ACA Employer Shared Responsibility Mandate

A Practical Guidance® Practice Note by Virginia E. McGarrity, Robinson+Cole LLP

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This practice note describes the shared responsibility rules for so-called applicable large employers (ALEs) implemented by the Patient Protection and Affordable Care Act (Pub. L. No. 111-148), as amended by the Health Care and Education Reconciliation Act (Pub. L. No. 111-152) (ACA). Although the ACA does not require businesses to provide health benefits to their workers, employers classified as ALEs—generally those with 50 or more full-time employees and full-time equivalent employees—may face excise tax penalties if they don't offer health coverage or don't offer coverage that meets certain minimum value and affordability standards. It is important for employee benefits practitioners and in-house counsel responsible for ACA compliance to understand when and how these rules apply so they can advise their clients that are or may be ALEs on the costs they potentially face and how to avoid them.

The shared responsibility rules are also commonly referred to as the employer mandate or pay-or-play provisions of the ACA. These rules were designed to promote employers' traditional role in providing access to health insurance for their employees despite rising health care costs and to complement the ACA's individual mandate, which requires individuals to obtain health coverage or pay an excise tax. Although 2017 tax reform legislation enacted in 2017 (Pub. L. No. 115-97) effectively repealed the individual mandate as of 2019, the employer shared responsibility rules remain intact.

This practice note addresses the following topics:

- Employer Shared Responsibility Basics
- Applicable Large Employer Status
- Offers of Coverage to Avoid Penalties
- Employer Shared Responsibility Payments
- Information Reporting Requirements

Additional general information on this topic can be found at Health Care Reform: Law and Practice § 2.02. For more information on determining employer mandate liability, see ACA Employer Shared Responsibility Full-Time Employee Determinations. Agency guidance can be found on the IRS website at ACA Information Center for Applicable Large Employers (ALEs), which contains links to additional resources. For additional background, see Congressional Research Service, The Affordable Care Act's (ACA's) Employer Shared Responsibility Provisions (Jan. 9, 2019).

Employer Shared Responsibility Basics

Section 1513 of the ACA added to the Internal Revenue Code sections 4980H(a) and 4980H(b) to require ALEs to make employer shared responsibility payments to the IRS (in the form of non-deductible excise taxes) for each calendar year in two situations:

(1) **4980H(a) penalty.** This shared responsibility payment generally applies if for any month of the year:

- The ALE does not offer substantially all (70% in 2015 and 95% in 2016 and future years) of its full-time employees and their dependent children a health plan constituting

minimum essential coverage (including, generally, most major medical health plans that are not excepted benefits (see I.R.C. § 9832(c)) –and–

- At least one of its full-time employees obtains for such month a premium tax credit or cost-sharing reduction for purchasing individual coverage on an ACA health insurance marketplace exchange (referred to in this practice note as subsidized exchange coverage)

  As described further below, the 4980H(a) penalty amount for each month of the year that the above conditions apply is one-twelfth of $2,000, adjusted for inflation ($2,700 for 2021), for each full-time employee of the ALE employed during that month (minus the first 30). It is usually the more significant shared responsibility payment since it is applied on a per capita basis for **every** full-time employee of the ALE, without regard as to whether any individual employee was offered employer plan coverage or obtained subsidized exchange coverage.

(2) **4980H(b) penalty.** This shared responsibility payment generally applies for any month of the year if:

- The ALE does offer substantially all of its full-time employees and their dependent children minimum essential coverage, but the plan is not offered to, or fails to meet affordability or minimum value standards for, at least one full-time employee –and–
- At least one such full-time employee obtains subsidized exchange coverage

  As described further below, the 4980H(b) penalty amount for each month of the year that the above conditions apply is one-twelfth of $3,000, adjusted for inflation ($4,060 for 2021), for each such full-time employee who obtains subsidized exchange coverage. This payment is generally less substantial than the 4980H(a) penalty because it is applied only with respect to those full-time employees of the ALE who were not offered qualifying coverage, signed up for individual health insurance on an ACA exchange, and received a tax credit or cost-sharing reduction.

A single employer cannot be subject to both the 4980H(a) and 4980H(b) penalties for the same month (because it either does or does not offer substantially all of its full-time employees minimum essential health coverage during that period). This is where the "pay or play" terminology comes from—employers can choose to "pay" for not offering coverage (the 4980H(a) penalty) or "play" by offering coverage, in which case 4980H(b) penalty may apply if the coverage is deemed not to provide minimum value or to be affordable for one or more full-time employees and such a full-time employee obtains subsidized exchange coverage.

These payment obligations only apply to employers that are considered ALEs—generally those having 50 or more full-time employees and full-time equivalent employees on average during the year prior to the assessment year. This determination is discussed in detail under Applicable Large Employer Status.

The employer shared responsibility rules can generate significant compliance obligations for large and mid-size employers, even if they ultimately will not incur any payment obligations. For example, because ALE status and the payment amounts are determined on a monthly basis, ALEs generally need to track the number of full-time employees and full-time equivalent employees, their offers of coverage to full-time employees, and their full-time employee coverage status for each month of the year. In addition, as summarized under Information Reporting Requirements below, all ALEs (and sponsors of self-funded employer health plans) have reporting and notice obligations to the IRS and to its full-time employees regarding their offers of health coverage.

Conditions for Employer Shared Responsibility Payments

Even employers that are ALEs can avoid the shared responsibility payments by offering health insurance coverage to all of its full-time employees that meets affordability and minimum value requirements, as described below, under Offers of Coverage to Avoid Penalties. An ALE does not need to offer any coverage to employees who are not full-time employees to avoid incurring the penalties, even though non-full-time employees are counted as full-time equivalent employees to determine whether an employer is an ALE. Further, the payment obligation is only triggered if at least one full-time employee who signs up for ACA exchange coverage obtains a tax credit or cost-sharing reduction for that coverage.

Given this statutory framework, employers will want to consider the consequences of the employer shared responsibility rules when making decisions about the health insurance coverage (if any) they offer to their employees as well as the benefits, cost, and eligibility terms under such coverage.

Effective Dates for the Shared Responsibility Rules

The employer shared responsibility provisions were originally intended to be effective for 2014, but enforcement was deferred for 2014 and substantial transition relief was available for 2015 and, for non-calendar-year plans 2016. See I.R.S. Notice 2013-45, I.R.S. Notice 2014-49, and Section

XV of the preamble to the final regulations at 79 Fed. Reg. 8543, 8569 (Feb. 12, 2014); see also IRS, Employer Shared Responsibility Provision Transition Relief for 2015 Plan Years. Transitional relief from information reporting penalties was also available for employers that could show that they made good faith efforts to comply with the requirements for years 2015–2019 (see I.R.S. Notice 2019-63 for the most recent extension). In determining good faith, the IRS will consider whether employers have made reasonable attempts to comply with the requirements (e.g., gathering and transmitting the necessary data to an agent or testing its ability to transmit information) and the steps that have been taken to prepare for next year's reporting. Note that the relief applies only to furnishing and filing incorrect or incomplete information, and not to a failure to timely furnish or file.

Applicable Large Employer Status

Whether an employer is an applicable larger employer, and is therefore subject to the employer shared responsibility rules, depends on the size of its workforce. In general, only employers employing on average at least 50 full-time employees (including full-time equivalent employees, discussed below) are ALEs. The vast majority of U.S. employers fall below the ALE threshold and therefore are not subject to the employer shared responsibility provisions. Treas. Reg. § 54.4980H-1(a)(4) (ALE definition); Treas. Reg. § 54.4980H-2 (ALE determination rules).

This workforce size determination is made without consideration of any health insurance coverage options that may be available to employees. That is, employees are counted even if they are eligible for health coverage from another source (e.g., a spouse's plan, Medicare, or Medicaid).

Who Is an Employer?

ALE determinations are made on an organization-wide basis under the rules of I.R.C. § 414(b), (c), (m), and (o), so you need to aggregate the employees of members of the same controlled group and affiliated service groups to determine if the entire group (and each of its members) is an ALE. Thus, you may even need to treat completely separate and distinct businesses as a single employer if there is sufficient common ownership. Although most of the discussion below refers merely to employers, keep in mind that this term incorporates applicable subsidiaries, parent companies, and other affiliated entities. Treas. Reg. § 54.4980H-1(a)(16). In the absence of specific, applicable guidance, governmental entities may apply a good faith reasonable interpretation of I.R.C. § 414 to determine if they should be aggregated with any other government entities for this purpose. IRS, Questions and Answers on Employer Shared Responsibility Provisions under the Affordable Care Act, Q&A-13.

For more information on the related employer rules, see Controlled Group and Affiliated Service Group Rules (Employee Benefits Plans).

When an ALE includes multiple member entities, employer shared responsibility liability is determined separately for each ALE member that employs full-time employees.

Who Is an Employee?

These rules use the common-law standard for determining who is an employee (as described under Treas. Reg. § 31.3401(c)-1(b), but exclude leased employees (as defined in I.R.C. § 414(n)), sole proprietors, partners in a partnership or members of a limited liability company, S corporation shareholders owning at least 2% of the entity, most real estate agents, and most people who are "direct sellers" (those who sell consumer goods that will be used or resold in a home, rather than a retail setting, like a newspaper distributor). Treas. Reg. § 54.4980H-1(a)(15). Under this standard, in general, an employment relationship exists where the company has the right to control and direct the individual regarding the details and means by which she or he performs work for the company. For more information on how to decide if a person is a common-law employee, see Joint Committee on Taxation, Present Law and Background Relating to Worker Classification for Federal Tax Purposes (May 8, 2008).

The ACA is another potential minefield for companies that misclassify workers as independent contractors instead of employees. An employer that treats individuals as independent contractors for a period when IRS rules would apply common-law employee status to those workers may not even be aware of its ALE status and that it has obligations under the employer shared responsibility rules. For information on the IRS tests for employee classification, see Independent Contractor Tests and Risks of Worker Misclassification.

Volunteers, work-study workers, and employees paid by non-U.S. entities are generally not taken into account. This is because any services provided by such individuals are usually excluded for purposes of the employer shared responsibility rules. Treas. Reg. § 54.4980H-1(a)(24)(ii).

Who Is a Full-Time Employee and What Are Full-Time Equivalent Employees?

For purposes of these rules, full-time employees are defined as employees who average 30 hours or more per week (or 120 hours per month). Treas. Reg. § 54.4980H-1(a)(21). All other types of employees are counted using the FTEE rules, described further below, unless an exception applies.

ALE determinations are based on the employer's so-called full-time equivalent employees (FTEEs), in addition to full-time employees. The FTEE calculation provides an equivalency estimate of the number of full-time employees it would take (at 30 hours per week) to perform the services provided by all of the employer's non-full-time employees. So a company that only employs part-time workers may technically be an ALE, if those part-time employees together provided services equivalent to over 50 full-time employees. But such an ALE would never be subject to a shared responsibility penalty because there are no full-time employees who could obtain subsidized exchange coverage, a condition of both the 4980H(a) and 4980H(b) penalties.

Counting Full-Time Employees and FTEEs

The threshold for imposing ALE status for a calendar year is based on the monthly average size of the employer's workforce for the prior year. Thus, to determine ALE status for a year, you would:

(1) Count the number of full-time employees for each month of the prior year and add them all together

(2) Calculate the FTEEs for each month of the prior year and add them all together

(3) Add the results from steps (1) and (2) together, and then divide by 12, rounding down any fraction to the nearest whole number

If the result in step (3) is 50 or over, the employer is an ALE for the year; if it is less than 50, the employer is not an ALE for the year. Treas. Reg. § 54.4980H-2(b)(1).

For new businesses that were not in operation during the previous year, ALE status applies if the employer is reasonably expected to employ, and actually does employ, an average of 50 full-time employees and FTEEs on business days in the current calendar year. Treas. Reg. § 54.4980H-2(b)(3).

The ALE counting rules are applied on an average monthly basis, so ALEs need to track their employee counts for each month of a year. The regulations establishing these rules are somewhat complex (see Treas. Reg. §§ 54.4980H-2 and 54.4980H-3), but in general the methods for counting full-time employees and FTEEs are as follows:

- **Full-time employee monthly counts.** Count each full-time employee employed during the month if they work at least 30 hours per week on average during that month.
- **FTEE monthly counts.** Determine the monthly FTEE count by dividing the total number of hours of service performed by all of the employer's non-full-time employees during the relevant month by 120. However, the number of hours for any single non-full-time employee for a month is capped at 120.
- **Hours of service.** Actual hours of paid service must be used for hourly employees. For non-hourly employees, an employer has the option of using actual hours of service, a days-worked equivalency based on an eight-hour day for any day where at least one hour of service was performed, or a weeks-worked equivalency based on a 40-hour week for any week where at least one hour of service was performed. In either case, you count all hours worked and hours for which payment is due (e.g., overtime, paid time off, etc.).

Treas. Reg. § 54.4980H-2(b), (c); Treas. Reg. § 54.4980H-3(b)(21).

This is known as the monthly measurement method and it must be used for ALE determinations. The rules for counting full-time employees for purposes of determining employer shared responsibility liability amounts are more flexible in that employers can choose to apply a look-back measurement method instead. Treas. Reg. § 54.4980H-3(a). See the section "Look-Back Method for Counting Full-Time Employees," under Employer Shared Responsibility Payments below and ACA Employer Shared Responsibility Full-Time Employee Determinations for further information.

Special Rules for ALE Determinations

Special rules apply for the following categories of employees:

- **Seasonal workers.** An employer is not an ALE if both:
  - The 50 full-time (plus full-time equivalent) employee threshold is exceeded for 120 days or fewer during the preceding calendar year –and–
  - All of the employees in excess of 50 during that period are seasonal workers (as defined by the Department of Labor or retail workers hired exclusively for a holiday season)

- **Employees covered by TRICARE or a Veterans Administration.** Employees having health coverage under TRICARE or a Veterans Administration health program during an entire month are excluded from that month's count for purposes of the ALE determination (but should still be offered coverage if they are eligible for coverage).

I.R.C. § 4980H(c)(2)(B), (c)(2)(F); Treas. Reg. § 54.4980H-2(b)(2).

For more detailed information on the definition and determination of applicable large employers, including the determinations of full-time employees and FTEEs, see ACA Employer Shared Responsibility Full-Time Employee Determinations.

Offers of Coverage to Avoid Penalties

Even if the employer is an ALE, the employer shared responsibility payments will not apply if all of its full-time employees (and their dependent children up to age 26) are offered qualifying health insurance coverage for each month of the applicable year. This coverage can be provided under a plan sponsored by the employer or its affiliate, under an applicable multiemployer plan or multiple employer welfare arrangement, or, in certain circumstances, under a plan sponsored a staffing agency. Treas. Reg. § 54.4980H-4(b)(2).

Coverage Offers to Avoid 4980H(a) Penalties

To avoid the 4980H(a) penalty, an ALE (or other applicable plan sponsor) only needs to offer minimum essential coverage to:

- At least 95% of its full-time employees (and their dependent children)
- ALEs having fewer than 100 full-time employees, to no fewer than all but five of its full-time employees (and their dependent children)

Treas. Reg. § 54.4980H-4(a).

The 95% threshold allows for some wiggle room in case there are small numbers of full-time employees who are not offered coverage due to administrative error or delay. In addition, this threshold determination ignores employees who are for the relevant month in a so-called limited non-assessment period. Examples are a waiting period before a full-time employee first becomes eligible for coverage or a partial period of non-coverage during the first month for which coverage begins. Id.; see Treas. Reg. § 54.4980H-1(a)(26) for the definition of limited non-assessment period.

Unlike the coverage that must be offered to avoid the 4980H(b) penalty, there are no affordability or minimum value requirements for relief from the 4980H(a) penalty, except as noted above for mandatory coverage plans. (The 4980H(b) affordability and minimum value standards are discussed in the next section.) The coverage merely needs to be minimum essential coverage, as defined in I.R.C. § 5000A(f). This includes any eligible employer-sponsored group health plan or group health insurance coverage offered by an employer (including a grandfathered plan), but excludes plans providing exclusively excepted benefits (e.g., disability insurance, accident-only coverage, travel insurance, dental or vision benefits, long-term care benefits). See also Treas. Reg. § 1.5000A-2.

General Rules for Offers of Coverage

The following rules apply for determining whether the offers of coverage are sufficient for an ALE to avoid incurring 4980H(a) penalties:

Dependent coverage. The dependent coverage offered need only cover dependents as defined in Treas. Reg. § 54.4980H-1(a)(12), which excludes stepchildren, foster children, individuals who do not qualify as dependents under I.R.C. § 152(b)(3), as well as spouses. For dependent children, the coverage must apply through the end of the month in which the child turns 26.

Monthly determination. The coverage requirement is applied on a monthly basis, so an ALE can meet the threshold and avoid penalties for certain months of a calendar year but incur penalties for the other months. To count as coverage for a month, the employee must be covered by the plan for every day of that month (except for coverage that terminates mid-month due to a termination of employment and where a limited non-assessment period applies).

Optional coverage or mandatory coverage that is affordable and offers minimum value. The coverage offered to the threshold number of full-time employees must be optional, so that the employee may choose or decline coverage at least once for the plan year, unless the coverage:

- Provides minimum value (as discussed in the next section) –and–
- Is offered at no cost to the employee or a cost of no more than 9.5%, as adjusted for premium inflation relative to income inflation (9.83% for 2021), of the federal poverty line for a single individual for the 48 contiguous states

Treas. Reg. § 54.4980H-4(b)(1); I.R.S. Notice 2015-87, Q&A-12.

So long as coverage as described above is offered to the threshold number of employees for a month, the ACA does not impose any 4980H(a) penalties on an ALE for that month. But if the offered coverage is not considered to be affordable or provide minimum value, as described in the next section, the ALE would still be susceptible to 4980H(b) penalties.

Coverage Offers to Avoid 4980H(b) Penalties

The 4980H(b) penalty applies to an ALE that offers its full-time employees (and their dependent children) minimum essential coverage if one or more of its full-time employees obtains subsidized exchange coverage, unless that employee was offered coverage meeting certain standards for affordability and minimum value. Treas. Reg. § 54.4980H-5(a). Thus, to avoid the possibility of both the 4980H(a) and 4980H(b) penalties, an ALE would need to offer affordable coverage providing minimum value to all of its full-time employees (and their dependent children).

The general rules for receiving offers of coverage discussed for the 4980H(a) penalty in the previous section also apply for this purpose. That is, coverage offers are assessed on a monthly basis, and the rules regarding dependent coverage and the requirement to offer either optional coverage or mandatory coverage that is affordable and provides minimum value are the same. Treas. Reg. § 54.4980H-5(b).

In addition, however, the coverage must meet the affordability and minimum value standards described here. The affordability and minimum value standards for the 4980H(b) penalty rules are generally the same as are used to assess employer-provided coverage for purposes of determining whether an individual offered such coverage is eligible for subsidized exchange coverage under I.R.C. § 36B(c)(2)(C)(i) (affordability) and I.R.C. § 36B(c)(2)(C)(ii) (minimum value). If an employee is offered employer-provided coverage that meets those affordability and minimum value tests, the employee will not be eligible for subsidized exchange coverage under the ACA.

These standards, as modified for the employer shared responsibility rules, are discussed in the following sections.

Affordability Standard for Coverage Offers under 4980H(b)

As further described below, there is an important difference for the affordability standard in that an employer may use a generally more lenient safe harbor test than the general rule that applies for subsidized coverage eligibility. This distinction means that it is possible for an ALE's full-time employee to receive subsidized exchange coverage without triggering the 4980H(b) penalty because the coverage offered to her or him could meet the more lenient affordability safe harbor for determining employer share responsibility payments, but could not meet the I.R.C. § 36B(c)(2)(C)(i) more stringent affordability standard.

General Rule for Affordability

Under the general rule, employer-offered coverage is considered affordable for an employee if the employee's required premium contribution (if any) is no more than 9.5% of that employee's household income, indexed annually under I.R.C. § 36B(c)(2)(C)(iv) to reflect disproportionate increases in premium inflation over income inflation (9.83% for 2021).

For this test, you look at the employee's cost of enrolling in the least expensive self-only coverage offered by the employer that provides minimum value, even if the employee elects more expensive coverage or coverage that does not provide minimum value. Treas. Reg. §§ 1.36B-2(a), 1.36B-2(c)(3)(v)(A).

The employee-required contribution includes amounts paid through salary reduction or otherwise, and takes into account the effects of employer arrangements such as health reimbursement arrangements (HRAs), wellness incentives, flex credits, and opt-out payments. Treas. Reg. § 1.36B-2(c)(3)(v)(A)(4) through (7). For guidance on assessing the effect of these types of benefits on the affordability test, see Treas. Reg. § 1.36B-2(c)(v) and I.R.S. Notice 2015-87, Q&A-7 to Q&A-12.

Affordability Safe Harbors

Since employers generally do not know their employees' household incomes, there are three affordability safe harbors available to ALEs. These safe harbors are based on information generally available to employers, such as the employees' IRS Form W-2 wages or rate of pay. Treas. Reg. § 54.4980H-5(e)(2).

If an ALE's offer of coverage is affordable using any of these safe harbors—that is, the employee's required contribution for self-only coverage is no more than 9.5% (as adjusted under I.R.C. § 36B(c)(2)(C)(iv)) of the baseline in the applicable safe harbor—then, the offer of coverage is deemed affordable for purposes of the 4980H(b) penalty provisions regardless of whether it is affordable based on the employee's actual household income (which is the test that applies for purposes of the premium tax credit). Id.; see I.R.S. Notice 2015-87, Q&A-12 regarding index adjustments of the 9.5% threshold (9.83% for 2021).

The three affordability safe harbors are:

- **Form W-2 wages safe harbor.** For this safe harbor, the employer can use the employee's Form W-2 wage

compensation for the year in question (issued by any employer within the ALE group) instead of household income to apply the affordability test, provided that the employee premium contribution for any relevant plan year remained (or would have remained, if elected) a consistent amount or percentage of the reported wage compensation. This test is applied retrospectively (after the Form W-2 information is available) for the entire previous year. Special rules apply for part-year coverage.

- **Rate of pay safe harbor.** Here, you test for affordability on a monthly basis, using income based on (1) for hourly workers, their hourly rate of pay (based on the lowest applicable rate for the month) multiplied by 130 hours; and (2) for salaried workers, their monthly rate of pay (but this safe harbor is not available if their rate is reduced during the month).
- **Federal poverty line safe harbor.** This safe harbor merely requires that the employee cost for the coverage is not over 9.5% (as adjusted) of the federal poverty line for the state of the employee's employment.

Treas. Reg. § 54.4980H-5(e)(2)(ii), (iii), (iv).

An ALE may choose to use one safe harbor for all of its employees or to use different safe harbors for employees in different categories, provided that the categories used are reasonable and the employer uses one safe harbor on a uniform and consistent basis for all employees in a particular category. Treas. Reg. § 54.4980H-5(e)(2)(i).

Minimum Value Standard for Coverage Offers under 4980H(b)

The minimum value standard used for the 4980H(b) penalty rules is the same as that used for assessing employer-provided coverage to determine if an individual is eligible for subsidized exchange coverage under I.R.C. § 36B(c)(2)(C)(ii). An employer's plan generally satisfies the minimum value standard if it covers at least 60% of the total allowed cost of benefits expected to be incurred under the plan for a standard population. I.R.C. § 36B(c)(2)(C)(ii); Treas. Reg. § 1.36B-6(a)(1). That is, the plan would cover at least 60% of the covered benefit costs, with the remainder being paid out of pocket by the insured through cost sharing (e.g., deductibles, coinsurance, etc.). To protect against so-called skinny plans that exclude significant benefit coverage, however, agency guidance clarifies that substantial coverage of in-patient hospitalization and physician services is a prerequisite to providing minimum value. I.R.S. Notice 2014-69.

Although the minimum value test regulations are not finalized, under the proposed regulations, which may be relied upon, employers can use the minimum value calculator provided by the Department of Health and Human Services (HHS) to determine whether coverage provides minimum value. The calculator is available on the HHS's Centers for Medicare & Medicaid Services website. The proposed regulations can be found at 78 Fed. Reg. 25,909 (May 3, 2013), as amended by 80 Fed. Reg. 52,678 (Sept. 14, 2015).

The proposed regulations also provide safe harbor plan designs that are deemed to satisfy the minimum value requirement. These designs must cover the 10 statutory categories of ACA essential health benefits, plus preventive screening, immunization and skilled nursing facility benefits, within specified cost sharing parameters, and meet other criteria. Plans with non-standard features may be required to obtain an actuarial certification. Id. For current information, see IRS, Minimum Value and Affordability. For more information on essential health benefits requirements, see ACA Essential Health Benefits.

Employer Shared Responsibility Payments

This section describes how to calculate and allocate employer shared responsibility payment liabilities. The employer shared responsibility payments are assessed annually, but are determined on a monthly basis for the applicable calendar year (if the employer is an ALE for that year). These payments are non-deductible excise taxes.

If an ALE is made up of multiple member entities, as in the case of a controlled group of corporations or other commonly controlled business entities, each separate member is liable for its allocable portion of any employer shared responsibility payment, based on its own employees, as determined under common-law employment principles. One consequence of this is that it is possible for different ALE members of the same organization to incur either type of penalty for the same month (whereas a single entity can never be subject to both for the same month). Rules for allocating a full-time employee to a particular ALE member entity when the individual is an employee of two or more entities are found in Treas. Reg. §§ 54.4980H-4(d), 54.4980H-5(d).

The Applicable Large Employer Status section above describes the monthly measurement method for counting full-time employees. For purposes of calculating employer shared responsibility payments, however, employers have the choice to use the monthly method or the look-back method described further below, after a description of how to calculate penalty amounts.

Calculating Employer Shared Responsibility Payments

As noted above, the general rules for calculating the 4980H(a) and 4980H(b) penalties for a year are:

- **4980H(a) penalty formula.** One-twelfth of $2,000, subject to adjustment for inflation ($2,700 for 2021) per full-time employee (reduced as noted below) for any month of such year in which (1) the ALE did not offer minimum essential coverage to substantially all of its full-time employees (and their dependent children), and (2) at least one full-time employee obtained subsidized exchange coverage.
- **4980H(b) penalty formula.** One-twelfth of $3,000, subject to adjustment for inflation ($4,060 for 2021) for each of the ALE's full-time employees who did not receive a qualifying offer of coverage and received subsidized exchange coverage, for each applicable month of such year, subject to a cap.

I.R.C. §§ 4980H(a)–(c).

The applicable adjustments and cap are described in the following sections. Note that you do **not** count FTEEs at all for purposes of determining the amount of the penalty. That calculation applies only in determining ALE status.

4980H(a) Payment Calculation

To calculate the 4980H(a) penalty, you adjust the number of full-time employees that is multiplied by the monthly portion of the index-adjusted $2,000 amount as follows:

- Reduce the number of full-time employees by 30 (or an allocable portion). All ALEs get to reduce their number of full-time employees counted for purposes of determining the 4980H(a) penalty amount by 30. If the ALE consists of multiple employers, then each employer is allocated a prorated portion of 30 based on its relative number of full-time employees employed for the applicable month (rounded up to the next integer). I.R.C. § 4980H(c)(2)(D); Treas. Reg. § 54.4980H-4(e).
- Exclude full-time employees in a limited non-assessment period. Limited non-assessment periods (as defined in Treas. Reg. § 54.4980H-1(a)(26)), include:
  - The three-month period when an employee may be subject to a waiting period but is otherwise eligible for coverage. Treas. Reg. § 54.4980H-3(c)(2).
  - If using the look-back method for full-time employee counting, the first three months of employment for a new employee expected to be a full-time employee, the initial measurement period (described below) for a variable hour, seasonal, or part-time employee determined to be a full-time employee under these rules, or the initial measurement period for an employee whose status changes to a full-time employee. Treas. Reg. § 54.4980H-3(d).
  - January through March of a year in which the employer is first considered an ALE, but only if the employer offers coverage providing minimum value to the employee on or before April 1 of that year. Treas. Reg. § 54.4980H-2(b)(5).

The 30-employee reduction can be an important factor for companies that employ small numbers of full-time employees but are considered ALEs due to a large FTEE workforce. For example, if the employer has fewer than 30 actual full-time employees, then no 4980H(a) penalty should result due to this automatic reduction.

Example (4980H(a) penalty). ABC Co. was founded in 2017 with a workforce of 20 total employees, but grew quickly so that it had on average 70 full-time employees plus FTEEs for 2018. Thus, ABC was an ALE in 2019 for the first time. Only 40 of those employees were full-time (FTEEs accounted for the other 30), and those 40 remained the only full-time employees for each month of 2019. The company began offering insurance coverage providing minimum value at no employee cost to all of its employees (and their dependent children) as of July 1, 2019. Several of ABC's full-time employees obtained coverage through the ACA marketplace for 2019 and received the premium tax credit for coverage from January through June of 2019, before the company began offering affordable coverage providing minimum value. No employees were in a limited non-assessment period for any month of 2019.

Conclusion. ABC is subject to the 4980H(a) penalty for the first six months of 2019 because it failed to offer minimum essential coverage to at least 95% of its full-time employees (and their dependent children) and at least one employee received subsidized exchange coverage for each of those months. ABC **is not** subject to any 4980H(b) payments—neither for the first half of 2019 (because it did not offer minimum essential coverage to its employees) nor for the second half of 2019 (because none of its full-time employees received the premium tax credit for any of those months since affordable coverage providing minimum value was available to them). The amount of the 4980H(a) penalty is $12,500, calculated as follows:

Step 1. Determine the monthly amount per full-time employee for 2019: $2,500 (the $2,000 amount adjusted for 2019) ÷ 12 = $208.33.

Step 2. Determine the number of full-time employees for each applicable month, less any reduction amount: 40 full-time employees, minus 30 (the automatic reduction figure and no reduction for a limited non-assessment period), for each of six months (January through June) = (40 – 30) × 6 = 60.

Step 3. Multiply the results from steps (1) and (2): $208.33 × 60 = $12,500.

Note that the relief offered to first-time ALEs does not apply here because ABC did not offer minimum value coverage by April 1, 2019. See Treas. Reg. § 54.4980H-2(b)(5).

4980H(b) Payment Calculation

For the 4980H(b) payment, you only look at months for which an ALE did offer minimum essential coverage to the threshold number of full-time employees (if it didn't, then the 4980H(a) penalty would apply instead). Then, you determine how many (if any) of the ALE's full-time employees obtained subsidized exchange coverage for any month of the applicable year, but did not receive an offer of coverage meeting the affordability and minimum value standards under the employer shared responsibility rules.

To determine the amount of the payment, you multiply the monthly portion of the inflation-adjusted $3,000 amount by the number of such full-time employees for each applicable month. Importantly, however, the 4980H(b) payment for an ALE is capped at the amount the ALE would have owed as a 4980H(a) penalty if the ALE did not offer minimum essential coverage to its full-time employees.

Example (4980H(b) penalty). XYZ Co. has an average 60 full-time employees and no FTEEs for 2018 (and is therefore an ALE for 2019). For 2019, it offers minimum essential coverage to all full-time employees (and their dependent children), but the coverage is not affordable for 30 of the employees. Of those 30 employees for whom the coverage was not affordable, 25 obtain health insurance through the ACA marketplace and receive the premium tax credit for each month of the year. No employees were in a limited non-assessment period for any month of 2019.

Conclusion. XYZ is not subject to the 4980H(a) penalty for 2019 because it offered minimum essential coverage to at least 95% of its full-time employees (and their dependent children) for each month of the year. XYZ **is** subject to the 4980H(b) payment for each month of the year because at least one full-time employee received the premium tax credit for each of those months. The amount of the 4980H(a) penalty is $, calculated as follows:

Step 1. Determine the monthly amount per full-time employee who obtained subsidized exchange coverage for 2019: $3,750 (the $3,000 amount adjusted for 2019) ÷ 12 = $312.50.

Step 2. Determine the number of applicable full-time employees for each month: 25 full-time employees were not offered affordable coverage and obtained subsidized exchange coverage for each of 12 months = 25 x 12 = 300.

Step 3. Multiply the results from steps (1) and (2): $312.50 × 300 = $93,750.

Step 4. Determine the 4980H(b) penalty cap, equal to the hypothetical 4980H(a) penalty: $2,500 (the $2,000 amount adjusted for 2019), multiplied by the total number of full-time employees (60) less the automatic 30-employee reduction = $2,500 x (60 – 30) = $75,000.

Since the ALE is subject to a penalty for all 12 months and the number of full-time employees did not change over the year, step (4) was calculated on an annual basis instead of month by month as in the previous example.

Step 5. The penalty amount is the lesser of the results of step (3) and (4): $75,000.

Look-Back Method for Counting Full-Time Employees

ALEs may choose to count their full-time employees for purposes of calculating the amount of employer shared responsibility payments using either the monthly measurement method described under Applicable Large Employer Status above (see Treas. Reg. § 54.4980H-3(c)) or the look-back method briefly described in this section (see Treas. Reg. § 54.4980H-3(d)). For additional details on this method, see ACA Employer Shared Responsibility Full-Time Employee Determinations.

ALE members of a multiple-entity ALE can use different counting methods, and individual employers can apply different methods for different groups of employees. Treas. Reg. § 54.4980H-3(d)(1)(v) and (e). Special rules apply for an employee who changes status from one category of employee to another category using a different counting method. See Treas. Reg. § 54.4980H-3(f).

Basically, for the look-back method, you determine an employee's full-time status for a "stability period" (e.g., a calendar year) by looking back at the individual's service over "standard measurement period" (e.g., the calendar year immediately preceding the stability period). The ALE can choose the stability period and standard measurement period to use for the different categories of employees listed in Treas. Reg. § 54.4980H-3(d)(v). The standard measurement period must be between three and 12 months long, and the

stability period must be at least six months but no shorter than the standard measurement period. Treas. Reg. § 54.4980H-3(d)(iii), (iv).

If the individual worked on average 30 hours per week or more during the standard measurement period, then they must be treated as a full-time employee for the entire stability period. If the individual did not work on average at least 30 hours per week during the standard measurement period, then they may be treated as a non-full-time employee for the entire stability period.

The status of new employees who are reasonably expected to be full-time is determined by the actual service provided for each month until they have been employed for a full standard measurement period. The status of new part-time, seasonal, and other variable-hour employees may be determined by a one-time "initial measurement period" that is between three and 12 months long.

Special rules apply for ALEs that want to base look-back periods on its payroll schedule, to use an administrative period in between the standard measurement period and the stability period, to determine when a rehired individual is treated as a new employee (e.g., as an eligible factor for limited non-assessment periods), among other things. Treas. Reg. § 54.4980H-3(d)(1)(ii), 54.4980H-3(d)(3)(ii), 54.4980H-3(d)(6).

Remember to take care that you are considering all workers who meet the common-law definition of an employee, other than the excluded classes under Treas. Reg. § 54.4980H-1(a)(15), as discussed above in the "Who Is an Employee" section under Applicable Large Employer Status. Pay particular attention to workers classified as independent contractors who may be deemed employees under IRS tests. See Independent Contractor Tests and Risks of Worker Misclassification for information on this issue.

Making Employer Shared Responsibility Payments

The IRS determines whether an employer may be liable for an employer shared responsibility payment and the amount of the potential payment. This determination is based on (1) information reported by ALEs to the IRS after the end of the applicable year on Forms 1094-C and 1095-C (discussed in the next section), and (2) information about individual full-time employees of the ALE who received subsidized exchange coverage. In addition, the ACA marketplace exchanges are required to send employers a Section 1411 Certification (named after Section 1411 of the ACA) regarding any of their employees who received subsidized exchange coverage during the year. See 42 U.S.C. § 18081(e)(4)(B)(iii); Treas. Reg. § 54.4980H-1(a)(40).

Receipt of a Section 1411 certification does not mean the employer owes an employer shared responsibility penalty, since an employee's obtaining subsidized exchange coverage doesn't mean that all of the requirements triggering a payment obligation have been met. But the notices do allow employers to determine their employer shared responsibility obligations, when considered together with the other pertinent information regarding full-time employee status, offers of coverage, and others.

The IRS first provided detailed guidance on shared responsibility payment assessments in November 2017. Shortly thereafter, the agency began sending Letter 226-J to ALE members who are identified as liable for a payment for any month in 2015 (sample here). Letter 226-Js for 2018 began arriving in early 2021. The letter notices contain:

- An explanation of the employer shared responsibility rules
- A summary table itemizing the proposed 4980H(a) and 4980H(b) penalties owed by month
- An employer shared responsibility response form, IRS Form 14764 (ESRP Response)
- An employee premium tax credit (PTC) list, IRS Form 14765, listing the ALE's assessable full-time employees (i.e., those receiving subsidized exchange coverage for a month when the ALE was not eligible for any relief from an employer shared responsibility payment)
- Steps for the ALE to take to pay or to challenge the penalty assessment
- Consequences if the ALE does not respond timely to the Letter 226-J
- IRS agent contact information for asking questions about the letter

IRS, Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act, Q&A-55 and Q&A-58; see also IRS, Understanding Your Letter 226-J.

ALEs have 30 days from the date of their Letter 226-J to respond to the IRS or request an extension before any liability is assessed. If needed, ALEs can call the IRS to request an extension for additional time to respond. The IRS routinely gives 30-day extensions to these requests. The IRS will acknowledge receipt of an ALE's response (whether it acknowledges or challenges the assessment) via Letter 227. There are five versions of Letter 227, depending on the status of the communications. See IRS, Understanding Your Letter 227. An ALE that receives a Letter 227 and believes there continues to be an error as to an employer shared responsibility assessment may request, within 30 days, a pre-assessment conference with the IRS Office of Appeals,

following instruction in the Letter 227 and IRS Publication 5 (Your Appeal Rights and How to Prepare a Protest If You Don't Agree). Id., Q&A-56. In some cases, the proposed assessment can be significantly reduced because the ALE (and/or its vendor) filed incorrect Forms 1094-C and 1095-C. Common errors that have recently triggered a Letter 226-J include the following: • • •

- **2015 Transition relief was not selected on Form 1094-C.** To obtain the 70% offer of coverage transitional relief for 2015, ALEs had to check Box C, "Section 4980H transition relief," and enter a transition relief indicator code on Form 1094-C. Otherwise, they were required to offer minimum essential coverage to 95% of full-time employees (and dependents) in 2015.
- **Minimum essential coverage offer not reflected on Form 1094-C.** Failing to check the "Yes" box for any month (or for "All 12 Months") on Form 1094-C indicated that the ALE did not offer coverage to substantially all of its full-time employees (and dependents) for that month. If a full-time employee obtained a premium tax credit for any month for which the "Yes" box was not checked, the ALE may be liable for a 4980H(a) penalty for that month.
- **Failing to offer affordable coverage that meets the minimum essential coverage offer standard and leaving line 16 of Form 1095-C blank.** Leaving line 16 blank on Form 1095-C indicates that the ALE did not offer affordable coverage that met minimum value requirements. If that full-time employee obtained a premium tax credit on the public exchange and the ALE failed to offer coverage to substantially all of its full-time employees (and dependents), the ALE may be subject to a penalty. While the IRS does not require ALEs to enter a code on Line 16, as a best practice ALEs should enter an affordability code — 2F (W-2), 2G (federal poverty line), or 2H (rate of pay) — for any full-time employee who waived the employer's offer of coverage.

The IRS will send a notice and demand for payment, Notice CP 220J, if the ALE does not respond or it the agency determines upon appeal that the ALE is liable for an employer shared responsibility payment. The notice will contain a summary of the payment owed, reflecting any payments made or credits applied, and instruct the ALE on how to make the payment. Employer shared responsibility payments are not paid in connection with any tax return that they file. Id., Q&A-57.

Prior to issuing this guidance, the Treasury Inspector General for Tax Administration (TIGTA) issued a report on the difficulties the IRS was having in establishing enforcement procedures for the employer shared responsibility payments. The report included several recommendations to improve the process going forward. See TIGTA, Assessment of Efforts to Implement the Employer Shared Responsibility Provision.

Information Reporting Requirements Related to the Shared Responsibility Rules

Employers subject to the employer shared responsibility provisions (i.e., ALEs for a particular year) are required to report information about whether they offered minimum essential coverage to their full-time employees and if so, information about the offer of coverage. I.R.C. § 6056. (A separate overlapping reporting obligation under I.R.C. § 6055 applies to any employer, including ALEs, that sponsors a self-funded health plan.) The information on these forms is used to help determine whether an ALE owes a payment under the employer shared responsibility provisions and whether employees are eligible for the premium tax credit.

An ALE (or, for multi-entity ALEs, each ALE member) is required to send this information to the IRS by the end of March of the year following the year in question on two forms:

- Form 1094-C (2019), Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, which summarizes the information for the reporting ALE member –and–
- Form 1095-C (2019), Employer-Provided Health Insurance Offer and Coverage, which are individualized statements for each full-time employee

The employer must also send the Form 1095-C for each employee to that employee, which generally must be furnished by the end of January in the year following the subject year.

ALEs need to track the relevant data on a monthly basis to complete and substantiate the information reported on these forms. This includes:

- Number of full-time employees (using either the monthly measurement method or the look-back method) for the month
- Whether each full-time employee (and that employee's dependent children up to age 26) received an offer of coverage for the month
- The lowest-cost monthly premium for self-only coverage that was made available to the employee
- Other applicable affordability assessment data (e.g., for the Form W-2 wages or rate of pay safe harbors)

- Whether any limited non-assessment period applied to any full-time employees for the month (e.g., during a waiting period)
- For employers offering coverage under self-funded plans, whether each full-time employee (and his or her dependents) were enrolled in such self-funded plans

There are significant penalties for failing to timely file accurate returns or statements, up to $280 per form (for 2020 reporting). Note also, that the IRS has taken the position that there is no statute of limitations applicable to Section 4980H penalties. I.R.S. Chief Couns. Mem. 20200801F.

For additional information, see ACA Employer Reporting Obligations for Employer Shared Responsibility and Individual Mandates. See also the I.R.C. § 6056 final regulations at Treas. Reg. §§ 301.6056-1 and 301.65056-2, the Instructions for Forms 1094-C and 1095-C (2019)., IRS, Questions and Answers about Information Reporting by Employers on Form 1094-C and Form 1095-C, and IRS, Questions and Answers on Reporting of Offers of health Insurance Coverage by Employers (Section 6056). Draft forms and instructions for the 2019 coverage year have been released and are available on the IRS website.

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Virginia is a member of the Employee Benefits + Compensation Group. Her practice focuses on the representation of employers with respect to retirement and welfare benefits, executive compensation, and benefits issues in corporate transactions. Ms. McGarrity advises clients on the implications of tax, securities, labor, and other laws, including ERISA and the Sarbanes-Oxley Act. Ms McGarrity partners with clients to develop benefit plan design and compliance strategies that meet both their business objectives and the legal requirements applicable to their employee benefit plans. She counsels clients with regard to the full spectrum of employee benefit matters, including qualified defined benefit and defined contribution plans, defined benefit plan funding, nonqualified programs and executive compensation arrangements, plan compliance and correction, health and welfare programs, participation in multiemployer plans, withdrawal liability, and mergers and acquisitions. Ms. McGarrity has spent significant time understanding and speaking on health care reform issues.

Virginia is an author of numerous articles and also a frequent speaker on employee benefits matters. She is a contributing author to the firm's *Data Privacy + Security Insider and ERISA Claim Defense* blogs.

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