IRS Proposes Rules for Federal Subsidy of Health Insurance Purchased in State Exchanges

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The Internal Revenue Service (IRS) on August 12, 2011 issued proposed regulations relating to the federal premium tax credit for individuals who purchase health insurance through a state insurance exchange beginning in 2014. Funds for the federal subsidy are obtained from employers that are subject to the “shared responsibility” provision of the Patient Protection and Affordable Care Act (Affordable Care Act), which is also known as the “free rider penalty.”

This Aon Hewitt bulletin provides:

- An overview of the federal subsidy (a health insurance premium tax credit) available to applicable taxpayers;
- An overview of the employer “shared responsibility” payment;
- Eligibility for the premium tax credit; and
- Calculating the premium tax credit.

Overview of the Federal Subsidy (Premium Tax Credit)

One of the federal subsidies available to individuals takes the form of a health insurance premium tax credit. Under the proposed regulations, the premium tax credit is claimed by individuals who enroll in qualified health plans (QHPs) through a state-based Affordable Insurance Exchange (Exchange). The premium tax credit is refundable and payable in advance directly to the insurance carrier.

The premium tax credit is generally available to individuals whose household income does not exceed a certain multiple of the federal poverty level (FPL). In addition, to be eligible for the premium tax credit, the individual cannot be eligible for minimum essential coverage (MEC). For premium tax credit eligibility purposes, an individual is eligible for MEC under an employer plan only if the plan also is affordable and provides a minimum actuarial value.

The preamble to the proposed regulations provides preliminary insight into how important concepts such as the premium tax credit will impact employers when the shared responsibility payment becomes effective in 2014.

Overview of the Employer “Shared Responsibility” Payment

A "large" employer (i.e., one that employs 50 or more full-time employees (FTEs)) generally is subject to a shared responsibility payment (or tax) if the employer:

1. **Fails to offer** MEC to its FTEs (and their eligible dependents); or
2. **Offers** MEC to its FTEs (and their eligible dependents) but that coverage is either unaffordable or does not provide a minimum actuarial value.
While the amount of the penalty differs based on whether MEC is offered or not, the penalty ultimately is “triggered” if an individual enrolls in a QHP through an Exchange and is eligible for the premium tax credit that is the subject of this bulletin. Another federal subsidy referred to as a cost-sharing reduction also will “trigger” the penalty; the details regarding such reduction to out-of-pocket expenses have not yet been issued. For now, it appears that as long as an employer offers MEC that is affordable and provides a minimum actuarial value to its FTEs, the shared responsibility payment should not apply.

Eligibility for the Premium Tax Credit

To be eligible for the premium tax credit, the “Applicable Taxpayer” or a member of the taxpayer’s family: 1) must be enrolled in a QHP through an Exchange; and 2) cannot be eligible for MEC other than coverage in the individual market.

Who Is an Applicable Taxpayer?

An Applicable Taxpayer is an individual who is eligible for the premium tax credit. To meet this requirement, such individual must have “household income” that is at least 100% but not more than 400% of the FPL. “Household income” is defined as the modified adjusted gross income of all members of the household who are required to file an income tax return. A special rule applies to lawfully present aliens. Individuals, other than lawfully present aliens, with household income below 100% of the FPL generally are not eligible for the premium tax credit because they are eligible for Medicaid. Further, a married individual, to be an Applicable Taxpayer, must file a joint return for the taxable year and cannot be a dependent of another taxpayer.

What Is Minimum Essential Coverage?

The Affordable Care Act generally defines MEC as:

1. Government programs, such as Medicare, Medicaid, CHIP, TRICARE for Life, the veteran’s health care program, and a health plan for the U.S. Peace Corps volunteers;

2. An eligible employer-sponsored plan;

3. Grandfathered health plans; and

4. Such other coverage designated by the Department of Health and Human Services (HHS).

Government Programs

The guidance generally indicates that an individual is eligible for government-sponsored MEC on the first day of the first month in which the individual may receive benefits. Therefore, a taxpayer would not lose eligibility for the premium tax credit if technically eligible for a government program, but not yet enrolled.

Example: A taxpayer turns 65 on June 3 and becomes eligible for Medicare. The taxpayer enrolls in Medicare on June 11 and may receive benefits immediately. The taxpayer is considered eligible for MEC on July 1, which is the first day of the first full month that the taxpayer may receive benefits under Medicare.
However, the individual is expected to meet the requirements to obtain coverage. For example, an individual must enroll in Medicare within the time frames required following attainment of age 65 or he or she will no longer be eligible for the premium tax credit.

**Eligible Employer-Sponsored Plan**

As a general matter, an individual is eligible for MEC through an eligible employer-sponsored plan if the individual had the opportunity to enroll in the plan (e.g., through annual enrollment) even if he or she did not enroll. In addition, for purposes of the premium tax credit, to be considered MEC through an eligible employer-sponsored plan, the coverage must be **affordable** and must provide **minimum actuarial value**.

The proposed regulations also confirmed the following:

1. Future regulations will clarify that a self-insured group health plan can meet the definition of MEC.

2. If an individual is eligible for COBRA, actual enrollment in COBRA is required for the participant to be “eligible for MEC.”

3. If an individual actually enrolls in an eligible employer-sponsored plan, he or she is considered “eligible for MEC” regardless of whether the coverage is affordable and provides minimum actuarial value.

**Affordability**

The affordability test for the premium tax credit is based on the cost of self-only coverage, even if the employee elects family coverage. The proposed regulations clarify that an employer-sponsored plan is affordable if the employee’s required contribution for self-only coverage under the plan does not exceed 9.5% of the Applicable Taxpayer’s **household income** for the taxable year. This is the rule, even if the employee elects family coverage and the cost of family coverage does not meet this requirement. A different test likely will apply to affordability for purposes of the individual mandate requirement.

*Example: In 2014, a taxpayer has a household income of $47,000. The taxpayer’s employer offers its employees a health insurance plan providing minimum actuarial value that requires the taxpayer to contribute $3,450 for self-only coverage for 2014 (7.3% of the taxpayer’s household income). Because the taxpayer’s required contribution for self-only coverage does not exceed 9.5% of household income, the employer plan meets the affordability test and the taxpayer is eligible for MEC for all months in 2014.*

The guidance provides a number of examples and scenarios, including how the affordability requirement applies if it is discovered that an employer-sponsored plan is unaffordable at year end.

While the affordability test for purposes of the premium tax credit will continue to be based on household income, the IRS anticipates issuing a safe harbor that will allow employers to calculate the affordability test for the employer’s shared responsibility payment using its employees’ W-2 wages. The IRS recognizes that employers have no reasonable mechanism for determining whether the 9.5% of household income test will be met with respect to the employer’s coverage, since an employer has no way of knowing an employee’s “household income.” The Treasury Department and the IRS intend to issue a request for comments on this affordability safe harbor for employers.
Minimum Actuarial Value
Guidance from HHS is expected later this year on how to calculate whether benefits provided under a plan equal at least 60% of the total costs of benefits. The preamble to the proposed regulations indicates that employer-sponsored group health plans will not be required to provide each of the essential health benefits or each of the ten categories of benefits outlined in the Affordable Care Act. Instead, the intent is to continue to preserve the employer-based health system, while still imposing the shared responsibility penalty where appropriate.

Calculating the Premium Tax Credit
A taxpayer’s premium assistance credit amount is the lesser of:

1. The premiums for the month for one or more QHPs in which a taxpayer or a member of the taxpayer’s family enrolls; or

2. The excess of the adjusted monthly premium for the applicable benchmark plan over 1/12 of the product of a taxpayer’s household income and the applicable percentage for the taxable year. The applicable benchmark plan generally is the second lowest cost silver plan offered at the time an individual enrolls in a QHP through the Exchange. The applicable percentage is derived from a table provided in the proposed regulations of household income expressed as a percentage of the FPL.

While many factors will affect the calculation of the premium tax credit—divorce, the purchase of a dental plan for pediatric coverage, etc.—the guidance suggests that the Exchanges, not employers, will be responsible for determining the amount of the credit. The amount of the credit allowed to a taxpayer will be reconciled with advance credit payments on a taxpayer’s income tax return for a taxable year. A taxpayer whose premium tax credit for the taxable year exceeds the taxpayer’s advance credit payments may receive the excess as an income tax refund. Whereas, a taxpayer whose advance credit payments for the taxable year exceed the taxpayer’s premium tax credit owes the excess as an additional income tax liability.

Effective Date and Comments
The regulations are proposed to apply for taxable years ending after December 31, 2013. Comments on the proposed regulations must be submitted by October 31, 2011.

More Information

An IRS fact sheet is available at: www.treasury.gov/press-center/Documents/36BFactSheet.PDF
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