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IRS Final Rule Partially Delays ACA Employer Shared Responsibility Requirement

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On February 12, 2014, the Internal Revenue Service (IRS) released final regulations governing the employer shared responsibility provisions of the Affordable Care Act (ACA).[1] The final rule addresses application of the so-called "play or pay" requirement that was added by the ACA. Under this requirement, employers with 50 or more full-time employees (as such term is defined in the rules) must offer health coverage to full-time employees and their dependents or pay a penalty. Even employers that offer coverage may incur a penalty if that coverage does not provide "minimum value" to plan participants or if it is not "affordable." Originally slated to become effective in 2014, the IRS had previously delayed the effective date of the employer responsibility provision until 2015. The long-awaited final rule further delays the effective date for employers with between 50 and 99 full-time employers until 2016. The final rule also provides that employers with 100 or more full-time employees must offer health coverage to only 70% of full-time employees in 2015, instead of 95%. The delay is certainly welcome news for employers and provides some much-needed clarity. Nonetheless, the final rule calls upon employers to make critical decisions in the months ahead as uncertainty about the play-or-pay requirement remains.

Section 4980H Background

Only applicable large employers are subject to the employer shared responsibility requirement. The ACA defines an applicable large employer with respect to a calendar year as an employer that, during the prior calendar year, employed an average of at least 50 full-time employees. To calculate the number of full-time employees for this purpose, an employer must look at: (1) actual full-time employees; and (2) the number of full-time equivalent employees (FTEs) represented by the employer's part-time employees. The statute defines a full-time employee as one working 30 or more hours a week, calculated on a monthly basis.

Although the hours of part-time workers are included for the purpose of determining status as an "applicable large employer," the penalty under Section 4980H applies only with respect to full-time employees. Section 4980H(a) requires "applicable large employers" to offer their full-time employees (and their dependents) "minimal essential" health benefit coverage or pay a penalty if any full-time employee receives a federal subsidy to purchase insurance through a

1 79 Fed. Reg. 8544 (Feb. 12, 2014). The IRS issued questions and answers on the final rule, *available at* http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act.

health exchange. This penalty will be $2,000 for each full-time employee in excess of 30 employees. For 2015 only, the penalty will exempt the first 80 full time employees instead of 30. Under Section 4980H(b), covered employers offering health coverage that either fails to provide minimum value (*i.e.*, the plan's share of the total allowed costs of benefits provided under the plan is not at least 60% of those costs)[2] or is deemed unaffordable (*i.e.*, the cost of coverage exceeds 9.5% of the employee's compensation), will pay the lesser of $2,000 for each full-time employee in excess of 30 (80 in 2015) or $3,000 for each full-time employee who receives a premium tax credit to enable him or her to purchase coverage through the health insurance exchanges. Generally, individuals with household incomes between 100% and 400% of the federal poverty level will be eligible for a federal subsidy. However, access to employer-sponsored coverage that is both "affordable" and provides "minimum value" disqualifies an individual from receiving the subsidy.

On December 28, 2012, the IRS released its proposed regulations on the employer shared responsibility provisions.[3] Consistent with previously issued guidance, the proposed rule adopted the use of a look-back measurement period/stability period approach to determine the full-time status of employees. The proposed rule included direction on how to calculate employee hours of service, use the measurement period approach, and determine whether health coverage is affordable. The proposed rule also specified that an employer could avoid paying a penalty under Section 4980H(a) if it offered health coverage to at least 95% of its full-time employees (and their children).

On July 9, 2013, the IRS issued Notice 2013-45, delaying the effective date of Section 4980H until 2015. Notice 2013-45 also provided transition relief for 2014 for the employer reporting requirements under IRC Sections 6065 and 6056, which were added by the ACA. Section 6055 requires providers of minimum essential health coverage to report information to the IRS. Section 6056 requires an applicable large employer to file a return with the IRS that reports, for each employee who was a full-time employee for one or more months during the calendar year, certain information about the healthcare coverage the employer offered to that employee (or, if applicable, that the employer did not offer healthcare coverage to that employee). Section 6056 also requires applicable large employers to furnish, by January 31 of the calendar year following the calendar year for which the return must be filed, a related statement regarding the full-time employee(s) for whom information is required to be included on the return.[4] On September 5, 2013, the IRS issued proposed rules on the Section 6055 and 6055 reporting requirements.

Transition Relief for 2015

The final rule further delays full implementation of the ACA's employer share responsibility requirement.

- **Employers with between 50 and 99 full-time employees**: Employers with least 50 but fewer than 100 full-time employees (including full-time equivalent employees) will have an additional year, until 2016, to meet the requirements of Section 4980H if the employer provides an appropriate certification described in the final rule. This transition relief is provided for all of 2015 plus, in the case of any non-calendar plan year that begins in 2015, the portion of that 2015 plan year that falls in 2016. To qualify for this relief, during the period beginning on February 9, 2014 and ending on December 31, 2014, the employer must not reduce the size of its workforce or the overall hours of service of its employees in order to satisfy the workforce size condition. A reduction in workforce size or overall hours of service for bona fide business reasons will not be considered to have been made in order to satisfy the workforce size condition. For the period from February 9, 2014 and ending on December 31, 2015 (or from February 9, 2014 until the last day of the plan year that begins in 2015 for non-calendar year plans), the employer must not eliminate or materially reduce the health coverage, if any, it offered as of February 9, 2014.
- **Employers with 100 or more full-time employees**: For each calendar month during 2015 and any calendar months during the 2015 plan year that fall in 2016, employers with 100 or more full-time employees (including full-time equivalent employees) will not be subject to a penalty for failing to provide minimum essential coverage under Section 4980H(a) if the employer offers coverage

2 An employer has several options for determining minimum value (MV), including the MV Calculator, *available at* http://cciio.cms.gov/resources/regulations/index.html. Alternatively, a plan may determine MV through one of the safe harbors being established by HHS and the IRS. For plans with nonstandard features that are incompatible with the MV Calculator or a safe harbor, the plan may determine MV through an actuarial certification from a member of the American Academy of Actuaries after the member performed an analysis in accordance with generally accepted actuarial principles and methodologies. 79 Fed. Reg. at 8545.

3 78 Fed. Reg. 217 (Jan. 2, 2013). *See also* Ilyse Schuman and David Weiner, *IRS Issues Proposed Rule on ACA Play or Pay Requirements*, Littler ASAP (Jan. 4, 2013), *available at* http://www.littler.com/publication-press/publication/irs-issues-proposed-rule-aca-play-or-pay-requirements.

4 78 Fed. Reg. 54996. (Sept. 5, 2013).

to at least 70% (instead of 95%) of its full-time employees (and their dependents). Beginning in 2016, such an employer must offer coverage to at least 95% of its full-time employees (and their dependents) to avoid paying the penalty under Section 4980H(a). For each calendar month during 2015 and any calendar months during the 2015 plan year that fall in 2016, the penalty for employers that fail to offer health coverage to at least 70% of full-time employees (and their dependents) is calculated by subtracting their allocable share of 80 rather than 30 full-time employees. In other words, the penalty will be $2,000 per year multiplied by the number of full-time employees over 80. Employers qualifying for this transition relief from a penalty under Section 4980H(a) in 2015 are still subject to a potential penalty under Section 4980H(b).

In addition to the above, the final rule extends the following transition relief outlined in the proposed rule:

- **Non-Calendar Year Plans**: Employers with healthcare plan years that do not start on January 1 will be able to begin compliance with the employer responsibility mandate at the start of their plan years in 2015, rather than on January 1, 2015, if certain conditions are met. If an employer maintains a fiscal year plan as of December 27, 2012, and offers affordable, minimum value coverage to a full-time employee no later than the first day of the 2015 plan year, no Section 4980H penalty will be due with respect to that employee for the period prior to the first day of the 2015 plan year. In addition, the scope of the transition relief is expanded to include employers that covered or offered coverage to a significant percentage of either full-time employees or a significant percentage of all employees.
- **Shorter Measurement Period**: For the purposes of stability periods beginning in 2015, employers may use a measurement period of at least six months that begins no later than July 1, 2014 and ends no earlier than 90 days before the first day of the first plan year beginning on or after January 1, 2015. Accordingly, employers can use a six-month measurement period for a stability period of up to 12 months in 2015.
- **Shorter Period to Determine Large Employer Status for 2015**: For the 2015 calendar year, employers can refer to the prior six-month period instead of 12 months in determining whether they are applicable large employers.
- **Coverage for Dependents**: The requirement to offer coverage to full-time employees' dependents will not apply in 2015 to employers that are taking steps during their 2014 plan year to arrange for such coverage to begin in 2016. The proposed rule defined a dependent as a child as defined under Section 152(f)(1) of the Internal Revenue Code (IRC) who has not reached age 26. The final rule modifies the definition of a dependent to exclude foster children, stepchildren, or a child who is not a U.S. citizen or a national (unless the child is resident of a country contiguous to the U.S or within the exception for adopted children described in Section 152(b)(3)(B)).
- **Multiemployer Plans**: The final rule extends the guidance in the proposed rule about the treatment of multiemployer plans. The transition guidance applies to an employer that is required by a collective bargaining agreement to make contributions with respect to some or all of its employees to a multiemployer plan that offers, to employees who satisfy the plans eligibility conditions, coverage that is affordable and provides minimum value, and that offers coverage to those employees' dependents. The guidance will apply unless and until further guidance is issued. Any further guidance that limits the scope of the interim guidance will be applied prospectively and will apply no earlier than January 1 of the calendar year beginning at least six months after issuance of the new guidance. Despite this guidance, the treatment of multiemployer plans under the ACA remains uncertain. Unions have voiced their concerns with the impact of the law on multiemployer plans and employers that contribute to multiemployer plans face challenges with the law's implementation.

Determining Full-Time Employee Status

The ACA defines full-time as 30 or more hours a week, calculated on a monthly basis. The final rule generally extends the proposed rule's standards for identifying full-time employees. Notably, the "common law" definition of employee is used for this purpose. The monthly equivalency of 30 hours is 130 hours. An employee's hours of service include the following: (1) each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer; and (2) 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 final rule provides additional guidance on the definition of hours of service and how some categories of employees are treated:

- **Volunteers**: Hours contributed by bona fide volunteers for a government or tax-exempt entity, such as volunteer firefighters and emergency responders, will not cause them to be considered full-time employees.
- **Student employees**: Hours of service do not include work performed by students in positions subsidized through the federal work study program or a substantially similar state or local program. However, hours of service for student interns who receive or are entitled to compensation from the employer would be included in the calculation to determine full-time employee status.
- **Adjunct faculty**: The final regulations provide that, until further guidance is issued, employers of adjunct faculty are to use a method of crediting hours of service for those employees that is reasonable in the circumstances and consistent with the employer responsibility provisions. However, consistent with the request for a "bright line" approach suggested in a number of the comments, the final regulations expressly allow crediting an adjunct faculty member with 2 ¼ hours of service per week for each hour of teaching or classroom time as a reasonable method.
- **Airline employees**: The IRS is continuing to consider how to determine hours of service, including layover hours, for airline industry employees and other employees whose hours of service are difficult to track. Until further guidance is issued with respect to categories of employees whose hours are particularly challenging to track, employers must use a method of crediting hours of service for those employees that is reasonable under the circumstances and consistent with the employer responsibility provisions. With respect to layover hours, it is not reasonable for an employer not to credit a layover as an hour of service if the employee receives any additional compensation for the layover.
- **On-call hours**: The IRS is considering additional rules the treatment of on-call hours. Until further guidance is issued, the preamble to the final rule states that it is not reasonable for an employer to fail to credit an employee with an hour of service for any on-call hour for which payment is made or due by the employer, for which the employee is required to remain on-call on the employer's premises, or for which the employee's activities while remaining on-call are subject to substantial restrictions that prevent the employee from using the time effectively for the employee's own purposes.
- **Service outside the United States**: An hour of service does not include any hour of service to the extent the compensation for such work constitutes foreign source income. Therefore, hours of service generally do not include hours worked outside the United States.

The final rule adopts the use of an optional look-back measurement period, and provides some additional guidance on how to use this approach. Employers can use the look-back method for determining the full-time status of ongoing as well new employees as an alternative to a monthly calculation.

- **Ongoing employees**: For ongoing employees, an employer would determine each employee's full-time status by looking back at a defined measurement period of three to 12 months to determine full-time status for a subsequent "standard stability period." If an employee worked an average of 30 hours per week during the measurement period, the employer would treat the employee as full-time during the subsequent stability period, the duration of which would be at least the greater of six consecutive calendar months or the length of the measurement period. If an employee did not work an average of 30 hours per week during the standard measurement period, the employer would treat the employee as not full-time during the subsequent stability period, which may be no longer than the associated measurement period.
- **New or seasonal employees**: As with the proposed rules, the final rule allows employers to use a look-back measurement period for determining the full-time status of variable hour or seasonal employees. The application of the look-back measurement period to a new employee depends on the employer's reasonable expectations of the status of the employee at the start date. The final regulations provide that whether an employer's determination that a new hire is or is not a full-time employee is reasonable is based on the facts and circumstances. Factors to consider include, but are not limited to, whether the employee is replacing an employee who was or was not a full-time employee, the extent to which employees in the same or comparable positions are or are not full-time employees, and whether the job was advertised, or otherwise communicated to the new hire or otherwise documented (for example, through a contract or job description), as requiring hours of service that would average 30 (or more) hours of service per week or less than 30 hours of service per week.

- **New employees reasonably expect to work full-time**: If an new employee is reasonably expected to work full-time at his or her start date, the employer must offer health coverage by the first day of the month immediately following the employee's initial three full calendar months of employment to avoid the penalty under 4980H(a). The employer will not be subject to a penalty under 4980H(b) for the initial three-month period only if the coverage offered provides minimum value.
- **New variable hour employees**: A new employee is considered a variable hour employee if the employer cannot determine whether the employee is reasonably expected to work full-time at the employee's start date. For new variable hour employees (as well as new part-time and seasonal employees), an employer may determine whether a new employee is a full-time employee using an initial measurement period of between three and 12 months that begins on any date between the employee's start date and the first day of the first calendar month following the employee's start date (or on the first date of the first payroll period starting on or after the start date, if later). The stability period for such employees must be the same length as the stability period for ongoing employees. If the new variable hour employee has averaged at least 30 hours of service during the initial measurement period, the employer must treat the employee as full-time during the subsequent stability period, which must be at least six consecutive calendar months and no shorter than the initial measurement period. If the new variable hour employee did not average at least 30 hours during the initial measurement period, the stability period must not be more than one month longer than the initial measurement period and must not exceed the remainder of the first entire standard measurement period (plus any associated administrative period). The final rule clarifies that the initial measurement period need not be based on calendar months, although the stability period must be based on calendar months. The employer must retest a new variable hour employee once he or she has been employed for an entire standard measurement period.
- **New part-time employees**: The final rule adds a definition of part-time employee, and clarifies that the measurement period rules applicable to new variable hour employees also apply to new part-time employees.
- **Seasonal employees**: Employers are also permitted to use the same measurement period rules to determine the full-time status of seasonal employees. The final rule defines a seasonal employee as one in a position for which the customary annual employment is six months or less.
- **Change in employment status**: The final regulations provide a special rule for an employee who changes status during the initial measurement period, from part-time to full-time status.

- **Administrative period**: As in the proposed rule, the final rule allows employers to use administrative periods of up to 90 days between the measurement period and stability period to determine which ongoing employees are eligible for coverage, and to notify and enroll employees. The final rule revises the definition of the administrative period to include periods before the initial measurement period. The employer can use an administrative period of up to 90 days for new variable hour, part-time and seasonal employees, which may not extend beyond the last day of the first calendar month beginning on or after the one-year anniversary of their start date.

The final rule adopts other key provisions of the proposed rule, in some cases with modifications, and in other cases rejecting requests for changes. The final rule does not expand the categories of employees that can have differing measurement and stability periods.[5] However, employers may use either the monthly measurement method or look-back measurement method for each of the categories of employees. The IRS also rejected requests to shorten the minimum length of the stability period. The final rule does not include special rules for short-term and high-turnover positions. The final rule does, however, clarify that employers may use payroll periods as described in the proposed rule for both the initial measurement period and the measurement period for ongoing employees.

The final rule also revises the rules regarding breaks in service. Under the final rule, the length of the break in service for a returning employee to be considered a new employee is reduced from 26 weeks to 13 weeks, although the employer may still use the "rule of parity" for shorter break periods of at least four consecutive weeks. The final rule adopts the averaging method for periods of special unpaid leave, which includes unpaid FMLA, USERRA or jury duty leave. The final rule also requires educational institutions that use a look-back measurement period to follow an averaging method for employment break periods.

5 Permissible employee categories are (1) collectively bargained employees and non-collectively bargained employees, (2) each group of collectively bargained employees covered by a separate collective bargaining agreement, (3) salaried and hourly employees, and (4) employees whose primary places of employment are in different states. 26 CFR § 54.4980H-3(d)(1)(v).

Affordability Safe Harbor

The final rule allows employers to take advantage of one of three safe harbors outlined in the proposed rule to determine whether the health plan they offer is "affordable." A plan will be deemed affordable with respect to a full-time employee if any one of the following safe harbors is satisfied:

- **W-2 safe harbor**: Health coverage is deemed affordable if that employee's required contribution for the calendar year for the employer's lowest cost self-only coverage that provides "minimum value" during the entire calendar year (excluding COBRA or other continuation coverage) does not exceed 9.5% of that employee's Form W-2 wages from the employer for the calendar year. The IRS rejected requests to use the wages from the prior year's W-2 instead of the current year's.
- **Rate of pay safe harbor**: Under the rate of pay safe harbor, an offer of coverage is deemed affordable to an hourly employee if the employee's required contribution for the calendar month for the lowest cost self-only coverage that provides minimum value does not exceed 9.5% of an amount equal to 130 multiplied by the employee's hourly rate of pay as of the first day of the coverage period (generally the first day of the plan year) or the lowest hourly rate during the calendar month. The final rule allows an employer to use the rate of pay safe harbor even if an hourly employee's rate of pay is reduced during the year. For non-hourly employees, the coverage is treated as affordable for the calendar month if the employee's required contribution for the calendar month for the lowest cost self-only coverage that provides minimum value does not exceed 9.5% of the employee's monthly salary.
- **Federal poverty level safe harbor**: An offer of coverage is deemed affordable if the employee's required contribution for the lowest cost self-only coverage that provides minimum value does not exceed 9.5% of the federal poverty level for a single individual.

Calculation and Payment of the Penalty

The penalty is calculated for each calendar month. For employers not offering minimum essential coverage, the amount of the payment for the month equals the number of full-time employees the employer employed for the month (minus 80 in 2015 and minus 30 thereafter) multiplied by 1/12 of $2,000. Although all entities treated as a single employer under IRC Section 414(b), (c), (m), or (o) with respect to retirement plans are treated as a single employer for purposes of determining large employer status, the penalty is calculated on an individual member company basis. However, if the employer is related to other employers in the controlled group, then the 30-employee exclusion (80-employee exclusion in 2015) from the total number of full-time employees for purposes of calculating the 4980H penalty is allocated ratably (based on each employer's number of full-time employees) among all the related employers.

The penalty will be adjusted for inflation after 2014. The IRS will adopt procedures that ensure employers receive certification that one or more employees have received a premium tax credit. The IRS will contact employers to inform them of their potential liability and provide them an opportunity to respond before any liability is assessed or notice and demand for payment is made. This will occur after the due date for employees to file individual tax returns for the year they are claiming premium tax credits and after the due date for applicable large employers to file the information returns identifying their full-time employees and describing the coverage that was offered.

What Does This Means for Employers?

The release of the final rule and further delay of full implementation of the employer responsibility mandate provide employers with some flexibility in their approach to ACA compliance. Yet, the rules themselves remain complex and present administrative burdens for employers. For employers with 100 or more full-time employees and equivalents, the question of playing versus paying remains a critical issue for 2015. In fact, key strategic decisions will still need to be made this year as will planning for implementation of the strategy. Although the final rules provide some clarity for employers, they do not provide finality. In a number of instances, the IRS noted that it was considering issuing additional guidance on the application of the employer responsibility mandate. Final rules on the related employer reporting requirements are expected shortly. As employers look ahead to 2015, enrollment in the health exchanges or marketplaces for 2014 is still ongoing. The status of health exchange enrollment and the cost of such plans may influence some employers' play-or-pay decisions. When making decisions about the ACA employer responsibility mandate and its impact on workforce and benefits strategy, employers should carefully consider all the related employment, labor and benefits law implications.[6] Release of the final rule does not delay this review or minimize its importance.

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6 *See* Ilyse Schuman, Michael Lotito, Steve Friedman, Barry Hartstein, Linda Jackson, and Tammy McCutchen, *Workplace Policy Institute: The Labor, Employment and Benefits Law Implications of the Affordable Care Act—Are You Prepared?* Littler Report (May 9, 2013), *available at* http://www.littler.com/publication-press/publication/workplace-policy-institute-labor-employment-and-benefits-law-implicati.