Proposed Regulations Issued on Employer Shared Responsibility Payments under the Affordable Care Act

Last Friday, the Department of the Treasury issued proposed regulations on the employer shared responsibility provisions in section 4980H of the Internal Revenue Code, under which an employer may be subject to an assessment for failure to offer its full-time employees health coverage that is affordable and provides a minimum value. These provisions take effect for the first time in 2014 and generally apply to employers with at least 50 full-time equivalent employees ("applicable large employers"). Employers are permitted to rely on these proposed regulations pending the issuance of final regulations or other guidance.

The proposed regulations build upon a series of proposals set forth in earlier guidance, the details of which were described in previous Ropes & Gray Alerts. The proposed regulations go beyond the scope of that prior guidance, however, to address for the first time certain aspects of how applicable large employer and full-time employee status will be determined and how an assessable payment will be calculated and assessed. In addition, the proposed regulations provide a number of new safe harbors for employers who offer coverage to their full-time employees, as well as transition relief for the first year of application in 2014. Simultaneously with the release of the proposed regulations, the IRS posted on its website questions and answers that provide less technical explanations of the statutory employer shared responsibility provisions and the proposed regulations.

In general, the proposed regulations reflect the ongoing attempt of Treasury and the IRS to balance the requirements of the statute and the practical concerns of employers. This alert highlights the significant provisions of the proposed regulations and discusses the available transition relief.

Determination of Applicable Large Employer Status and Assessment of Shared Responsibility Payments

The rules in the proposed regulations for determining applicable large employer status generally mirror those proposed in previous guidance, with additional details on how applicable large employer status is determined for an employer not in existence for the entire preceding calendar year. While the statutory language clearly provides that applicable large employer status is determined on a controlled group basis, the proposed regulations clarify that the employer shared responsibility provisions are applied separately to each individual controlled group member (referred to in the proposed regulations as an "applicable large employer member"). Assessable payments will be assessed and paid, and associated reporting will be done, at the applicable large employer member level and not at the controlled group level.[1] The IRS and Treasury have reserved on the application of these controlled group rules in two important aspects – how the rules apply to governmental entities and churches and how predecessor and successor employers are to be identified. Employers are permitted to rely on a reasonable, good faith interpretation of the rules in determining applicable large employer status in these contexts.

While the proposed regulations do not address how assessable payments will be administered by the IRS, the preamble to the proposed regulations and the questions and answers posted on the IRS website state that any assessment will be payable only after notice and demand from the IRS and that an employer will be given a chance to respond prior to any notice and demand for payment. While many questions remain regarding the

[1] The preamble to the proposed regulations notes that the Treasury Department expects to issue regulations providing guidance on information reporting under Section 6056, which will be used by the IRS in administering the employer shared responsibility provisions.

enforcement of the employer shared responsibility provisions, it is clear that applicable large employer members will not be required to self-report any assessable payment on their tax returns.

Identifying Full-Time Employees for Section 4980H Purposes

One of the most challenging aspects of the employer shared responsibility provisions is the identification of full-time employees (defined statutorily as employees who work an average of 30 hours per week), particularly with respect to employees whose hours of service may vary from month to month or whose compensation or work schedule is structured such that hours of service is not a relevant concept. The proposed regulations continue to recognize the difficulty in applying the employer shared responsibility provisions to certain employment models. As discussed below, Treasury and the IRS continue to seek comment on how these rules may apply to certain types of employers and the proposed regulations permit employers to comply with good faith interpretations of the rules in a number of circumstances.

The concept of "hours of service" is relevant for purposes of determining applicable large employer status and in determining the amount of any potential liability under the employer shared responsibility provisions. Consistent with the approach described in prior Department of Labor and Affordable Care Act guidance, the proposed regulations provide that, for these purposes, "hours of service" include not only hours when work is performed, but also hours for which an employee is paid or entitled to payment even when no work is performed (e.g., vacation and sick time). In addition, hours of service do not generally include hours of service worked outside the United States, regardless of whether the employee is a U.S. resident or citizen. In response to concerns from commenters regarding the use of an hours of service framework for employees whose compensation is not based primarily on hours worked (such as salespeople compensated on a commission basis or adjunct faculty paid on the basis of credit hours taught) and employees whose active work hours may be subject to safety-related limits (such as airline pilots), employers of such employees may, until further guidance is provided, use a reasonable method of crediting hours of service consistent with the purposes of the employer shared responsibility provisions.

For purposes of determining the amount of any potential employer shared responsibility liability (and not for purposes of determining applicable large employer status), the proposed regulations also largely incorporate the approach to determining full-time employee status contained in prior guidance. As described in the previous guidance, employers are permitted to use a safe harbor under which a look-back measurement period of up to twelve months, followed by a stability period, may be used in determining who is a full-time employee. The proposed regulations provide additional details on how the look-back measurement and stability period safe harbor can be applied to ongoing employees, new employees, variable hour and seasonal employees, employees who experience a change in employment status during their initial measurement period, and employees who experience a break in service. Special break-in-service rules apply to educational organizations; these rules will generally result in full-time employee treatment for employees who work full-time during the academic year. The IRS and Treasury have requested comments on whether these rules should be extended to all employers, as well as on whether special safe harbors or presumptions should or could be developed with respect to the classification of common law employees of temporary staffing agencies.

Complying with Section 4980H(a) and 4980H(b)

In order to avoid liability under the employer shared responsibility rules, an employer must offer full-time employees the opportunity to enroll in health coverage that is affordable and provides minimum value. The

proposed regulations provide long-awaited guidance on what constitutes an affordable, minimum value offer of coverage. In particular, the proposed regulations:

- Confirm that an offer of coverage must be made to a full-time employee's dependents, but not to the employee's spouse.
- Treat an employer as offering coverage to its full-time employees if it offers coverage to all but 5% or (if greater) 5 of its full-time employees, whether or not the failure to offer is inadvertent.
- Clarify that a full-time employee must be offered an effective opportunity to elect coverage and to decline an offer of coverage that is not affordable or that does not provide minimum value.
- Clarify that, except in the case of terminated employees, if an employer fails to offer coverage to a full-time employee for any day of a calendar month during which the employee is employed by the employer, the employee is treated as not being offered coverage during that month.
- Do not penalize an employer for a failure to provide coverage to a full-time employee who fails to pay his or her share of a premium on time, so long as the employer abides by certain existing rules regarding non-payment of premiums in the COBRA context.
- Include the previously proposed safe harbor that permits employers to use W-2 wages to determine the affordability of self-only coverage for full-time employees and provide two new additional safe harbors – one based on an employee's rate of pay and one based on the federal poverty line. Under each safe harbor, the full-time employee's required contribution to the cost of coverage cannot exceed 9.5% of the relevant benchmark. Because compliance with the W-2 safe harbor cannot, in all circumstances, be known until the end of the current plan year, the addition of the two new safe harbors is a welcome development for employers looking for additional certainty with respect to the affordability calculation.

The proposed regulations provide no specific rules for demonstrating that affordable, minimum value coverage was offered to a particular full-time employee or employees, other than noting that the generally applicable substantiation rules of the Code apply.

Transition Relief

The proposed regulations provide helpful transition relief for fiscal year plans (including health plan coverage elected under a cafeteria plan), measurement periods for stability periods starting in 2014, applicable large employer members participating in multiemployer plans, determination of applicable large employer status, and coverage for dependents.

Fiscal Year Plans: General Relief

Treasury and the IRS have provided transition relief for employers who sponsor plans with plan years other than the calendar year. Such employers would otherwise be faced with the choice of changing the terms and conditions of coverage in the middle of the 2013 plan year or risking exposure for an employer shared responsibility assessment for the portion of that plan year falling in 2014. These transition rules are available to any applicable large employer (or, in the case of a controlled group, its applicable large employer members) who maintains a fiscal year group health plan as of December 27, 2012 and provide that:

- An applicable large employer member will not be subject to a potential employer shared responsibility payment with respect to any employees who are eligible to participate in the fiscal year plan under its terms as of December 27, 2012, regardless of whether such employees are actually enrolled in the plan, until the first day of the fiscal plan year beginning in 2014.

- If a fiscal year plan (including any other plan sponsored by the relevant applicable large employer member with the same plan year) was offered to at least one-third of the applicable large employer member's employees (whether full-time or part-time) during the most recent open enrollment period prior to December 27, 2012 or the plan covered at least 25% of its employees (measured as of any day between October 31, 2012 and December 27, 2012), then the applicable large employer member will not be subject to a potential employer shared responsibility payment with respect to any of its full-time employees until the first day of the fiscal plan year beginning in 2014, provided that those full-time employees are offered affordable coverage that provides minimum value as of the first day of the 2014 plan year.

Fiscal Year Plans: Cafeteria Plan Relief

With the individual mandate and the availability of coverage purchased through an Exchange both effective as of January 1, 2014, employees eligible to enroll in or already covered under fiscal year plans might wish to either enroll in the employer's plan or drop coverage under that plan and enroll in an Exchange plan, as applicable, in the middle of the plan year. Recognizing that many employees elect their health plan coverage under their employer's cafeteria plans and that such elections are generally irrevocable for the plan year except in a narrow set of circumstances specified in existing regulations, the proposed regulations permit applicable large employer members sponsoring a fiscal year cafeteria plan to amend the cafeteria plan to permit a current plan participant to prospectively revoke or change his or her election and to permit an employee who failed to make an election to make a prospective election. Such changes are permitted only once during the plan year, and only with respect to accident and health plan coverage offered under a fiscal year plan. Plan amendments permitting this change must be made by December 31, 2014, and may be effective retroactively to the date of the first day of the cafeteria plan's 2013 plan year.

Measurement Periods for Stability Periods Starting in 2014

Employers intending to use the look-back measurement and stability period safe harbor for determining full-time employee status for purposes of calculating any potential liability under the employer shared responsibility provisions in 2014 will need to begin their measurement period in 2013 to have a corresponding stability period in 2014. As a practical matter, this means that an employer wishing to adopt a 12-month measurement period and a 12-month stability period will have to use a measurement period that begins prior to the issuance of final regulations. For that reason, solely for purposes of stability periods beginning in 2014, employers may adopt a transition measurement period that is shorter than 12 months but no less than 6 months. Any transition measurement period must begin no later than July 1, 2013 and end no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2014.

Multiemployer Plans

The proposed regulations provide transition relief for 2014 for contributions made by applicable large employers participating in a multiemployer plan. Under this rule, an applicable large employer will not be subject to an employer shared responsibility assessment with respect to a full-time employee if: (i) the employer is required to make a contribution to a multiemployer plan with respect to that employee pursuant to a collectively bargained agreement, (ii) coverage under that plan is offered to the full-time employee (and his or her dependents), and (iii) the coverage offered is affordable and provides minimum value. This relief is available only with respect to multiemployer plans and does not apply to any single employer plan to which

contributions are made pursuant to a collectively bargained agreement. Treasury and the IRS are seeking additional comments on how section 4980H should apply to employers participating in multiemployer plans.

Applicable Large Employer Determination for 2014

While status as an applicable large employer will be obvious for many employers, those who are close to the 50-employee threshold will likely be required to determine whether they are an applicable large employer. In order to minimize any administrative burden on these employers, the proposed regulations allow an employer to measure whether it has 50 full-time employees using any six-month consecutive period in 2013 rather than the full twelve months otherwise required by the statute. This gives an employer the flexibility to use the first six months of 2013 to make a determination of applicable large employer status and, if deemed to be an applicable large employer, the second six months for it (or, in the case of a controlled group, its applicable large employer members) to choose and establish a plan for coverage effective January 1, 2014.

Dependent Coverage

The proposed regulations give employers who do not currently offer coverage to dependents time to implement changes to their plans to provide such coverage. Any employer that takes steps during its plan year that begins in 2014 to offer coverage to full-time employees' dependents will not be liable for any employer shared responsibility assessment solely because it failed to offer coverage to these dependents for that plan year.

Comments Requested

Treasury and the IRS have requested comments on all aspects of the proposed regulations and comments must be received by March 18, 2013. A public hearing on the proposed regulations is scheduled for April 23, 2013.

The proposed regulations answer, or begin to answer, many of the questions employers are facing as they consider whether and how to meet their obligations under the employer shared responsibility provisions. For more information about the proposed regulations, please contact your usual Ropes & Gray advisor or a member of the employee benefits practice group. For information on federal health reform generally, please visit our Health Reform Resource Center.