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REFORM Update

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The Internal Revenue Service (IRS) recently released final shared responsibility regulations. The shared responsibility provisions are more commonly referred to as the employer mandate or "play or pay" rules. Initial proposed regulations were released in January 2013. We addressed these rules in our *Reform Update* at http://www.mcgrawwentworth.com/Reform_Update/2013/Reform_Update_57.pdf.

In July, the IRS delayed the application of penalties until 2015. The delayed penalties created uncertainty in how some employers should comply with the shared responsibility requirements.

The final rules clarify many employer questions regarding these requirements. This *Reform Update* will summarize the following key topics:

- Background
- Delays/Modifications for 2015
- Applicable Large Employers
- Hours of Service
- Determining Full-Time Employee Status
- Seasonal Employees
- Penalties
- Non-traditional Employees
- Action Steps

These final rules make changes to some of the provisions included in the initial proposed regulations. Employers need to understand these rules to meet the requirements of the “play or pay” mandate.

Background

The shared responsibility provisions require employers to offer minimum essential coverage (MEC) to substantially all full-time employees (and dependent children) or be subject to a mandate penalty. Employers that offer substantially all full-time employees and dependent children MEC may also be penalized. This penalty depends on the coverage offered. If coverage is not affordable or does not provide minimum value, an employer can be penalized for each employee that purchases subsidized coverage in the Exchange.

These requirements seem straightforward, but they have created a number of issues for employers. First, full-time is defined as working 30 or more hours per week. Many employers currently define full-time as something higher than 30 hours per week. These employers have a decision to make regarding which employees will be offered coverage. Some employers do not measure hours worked and simply base employee pay on another metric. These employers need to figure out a way to track hours.

Each employer has likely identified their issues relating to complying with the shared responsibility regulations. The penalty delay for 2014 provided additional time for employers to make decisions regarding these requirements. These final regulations provide more details and examples to help employers fully understand the impact of these requirements.

Delays/Modifications for 2015

The final regulations provide an additional delay in the "play or pay" penalties. If an employer qualifies for the delay in penalties, no penalties will be assessed related to any "play or pay" requirements in 2015.

Penalties Delayed for Employers (50-99 employees)

A number of provisions must be met for an employer to qualify for this delay. The following summarizes these requirements:

- The 50-99 determination is made based on IRS controlled group rules.
- The 50-99 determination is made in the same manner as the 50 or more determination for an applicable large employer. Full-time employees and full-time equivalent employees are counted.
- To be eligible for this delay, the employer must certify that it meets the following conditions:
    - **Limited Workforce Size** – certify your full-time employees and equivalents fall between 50-99.
    - **Maintenance of Workforce and Aggregate Hours of Service** – From February 9, 2014 to December 31, 2014, the employer may not reduce the size of their workforce or overall hours of service worked in order to qualify for this transitional relief. A reduction is permitted if it is the result of a bona fide business reason.
    - **Maintenance of Previously Offered Health Coverage** - From February 9, 2014 to December 31, 2015, the employer does not eliminate or materially reduce health care coverage that was offered as of February 9, 2014. For non-calendar year plans, the reduction in health care coverage cannot occur before the last day of the 2015 plan year. An employer will not be treated as eliminating or reducing coverage if:
        - It continues to offer employer funding for coverage that is at least 95% of the employer contribution on February 9, 2014, or the employer offers the same contribution percentage.
        - If benefits are modified, the plan retains minimum value after any benefit changes.
        - The employer does not alter the terms of eligibility for the group health plan to narrow or reduce the class of employees or dependents offered coverage under the plan as of February 9, 2014.

The certification process will be included in the final regulations related to the employer reporting requirements under Section 6056.

Reduced "Substantially All" Threshold for Employers with 100 or More Employees

The final regulations also include a modification for employers with 100 or more employees in 2015. The penalty determination has been modified for 2015 only. To avoid the $2,000 per employee penalty, an employer must offer "substantially all" full-time employees and their children MEC. "Substantially all" was defined as 95 percent of full-time employees. However, for 2015, it has been reduced to 70 percent of full-time employees. Please note, the $3,000 penalty can still apply. The penalty can apply if any of the 30% of full-time employees not offered coverage, purchases subsidized coverage through the state Exchange.

It can also still apply if a full-time employee is not offered affordable, minimum value coverage and purchases subsidized coverage through the state Exchange.

Non-Calendar Year Plan Transitional Guidance

The final rules retained the transitional guidance with a few changes for 2015. As long as certain conditions are met, non-calendar year plans can comply with "play or pay" on their plan year. This relief applies to non-calendar year plans as of December 27, 2012 and only if the plan year was not modified after December 27, 2012.

In order to be eligible to delay compliance to the first day of the plan year, employers must meet *one* of the following two tests:

1. Did the plan offer coverage to at least 33 percent of all employees at the most recent open enrollment period before February 9, 2014?

   OR

2. Did the plan *cover* at least 25 percent of all employees? For this test, employers can use enrollment as of any date between February 10, 2013 and February 9, 2014.

The final regulations allow employers to conduct these tests on full-time employees only, however, different percentages apply:

1. Did the plan offer coverage to at least **50 percent of all full-time employees** at the most recent open enrollment period before February 9, 2014?

   OR

2. Did the plan *cover* at least **33 percent of all full-time employees?** For this test, employers can use enrollment as of any date between February 10, 2013 and February 9, 2014.

The employer will not pay a penalty for the initial part of 2015 if substantially all full-time employees are offered minimum value affordable coverage on the first day of the 2015 plan year. The "substantially all" measure is determined by the transitional guidance mentioned above. Threshold of full-time employees considered "substantially all" is 70% in 2015 and 95% in 2016.

Applicable Large Employers

Applicable large employers are employers that employed at least 50 full-time and full-time equivalent employees on the business days in the preceding calendar year. The employer is determined by IRS controlled group rules.

The final rules adopt the proposed rules approach to calculating full-time equivalents. Basically, employers will add the hours of service each month for all part-time employees (30 hours or less per week) and divide by 120. The final regulations allow employers to round the monthly full-time equivalent calculation to the nearest one hundredth. In addition, once the full-time employees are added to the full-time equivalents each month in the year, the employer can round down its year-end sum of full-time workers.

Employers can use the methods described in the next section to determine the hours of service for non-hourly employees. If an employer uses an equivalency method, it cannot substantially understate the hours worked.

The final rules include a number of modifications to the determining applicable large employer status. If an employer was not in existence in the preceding calendar year, the determination of applicable large employer is based on the average number of employees that the employer is reasonably expected to employ in the current calendar year. An employer will only be treated as if it was not in existence in the preceding calendar year if the employer was not in existence on any business day in that preceding calendar year. For example, if an employer is in existence on May 1 of Year 1, the employer's status as an applicable large employer is determined based on the average number of employees that it is expected to employ in Year 1. To determine applicable large employer status in Year 2, the employer would look at the number of employees employed on business days between May 1 and December 31 of Year 1.

An employer is not considered an applicable large employer if:

- The employer's workforce exceeds 50 full-time employees for 120 days or fewer during the calendar year, ***and***
- The employees in excess of 50 employed during that 120 days are seasonal workers.

The IRS is continuing to develop rules for identifying predecessor and successor employers for the applicable large employer determination. Until rules are issued, employers can rely on a good faith interpretation of predecessor and successor employer rules developed in the employment tax context.

Transitional relief has been included for applicable large employer status determinations for the first year of "play or pay" applicability. The government recognizes that new employers may need time to determine large employer status and to apply for health coverage for the first time. As a result, this transition relief applies **only** during the first year an employer is an applicable large employer. If a current applicable large employer falls below 50 in future years and then expands to become an applicable large employer again, this transition relief will not apply at that point.

The relief provides these first-time large employers more time to establish a group health plan.

- An employer will not be subject to the $2,000 penalty for January through March if the applicable large employer offers coverage no later than April 1st in the **first year** the employer is an applicable large employer.
- An employer will not be subject to the $3,000 penalty for January through March if the applicable large employer offers **minimum value** coverage no later than April 1st in the first year the employer is an applicable large employer. If the employer fails to offer minimum value coverage as of April 1st, the employer will be subject to this penalty from January on if any full-time employees are covered by subsidized coverage in the Exchange.

The transitional relief from the proposed regulations was extended to 2015. For the 2015 calendar year, an employer may determine its status as an applicable large employer by reference to a period of at least six consecutive calendar months as chosen by the employer during the 2014 calendar year. This transitional rule can also be used to determine if an employer has 50-99 full-time employees and equivalents to qualify for the delay in penalties until 2016.

Hours of Service

Hours of service are a critical concept for compliance with the "play or pay" mandate. Hours of services are counted to determine applicable large employer status. They are also counted to determine full-time status for coverage eligibility or application of penalties.

The final regulations retained the definition of hours of service:

> **An hour of service is an hour for which an employee is paid or entitled to payment for the performance of duties for the employer. It is also each hour an employee is paid or entitled to payment for 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.**

For employees paid on an hourly basis, an employer is required to calculate the actual hours of service worked or for which payment is made. For employees paid on a non-hourly basis, like salaried employees, employers can calculate the actual hours worked or apply a days-worked or weeks-worked equivalency. For the days-worked equivalency, if one hour of service is required to be credited per day, the individual is credited with eight hours of service that day. For the weeks-worked equivalency, the employee is credited with 40 hours per week, if the employee is required to be credited one hour of service during that week. Equivalency methods can't be used if they substantially understate the employee's hours of service in a manner that would cause the employee not to be treated as full-time.

The final rules clarify that the employee does not need to work one hour of service for the equivalency methods. The employee must be credited with an hour of service, even if no services are performed, if the employer is required to make payment.

Employers can change the approach to calculating non-hourly employees' hours of service each calendar year. Employers may apply different methods to calculating non-hourly employees' hours of service for different categories of employees, as long as the categories are reasonable and consistently applied.

The final rules include specific exclusions to the definition of hours of service:

1. **Bona Fide Volunteers** – Bona fide volunteers include an employee of a government entity or a Section 501(c) organization that is exempt from taxation under 501(a), whose only compensation from that entity is in the form of:
    - Reasonable reimbursement for expenses incurred in the performance of services by volunteers
    - Reasonable benefits (including length of service awards)
    - Nominal fees customarily paid by similar entities in connection with service performed by volunteers
2. **Student Employees** – Student employees are students in positions subsidized through the federal work study program or a substantially similar state program. This is **not** a general exception for student employees. The final regulations also address the treatment of internships and externships. Hours of service for an intern or extern are not counted if the intern or extern does not receive or is not entitled to receive payment for their hours of service. If an intern or extern is entitled to receive payment for hours of service, those hours must be counted to determine full-time status.
3. **Religious Orders** – The IRS is considering additional rules for certain categories of employees that are particularly difficult to identify or track. Hours worked by members of religious orders are mentioned in the final regulations. Until further guidance is released, a religious order is permitted to disallow as hours of service any work performed by an individual who is subject to a vow of poverty as a member of the order, for tasks that are usually required of an active member of the order.
4. **Compensation That is Taxed as Income from Sources Outside the United States** – Any hours worked that are compensated and taxed as income from sources outside the United States are not considered hours of service. The final regulations clarify that this rule applies to transportation workers, such as employees of cruise ships.

The regulations note that the Treasury Department is considering additional rules for determination of hours of service with respect to certain categories of employees. These categories include adjunct faculty, commissioned salespeople and airline employees. They are also considering additional rules for categories of hours worked by certain employees, such as layover hours for airline employees and on-call hours. Until guidance is issued, employers are required to use a reasonable method for crediting hours. A method is not reasonable if it takes into account only a portion of the hours worked with the effect of categorizing the employee as part-time.

Determining Full-Time Employee Status

Employers will have to determine whether an employee works full-time (30 hours or more per week). This will be needed to determine whether health plan coverage will be offered or if a penalty will apply. In addition, employers will need to indicate if an employee is full-time for the reporting requirements that will apply in 2015.

The final regulations adopt the determination of an employee based upon the common law standard. As a result, the definition of employee does not include a leased employee, a sole proprietor, a partner in a partnership, a 2 percent S-corporation shareholder, or a worker described by Section 3508. The Section 3508 workers were added to the final regulations. Section 3508 identifies categories of workers not treated as employees under any section of the Internal Revenue Code. These individuals include real estate agents and direct sellers.

The final regulations provide two methods to determine full-time status:

- Monthly measurement method
- Look-back measurement method

These methods outline the minimum standards employers can adopt to determine an employee's full-time status. Under both of these measurement methods, an employer can use a standard of 130 hours of service per calendar month to determine full-time.

If an employee works for two related employers in an IRS controlled group, the hours of service must be added from the two employers to determine full-time status.

Employers can vary the measurement method they use on different employees. However, the final regulations limit the classes in which employers can vary measurement methods to:

- Hourly and salaried
- Union and non-union
- Employees in different states
- Employees in different collective bargaining units.

Employers should document their measurement approaches. It is not required by law, but a good practice as part of defining how full-time employment is determined.

Monthly Measurement Method

Full-time employees that are reasonably expected to work 30 hours or more per week should be measured using this monthly method. Full-time hours are determined based on whether or not an employee works 130 hours of service per month or 30 hours per week. These employees generally are expected to work on a full-time basis. The employer measures the first three calendar months of employment. If the employee works 30 or more hours of service per week, the employer must offer coverage as of the 91st day of employment. The penalty will be applied as of the first of the month following three calendar months of employment. The employer will not be subject to the mandate penalty for the failure to offer coverage for the first three calendar months of employment. The employer may be subjected to the Adequate Coverage penalty outlined in the next section. If an employer fails to offer minimum value after the 90 days of employment, the Adequate Coverage penalty may apply as of the first month of employment.

The final rules also allow employers to base their measurements on weekly payroll periods. If the weekly pay period includes the first of the month, then the weekly pay period that includes the last day of month does not need to be included in the measurement month. The inverse is also true. If the weekly pay period does not include the first of the month, then the weekly pay period that includes the last day of the month must be included in the measurement period.

If an employer offers coverage mid-month to a full-time employee, that partial month is not counted when determining potential penalties. For penalty calculations, an employee must be covered for the entire calendar month to be considered as having been offered coverage.

Look-Back Measurement Method

The look-back measurement method is a good fit for measuring variable hour, part-time and seasonal employees. Seasonal employees are defined by the final regulations and discussed in more detail in the next section.

Since the final regulations limit when different measurement approaches can be used, an employer may end up with regularly scheduled and variable hour employees in a look-back measurement period. Within this look-back measurement approach, if an employee is regularly scheduled to work 30 or more hours per week, they will **not** be included in the initial measurement periods discussed below. These employees need to be offered coverage as of their 91st day of employment. If the employee continues as an employee, he or she will be measured as part of the next standard measurement period. If these employees have set schedules, they will always measure at or above the 30 hours threshold.

This is an added confusion included in the final regulations. An example will help. ABC Company has both salaried and hourly employees. Hourly employees are divided into two classes. Corporate hourly employees are regularly scheduled to work 38 hours per week. Plant hourly employees have variable hours. One week they may work 20 hours and another 40 hours depending on production schedules. ABC Company will use the monthly measurement method for salaried employees and the look-back measurement method for hourly.

Corporate hourly are regularly scheduled 38 hours per week. Newly hired corporate hourly must be offered coverage as of the 91st day of full-time employment. They need to be included in the next standard measurement period. They will be measured as ongoing employees going forward. With a set schedule, they will always measure as full-time. Plant hourly employees are not predictable from an hours worked perspective. Newly hired plant hourly employees will be measured according to the initial measurement periods indicated below. It is not clear at the point of hire whether they will work 30 or more hours per week. If they maintain employment, they will roll into the next standard measurement period for ongoing employees. Determining full-time status on ABC hourly employees will be a process determined by the measurement period. Coverage will be offered to all full-time employees (working 30 or more hours per week) during the corresponding stability periods.

This method is intended to provide a time period to measure hours of service when an employer is not sure whether an employee will work 30 hours or more per week. An employer may not take into account the likelihood that an employee may terminate employment before the end of the initial measurement period when determining if the employee is variable hour.

The employer determination of whether an employee would be considered full-time at the start date is a facts and circumstances decision. Factors to consider include but are not limited to:

- Is the employee replacing an employee that worked full-time?
- Are employees in the same or comparable positions full-time?
- Was the job advertised or otherwise documented as requiring 30 or more hours of service per week?

If the employer can't determine if the employee will be working 30 or more hours per week, a measurement period must be used to determine full-time status. The final regulations maintained the approach of employers setting measurement periods, optional administrative periods and stability periods. Employers need to set these time periods for ongoing employees and newly hired employees. The purpose of each is as follows:

- **Measurement period** – time period an employer sets to measure the hours of service for employees that are variable hour or seasonal.
- **Administrative period** – optional time period an employer sets to communicate to employees they are eligible for coverage and provide time for employee to enroll in plan. It begins at the end of the measurement period and ends at the beginning of the stability period.
- **Stability period** - time period an employer sets that they must provide coverage if an employee averages 30 or more hours of service during the measurement period. If an employer does not offer coverage to employees, it is the time period the employee will be considered full-time for penalty payments.

Rules apply to how each of these time periods are set. Different rules apply to ongoing employees and newly hired employees. Ongoing employees are employees that are employed as of the first day of the standard measurement period. Each year they are measured during the standard measurement period.

Rules for Ongoing Employees

Standard Measurement Period

- Employers can base measurement periods on pay periods
- Must be at least 3 but no more than 12 consecutive months

Standard Administrative Period

- Administrative period is optional
- Administrative period can be up to 90 days

Standard Stability Period

- Must be the greater of:
  - at least 6 consecutive calendar months
  - the length of the established standard measurement period
- Stability period or periods must cover entire year – such that ongoing employees that continue to work full time for the employer will have continuous coverage. Stability periods will overlap with administrative periods to ensure continuous coverage.
- Stability period must begin at the end of the measurement period or at the end of the administrative period, if the employer chooses to have one.

Rules for Newly Hired Employees

If the employees' hours don't vary, they must be offered coverage no later than the 91st day of full-time employment. If the employees' hours vary and the employer does not know if the employee will work 30 or more hours per week, the initial measurement period will apply.

Rules for Newly Hired Variable Hour and Seasonal Employees

Initial Measurement Period

- Must be between 3 and 12 months (final regulations do not require the months to be calendar months) – for example, the period can run from March 15 to March 14)
- Must be measured from the date of hire or first of the month following the date of hire. The final regulations note that if the employer measures from the first of the month following the date of hire, the time between the date of hire and first of the month is considered part of the administrative period.

Initial Administrative Period

- Up to 90 days permitted
- Combined measurement period and administrative period can't be more than 13 months measured from first of month following start date (so if the employer is using a 12-month measurement period, the maximum administrative period is one month)

Initial Stability Period

- Must be the same length (number of months) as the ongoing variable/seasonal employees
- Must be calendar months
- Must immediately follow the measurement period or administrative period if the employer chooses to have one

If there is a gap between the initial stability period and the next ongoing employee stability period, the employee has to be treated as the type of employee determined by the initial measurement period until the beginning of the next ongoing stability period. If a variable hour employee is determined to be full-time during the initial measurement period, that employee needs to be treated as full-time until the beginning of next ongoing stability period if there is a gap between the two.

The final regulations include a number of examples of measuring hours of service. Several of these examples are summarized below:

- ABC Company uses a 12-month initial measurement period followed by 1+ month administrative period for newly hired variable hour employees. The hours are measured from the start date. Administrative period is included from the end of the measurement period. The initial measurement period and administrative period is 13 months plus the partial month since the measurement period begins on the start date.

  ABC hires Employee A on May 10, 2015. Employee A's measurement period runs from May 10, 2015, through May 9, 2016. The administrative period will run from May 10, 2016 through June 30, 2016. Employee A works 35 hours per week on average during the measurement period. Employee A must be offered coverage for the initial stability period which runs from July 1, 2016, through June 30, 2017. The coverage offered is affordable, minimum value coverage.

  ABC will not be subject to any penalties because their measurement, administrative, and stability periods all meet the requirements outlined in the final rules.

- Same facts as the example above, but Employee A continues to work for ABC Company. ABC Company's standard measurement period runs from October 15 through October 14 each year. ABC's administrative period runs from October 15 through December 31 each year. The stability period runs from January through December each year. Employee A is measured in the standard measurement period from October 15, 2015 through October 14, 2016. For this time period Employee A only works 28 hours per week on average. She does not qualify for coverage under the stability period running from January 1, 2017 through December 31, 2017. However, as a result of her initial measurement period, she earned coverage through June 30, 2017. ABC will terminate her coverage on June 30, 2017 and offer COBRA.

  ABC will not be subject to any penalties because their measurement, administrative, and stability periods all meet the requirements outlined in the final rules.

Transitional Guidance Extended

The Departments extended the transitional guidance for setting measurement periods in 2014. The final regulations update this guidance for the delayed application of penalties until 2015.

For the purposes of stability periods beginning in 2015:

- The measurement period beginning in 2014 can be shorter than 12 consecutive months, but must be at least six months.
- If the shortened measurement period is used, it must begin no later than July 1, 2014 and end no earlier than 90 days before the first day of the first plan year beginning on or after January 1, 2015.

The goal for the transitional guidance is to allow employers to align stability periods with plan renewals. For example, let's say an employer has a plan year that runs from April 1 through March 31 and wants to include a 90-day administrative period. This employer could use a measurement period for 2014 only that begins on July 1, 2014, and runs through December 31, 2014. The administrative period would end on March 31, 2014. The stability period would begin on April 1, 2015. The stability period can be 12 months.

In another example, the employer's plan year runs from July 1 through June 30. In this case, the 2014 measurement period would have to exceed six months to comply with the requirement that it begin no later

than July 1, 2014. This employer could start the 2014 measurement period on June 15, 2014. It would end on April 14, 2015. The employer could include an administrative period that runs from April 15 through June 30. The stability period would begin on July 1, 2015.

As a part of this transitional relief, in the first year only, an employer can have a shortened measurement period. In the example above, if the employer wanted a 12 month period for 2014, they could adopt a measurement period of April 15, 2014 through April 14, 2015.

Special Unpaid Leave Rules

For certain unpaid leaves, employers are required to credit service when using the look-back measurement period. These leaves include:

- Family Medical Leave Act (FMLA)
- Uniformed Services Employment and Reemployment Rights Act (USERRA)
- Jury Duty

The final rule retained the two options for crediting service:

1. Determine the average hours of work per week based on the time the employee spent in active service. This average disregards any time spent on a special leave.
2. Credit the hours of service during the special leave at the same rate in which hours were credited during the time spent actively employed during the measurement period.

Breaks in Service

Employers need to understand how to treat breaks in service when determining full-time status. A break in service is a period of time where zero hours of service are credited. The final regulations reduced the break in service time required before an employee can be treated as a new hire. The proposed regulations had the break in service time set at 26 weeks. Final regulations reduce that time period to 13 weeks. If an employee has a break in service that lasts 13 weeks or longer, an employer can treat that employee as a new hire upon return to work. This lowered break in service period **does not** apply to educational institutions.

The final regulations also maintained the rule of parity. An employee can be treated as a new hire if a break in service lasts at least 4 consecutive weeks, and is longer than the immediately preceding period of employment. For example, if an employee worked for 6 weeks and then had a break in service of eight weeks, that employee could be treated as a new hire upon return to work after the 8 week break.

If a break in service is not long enough to warrant an employee being treated as a new hire, the employee is considered a continuing employee upon return to work. If the employee is eligible for coverage (either by virtue of the monthly measurement period or a stability period), coverage needs to be reinstated as soon as practical. As soon as practical is defined as no later than the first of the month following the return to work. If an employee was in a look-back measurement period, the employee will return to the measurement period and the employer can record zero hours of service while the employee was on the break of service.

Change in Employment Status

In some situations, an employee may change employment status during the year. The final regulations include more detail on how to handle a change in status:

- Monthly Measurement Periods
    - Regular full-time employee works 30 hours per week. The employee is offered and elects coverage under the employer plan after 90 days of employment. The employee changes to a regular part-time position, working 21 hours per week. The employee will be working 3 days a week/7 hours per day. The employer can terminate coverage because of the change in employment status after the employee measures part time for the 90 days following change in status. The employer can cancel coverage at that point and offer this employee COBRA.
    - The inverse is also true. Regular part-time employee increases hours to become a regular full-time employee working 30 or more hours per week. The employer must follow their procedures regarding change in employment status but coverage must be offered as of the 1st of the month following 3 calendar months of full-time employment.
- Look-Back Measurement Period
    - If a variable hour employee moves to a regular full-time employee position (30 hours or more per week), coverage must be offered by the earlier of:
        - The first of the month following 3 calendar months of employment of full-time employment
        - The first of the month following the end of the measurement period or administrative period if applicable, if the employee averaged 30 hours per week during the measurement period.

The final regulations include an example of a change of employment status from variable hour to full-time employee. This example assumes an employer (ABC Company) with 200 full-time employees that offers coverage to full-time employees.

- For new variable hour employees, ABC uses a 12-month initial measurement period that begins on the start date and applies an administrative period from the end of the initial measurement period through the end of the first calendar month beginning on or after the end of the initial measurement period.
- For new variable hour employees, ABC offers coverage no later than the first day of the thirteenth month after the start date if an employee averages 30 or more hours of service per week during the initial measurement period.
- ABC hires Employee A on May 10, 2015. A is a variable hour employee. A's initial measurement period runs from May 10, 2015, through May 9, 2016, with the optional administrative period ending June 30, 2016.
- On September 15, 2015, ABC promotes Employee A to a position that can reasonably be expected to average at least 30 hours of service per week. For October 2015 through December 2015, Employee A works 30 or more hours per week.
- Because of the change in employment status that results in a regular work schedule, A qualifies for coverage sooner than her first stability period begins. To avoid the mandate penalty, ABC needs to offer A coverage as of January 1, 2016. This is the first of the month following 3 calendar months of full-time, regularly scheduled employment. ABC will avoid all penalties if the coverage offered is minimum value, affordable coverage.

Employers need to be careful with mid-year status changes related to employment hours and positions.

Seasonal Employees

The proposed regulations indicated that seasonal employees should be treated as variable hour employees. Full-time status would be determined based on the hours worked during the measurement period. The final regulations retain this approach. The final regulations provide a definition of seasonal employees:

- Customary employment is six months or less per year
- The seasonal work period should begin roughly at the same time each year (for example, summer or winter)

Employers can rely on this definition of seasonal to determine if an employee should be placed in the variable hour category. In most cases, if the employee is seasonal, the break in service rule means the employee will never gain full-time employee status. After a break in service of more than 13 weeks, the seasonal employee would be treated as a new hire when they returned to work.

In certain circumstances, an employer may change the employment status of seasonal employee. If the seasonal employee becomes a variable hour employee, the employer would just continue measuring the hours during the measurement period. If the seasonal employee is hired to a regular full-time position, the employer must offer coverage the earlier of:

- The first of the month following 3 calendar months of employment in the new job position.
- The first of the month following the end of the measurement period or administrative period if applicable, if the employee averaged 30 hours per week during the measurement period.

Penalties

In the initial regulations, an applicable large employer is subject to a penalty if either of the following occurs:

1. **Mandate penalty**: The employer fails to offer substantially all of its full-time employees and their dependents MEC under an employer-sponsored plan and at least one full-time employee is certified as having received an applicable premium tax credit to purchase subsidized coverage in the Exchange.
2. **Adequate Coverage penalty**: The employer offers substantially all of its full-time employees and their dependents MEC but for some employees that coverage is not considered affordable or of minimum value. If any of those employees are certified as having received an applicable premium tax credit to purchase subsidized coverage in the Exchange, a penalty applies.

The penalty amounts differ, depending on the situation.

1. For failing to offer substantially all full-time employees and their dependents MEC, the annual penalty is $2,000 per full-time employee less the first 30. In 2015, the penalty is calculated per full-time employees less the first 80.
2. For failing to offer affordable, minimum value coverage, the annual penalty is $3,000 for each employee that receives premium tax credit to purchase subsidized coverage in the Exchange.

The penalties will be determined at the end of year. They will be assessed monthly at 1/12 the above amounts. While IRS controlled group rules are used to determine applicable large employer status, penalties are assessed based on employer members of controlled groups. Basically, they are determined based on employer identification number (EIN).

To avoid penalties for dependents, coverage must be extended to the end of the month in which a dependent turns age 26. The definition of dependent child is changed by the final regulations. The final rules do not include step-children or foster children in the definition of dependent. The definition of dependent is also changed in regard to children who are not residents or citizens of the United States. The final regulations exclude a child who is not a US citizen or resident from the definition of dependent unless that child is a resident of a country that is contiguous to the United States or is within the exception for adopted children.

The final rules note that employers will not be assessed a penalty if a dependent only secures subsidized coverage in the Exchange.

The final rules also retain the transitional guidance for employers with plans that:

1. Do not offer dependent child coverage
2. Only offer some, but not all dependent children coverage

The transitional relief does not apply if the employer offered dependent child coverage in either the 2013 or 2014 plan year. If an employer did not offer coverage to all dependent children or to just some dependent children, they will have extra time to add coverage on these children. As long as employers are taking steps in 2014 and 2015 to cover the children that were not offered coverage in 2013 and 2014, the employer will have until 2016 to provide access to this coverage.

If an employer fails to offer coverage to a full-time employee for any day in a calendar month, that employee is not treated as being offered coverage for that month. There are two exceptions to this rule:

- If an employee terminates employment and coverage terminates as of the last day worked, employers will be treated as offering coverage for the full month in this situation.
- Only for January 2015, if a large employer offers full-time employee coverage no later than the first day of the first pay period that begins in January 2015, the employer will be treated as offering coverage for January of 2015.

The final regulations also retain the definition of Minimum Essential Coverage (MEC). MEC is employer-sponsored health coverage that **does not** consist solely of excepted benefits. MEC can be an insured or self-funded plan.

Minimum value and affordability are discussed in these regulations. A plan offers minimum value if the plan's share of expenses is expected to be at least 60% or more of the total allowed cost of benefits. Total allowed cost is defined as:

1. Anticipated covered medical spending for essential health benefits paid by the health plan on the standard population
2. Determined in accordance with plan cost-sharing

Plans determine minimum value through a number of options:

- Use of the minimum value calculator

- Through one of the safe harbors being established by the IRS
- Securing an actuarial certification if neither of the above options is feasible

Plans offered in the small group market satisfy minimum value if they meet the requirements for any metal tier (platinum, gold, silver and bronze).

Affordability is also addressed in these rules. Coverage is determined affordable if the cost for employee only coverage does not exceed 9.5% of the employee's household income. Employers do not have access to household income. Three safe harbors have been established for employers to determine if their contributions are affordable. If the employer passes a designated safe harbor, no penalties will be assessed, even if the employee secures subsidized coverage in the Exchange. These safe harbors are optional.

The new rules provide added details to the safe harbors:

- **W-2:** This safe harbor applies based on W-2 wages as of the end of the year. The final regulations maintain that affordability is based on earnings reported in Box 1. The final regulations retained the ability to pro-rate for employment or coverage based on a partial year.
- **Rate of Pay:** The final regulations allow affordability to be calculated based on employee rate of pay. For salaried employees, affordability is calculated based on monthly salary. For hourly employees, the hourly rate is multiplied by 130 to determine monthly salary. The proposed regulations did not allow an employer to use this safe harbor if the rate of pay was reduced during the year. The final regulations allow the rate of pay safe harbor to be used even with a mid-year reduction in the rate of pay. If there is a reduction in pay, affordability is calculated based on the lowest wage for the year.
- **Federal Poverty Limit (FPL):** The FPL option was maintained. An employer passes affordability on all employees if their plan passes based on the FPL. The final regulations allow employers to rely on the FPL in effect six months prior to the beginning of the plan year. This allows employers to use the FPL method and plan accordingly for open enrollment.

Remember, the minimum value and affordability tests only need to be passed on one plan option offered by the employer. The employee must be eligible for the plan that passes.

Non-traditional Employees

The final regulations address certain employees directly. These are employees that present a challenge to their employers when tracking hours of service. The general requirement is that an employer must use a reasonable method to track hours of service. A reasonable method is determined by the facts and circumstances of each situation. Additional details are provided for the specific employees, as noted below.

Adjunct Faculty

Until further guidance is issued, one reasonable method for calculating the hours of service for adjunct faculty member would be to use 2.25 hours of service per week for each hour of teaching or classroom time. The additional time credited would reflect the time spent preparing for class, grading papers, etc.

Airline Employees

It is common for certain employees to have layover hours associated with their job functions. An employer must count a layover hour as an hour of service if the employee receives compensation for the layover hour. If an employer counts the layover hour toward the required service to earn regular compensation, then the layover hour must be counted as an hour of service. For example, if an employer required 40

hours of work per week to earn full compensation, and layover hours are counted in determining the 40 hours, they must be counted as hours of service to determine full-time status.

If an employer does not compensate for layover hours or these hours are not counted as hours worked to receive full compensation, the employer can adopt a reasonable approach to counting hours. The final regulations indicate it would be reasonable to credit an employee in the airline industry with eight hours of service for each day an employee is required to stay away from home overnight for business reasons. For a one night stay, it would total 16 hours, eight hours each for the two days encompassing the overnight stay. If this crediting of eight hours substantially understates actual hours of service, the employer must count actual hours of service.

On-Call Employees

Employers need to use a reasonable method for counting on-call hours as hours of service. If an employer compensates an employee for on-call hours, those hours must be counted as hours of service. If an employee is required to remain on the employer's premises for on-call hours, those hours must be counted as hours of service. If the employee's activities while remaining on call are subject to substantial restrictions that prevent the employee from using that time for the employee's own purposes, those on-call hours needs to be counted as hours of service.

Employees Covered by Union Trust Plans or Multiple Employer Welfare Arrangements

Employers were uncertain how to treat employees covered by union plans and not employer-sponsored health plans. The proposed regulations included transitional guidance that allowed employers to avoid penalties for employees covered by these plans as long as specific requirements were met in 2014.

The final regulations adopted transition relief on multi-employer plans, until the IRS issues additional guidance on these plans. A large employer will not be subject to the "no coverage" penalty for failing to offer coverage if:

1. The employer is required to make a contribution to a multi-employer or union plan for full-time employees pursuant to a collective bargaining agreement, and
2. The coverage under the plan is offered to full-time employees and their dependent child(ren), and
3. The waiting period for new hires does not exceed 90 days.

If coverage under the union plan passes benefits and affordability tests, the employer will not be subject to the "Not Adequate Coverage" penalty.

Temporary Staffing Employees

The final regulations provide additional details to help staffing firms determine full-time employee status. Temporary staffing firms will need to determine if any of their employees can be treated as variable hour employees. The staffing firm must review the following factors in determining if an employee being placed in a temporary assignment at a client organization is considered a variable hour employee. The first step is to review the typical experience of an employee in the position the employer is trying to determine is variable hour.

- Does the typical employee experience involve set hours or variability in schedule?
- Does the employee retain the right to reject temporary placements that are offered?
- Do employees in the same position typically have periods in which no offers of temporary placement are made?

- Do employees in the same position typically have temporary placements offered for differing lengths of time?
- Does the typical temporary placement not exceed 13 weeks?

No one of these factors is determinative. An employee may be classified as variable hour if that classification is appropriate based on the employer's reasonable expectation at the start date.

Temporary staffing firms also have breaks in service more often than other types of employers. Sometimes it is difficult for these firms to determine when an employee has separated from service. Until further guidance is issued, all employers may determine when an employee separates from service based on the facts and circumstances, using a reasonable method that is consistent with employer practices.

The regulators continue to be alert to temporary staffing employers trying to sidestep the shared responsibility requirements. The final regulations maintained the rules relating to staffing firms splitting hours with other firms to keep work hours under 30 hours per week for each firm. If hours are split to avoid compliance, one of the firms will be treated as the employer for the "play or pay" rules.

Educational Employees

Special rules are included for employees of educational institutions. First, an educational institution cannot take into account the potential for an employment break period in determining the expectations of future hours when evaluating full-time employment status. An employment break period is a period of four consecutive weeks with no hours of credited service.

Special employment break period rules will apply for educational institutions to help them determine hours of service. An educational institution must either:

1. Determine average hours of service during the measurement period, excluding the employment break. The employer should use those average hours for the entire measurement period.
2. Credit hours of service during the employment break at a rate equal to the average weekly rate during the measurement period, not taking into account the employment break.

The educational institution does not need to credit more than 501 hours of service for any employment break. The 501 hours of service does not take into account any time off for special unpaid leave (FMLA, USERRA and jury duty).

Educational institutions also maintained the 26 week break in service requirement. This means the employee of an educational institution must have 26 weeks of no hours of service to be treated as a new hire upon return to work.

H-2A and H-2B Visa Holders

H-2A and H-2B visa holders are not excluded from the definition of employee in the "play or pay" requirements. These employees are treated as any other employee in determining full-time status.

The IRS is committed to addressing these unusual employee situations. Until additional guidance is issued, employers need to use a reasonable method to track hours of service.

Action Steps

These final regulations made changes to the proposed rules. Most employers were taking steps to comply with the proposed rules when the penalties were delayed for 2014. The delay left some plans in limbo as employers were unsure what transitional guidance would roll over for 2014/2015. These final regulations provide clarity on those issues.

First step for employers is to determine when penalties will apply to their plans. If your organization falls into the 50-99 category and is eligible for another year of delayed penalties, you will need to watch for the certification process.

All other employers need to move forward on identifying their full-time employees. The final rules offer two methods for calculating hours of service per week or month. The employer is limited in applying different methods to specific classes of employees noted by the regulations. Employers that use the look-back measurement option for variable hour, part-time and seasonal employees will need to develop communications for employees. These employees should understand that the measurement timeframes will determine full-time employment status for eligibility for the health plan. Communication pieces should include one for employees that will be eligible for health plan coverage and one for those who will not be eligible.

Employers also need to evaluate if they will offer coverage to all full-time employees. Transitional guidance provides some relief in 2015. Large employers will only have to offer coverage to 70% of full-time employees and their dependent children to avoid the $2,000 mandate penalty.

Employers should review their dependent coverage. The final rules allow employers to exclude step-children and foster children from the definition of dependent child. Also, in order to avoid penalties, employers should extend coverage to the end of the month in which a child turns 26.

Employers who currently have segments of employees that are not offered coverage will need to make difficult decisions. Employers will have to choose to offer coverage, be subject to the penalty, or reduce work hours below 30 hours per week.

Employers should be working through these issues now as many will need to set up measurement period and stability periods for determining full time status.