# CLIFTON BUDD & DEMARIA, LLP

## WHITE PAPER

## Health Care Reform: IRS Issues Final Regulations on "Pay-or-Play Mandate"

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The IRS has recently issued final regulations on the Pay-or-Play Mandate under the Affordable Care Act. The Pay-or-Play Mandate requires employers with at least 50 full-time employees to offer affordable health care coverage with minimum value (“play”) to its full-time employees or pay a penalty (“pay”). The guidance includes many clarifications to the proposed rules as well as transition rules designed to make it easier for employers to comply with the mandate.

Under proposed regulations issued in December 2012, the Pay-or-Play Mandate was scheduled to become effective on January 1, 2014 but enforcement was delayed until January 1, 2015 pursuant to IRS Notice 2013-45. Under the final regulations, employers with 50-99 full-time employees in 2014 will not have to comply with the Pay-or-Play Mandate until the first day of the plan year beginning in 2016 provided they provide appropriate certifications on a prescribed form. The employer must certify that it has not (i) reduced the size of its workforce from February 9, 2014 – December 31, 2014 to less than 100 employees merely to qualify for this transition relief and (ii) eliminated or materially reduced the health coverage it offered on February 9, 2014. A reduction in force for another purpose will not disqualify the employer from this transition relief.

Employers with at least 100 full-time employees in 2014 are subject to the mandate for the plan year commencing in 2015 subject to transitional rules. Employers with less than 50 full-time employees are not subject to the mandate. The final rules provide sufficient guidance for employers to determine if they are subject to the Pay-or-Play Mandate and which employees should be offered coverage to avoid penalties.

## I. Overview of Pay or Play Mandate

Once the mandate becomes effective, employers with 50 or more full-time and full-time equivalent employees ("FTEs") (who work an average of at least 30 hours/week in the prior calendar year) must pay a penalty or offer affordable healthcare coverage to their full-time employees. Effective for plan years beginning in 2016, coverage must be extended to children (excluding step-children and foster children of such employees but not spouses).

The coverage that is offered must be both:

A. Affordable — A plan is considered affordable if the employee's required contribution for employee-only coverage under the lowest cost option does not exceed 9.5% of (i) the employee's household income for the year, (ii) the employee's W-2 wages from the employer-sponsor as reported in Box 1 (which excludes pre-tax contributions to a 403(b), 401(k) or 457(b) plan, cafeteria plan or transportation fringe benefit plan), (iii) the employee's rate of pay (for hourly employees, multiply the lowest hourly rate earned during a month by 130 hours per month) or (iv) the Federal poverty level for a single individual. If a plan does not satisfy the affordability test, it may be able to do so by adding a low cost option.

B. Minimum Value — The plan must cover at least 60% of the average employee's eligible expenses. It is anticipated that the vast majority of plans will satisfy this requirement.

## II. Penalties

There are two potential penalties that may apply:

A. "A" Penalty — An employer who does not offer coverage to "substantially all" (70% for 2015 and 95% for later years) of its full-time employees and has at least one employee who is certified by an Exchange as eligible for a premium tax credit to help pay for coverage on an Exchange, a penalty under IRC Section 4980(a) will apply ("A Penalty"). The monthly A Penalty is 1/12$^{th}$ of $2,000 per full-time employee disregarding the first 30 employees (80 employees for 2015 if the employer has at least 100 full-time employees in 2014). The A Penalty has the potential to be draconian as the penalty applies to all full-time employees (less 30 or less 80 for 2015) even those with employer-provided coverage and those who do not receive a premium tax credit.

B. "B" Penalty – An employer who offers coverage to "substantially all" of its full-time employees but the coverage is either unaffordable or does not provide minimum value will be subject to a penalty under IRC Section 4980(b) ("B Penalty"). The monthly B Penalty is 1/12$^{th}$ of $3,000 per full-time employee who receives a premium tax credit. The B Penalty may not exceed the A Penalty described above. The B Penalty is more manageable than the A Penalty as it only applies to full-time employees who receive a premium tax credit.

In order to avoid the A Penalty described above, an employer must offer coverage to substantially all of its employees. Merely offering coverage during collective bargaining negotiations is not sufficient. However, an employer who is required to contribute to a Taft-Hartley health fund (whether a multiemployer or single employer plan) will be considered to be offering health coverage to those for whom it must make contributions. Such an employer will not be liable for the B Penalty if the plan is affordable, provides minimum value and offers coverage to dependents. This transitional a rule will apply until a date that is no earlier than January 1 of the calendar year beginning at least six months after new guidance is issued. It appears that to qualify for this transitional rule, the plan must offer coverage to dependents even though dependent coverage is generally not required until the 2016 plan year (see Section VI).

## III. Determining Applicable Large Employer Status

To determine if an employer is an "applicable large employer" subject to the Pay-or-Play Mandate, the employer should:

A. Determine the Controlled Group of Employers — Companies that have a common owner or are otherwise related generally are combined together for purposes of determining if they employ at least 50 full-time equivalent employees.

There are two types of related entities:

(i) Parent-Subsidiary Group — One or more chains or organizations are connected through ownership of a controlling interest of at least 80%.

(ii) Brother-Sister Group — The same five or few individuals own, directly or constructively, a controlling (80% or more) interest in each organization and taking into account the ownership of each such person only to the extent it is identical with respect to each such organization, such individuals are in effective control (more than 50%) of the organization.

These rules are very complicated and require a detailed review of relationships between the individuals involved, the shares each holds, any stock that is held by a qualified retirement plan and any shares subject to substantial restrictions. This analysis may already have been done to determine required coverage for qualified retirement plans.

B. Determine if the Controlled Group is an Applicable Large Employer — An employer is an applicable large employer subject to the Pay or Play Mandate if, for any calendar year it (and other members of its controlled group on an aggregate basis) employed an average of at least 50 full-time employees (including FTEs) on business days during the preceding calendar year. A full-time employee is one who works 30 hours/week. Once the number of full-time employees and FTEs for each month is determined, the totals (including fractions) for each month are added and divided by 12 and rounded down to the next lowest whole number. For 2015 only, a shorter period that is at least six consecutive months in 2014 may be used rather than all of 2014. If this transition rule is followed, the aggregate monthly totals for a 6-month period is divided by 6. This shorter period may also be used to determine if an employer has less than 100 employees in 2014.

In making this determination:

(i) Full-Time Equivalent Employees — The number of FTEs for any month is determined by calculating the aggregate number of hours of all employees (including seasonal workers) who were not full-time employees (limited to 120 hours for any employee per month) and dividing by 120. The number of FTEs for any month may be rounded to the nearest one hundredth.

(ii) Exclusions — Sole proprietors, partners, 2% shareholders in a Subchapter-S Corporation, leased employees and employees who worked outside of the U.S. are excluded.

(iii) Non-Hourly Employees — The hours of service for a non-hourly employee may be determined by counting actual hours, a days-worked equivalency (8 hours for each day in which at least one hour is credited) or a weeks-worked equivalency (40 hours for each week in which at least one hour is credited). Equivalencies may not be used if they would substantially understate an employee's hours of service.

(iv) Seasonal Workers — If an employer's workforce exceeds 50 full-time employees (including FTEs) for four months (120 days) or less in the preceding calendar year and the employees in excess of 50 were "seasonal workers," the employer is not an applicable large employer. Seasonal workers include, but are not limited to, holiday workers and agricultural workers. The transitional rule that that allows a six-month measurement period in 2014 does not apply to this “seasonal worker” exception.

## IV. Measurement Methods

Although FTEs are counted in determining whether an employer is subject to the Pay-or-Play Mandate, coverage must only be offered to full-time employees (those who actually work at least 30 hours/week). The final regulations prescribe two methods to determine if an employee is a full-time employee:

A. Monthly Measurement Method — Under the Monthly Measurement Method, an employee's hours of service for each calendar month are counted. If the employee is credited with 130 hours of service for the month, he is considered a full-time employee. This method must be used for any employee who is not a part-time, variable-hour or seasonal employee.

An employer may count hours on a weekly basis. Each week that overlaps two months is consistently assigned to either the month in which it begins or the month in which it ends. Each month will then consist of either four or five weeks. An employee who is credited with 120 hours during a four week month will be considered a full-time employee. For a five week month, the employee must be credited with 150 hours to be considered full-time.

B. Look-Back Measurement Method —It could be problematic to determine eligibility for coverage based on actual hours credited each month as part-time, variable-hour and seasonal employees would drift in and out of coverage. Thus, the final regulations permit an optional look-back measurement method during which it is determined whether an individual is a full-time employee, in which case, he or she will be treated as a full-time employee for a subsequent "stability period." The Look-Back Measurement Method may only be used for part-time, variable-hour and seasonal employees. A seasonal employee is defined as an employee whose customary annual employment is six months or less.

## V. Determining Full-Time Status for Purposes of Offering Health Coverage

A. Current Employees — With respect to part-time, variable-hour and seasonal employees, an employer may use a look-back standard measurement period of 3-12 months to determine if an employee is a full-time employee. If so, he or she is treated as a full-time employee for the stability period regardless of the number of hours worked during the stability period. If not, he or she is not treated as a full-time employee for the stability period. Generally, the stability period must be for at least six months and, if an employee is determined to be a full-time employee, must be at least equal to the standard measurement period.

Different measurement and stability periods may be used for different groups of employees including each group of collectively bargained employees, collectively bargained and non-collectively bargained employees, hourly and salaried employees, employees whose primary places of employment are in different states and different members of the controlled group. Measurement and stability periods may be changed for subsequent periods but may not be changed once the periods have begun.

In order to allow an employer a period of time to determine which employees are eligible for coverage based on the hours credited during the measurement period, notify eligible employees and enroll them if the employee elects coverage, employers may delay coverage for an administrative period of up to 90 days. The administrative period must overlap the prior stability period.

Planning Tip: It is anticipated that most employers will want to have a stability period that corresponds to the plan year of their health plan. Thus, assuming the plan year is calendar year and that the employer needs a two-month administrative period, the employer could elect a standard measurement period beginning on November 1, a stability period equal to the calendar year and an administrative period beginning on November 1. For 2015, the measurement period would run from November 1, 2013 – October 31, 2014, the administrative period would run from November 1, 2014 – December 31, 2014 and the stability period would be 2015. Under the transition rule for 2015, the measurement period could be any six-month period in 2014 such as May 1, 2014 – October 31, 2014.

B. New Employees

(i) Non-Part-Time, Non-Variable-Hour and Non-Seasonal Employees — If an employee is reasonably expected to be a full-time employee when hired, no penalty will be assessed if affordable coverage is offered after a waiting period that does not exceed three full calendar months. The final regulations allow a plan to delay eligibility until the first day of the month following a three-month waiting period. However, if coverage is not offered, the employer may be subject to a penalty for the initial three months as well as subsequent months during which affordable coverage was not offered.

(ii) Part-Time, Variable-Hour, and Seasonal Employees — If it cannot be reasonably determined if an employee will be a full-time employee at his date of hire, the employer may use an initial measurement period of 3-12 months commencing on any date between the employee's start date and the first day of the following month and an administrative period of up to 90 days. The combined measurement and administrative periods must end no later than the last day of the calendar month beginning on or after the employee's first anniversary of his hire date. For example, if an employee is hired on June 1, 2015, the initial measurement period could be as long as June 1, 2015 to May 31, 2016 and the administrative period must end no later than June 30, 2016.

If the employee meets the full-time employee threshold based on the initial measurement period, he or she will be considered full-time for a stability period that is at least six months and that is at least equal to the initial measurement period. If he or she does not meet the threshold, he will not be considered a full-time employee for a stability period that is not more than one month longer than the initial measurement period and does not exceed the remainder of the standard measurement and administrative periods for current employees in which the initial measurement period ends. An exception exists for an employee who does not meet the threshold and has a change in employment status that would reasonably be expected to make the employee a full-time employee. In this case, the employee must be treated as a full-time employee no later than the first day of the fourth month following the change in status or, if earlier, by the first day of the month following the initial measurement period.

Once an employee is employed for an entire standard measurement period, he or she must be tested for full-time employee status based on the standard measurement period and on the same conditions as apply to current employees.

Based on the above example, if the employee meets the full-time employee threshold during the initial measurement period (June 1, 2015 — May 31, 2016), he or she should be offered coverage by July 1, 2016 to avoid any liability for a penalty. The stability period would run until June 30, 2017. As the employee has now been employed for a full standard measurement period (November 1, 2015 — October 31, 2016), his eligibility for the remainder of 2017 and subsequent years should be based on the hours credited in the standard measurement period.

If the employee does not meet the full-time employee threshold in the initial measurement period, he or she will not be considered a full-time employee through December 31, 2016 (end of standard measurement and administrative periods in which the initial measurement period ends). Thereafter, the employee is tested as a current employee.

C. Rehired Employees — A rehired employee may only be treated as a new employee if he or she is not credited with any hours of service for 13 consecutive weeks (26 weeks for an employee of an educational organization). Otherwise, he or she is treated as an ongoing employee and retains his or her prior status as a full-time employee or not for any applicable stability period. An employer may adopt a "Rule of Parity" whereby an employee is treated as a new employee if he is not credited with any hours of service for a period of at least four weeks and the break in service is greater than the employee's prior service.

## VI. Dependent Coverage

In order to avoid a penalty, coverage must be offered to dependents as well as full-time employees. "Dependents" are defined as children, including adopted children but excluding step-children and foster children. Spouses are not considered dependents. If an employer does not currently offer dependent coverage or only offers it to some employees, the requirement to cover dependents will not apply until the 2016 plan year as long as the employer is taking steps to provide coverage starting with the 2016 plan year.

## VII. Conclusion

These rules are complex and the application to your company will depend on many factors including the ownership of the related companies, the plan years of the health plans you offer, the types of employees you employ and the recordkeeping systems you have in place. Although no employer is required to provide health coverage to any employee, in order to evaluate if it is beneficial to extend coverage or risk possible penalties, it is necessary to determine if the Pay or Play Mandate applies and, if so, which employees might give rise to penalties.

If you have any questions on the application of these rules to your company, employees, and plans or have any questions regarding this newsletter, please contact Eva Rasmussen (earasmussen@cbdm.com), or Richard Muser (rkmuser@cbdm.com) lead attorneys at CB&D's employee benefits, executive compensation and ERISA litigation group.