Health Reform Road Map for Cities and Villages

By Josh Brown, Esq.

Weekly Update 2 – May 10, 2013

Question: How Will the Tax Penalties be Assessed on Municipalities?

This week I will be updating my road map by responding to a question I recently received. Below, you will find the question and my answer.

> Mr. Brown,
>
> I read your article about the Affordable Care Act and how this affects municipalities. What we need to know is how the tax credit and tax penalty process works.
>
> We do offer coverage to all employees and we do believe our coverage is beyond what will be considered minimum essential coverage. None of our employees should be eligible for this tax credit. However, unless they share their return with us, we can't be sure they won't try to take the credit.
>
> Further what if they take the credit and they are not entitled to do so? Do we have the right to fight any penalty assessed if we prove they weren't entitled to take the credit?

Here is my answer:

> Dear _____,
>
> Thank you very much for your question.
>
> I spent a lot of time trying to figure this out myself. The law does not address it, and neither do any *current* regulations—although it is glossed over in a FAQ section. This is further complicated by the fact that certain employers (such as municipalities) are tax exempt – how does the IRS impose a tax penalty on a tax-exempt entity?
>
> So after a number of calls and emails, about a month ago, I finally was able to speak to one of the head lawyers at the IRS personally. He told me that they had not written the rules yet, but he had some expectations. His expectations were consistent with my conversations and readings concerning this subject.
>
> So this is what is likely to happen after your employee opts out of the employer coverage that you properly offer him/her. The employee will go on

the health exchange and apply for a credit. Once he receives the credit, the IRS will send a letter to the employer. This letter will inform the employer that an employee has claimed a tax credit and why. The employer will then be given an opportunity to contest or pay. The lawyer I spoke with said this will be similar to an excise tax. The IRS rules say that the Penalty is only incurred after it is certified to the employer [that the employee has] received an applicable premium tax credit or cost-sharing reduction."[1]

Please note: This is merely my own research on the subject. Nothing in this email should be construed as legal advice. If you need legal advice, please speak to your city attorney. I am glad to speak with your city attorney concerning this subject.

I would like to expand upon my answer a Little for this Update:

First, let's do a little review. The rule says that the employer must pay the penalty after the employee "obtains" the tax credit to purchase his/her own coverage on a state exchange. The rule does not look for eligibility or application for the tax credit, rather it is obtainment.

"The tax credit may be **obtainable** by an employee for any one of four reasons:
Reason 1: the employer did not offer coverage to that employee;
Reason 2: the offered plan did not provide "minimum essential coverage";
Reason 3: the offered plan did not provide "minimum value";
Reason 4: the offered coverage was "unaffordable" to the employee."

As you can see, the law does not require your employee to accept your employer-offered coverage. If the employee opts out, he is not required to obtain a tax credit. Although, the employee is required to obtain health insurance under the ACA's individual mandate. This gives rise to the following question:

What if the employee obtained the tax credit improperly or under an improper basis?

So in the scenario posed by the letter above, we are assuming that the employer's coverage satisfies reasons 2, 3, and 4.[2] That being said, you should be aware of the following points:

Nothing in federal law prohibits an employer from requiring its employees to enroll in its employer-sponsored health coverage, even if the employee has to pay part of the premium. However, you should check with your local counsel about state and local rules on this.

Outside of internal city policy, the employee is well within his/her rights to reject employer coverage, and get his/her own coverage elsewhere. This is a likely scenario where you have an employee who is eligible for coverage under someone else's plan. This would likely be the case for someone who is eligible for

[1] See: http://www.irs.gov/pub/newsroom/reg-138006-12.pdf , pages 3-4.

[2] However, you still have to be careful about Reason 1. You have to make sure you make a proper offer. In my essay, I recommend consulting with your attorney to develop a standardized process for making a proper offer. Many employers have standardized waiver forms. However, I would also discuss with your attorneys whether you want to also include a counseling session, to be sure the employee is fully aware of his decision and cannot later come back and say he didn't know what he was signing.

another employer's family plan coverage by virtue of their status as a spouse or a dependent (under the age of 28 in Ohio) of an employee of another company. However, they may just want to purchase their own coverage as well. So this question then arises:

Is There Penalties for Those Acquiring Coverage Through Another Employer?

The question is this: what if your employees are not eligible for the tax credit, but your employee opts out of your employer coverage because he/she receives health insurance from a subsidized family plan, such as where: 1) his/her spouse lawfully obtains the credit, or 2) he/she is a dependent of someone who lawfully obtains the credit? In other words, another employer's employee has purchased coverage for himself and his spouse or his dependent with the premium tax credit—and your employee happens to be that spouse or dependent, who is not eligible for the credit his/herself. In response, you are concerned you could be on the hook to pay a penalty for that coverage.

Rest easy; the IRS rules say that employers are only responsible for a "premium tax credit with respect to that employee's purchase of health insurance for himself or herself on an Exchange . . . an employee's receipt of a premium tax credit or cost sharing reduction with respect to coverage for a dependent will not result in liability for the employer under section 4980H."[3] So if somehow, someway, you get a penalty for coverage to anyone except that employee, then you are being improperly assessed a penalty.

Also Note:
Also, let's say that you somehow get stuck with this penalty. Before you get too weary, look at the penalty itself. The penalty is either $2000 per employee per year or $3,000 per individual tax credit per year. Compare that to the cost of insurance, which, according to the Kaiser Family Foundation, is over $5,000 per year, for individual coverage. In other words, if your employee rejects your coverage, and somehow claims a tax credit, you're still spending less money on that employee. However, many employers may have other reason for wanting to have their employees enroll, such as a safety management program or group rating system.

*Josh Brown, Esq. is the Legislative Advocate and a Policy Analyst at the Ohio Municipal League.
This is a working paper, available at www.omlohio.org . To help improve this paper, we need your input.
Please send your feedback and questions to jbrown@omlohio.org .*

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