Employment, Labor & Benefits

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Employment, Labor & Benefits Advisory

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IRS/Treasury Issue Employer Shared Responsibly Proposed Regulations

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Beginning in 2014, the Patient Protection and Affordable Care Act (Act) requires "applicable large employers" (i.e., employers with 50 or more full-time equivalent employees) to either offer group health insurance coverage to their full-time employees or (potentially) pay a fine. Referred to as "Employer Shared Responsibility" or "pay-or-play" requirements, these rules are set out in new Internal Revenue Code § 4980H. In a notice of proposed rulemaking issued December 28, 2012 (the "proposed regulations"), the Treasury Department and the IRS offered a set of comprehensive rules that address Code § 4980H compliance. This client advisory explains the key features of the proposed regulations.

Summary of Important Provisions

The proposed regulations include a series of clarifications and new rules that are generally employer-friendly. This is not to say that compliance will be a simple matter; it will not. The statutory scheme is too complex for that. Nevertheless, in a handful of instances, the proposed regulations adopted common sense rules that smooth over some of the Act's rougher edges. These include:

- Penalties are determined and assessed by controlled group member. This rule is in contrast to the rule for determining whether an employer is an applicable large employer, under which all employers under common control are aggregated and treated as a single employer.
- For purposes of determining whether an employer makes an offer of group health plan coverage, at least 95% (and not 100%) of an employer's full-time employees must be offered coverage.
- The look-back measurement safe harbors for purposes of establishing full-time employee status are clarified and expanded upon.
- While employers must offer dependent coverage in order be deemed to make an offer of coverage, coverage need not be offered to spouses.
- Transitional relief is provided for fiscal year plans and for other purposes.

Background

The Act's employer shared responsibility requirements apply to "applicable large employers." An applicable large employer means "an employer that employed at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year." Thus, whether an employer is an applicable large employer depends on the number of full-time equivalent employees (FTEs), which includes full-time and part-time employees. In contrast, penalties or "assessable payments" under Code § 4980H (discussed below) are determined on the basis of full-time employees *only*. The Act provides that a "full-time employee" with respect to any month is an employee who is employed on average at least 30 hours of service per week.

Beginning in 2014, each applicable large employer is subject to an assessable payment if any full-time employee is certified as eligible to receive an applicable premium tax credit or cost-sharing reduction from a public insurance exchange and either:

- Code § 4980H(a) Liability

  The employer fails to offer to all its "full-time employees" (and their dependents) the opportunity to enroll in "minimum essential coverage" under an "eligible employer-sponsored plan." Under this prong, if an employer fails to make an offer of coverage to its full-time employees, an assessable payment is imposed monthly in an amount equal to $166.67 multiplied by the number of the employer's full-time employees, excluding the first 30.

  \- OR -

- Code § 4980H(b) Liability

  The employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan that, with respect to a full-time employee who qualifies for a premium tax credit or cost-sharing reduction, either is (i) "unaffordable" or (ii) does not provide "minimum value." If the employer makes the requisite offer of coverage, the assessable payment is equal to $250 per month multiplied by the number of full-time employees who qualify for and receive a premium tax credit or cost-sharing reduction from a health insurance exchange. The amount of the Code § 4980H(b) Liability is capped at the Code § 4980H(a) Liability amount. As a result, an employer that offers group health plan coverage can never be subject to a larger assessable payment than that imposed on a similarly situated employer that does not offer group health plan coverage.

Amounts collected under § 4980H generally will be made available to help pay for coverage for employees (i) whose household income is between 100% and 400% of the federal poverty level and who enroll in coverage through a public insurance exchange, (ii) who are not eligible for coverage through a government-sponsored program (e.g., Medicaid or CHIP), and (iii) who are not eligible for coverage offered by an employer or are eligible only for employer coverage that is unaffordable or that does not provide minimum value.

"Minimum essential coverage" includes coverage under an "eligible employer-sponsored plan." An "eligible employer-sponsored plan" includes "group health plans offered in the small or large group market within a state" but does not include "excepted benefits" as defined and described under the Public Health Service Act, e.g., stand-alone vision or dental benefits, most medical flexible spending accounts, hospital indemnity plans, etc.

Employer-provided health insurance coverage is deemed "unaffordable" if the premium required to be paid by the employee exceeds 9.5% of the employee's household income. The IRS in prior guidance proposed a safe harbor under which affordability is determined on the basis of an employee's income as reported on his or her Form W-2 (in Box 1) instead of household income. The substitution of W-2 income for household income is referred to as the "affordability safe harbor."

Coverage is deemed to provide "minimum value" if it pays for at least 60% of all plan benefits, without regard to co-pays, deductibles, co-insurance, and employee premium contributions. The IRS in prior guidance established rules for determining minimum value based on guidance issued by the Department of Health and Human Services relating to actuarial value.

The Proposed Regulations

The proposed regulations are organized into the following topics:

Determination of Applicable Large Employer Status

An applicable large employer with respect to a calendar year is an employer that employed an average of at least 50 full-time employees (taking into account full-time equivalent employees) on business days during the preceding calendar year. This includes governmental entities (e.g., federal, state, local or Indian tribal government entities) and tax-exempt entities of all stripes. Sole proprietors, partners, and 2-percent S corporation shareholders are not employees, but an individual who provides services as both an employee and a non-employee (such as an individual serving as both an employee and a director) is an employee.

Solely for purposes of counting the number of full-time and full-time equivalent employees, the Act provides that *all* entities treated as a single employer under the tax code's controlled group rules are treated as a single employer for purposes of determining whether an employer is an applicable large employer.

For purposes of determining applicable large employer status, an employer includes a predecessor employer. The proposed regulations do not further address this requirement. They instead note that rules for identifying successor employers have been developed in other contexts such as the rules governing employment taxes. Comments are invited on whether these rules are an appropriate analog in this instance. Similar rules apply to new employers, with respect to which the proposed regulations provide that an employer not in existence during an entire preceding calendar year is an applicable large employer for the current calendar year if it is reasonably expected to employ an average of at least 50 full-time employees (taking into account full-time equivalent employees) on business days during the current calendar year.

The proposed regulation clarifies that certain foreign employers and foreign employees are excluded when applying the Act's Employer Shared Responsibility provisions. Specifically, for purposes of determining an employer's status as an applicable large employer, an employer need only take into account work performed in the United States. Similarly, U.S. citizens working abroad generally would not be taken into account for purposes of determining whether the employer owes an assessable payment.

The Act includes a special rule under which, if an employer's workforce exceeds 50 full-time employees for 120 days or fewer during a calendar year, and the employees in excess of 50 who were employed during that period of no more than 120 days were "seasonal workers," the employer is not an applicable large employer. For these purposes, a "seasonal worker" is defined to mean:

> [A] worker who performs labor or services on a seasonal basis, as defined by the Secretary of Labor, … and retail workers employed exclusively during holiday seasons.

Following prior guidance, the proposed regulations provide that, for this purpose only, four calendar months will be treated as the equivalent of 120 days. The preamble to the proposed regulations emphasizes that this rule is relevant *only* for applying the seasonal worker exception for determining status as an applicable large employer. A different rule applies for determining whether an employee is a *seasonal employee* for purposes of the look-back measurement method (described below).

Determining Full-Time Employee Status

A full-time employee is an employee who was employed on average at least 30 hours of service per week. The proposed regulations treat 130 hours of service in a calendar month as the monthly equivalent of 30 hours of service per week ((52 x 30) ÷ 12 = 130). Hours of service include:

i. Each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer; and

ii. Each hour for which an employee is paid, or entitled to payment by the employer on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence.

The proposed regulations clarify that the term "employee" for purposes of Code § 4980H means a "common law employee" and not one of the broader definitions used for most employment law purposes (the common law definition already applies for most tax and benefits purposes). Citing the explicit lack of any reference to "leased employees," however, the proposed regulations carry forward the position taken in previous guidance that "leased employees" are not treated as employees for Code § 4980H purposes.

Full-time equivalent employees factor into the determination of applicable large employer status. The proposed regulations offer detailed guidance on the manner of determining the number of full-time equivalent employees. Generally, each full-time equivalent employee is counted as one full-time employee for that year. All employees (including seasonal workers) who were not full-time employees for any month in the preceding calendar year are included in calculating the employer's full-time equivalent employees by (i) calculating the aggregate number of hours of service (but not more than 120 hours of service for any employee) for all employees who were not employed on average at least 30 hours of service per week for that month, and (ii) dividing the total hours of service in step (i) by 120.

For employees paid on an hourly basis, the proposed regulation permits employers to calculate actual hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence. For employees not paid on an hourly basis, employers are permitted to calculate the number of hours of service under any of the following three methods:

i. Actual hours. Counting actual hours of service (as in the case of employees paid on an hourly basis) from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence;

ii. Days-worked equivalency. Using a days-worked equivalency method whereby the employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service under these service crediting rules; or

iii. Weeks-worked equivalency. Using a weeks-worked equivalency of 40 hours of service per week for each week for which the employee would be required to be credited with at least one hour of service under these service crediting rules.

Special rules are provided for educational organizations that impute up to 501 hours of service for certain periods of absence with zero hours of service.

Look-Back Measurement Periods

The Act determines an employer's liability for assessable payments month-by-month. Recognizing that a month-by-month determination would prove difficult to administer, particularly for employers with large cohorts of contingent and variable workers, regulators previously proposed a "look-back/stability period" safe harbor. Under this approach, full-time status is determined over a "measurement" period of up 12 months, followed by a "stability" period of like length during which coverage must be offered without regard to hours as long as the individual remains employed.

The look-back/stability period approach was at first limited to ongoing employees. It was later expanded to new hires, but only after some false starts. Also added along the way was the ability to insert an "administrative period" of up to 90 days in between the end of a measurement period and the start of a stability period in order to accommodate eligibility determinations and handle enrollment. The combined length of the measurement period and the stability period was further limited in the case of new hires. The proposed regulations retain the look-back/stability approach with a few changes, including a change in name—the rules are now called "look-back measurement period methods."

The look-back measurement period rules apply only to ongoing employees, new variable hour employees, and new seasonal employees (not "seasonal workers" as described above). Neither these proposed regulations nor prior guidance define the term "seasonal employees." The proposed regulation permits employers to adopt a reasonable good faith interpretation of the term until further guidance is provided. In many cases, it will be clear that an employee is, or is not, full-time. In these instances, the look-back measurement period safe harbors don't apply. But what if an employer is unable to predictably identify which employees are full-time employees and which are not (e.g., employees whose hours vary from month-to-month)? The proposed regulations provide for two look-back measurement methods, one for "on-going employees" and the other for "new variable hour employees."

Ongoing employees

An ongoing employee is an employee who has been employed by an employer for at least one "standard measurement period." A standard measurement period is a time period of not less than 3 but not more than 12 consecutive months, as chosen by the employer. Measurement periods may be coordinated with one week, two week, or semi-monthly payroll periods, such that a measurement period does not end in the middle of a payroll period. If the employer determines that an employee was employed on average at least 30 hours of service per week during the standard measurement period, then the employer must treat the employee as a full-time employee during a subsequent "stability period," regardless of the employee's number of hours of service during the stability period, so long as he or she remains an employee. If, on the other hand, an employee is determined not to be employed on average at least 30 hours of service per week during the standard measurement period, he or she need not be treated as a full-time employee during the stability period that follows. The stability period must be at least six consecutive calendar months but no shorter than the measurement period.

Measurement periods and stability periods may differ in length or in their starting and ending dates for the following categories of employees: (i) collectively bargained employees and non-collectively bargained employees, (ii) each group of collectively bargained employees covered by a separate collective bargaining agreement, (iii) salaried employees and hourly employees, and (iv) employees whose primary places of employment are in different states.

The employer may also add an “administrative period” between the measurement period and the stability period of up to 90 days. To prevent an administrative period from creating a gap in coverage, the administrative period must overlap with the prior stability period. For an employee whom the employer determines to be a full-time employee during the standard measurement period, the stability period would be a period that immediately followed the standard measurement period (and any applicable administrative period), the duration of which would be at least the greater of six consecutive calendar months or the length of the standard measurement period.

New variable hour employees

An employee who is reasonably expected at his or her start date to be employed on average 30 hours of service per week must be offered coverage within the employee’s initial three calendar months of employment in order for the employer to avoid any assessable payments.

A different rule applies to “variable hour employees.” A new employee is a “variable hour employee” if, based on the facts and circumstances at the start date, it cannot be determined that the employee is reasonably expected to be employed on average at least 30 hours per week. A new employee who is expected to be employed initially at least 30 hours per week but whose tenure is expected to be of limited duration may nevertheless be a variable hour employee. The proposed regulations include a special rule under which the employer is not permitted to take into account the likelihood that the employee’s employment will terminate before the end of the initial measurement period in determining the employee’s status as a variable hour employee. (Recognizing that this interpretation may cause some hardship, the proposed regulations defer enforcement of this latter provision as to variable hour, but not seasonal, employees until 2015.)

If a new variable hour employee or new seasonal employee has on average at least 30 hours of service per week during the initial measurement period, the employer must treat the employee as a full-time employee during the stability period that begins after the initial measurement period (and any associated administrative period). The stability period must be a period of at least six consecutive calendar months that is no shorter in duration than the initial measurement period. If a new variable hour employee or new seasonal employee does not have on average at least 30 hours of service per week during the initial measurement period, the employer need not treat the employee as a full-time employee during the stability period that follows the initial measurement period. If the employee was not employed an average of at least 30 hours of service per week during the initial measurement period, but was employed at least 30 hours of service per week during the overlapping or immediately following standard measurement period, the employee must be treated as a full-time employee for the entire stability period that corresponds to that standard measurement period.

An employer may apply an administrative period of up to 90 days for variable hour and seasonal employees. However, the initial measurement period and the administrative period combined may not extend beyond the last day of the first calendar month beginning on or after the one-year anniversary of the employee’s start date (totaling, at most, 13 months and a fraction of a month).

Once a new variable hour employee or new seasonal employee has been employed for an entire standard measurement period, the employer must test the employee for full-time employee status, beginning with that standard measurement period, at the same time and under the same conditions as apply to other ongoing employees. An employee who was employed an average of at least 30 hours of service per week during an initial measurement period or standard measurement period must be treated as a full-time employee for the entire associated stability period. Thereafter, the employer determines the employee’s status as a full-time employee in the same manner as it tests ongoing employees.

Changes in employment status

The proposed regulations provide special rules that apply when a new variable or seasonal employee changes his or her employment status during the initial measurement period. This might occur, for example, if a new variable hour employee is promoted during the initial measurement period to a position in which employees are reasonably expected to be employed on average 30 hours of service per week. A new variable hour or seasonal employee who has a change in employment status during an initial measurement period is treated as a full-time employee as of the earlier of (i) the first day of the fourth month following the change in employment status, or (ii) if the employee averages more than 30 hours of service per week during the initial measurement period, the first day of the first month following the end of the initial measurement period (including any optional administrative period).

Breaks in service

The proposed regulations include rules for determining when a rehired employee may be treated as a new hire for purposes of the look-back measurement period safe harbors. If the period for which no hours of service are credited is at least 26 consecutive weeks, an employer may treat an employee who has an hour of service after that period, for purposes of determining the employee's status as a full-time employee, as having terminated employment and having been rehired as a new employee. Alternatively, the employer can choose to apply a rule of parity for periods of less than 26 weeks under which an employee may be treated as having terminated employment if the period with no credited hours of service (of less than 26 weeks) is at least four weeks long and is longer than the employee's period of employment immediately preceding that period with no credited hours of service.

A separate rule applies to service breaks of employees of an educational organization under which an employment break period is a period of at least four consecutive weeks (disregarding special unpaid leave).

Employer Disaggregation

While all employers under common control are aggregated for purposes of establishing applicable large employer status, there is no aggregation when determining liability. Instead, penalties under Code § 4980H are determined separately to each member in the controlled group or, in the parlance of the proposed regulations, "applicable large employer member." This means, for example, that one member of a controlled group might choose to offer affordable coverage that provides minimum value across-the-board, thereby incurring no penalty; while another might offer no coverage and elect to pay the Code § 4980H(a) Liability; and yet another might make an offer of coverage that may not be affordable in each case, thereby incurring Code § 4980H(b) Liability.

When calculating Code § 4980H(a) Liability, an employer is permitted one reduction of 30 full-time employees. In the case of a controlled group, the reduction must be allocated ratably based on each applicable large employer member's number of full-time employees, and any controlled group member with a ratable allocation of between zero and one employee may be allocated one employee.

Offer of Dependent Coverage

The Act provides that an applicable large employer is liable for an assessable payment under Code § 4980H(a) if, for any month, any full-time employee is certified to receive an applicable premium tax credit or cost-sharing reduction and the applicable large employer "fails to offer its full-time employees *(and their dependents)* the opportunity to enroll in minimum essential coverage" (Emphasis added). The proposed regulations clarify that, in order to be subject to Code § 4980H(b) Liability (rather than subject to Code § 4980H(a) Liability), dependent coverage is required. But noting that "Section 4980H does not contain a statutory definition of the term dependents," the proposed regulations fill in the void by defining an employee's dependents as an employee's child who is under 26 years of age. Noting also that the statute does not include any reference to an employee's spouse, the proposed regulations provide that spousal coverage is not required.

Relief for Failure to Offer Coverage to a Limited Number of Full-Time Employees

While not entirely clear from the face of the statute, the regulators have assumed that Code § 4980H(a) Liability applies in an instance where an applicable large employer fails to offer coverage to *all* full-time employees, and that the assessable payment is determined by reference to an employer's total number of full-time employees, including full-time employees offered employer-sponsored coverage. Recognizing that the assessable payment should not apply where an employer intends to offer coverage to all its full-time employees, but fails to offer coverage with respect to a few full-time employees, the proposed regulation offers some welcome relief. The proposed regulations allow a margin of error to take account of inadvertent errors under which an employer is treated as offering coverage to its full-time employees (and their dependents) for a calendar month if, for that month, it offers coverage to all but 5% or, if greater, five of its full-time employees.

Affordable Coverage

Code § 4980H(b) Liability may arise because, with respect to a full-time employee who has been certified to the employer as having received an applicable premium tax credit or cost-sharing reduction, the employer's coverage is unaffordable or fails to provide minimum value. An employer-sponsored plan is affordable if the employee's required contribution for self-only coverage does not exceed 9.5% of the employee's "household income" for the taxable year. Recognizing that this is an unworkable standard, the IRS previously proposed an affordability safe harbor under which an employer could substitute an employee's W-2 wages for household income. (This approach was dubbed the "W-2" safe-harbor.) The proposed regulations retain the W-2 safe harbor, and it adds two additional safe-harbors, a "rate of pay" safe harbor and a "federal poverty line" safe harbor.

- Under the "rate of pay" safe harbor the employer would (i) take the hourly rate of pay for each hourly employee who is eligible to participate in the health plan as of the beginning of the plan year, (ii) multiply that rate by 130 hours per month (the benchmark for full-time status for a month), and (iii) determine affordability based on the resulting monthly wage amount.
- Under the federal poverty line safe harbor, coverage offered to an employee is affordable if the employee's cost for self-only coverage under the plan does not exceed 9.5% of the Federal Poverty Line for a single individual.

Transition Rules

Code § 4980H applies beginning January 1, 2014, which poses a compliance challenge for fiscal year plans. Recognizing this to be the case, the proposed regulations provide two transitional rules that apply to employers that offer health coverage under a fiscal year plan as of December 27, 2012. Under the first, an employer will not be subject to a potential payment until the first day of the fiscal plan year starting in 2014 with respect to employees who are eligible to participate in the plan. Under the second, an employer will not be subject to any Code § 4980H liability until the first day of the fiscal plan year starting in 2014 if (i) the plan was offered to at least one third of the employer's employees (full-time *and* part-time) at the most recent open enrollment, or (ii) the plan covered at least one quarter of the employer's employees as of December 27, 2012, provided that those full-time employees are offered affordable coverage that provides minimum value no later than the first day of the next plan year.

The proposed regulations provide a separate transitional rule under the look-back measurement period safe harbor under which an employer may measure using any six-consecutive-month period in 2013.

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