offers minimum essential coverage, its portion of the free employees may not be shared.

PENALTY #2: AFFORDABLE MINIMUM VALUE COVERAGE

Employers who offer minimum essential coverage to substantially all of their full-time employees may still owe penalties if the coverage they offer is deemed inadequate because it is not "affordable" and/or does not provide "minimum value."

What is "affordable" coverage?

Coverage is considered affordable if self-only coverage costs less than 9.5% of the employee's household income. Because employers rarely know an employee's household income, employers may meet the affordability requirement through one of three safe harbor options: the W-2 safe harbor, the rate of pay safe harbor, or the Federal Poverty Level (FPL) safe harbor.

What is the W-2 safe harbor?

Under the rate of pay safe harbor, coverage is affordable if the employee's contribution for self-only coverage is less than 9.5% of her/his rate of pay at the start of the calendar year. For hourly employees, the safe harbor uses the employee's hourly rate multiplied by an assumed 130 hours worked during a month (regardless of how many hours the employee actually works). For salaried employees, the monthly salary is used. Employers who choose to use this method may not reduce an employee's rate of pay during the year. (Note: This method excludes tips and overtime and disregards any pay increase an employee may receive during the year.)

What is the Federal Poverty Level (FPL) safe harbor?

Under the Federal Poverty Level safe harbor, coverage is affordable if the employee's contribution for self-only coverage is less than 9.5% of the FPL as of the start of the plan year. For 2013, the FPL for a single person in the 48 contiguous states and Washington, D.C., is $11,490, so the maximum employee contribution would be $90.96 per month. The FPL for a single person in 2013 in Alaska is $14,350; in Hawaii it is $13,230. (Note: Although this amount is low, it would be simple to apply, and may be attractive to employers who have employees with compensation that varies widely from month to month.)

What is "minimum value" coverage?

Coverage is considered "minimum value" if it is expected to pay at least 60% of covered claims costs. To assist with this determination, the government has provided calculators and several safe harbor plan designs. In addition, fully insured plans provided to small groups must provide coverage for certain "essential health benefits."

What is the penalty for not offering affordable, minimum value coverage?

The penalty is $250 per month ($3,000 per year) for each full-time employee who:

- is not offered coverage that is considered both minimum value and affordable;
- and purchases coverage through a government exchange;
- and is eligible for a premium tax credit/subsidy (her/his household income must be below 400% of the federal poverty level).

EXAMPLE: Jones, Inc. has 55 full-time employees and eight part-time employees. Jones offers coverage that is minimum value, but which is not affordable for 10 of the full-time employees (nine of whom buy coverage through an exchange) and all of the part-time employees (who all buy coverage through an exchange). Seven of the nine full-time employees and six of the eight part-time employees who buy through an exchange qualify for a premium tax credit.

Jones, Inc. owes a penalty on each full-time employee who enrolls in an exchange plan and receives a premium tax credit, so the company owes $1,750 (seven regular full-time employees who receive a premium credit multiplied by $250; the part-time employees are not counted). The first 30 employees do count under this "inadequate coverage" penalty. Also, if the "no offer" penalty would be less expensive than the "inadequate coverage" penalty, the employer would pay the "no offer" penalty.

Paying the Penalties

For employers who elect to pay the play or pay penalties, two basic questions arise:

When are penalties due?

The penalties will be due sometime after April 15, since penalties will be determined after the end of each calendar year.

How will the penalties be paid?

Penalties will be paid annually but not as part of an employer's standard tax filings. Employers will receive a special notice of assessment from the IRS and will have the right to dispute the penalty amount due.

What Matters: Subsidies, Medicaid & More

While play or pay decisions will have an immediate effect on an employer's bottom line, these decisions also carry long-term implications regarding employee relations and the ability to attract/compete for talent—especially if an employer decides to eliminate the medical coverage it offers. Therefore, employers should seriously consider what they and their employees stand to gain and/or lose as a result of their play or pay verdicts.

For example, employers should take into account their employees' perceived value of health care coverage—or the lack of it, alternatively. Offering employees nominal, affordable coverage, for instance, might actually be "worth" more to an employer in terms of employee satisfaction, productivity and loyalty than the actual expense of providing the coverage.

Following are some of the top considerations for employers weighing their play or pay options:

Compensation matters

Under the new legislation, seemingly small decisions on compensation can have significant ramifications for employers and employees alike. This is true for all organizations regardless of whether or not they offer benefits. Consider the following:

- Your compensation strategy could cause an employee's health care costs to soar because of her/his income bracket. For employees not offered benefits, a subsidy may be an option to reduce costs on the individual market. There are income break points relative to the poverty level when a plan design subsidy decreases dramatically. In addition, there is a break point when a subsidy is eliminated. This will have a tremendous impact on older individuals, who could incur an added expense of $2,500 or more when, for example, a small year-end bonus is added to their income.

  The amount of tax credit that a person can receive is based on the premium for the second lowest cost Silver Plan in the exchange and area where the person is eligible to purchase coverage. The Silver Plan is one that provides essential benefits and has an actuarial value of 70%, meaning that, on average, the plan pays 70% of the cost of covered benefits for a standard population of employees. The amount of the tax credit varies with income such that the premium that a person would have to pay for the second lowest cost Silver Plan would not exceed a specified percentage of their income (adjusted for family size), as shown below:

Percentage of FPL*	Maximum Percentage	Single Income	Maximum Single Premium	Family of 4 Income	Maximum Family of 4 Premium
133%	3.00%	$15,282	$38.21	$31,321	$78.30
150%	4.00%	$17,235	$57.45	$35,325	$117.75
200%	6.30%	$22,980	$120.65	$47,100	$247.28
250%	8.05%	$28,725	$192.70	$58,875	$394.95
300%	9.50%	$34,470	$272.89	$70,650	$559.31
400%	9.50%	$45,960	$363.85	$94,200	$745.75

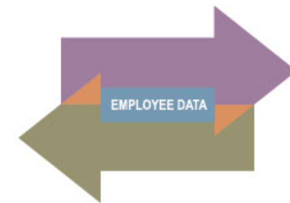
*Note: The Federal Poverty Level for 2013 is $11,490 for an individual and $23,550 for a family of four. This table only represents the 48 contiguous states and Washington, D.C., not Alaska and Hawaii.

Beyond Penalties: Seven Issues To Consider

In addition to the two potential penalties, there are a number of other issues employers should factor into their decision-making process. Here are seven of the most significant:

1 Lost tax advantages

Employers that eliminate health care coverage or opt not to offer it to full-time employees will be missing out on tax breaks (as will their employees). Employer contributions for health care coverage are not considered taxable income to the employee (and are deductible by the employer). Employee premiums that are paid through a Section 125 plan reduce the employee's taxable income, which reduces both the employer's and the employee's FICA tax.



2 Reporting burdens remain

Employers that don't offer health care coverage will still face federal reporting requirements, in part so the penalty amount can be determined. In addition, employees who are not offered coverage are likely to go to the exchanges for coverage. These exchanges will require employee data from employers, particularly for employees who may be eligible for the premium tax credit, which means employers may have to deal with a significant number of inquiries from exchanges (staff time, effort, costs, etc.).

• Employers might force employees to reduce their hours because a pay cut and reduced coverage costs are more advantageous than a higher salary with health care as a full-time employee. (More importantly, employees may ask for reduced hours, slightly lower pay or put more into their 401k in order to qualify for a richer subsidy or a subsidy at all.) Some employers may redefine positions and total compensation of those positions so when an employee is hired, they can choose a less than 30-hour position that has some other enhanced benefits or a 30-hour-plus position that has medical care, but not the other enhancements.

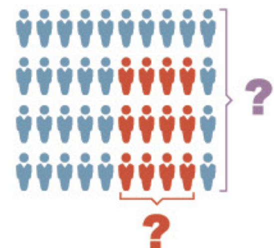
Subsidies matter

For individuals with moderate to low incomes, PPACA provides subsidies that assist them in the purchase of coverage through an exchange. Many factors may limit an individual's ability to qualify for a subsidy, such as affordable care offered from an employer. For those employees who do qualify for a subsidy, the value can be tremendous. As a result, subsidies can significantly change the value employees place on employer-based health care plans, depending on their family income and specific circumstances. Here are some points to consider:

• Employers who seek to avoid penalties by offering a 60% benefit at affordable levels may create retention issues when employees realize what they are not receiving. Example: An employee who makes $35,000 a year is offered a 60% benefit at a charge of $150 per month for himself (regardless of family cost). Essentially, his employer is taking away his ability to have a subsidy pay a significant portion of his costs on an exchange plan. On an exchange plan, the employee would pay roughly $111 a month for a 94% plan to cover his entire family. In this scenario, the employee would be better off financially working for a company that paid him a little less and offered no benefit. Bottom line, the minimum offering strategy can eliminate an employees' ability to get subsidies for themselves and their families.

3 Recruitment and retention challenges

Employers who opt not to offer health care coverage could be doing long-term damage to their employment brands, thus making it difficult to attract top talent in the future. Even worse, they could lose current employees to organizations that do provide coverage. And the damage to the brand could be even greater for employers that once offered coverage, but elect to eliminate it in favor of paying penalties. Not offering coverage could tarnish the employment brand and disrupt business in another way: Employees who are forced to use exchanges—especially untested or insufficiently staffed exchanges—could feel undervalued or abandoned by their employers.



4 Counting employees can be complex

What constitutes a full-time employee? Answering this question can be tricky. In early January 2013, the IRS issued 37 pages of rules on the play or pay requirements that only partly answer the question. Employers that believe they won't face penalties for dropping or not offering coverage because they have fewer than 50 employees may have calculated incorrectly. If that happens, the results could be costly. Be certain you know how to count full-time and full-time equivalent employees and what your obligations are.

- A health care benefit may not be the retention tool it once was. The upside: Employees with health issues may not feel forced to stay in their jobs. The downside: Employees may change employers more freely, thus creating serious retention issues. A "total compensation" approach may be warranted.
- Continuing to offer coverage to spouses may be more harmful than helpful, given the fact that employers do not have to offer coverage to spouses. If spouses are eligible for subsidies, the subsidies may be cheaper than health care plans if the employers were requiring spouses to pay the majority of the rate.
- It's important to remember who can get a subsidy:
  - Individuals or families who do not have access to affordable and minimum value insurance through an employer, Medicare, Medicaid, TRICARE or any other entity.
  - Household income must be below 400% of the Federal Poverty Level and above 100% of the Federal Poverty Level.
  - A plan's affordability is based on the single employee monthly contribution rate, regardless of how much it costs to add other family members. If any one of two spouses has access to affordable care, the family is considered to have access to affordable care. (However, if the employer offering affordable coverage does not provide coverage at all for spouses, then the spouse can get a subsidy.)

5 The cost of coverage can be adjusted

While employers may have to cover more people, they do have options for reducing the costs of this coverage. For example, employers could reduce their lowest-cost coverage to stay just above the 60% minimum value threshold; they could reduce workers' hours below the "full-time employee" level; and they could consider paying targeted penalties (e.g., not providing "affordable coverage" to certain segments of their workforce).

6 There are other financial implications

Employees may demand additional compensation from employers that elect to drop coverage to cover the cost of health care they must now purchase with their own, after-tax dollars. Employers who haven't properly budgeted for nondeductible penalties may compound their financial burdens, especially if they don't make long-term plans for penalty increases.

Age matters

While exchange rates will be different based on employees' age, subsidies are set the same for everyone. The value of the subsidy will be different, but the cost of coverage will be the same. Here are some points to consider:

- Older individuals have more to lose if their employers offer no coverage and the individuals exceed the poverty level by four times or more. Consider the 60-year-old woman working full-time in New York for $90,000 per year; she is not eligible for a subsidy and her cost of coverage could be as much as three times the cost of a 20-year-old in the same situation. A subsidy that only requires an employee to pay $350 per month for coverage is worth significantly more to the 60-year-old.
- For older individuals working for a health care benefit, there may be more incentive to retire early or switch to part-time employment, as they can take advantage of subsidies to cost-effectively bridge the gap between semi or full retirement to Medicare.

Family size and income matter

The bigger a family is, the more valuable a subsidy will be and it will last well into higher salary levels. Medicaid also will be a possibility at higher income levels. Consider the following:

- Families may make employment choices in order to receive a subsidy. This will make employer-sponsored health care less valuable to them unless the employer offers a strong benefit at relatively low cost to the entire family.
- Families' employment choices also may encompass whether both spouses should be working. Health care savings in addition to daycare savings may be the tipping point for one spouse to stop working.
- As for family income, small gains could have big impacts. A child could work during the summer, for example, and earn $5,000. This could result in the family paying more for coverage by reducing its subsidy and benefit.

7 Carriers will address plan designs

Insurance carriers will become experts on coverage requirements out of sheer necessity, so the myriad of plan design criteria won't likely be a burden on many employers. In addition, carriers will implement a variety of tools to communicate with employees, thus helping to keep business disruptions to a minimum.

The state(s) you and your employees are in matters

Costs, minimum wage, poverty levels and other factors vary widely from state to state. Be sure to include these variables in your decisions. Here are some points to consider:

- Because costs vary by state, it might be financially advantageous in very high-cost regions to make health care plans unaffordable—or not offer them at all—and pay the penalties instead.
- Some states (Alaska and Hawaii) have higher poverty levels. This means families can receive subsidies at higher salary levels.
- The minimum wage varies by state and by its nature may place employees in Medicaid. In other cases, it might make employees ineligible for Medicaid.
- The personal income tax levels vary by state (and sometimes within a state). Since an employer plan is tax preferred, the higher the state income tax level is on individuals, the more valuable an employer plan will be relative to non-tax deductible alternatives such as exchange plans, including those purchased with a subsidy.
- Medicaid expansion has a tremendously positive impact on employers with low wage earners.

Conclusion

PPACA creates a highly complex set of play or pay decisions that demand careful thought. No two employers face the same set of circumstances and each should base its decision-making process on its own size, industry, region, workforce characteristics, financial considerations and strategic goals.

Undoubtedly, many employers will find it immensely beneficial to consult an expert to help them consider all of their options and factor in the many variables required to make educated decisions. Contact your nearest United Benefit Advisors (UBA) Partner Firm for knowledgeable guidance and support you can trust. You can find a list of office locations, contact and additional information about UBA and our Partner Firms on our website (www.ubabenefits.com).

Acknowledgements

We would like to thank the following contributors:

David Smith, Director of Analytics, Moloney+O'Neill

Moloney+O'Neill is a full service brokerage firm based out of Spokane, Washington. They specialize in claims data analytics, predictive modeling and other risk retention strategies primarily employed by self-funded medical plans. They have created a PPACA Impact Analysis tool that is currently being used by brokers across the country.

Terriann Procida, President, Innovative Benefit Planning, LLC

Innovative Benefit Planning, LLC is a specialty consulting firm located just outside Philadelphia in Cinnaminson, New Jersey. They provide high-end consulting in employee benefits, retirement plans/fiduciary services, and executive benefits, enjoying a 99% client retention rate. In addition, they have enjoyed a sterling reputation for integrity, credibility, and experience for the last 24 years and look forward to maintaining that trademark in the future.

Jim Patrician, President
(847)605-8560
jpatrician@cbcco.com
www.chcco.com

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