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UPDATE ON THE AFFORDABLE CARE ACT

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The Affordable Care Act was enacted in 2010. Portions of the ACA have been put on hold and other portions of it have been changed. These materials summarize the status of the ACA provisions that are most important to school districts.

I. SHARED RESPONSIBILITY PENALTIES

The Affordable Care Act imposes so-called "shared responsibility" penalties on large employers[1] which fail to offer health insurance to full-time employees, or which offer full-time employees health insurance that is either unaffordable or of less than minimum value. After multiple delays, these penalties took effect on July 1, 2015, for most New Hampshire school districts.

A. Penalty For Failure To Offer Insurance

The ACA imposes a penalty on a large employer that fails to offer insurance to full-time employees and their dependents. The definition of "dependents" includes an employee's children who are younger than age 26, but excludes the employee's spouse, foster children and step children. ACA regulations provide that an employer will be deemed to have offered coverage to all of its full-time employees and their dependents for each month that the employer offers such coverage to all but 5% (or, if greater, 5) of its full-time employees, provided the offer also includes coverage for the employees' dependents. If the employer is not deemed to have offered insurance to the required percentage of its full-time employees and even one such employee obtains an ACA insurance subsidy, the employer is penalized under 26 U.S.C. 4980H(a).

The penalty initially was $166.67 per month ($2000 per year) times the number of all the employer's full-time employees (except that the first 30 full-time equivalent employees are excluded from the penalty calculation). However, the penalty is indexed for inflation based upon the percentage by which the average per capita health insurance premium in the prior year exceeds the average per capita health insurance premium in 2013. The government recalculates the penalty every October. So far, the penalties have been:

Calendar Year	Section 4980H(a) Annual Penalty
2014	$2,000
2015	$2,080
2016	$2,160
2017	$2,260
2018	$2,320

[1] Large employers are those who employed an average of at least 50 full-time employees during the previous calendar year.

In 2018, school districts began receiving assessments of shared responsibility penalties for Tax Year 2015. In several cases, the Internal Revenue Service preliminarily assessed penalties to school districts in error – sometimes hundreds of thousands of dollars – because the districts had failed to click a box on their electronically filed Form 1094-C. This resulted in the districts misreporting that they had not offered insurance coverage. In order to challenge preliminary assessments and to correct misreporting, districts need to file Form 14764 and supporting documents by the deadline specified in the preliminary penalty assessments. In all cases of which we are aware, the IRS rescinded the preliminary penalty assessments after Form 14764 was timely filed. If your district wants to challenge a preliminary penalty assessment from the IRS, it is important that you consult with legal counsel and file appropriate materials with the IRS by the deadline.

B. Penalty for Offering Unaffordable Insurance

If a large employer offers full-time employees either unaffordable insurance or insurance that is of less than minimum value, the Affordable Care Act calls for the employer to be penalized under 26 U.S.C. 4980H(b) for each full-time employee who declines the employer's insurance and instead receives ACA-subsidized insurance. Plans of less than minimum value essentially are plans that pay less than 60% of covered claims costs. Few, if any, New Hampshire school districts currently offer full-time employees insurance that is of less than minimum value.

Unaffordability penalties are triggered when the employer offers no insurance plan for which the employee's share of the single coverage premium is less than an indexed percentage of the employee's household income. Initially, that percentage was 9.5% of an employee's household income.

Indexing of the percentage is based upon two factors: (1) the extent to which insurance premiums rose faster than incomes rose in the prior year, plus (2) the extent to which insurance premiums rose faster than the Consumer Price Index in the prior year. Both factors are computed nationally, not locally or regionally. Using this formula, the government has used the following percentages of household income to define affordability:

Calendar Year	Percentage of Household Income
2014	9.50%
2015	9.56%
2016	9.66%
2017	9.69%
2018	9.56%

The basic penalty calculation for offering unaffordable insurance initially was $250 per month ($3,000 per year) for each full-time employee who declines employer-offered insurance

and receives government-subsidized insurance. However, this amount is recalculated for inflation each October based upon the same formula by which penalties for failure to offer insurance are indexed. So far, these penalties have been:

Calendar Year	Section 4980H(b) Annual Penalty
2014	$3,000
2015	$3,120
2016	$3,240
2017	$3,390
2018	$3,480

The total of all penalties to an employer for offering unaffordable insurance is capped at the amount of the penalty for failure to offer insurance times the number of all full-time employees (minus 30 employees).

The result of this indexing is that the definition of affordability has changed only slightly from 2014 to 2018, but the penalties for failure to offer insurance and for offering unaffordable insurance have risen 16% during the same period. Many school districts have decided to pay unaffordability penalties because they have concluded that doing so is less costly than offering affordable insurance. School districts should periodically reexamine whether this continues to be true. Yet, even if penalties continue to rise, paying the penalties probably will continue for many years to be less expensive than offering affordable insurance to all full-time employees.

C. Health Insurance Opt-Out Payment

In July 2016, the IRS issued proposed new rules that would expand the affordability calculation to include the amount of some employer-offered insurance opt-out payments. The proposed rules would add employer-offered insurance opt-out payments except for "eligible opt-out arrangements" to the share of the premium paid by the employee for single coverage, and then would calculate whether that total exceeds the indexed percentage of household income. An "eligible opt-out arrangement" will be one under which:

> "[A]n employee's right to receive an opt-out payment is conditioned on the employee providing reasonable evidence that the employee and all other individuals for whom the employee reasonably expects to claim a personal exemption deduction for the taxable year... have... minimum essential coverage (other than coverage in the individual market, whether or not obtained through the Marketplace)... ."

Proposed Rule 26 C.F.R. 1.36B-2(c)(3)(v)(A)(7). Ineligible arrangements will include arrangements through which the employee will receive the opt-out payment simply by declining

employer-offered insurance without needing to meet other conditions; arrangements for which the employee does not provide proof of insurance for other family members who the employee will claim as exemptions; and arrangements that make the opt-out payments when an employee purchases alternative insurance in the individual (non-group) market.

Adding the amount of opt-out payments to the unaffordability calculation will increase the number of employees for whom a district must pay unaffordability penalties. Consequently, many districts have begun conditioning opt-out payments on the employee providing proof that the employee and family members who the employee will claim as tax exemptions have other insurance.

In December 2016, the IRS put the proposed new rule for opt-out payments on hold, but the IRS did not withdraw the proposed rule. Therefore, school districts would be prudent to condition employee's receipt of opt-out payments on the employees providing proof that they and their family members have alternative insurance in accordance with the proposed rule.

II. EXCISE TAX

The Affordable Care Act originally imposed an excise tax for high-cost health insurance plans, beginning on January 1, 2018. The tax is on coverage providers of applicable employer-sponsored health insurance coverage that has "excess benefits."

The excise tax equals 40% of excess benefits. Excess benefits are the aggregate cost of insurance coverage that exceeds the "applicable dollar limit." The aggregate cost includes both the employer's and the employee's payments for the coverage (employer and employee contributions to premiums, HRAs, HSAs, and FSAs). For 2018, the applicable dollar limit generally was to have been $10,200 per year ($850 per month) for single coverage, or $27,500 per year ($2,291.66 per month) for two-person or family coverage.[2] The applicable dollar limits (the thresholds for the excise tax) are indexed for inflation.

In December 2015, the government postponed the effective date of the excise tax until January 1, 2020. In January 2018, in conjunction with legislation to temporarily fund the federal government, the excise tax was delayed again. The excise tax on high cost plans now is scheduled to begin accruing on January 1, 2022.

Although the government postponed accrual of the excise tax, it did not postpone indexing of the applicable dollar limits. They will rise by the national Consumer Price Index for

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[2] For example, if the aggregate cost of an employee's family plan is $30,000 and the applicable dollar limit is $27,500, the excess benefits will equal $2,500 and the excise tax will equal $1,000 for that employee's insurance plan.

Urban Consumers (CPI-U) plus 1% in 2019, and by the CPI-U alone in 2020 and subsequent years.

In 2010, when Congress was considering the ACA, the Congressional Budget Office projected that the CPI-U would rise by 2% per year in 2018 and subsequent years. The CBO appears to have underestimated inflation, at least in the near term. The national CPI-U for the 12 months ending in July 2018 was 2.9%.

Unfortunately, health insurance costs rise faster than the CPI-U. Consequently, over time, more and more plans whose costs currently do not exceed the applicable dollar limits will begin triggering excise tax. For this reason, districts that wish to prevent taxpayers from paying excise tax would be prudent to begin planning for it now, despite the delay until 2022. In the short term, if districts enter into collective bargaining agreements that expire before 2022, those collective bargaining agreements will not trigger any excise tax, even if the CBAs offer high cost plans. Long term options for school districts to avoid excise tax liability include replacing high cost plans with low cost plans so that no excise tax is incurred, or requiring employees who select high costs plans to pay a greater share of plan costs in order to offset the excise tax.

III. ANTI-DISCRIMINATION PENALTIES FOR HIGHLY COMPENSATED EMPLOYEES

When the Affordable Care Act was enacted in 2010, it included a provision that required the Internal Revenue Service to adopt anti-discrimination rules for group health insurance plans that are "similar" to the anti-discrimination rules for self-insured plans. These anti-discrimination rules would penalize an employer for discriminating in favor of highly compensated employees (generally the highest paid 25% of employees) either as to eligibility to participate in a plan or as to the benefits provided under the plan. The penalty is $100 per day for each lower-paid employee who is "discriminated" against; however, the penalty is capped annually at $500,000 or 10% of the aggregate amount paid or incurred by the employer for health insurance, whichever is less.

The Act left it to the IRS to write regulations that define the anti-discrimination rules, but the IRS suspended its rulemaking in late 2010. The IRS has issued notice that it does not know when regulations for anti-discrimination penalties will be adopted. It also has issued notice that it will provide a grace period after the regulations are adopted before it begins imposing the penalty, but it has not specified the duration for such a grace period. Thus, it is uncertain whether and when the IRS will write the regulations, and what the regulations will require if they are written. Accordingly, it currently is a practical impossibility for school districts to plan how to address anti-discrimination penalties.

IV. CONSTITUTIONALITY OF IMPOSING ACA TAXES AND PENALTIES ON SCHOOL DISTRICTS

In 2010, several states, individuals and the National Federation of Independent Business sued the federal government in an effort to have parts of the Affordable Care Act declared unconstitutional. The states claimed in the litigation that the ACA's penalties and taxes on them violated state sovereignty and the doctrine that states are immune from taxation by the federal government. The federal District Court for the Northern District of Florida rejected the states' claims, but the states appealed some of those claims to the 11th Circuit Court of Appeals and then to the United States Supreme Court. In 2012, the Supreme Court ruled that the ACA's penalty on individuals who do not obtain health insurance is a constitutional tax, but the Supreme Court did not decide the issues raised by the states in the Florida litigation. National Federation of Independent Business v. Sebelius, 567 U.S. 519 (2012).

The State of Indiana and 39 of its school districts then sued the federal government in 2013. They claimed that the employer mandate in the ACA either is a tax on the State and the school districts in violation of the intergovernmental tax immunity doctrine, or otherwise impedes state sovereignty in violation of the 10th Amendment to the United States Constitution. In 2014, the District Court for the Southern District of Indiana dismissed the State from the case because the State had been a plaintiff in the Florida litigation, and therefore was bound was by lower courts' decisions in that litigation. However, the court did not dismiss the school districts' claims.

This created the possibility that the ACA's penalties and taxes on school districts might be declared unconstitutional. Yet, in February 2018, the court entered summary judgment against the school districts. The court concluded that the school districts, as political subdivisions of the State of Indiana, were in privity with the State and therefore were bound by the lower courts' decisions in the Florida litigation. The court also held that Congress' enactment of the ACA was within its authority under the Commerce Clause of the United States Constitution to regulate state and local government employees similarly to regulation of private sector employees, and did not unduly burden state sovereignty.

Other suits challenging the constitutionality of the ACA are pending. However, it is very likely that any future constitutional challenges by school districts will fail for the same reasons that the claims in the Florida and Indiana litigation failed.