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The IRS proposed regulations on a variety of issues surrounding the employer penalty provisions under the ACA. While the new rules leave a number of questions unanswered, they do provide greater clarity on how the penalty provisions will work and offer some transitional and administrative relief, as well as a few surprises. These proposed rules can be relied on until final guidance is issued and any more restrictive rules will only be applied prospectively.

The new rules are lengthy and complex. Below you will find some of the highlights of the new guidance. More details will follow in short order.

### **“Substantially All” Means 95%**

The requirement to offer some level of coverage (“minimum essential coverage”) to substantially all full-time employees and their dependents in order to avoid the “\$2,000 times all full-time employees” penalty will require an offer of such coverage to at least 95% of all full-time employees and their dependents. Just for plan years beginning in 2014, transitional relief will allow an employer to limit the coverage offer to employee only coverage, as long as it is taking steps during that plan year to expand the offer of coverage to dependents for future plan years.

### **Dependent Does Not Include Spouse**

For purposes of the requirement to offer coverage to dependents as a condition of avoiding the penalty, the regulations define “dependent” as the employee’s children up to age 26, and not the spouse.

### **No Controlled Group Aggregation for Penalty Assessment**

The regulations clarify that while commonly owned employers will be aggregated for purposes of determining whether they are subject to the penalty rules (the 50 full-time employee test), the actual penalty assessment will be done on an employer by employer basis, based on whether the individual employer provides the required coverage or not. The regulations provide a methodology for allocating to individual employers the “first 30 employee” reduction in the “\$2,000 times all” penalty calculation.

### **Limited Transitional Relief for Non-calendar Year Plans**

Because the penalty provisions go into effect on January 1, 2014 and are not based on plan years, many fiscal year plans would be at risk as of January 1, 2014, unless they made changes during or at the beginning of the 2013 plan

year. The transitional relief under the new guidance generally covers fiscal year plans in place on December 27, 2012. It offers relief with respect to (i) employees who would be eligible for coverage in 2014, based on eligibility rules in effect on December 27, 2012; and (ii) employees not previously offered coverage but who will be offered coverage beginning in the 2014 plan year - but, for this latter group, only where the plan already covered at least 25% of full-time employees at some time between October 31, 2012 and December 27, 2012, or offered coverage to at least 33-1/3% of full-time employees during the most recent open enrollment before December 27, 2012. The relief from penalty assessments beginning January 1, 2014 will only apply if the affected employees are offered affordable minimum value coverage as of the plan year beginning in 2014.

## **Section 125 Will Allow Mid Year Changes for Fiscal Year Plans**

The guidance contemplates expansion of the section 125 change in status rules to allow employees in non-calendar year plans to change pre tax elections in order to drop coverage under the plan to enroll in a State Exchange or to join the employer plan to avoid the Individual Mandate penalty. Employers will have to amend their cafeteria plans if they wish to adopt these changes and the amendment must be made by December 31, 2014, retroactive to the beginning of the 2013 plan year.

## **Additional 9.5% W-2 Safe Harbor Methodologies**

The affordability safe harbor rules have been expanded to include a fail safe based on the Federal Poverty Level, a determination based on monthly rates of pay and adjustments for partial years of coverage.

## **Significant Clarification of the Rules for Determining Full-Time Employee Status**

These include employee-friendly definitions of hours to be counted and standards for applying the measurement periods, special protections for teachers and certain other full-time workers that may not work a full calendar year and good faith reliance rules for seasonal worker scenarios.

## **Transitional Rules for 2013 Look Back**

Employers intending to use a 12 month look back period for determining full-time employee status will be allowed to use a shortened 2013 look back period of at least six months beginning no later than July 1, 2013 for determining 2014 eligibility. This relief is being offered in order to give employers sufficient time to assess the various options afforded them under the new guidance.

## **Special Rules for Multiemployer Plan Coverage**

Transitional relief is being provided through 2014 to employers that contribute to multiemployer plans to cover situations where employer contributions are made on other than an hourly rate basis. Further clarification will be needed to determine the value of this relief for employers whose contributions are calculated solely based on hours.