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REFORM Update

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The Internal Revenue Service (IRS) and the Department of Health and Human Services (DHHS) recently released guidance on the individual shared responsibility provision of health care reform. This provision requires everyone to obtain health coverage or pay a tax penalty. This provision was addressed by the Supreme Court in 2012. The Court determined the shared responsibility requirement was constitutional.

This guidance explains the specifics of this requirement and details its implementation.

The basic requirement of the shared responsibility provision is that for ***each month*** after December 31, 2013, an individual must do one of the following:

1. Obtain minimum essential coverage
2. Qualify for an exemption
3. Pay a tax penalty

The requirements seem simple on the surface. However, they involve a host of details.

Minimum Essential Coverage

Anyone can meet the requirement for obtaining minimum essential coverage by enrolling in one of the following:

- Employer-sponsored health coverage (includes COBRA coverage and retiree health coverage)
- Coverage purchased in the individual health insurance market
- Medicare coverage (including Medicare Advantage)
- Medicaid coverage
- Children's Health Insurance Program (CHIP) coverage
- Certain types of veterans' health coverage
- TRICARE

Coverage limited in scope is specifically excluded from minimum essential coverage. This includes vision only, dental only, critical illness and dread disease plans. In addition, plans where the medical coverage is secondary to the purpose of the plan are also excluded. For example, workers' compensation and disability plans may cover some medical expenses, but they are not designed to offer comprehensive medical coverage. HIPAA-excepted benefits are also excluded from minimum essential coverage.

DHHS may designate additional types of coverage as minimum essential coverage such as student health plans and coverage from foreign governments. DHHS wants comments from stakeholders on whether these two types of coverage should be classified as minimum essential coverage.

Qualifying for an Exemption

Health care reform exempts the following from the requirement to obtain minimum essential coverage:

1. ***Religious conscience***: Members of a religious sect conscientiously opposed to accepting any insurance benefits. The Social Security Administration has a process for recognizing these sects, which must meet certain IRS requirements to be recognized.
2. ***Health care sharing ministry***: Members of a recognized health care sharing ministry.
3. ***Indian tribes***: Members of a federally recognized Indian tribe.
4. ***No filing requirement***: Anyone with a household income below the minimum threshold for filing a federal tax return. The requirement to file a tax return depends on filing status, age, and types and amounts of income. The IRS offers a tool to help determine whether the person needs to file an income tax return. This Interactive Tax Assistant can be found at http://www.irs.gov/uac/Interactive-Tax-Assistant-(ITA)-1.
5. ***Short coverage gap***: Going without coverage for less than three consecutive months during the year.
6. ***Hardship***: The state health insurance Exchange determines the person cannot obtain coverage because of a hardship.
7. ***Unaffordable coverage options***: Coverage is unaffordable because the minimum premium is more than 8 percent of the person's household income.
8. ***Incarceration***: The individual is in a jail, prison or a similar correctional facility.
9. ***Not lawfully present:*** The individual is neither a U.S. citizen, U.S. national, nor an alien lawfully present in the United States.

The regulations explain how to apply for exemptions. The state health Exchange will grant some exemptions, while others will be part of the tax filing process at year-end. The exemptions will be handled as follows:

- The religious conscience and hardship exemptions are available only through the state health Exchange. The Exchange will have a process to apply for either of these exemptions. If the Exchange approves the exemption, it will issue an exemption certificate. The exemption certificate will need to be documented as part of the tax filing process.
- Indian tribe members, health care sharing ministry members and anyone incarcerated can either apply to the Exchange or claim the exemption during the tax filing process.
- Anyone not lawfully present in the U.S., who has had a short coverage gap, or who cannot afford coverage can claim an exemption only as part of the tax filing process.
- The exemption for anyone who falls beneath the tax filing threshold will be automatic. Since there is no tax return, he or she will not need to report coverage or pay the tax penalty.

Children are subject to the shared responsibility requirement. The adult or married couple that claims the child as a dependent for federal income tax purposes will pay the child's tax penalty.

Senior citizens are also subject to the shared responsibility requirement. However, those enrolled in Medicare have minimum essential coverage and will not pay a tax penalty.

All citizens of the United States are subject to the individual shared responsibility provision. In addition, permanent residents and foreign nationals who qualify as resident aliens for tax purposes are subject to this requirement.

A U.S. citizen who lives abroad for at least 330 days within a 12-month period will be treated as having minimum essential coverage for that time period.

All bona fide residents of the U.S. territories are treated by law as having minimum essential coverage. They are not required to take any action to comply with the individual responsibility requirement.

Anyone having minimum essential coverage for at least one day in a month will be treated as being covered for that entire month.

Paying the Tax Penalty

The tax penalty is calculated and assessed at year-end as part of individual's tax filing process. Anyone without minimum essential coverage and ineligible for any of these exemptions must pay a tax penalty. In general, the tax penalty will be the lesser of:

1. The sum of the monthly penalty amounts for everyone in the shared responsibility family. The family would include the individual, spouse and any tax dependents.
2. The sum of the monthly national average bronze plan premiums for the shared responsibility family.

The monthly penalty amount is the **greater of** the following:

1. **The flat dollar amount.** This amount varies by year, and applies to anyone in the shared responsibility family who does not have minimum essential coverage. The amounts for the first three years of this tax are as follows:
   - $95 in 2014
   - $325 in 2015
   - $695 in 2016

   These following special circumstances apply to these amounts:

   - The total penalty on the shared responsibility family cannot exceed 300 percent of the flat dollar amount.
   - The amount is less for children under age 18 on the first day of any applicable calendar month. For these children, the flat dollar amount is one-half of the amounts shown above.
   - These amounts will be indexed annually after 2016 by a cost of living adjustment.

2. **Excess income amount.** The taxpayer's excess household income amount is the taxpayer's household income less the applicable filing threshold. The excess amount is multiplied by the income percentage as follows:
   - 1.0% for taxable years beginning in 2013
   - 1.0% for taxable years beginning in 2014
   - 2.0% for taxable years beginning in 2015
   - 2.5% for taxable years beginning in 2016

Because these calculations can be confusing, the guidance offers several examples. Let's say Taxpayer B is unmarried, has no tax dependents, and has no minimum essential coverage in 2016. Since he does not qualify for any of the exemptions, he must pay a tax penalty. His 2016 household income is $120,000, and the applicable filing threshold is $12,000. The national average premium for the bronze plan is $5,000. What is Taxpayer B's tax penalty?

- The flat dollar calculation would be $695 a year, or about $58 a month.
- The excess income calculation would be ($120,000 - $12,000) multiplied by 0.025. This is the 2.5% for 2016. That amount would be $2,700 a year or $225 a month.
- The bronze plan average premium is $5,000 a year, or about $417 a month.

Taxpayer B's tax penalty for 2016 will be $225 a month, or $2,700 a year. The excess income calculation is greater than the flat dollar amount. Both amounts are less than the national bronze premium average. The excess income calculation will, therefore, be the method used to determine the tax penalty.

More complicated examples are included in the proposed rules, which are found at http://www.mcgrawwentworth.com/wp-content/uploads/2013/03/January-31-2013-IRS-guidance-on-individual-penalties.pdf.

Concluding Thoughts

The individual shared responsibility requirement does not directly affect employers, although some employees who currently waive coverage may choose to enroll for 2014 to avoid the tax penalty.

Nevertheless, since employers typically provide coverage, your employees may come to you with questions on the shared responsibility payment. If they need detailed answers to these questions, refer them to the IRS. This is a tax issue, not a benefit plan issue.