Analysis of the Final Employer Shared Responsibility Rules under the Patient Protection and Affordable Care Act (Internal Revenue Code section 4980H)

On February 10, 2014, the federal Department of Treasury released the final rules on compliance with the employer shared responsibility requirements under the health reform law, which is often referred to as the law's employer mandate provisions. The rules will take effect generally on January 1, 2015 The Department of Treasury also has a web page available offering more guidance on the rules and determining employer eligibility.

The final rules provide a number of important changes from the proposed rules issued in December 2012, and provide a great deal of transition relief for employers of all sizes who are subject to the mandate. Some of the more notable provisions are as follows:

- The final rules phase in the employer requirements for smaller employers, giving employers with less than 100 full-time equivalent employees (FTEs) but more than 50 FTEs until January 1, 2016, to comply with the employer requirements. To be eligible, an employer will have to go through a certification process to demonstrate that during a period beginning on February 9, 2014, and ending on December 31, 2014, the employer did not reduce the size of its workforce or the overall hours of service of its employees in order to satisfy the workforce size condition. Employees of entities that are part of a controlled group are still all aggregated when an employer is determining whether or not mandate enforcement would apply in 2015. However, applicable penalties will still be applied on an entity basis. So, for example, a company with 800 full-time employees would be obligated to offer coverage or face penalties in 2015, as would its wholly owned subsidiary with 60 employees. However, if the 60 person subsidiary group did not offer affordable and minimum value coverage and the 800 employee parent company did, applicable penalties would be applied to the subsidiary separately according to a formula outlined in the final rule and the parent company would not be penalized for the actions of the subsidiary.

- For employers seeking to determine if the mandate applies to them at all, the employer may establish a consecutive six-month period of their choosing to count employees to determine applicability. For the first year an employer is determined to be an applicable large employer, if the employer uses the last few months of the year as its measurement period for applicability, the employer will not have to have a compliant plan in place for all employees by January 1 of the next year if their previous plan was not compliant. Instead, the employer will have a one-time penalty-free period of three months, as long as they establish a compliant plan and offer it to eligible employees by April 1 of the next year.

- The regulations provide that employers will not be subject to a penalty for not offering coverage under section 4980H(a) in 2015 if they offer coverage to at least 70% of their full-time employees. This means the employer will not be subject to the $2000 per employee "no coverage" or "A" penalty if they offer coverage to 70% or more of eligible employees in 2015. This is a change from the proposed rule, under which employers would have had to offer coverage to at least 95% of their full-time employees right away. All eligible employers will need to offer coverage to 95% of eligible employees and their dependents in 2016 to avoid potential tax penalties under section 4980H(a) In 2015 under the 70% standard and in later years under the 95% standard, the employer may still be subject to the "b" penalty of $3000 per individual employee if an otherwise eligible employee who was not offered coverage does seek and obtain subsidized coverage through a health insurance exchange. The choice to exclude certain classes of workers (such as variable hour employees) in order to fall

under the 70 percent coverage standard may be deliberate for 2015, as this transition relief was intended to make the transition to the 30 hour/week standard of offering coverage easier for employers.

- The final rule changed the calculation for employers not offering coverage under section 4980H(a) in 2015. The original penalty for the failure to offer coverage was $2,000 x full-time employees not covered, minus the first 30 employees, i.e. your first 30 full time employees are exempt from the calculation. For 2015 only, employers may subtract the first 80 employees.

- Employers who offer non-calendar year plans are not required to comply with section 4980H until the start of their plan years in 2015, rather than on January 1, 2015, provided that the plan meets certain key conditions. These conditions include: (1) Maintained non-calendar year plan before December 27, 2012, (2) Did not modify plan year after December 27, 2012, (3) Did not change eligibility rules after February 9, 2014. In addition, the group needs to have met one of two coverage tests. Since December 27, 2012, the plan needs to have been either offering coverage to at least 33 percent of all employees or covering at least 25 percent of its entire workforce, including part-time workers. Alternatively, the group would have to demonstrate that since December 27, 2012 it has been offering coverage to at least 50 percent of all full-time employees or covering at least 33 percent of all full-time employees. Another important point is that this provision applies to the ERISA plan year stipulated in the group's plan documents, not their plan contract renewal date, and these dates may differ! If a group doesn't have legal ERISA plan documents, the contract renewal date is the default date, but plan documents need to be established. If a group has appropriate plan documents, they may want to modify their ERISA plan year to conform with the plan renewal date for ease of administration, but they can only do that if the ERISA renewal date is later in the year than the plan contract renewal. If the ERISA date comes first, the plan needs to have all changes in effect on the date of the ERISA plan anniversary.

- The policy that employers offer coverage to their full-time employees' dependents will not apply in 2015 to employers that are taking steps to arrange for such coverage to begin in 2016.

- A one-year transition period outlined in the proposed rule for employers who contribute to multiemployer plans will carry forth until such a time when the IRS issues different guidance on the topic. The final rule says that should the current requirements ever change, then the change will be applied prospectively, so that employers will always have the chance to come into compliance before being penalized. The existing guidance on multi-employer plans provides that if an employer contributes to a multi-employer plan on behalf of employees (such as union employees) and the multiemployer plan meets the affordability and minimum value coverage criteria, the employer's obligation to offer coverage to these employees will be considered met.

- The rules provide that the service hours of certain types of individuals are not taken into consideration, even if these individuals receive some form of compensation (such as expense reimbursements). These include hours worked by individuals who meet a definition of a bona fide volunteer, students who are participating in the federal work study program or a similar state-based program and individuals who work for religious organizations who have taken a vow of poverty. Student workers and paid interns whose wages do not flow from state or federal work-study funds must be included in employee counts; however, the final rule notes that the variable hour rules would apply and an employer could utilize the optional look-back and measurement period counting methodology for this class of workers with regard to coverage offerings.

- Additional guidance about how to count the hours of employees whose working hours are particularly difficult to track including adjunct faculty, people with on-call duty responsibility like medical personnel, people with

layover hours like airline employees and commissioned salespeople is included in the proposed rule. Adjunct faculty hours will be counted as 2 ¼ hours worked for every hour in the classroom. Open office hours and compulsory meeting attendance will be treated as actual time and added to the hours calculation. Employers are encouraged to use reasonable methods to count layover and on call hours, and the rule notes that if such hours are fully compensated they should be counted. The regulation indicates that further guidance may be released further clarifying hour of service issues for professions with hour requirements that are challenging to track.

- The final rule attempts to provide flexibility in the monthly measurement method for hours worked to be applied in a manner that approximated or otherwise took into account payroll periods. The final rule allows an employer to determine an employee's full-time employee status for a calendar month under the monthly measurement method based on the hours of service over successive one-week periods.

- The new rule provides some additional guidance about employees associated with staffing firms and professional employer organizations. With regard to coverage offers, the rule states that a determination has to be made if the employee is the "common law" employee of the hiring company or the PEO or staffing firm. The IRS states that in typical cases the PEO or staffing firm is not the common law employer, so the coverage offer would be the responsibility of the hiring entity if it was an applicable large employer. A staffing firm or PEO may make the offer of coverage for the hiring employer, but if the hiring employer is an employer subject to the mandate, the employer's obligation to offer coverage will only be satisfied if: "the fee the client employer would pay to the staffing firm for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay to the staffing firm for the same employee if the employee did not enroll in health coverage under the plan. When tracking hours due to extreme variability in practices within this industry, temp firms are directed to calculate their employees' hours based on "the typical experience of an employee … with the temporary staffing firm."

- The final rule retains the requirements for an employer to use when classifying an employee with a break in service as a "rehire" with regard to the coverage rules but reduces the length of the break in service required before a returning employee may be treated as a new employee from 26 weeks to 13 weeks (except for certain educational organization employers). This break-in-service period applies for both the look-back measurement method and the monthly measurement method. To avoid educational employees being treated as rehires after each summer break, the 26 week window is required for this industry only.

- Seasonal employees are defined as an employee who is hired into a position for which the "customary annual employment is six months or less." The term is further defined by reference to Department of Labor guidance and also notes that the seasonal worker term also includes "retail workers employed exclusively during holiday seasons."

- The final regulations also note that holders of H-2A and H-2B visas are not generally exempted from the definition of employee for purposes of section 4980H. The guidance notes that whether an employee holds any particular visa is not relevant to determining an employee's status as a full-time employee.

In addition to all of the new changes, the final rule maintains a number of provisions included in the proposed rules. These include the methodology for determining mandate applicability, the optional look-back measurement method of determining full-time employee status and employer affordability safe harbors based on employee W2 wages, rates of

pay or the federal poverty level. The rule also includes many specific examples about what is and is not permissible for employers and agents and brokers to use as guidance.

The rules released on February 10, 2014 do not address the employer reporting requirements necessary for enforcement of both the employer and individual mandate components of the law (sections 6055 and 6056 of the IRS code). However, a fact sheet on the final rules states that final rules intended to simplify the employer information reporting requirements, and that proposed rules on these requirements will be issued "shortly."