IRS issues final regulations on employer shared responsibility

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The Department of the Treasury published final regulations on the employer shared responsibility provisions of the Patient Protection and Affordable Care Act (ACA) on February 12, 2014. The final regulations provide changes to the proposed regulations that were initially published on January 2, 2013.

Overview of Employer Shared Responsibility Regulations

Under the Internal Revenue Code an assessable payment may be imposed on an employer if it does not offer minimum essential group health plan coverage or does not offer group health plan coverage that is affordable and provides minimum value.

Specifically, Internal Revenue Code §4980H provides that, beginning January 1, 2015, a large employer is subject to an assessable payment if any full-time employee is certified to the employer as having received an applicable premium tax credit or cost-sharing reduction and either:

1. The employer fails to offer its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage (MEC) under an eligible employer-sponsored plan; or
2. The employer offers its full-time employees (and their dependents) the opportunity to enroll in MEC coverage under an eligible employer-sponsored plan and such coverage is either unaffordable or does not provide minimum value.

The final regulations, effective January 1, 2015,[1] explain how to determine who is a large employer and how to calculate the assessable payments.

Employers cannot wait until 2015 to take action. Employers, specifically large employers, may need to use information gathered about their employees during 2013 and 2014 to determine whether they may be subject to these assessable payments. Such employers should consider whether there is any planning they can do now to avoid the assessable payments later, and whether they need to implement administrative schemes to identify full-time employees.

Determination of Large Employer for Purposes of the Assessable Payments

Since only "large employers" are subject to the assessable payments, the first step in determining whether an employer may be subject to an assessable payment is to decide whether the employer is a large employer. A large employer for purposes of Code §4980H is any employer that employed an average of at least 50 full-time employees on business days in the preceding calendar year. The total number of full-time employees is determined by taking the sum of the total number of full-time employees and the total number of full-time equivalent employees (FTEs) for each calendar month in the preceding calendar year and dividing by 12. If this calculation results in a number that is 50 or more, the employer is a large employer subject to the assessable payments. For 2015, an employer is permitted to determine its large employer status by using a shorter period of time in 2014 that is at least equal to six consecutive calendar months.

An employee is considered a "full-time employee" for purposes of this calculation if the employee performed on average at least 30 hours of service per week for a calendar month in the preceding calendar year (or an equivalent of 130 hours for the month). Any employee who was not employed on a full-time basis must be taken into account in determining the number of FTEs of an employer. The number of FTEs is determined for each calendar month by aggregating the number of hours of service for each FTE (up to a maximum of 120 hours for any employee) and dividing that number by 120.

- Hours of Service: An employer must count actual hours of service for hourly employees. For non-hourly employees, an employer must use one of three methods: (a) actual hours, (b) days-worked equivalency, or (c) weeks-worked equivalency. If the days-worked or weeks-worked equivalencies are used, the hours calculated using those methods must generally reflect the hours of service actually worked.
  An employee's hours of service include: (a) each hour for which an employee is paid or entitled to payment for the performance of duties for the employer, and (b) 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, illness, injury, incapacity, disability, jury duty, military duty or leave of absence (without regard to the length of the unpaid service).

  An employee's hours of service do not include hours of service worked outside the United States.

The final regulations apply to common law employees and include special rules addressing controlled groups, affiliated service groups, successor and new employers, seasonal workers and new employees.

The following example illustrates how to determine large employer status: During each calendar month of 2015, Employer L has 20 full-time employees (each of whom averages 35 hours of service per week) and 40 employees (each of whom averages 90 hours of service per month). Each of the 20 employees who average 35 hours of service per week count as one full-time employee for each month. To determine the number of FTEs for each month, the total hours of service of the employees who are not full-time employees (but not more than 120 hours of service per employee) are aggregated and divided by 120. The result is that the employer has 30 FTEs for each month (40 x 90 = 3,600 and 3,600 ÷ 120 = 30). Because Employer L has 50 full-time employees (the sum of 20 full-time employees and 30 FTEs) during each month in 2015, Employer L is an applicable large employer for 2016.

Calculation of Assessable Payment on the Failure to Offer Minimum Essential Coverage (MEC)

If any full-time employee of an applicable large employer receives a premium tax credit or cost-sharing reduction and the employer fails to offer its full-time employees (and their dependents) minimum essential group health coverage, the applicable large employer must pay an assessable payment that is determined on a monthly basis. The payment is equal to 1/12 of $2,000 for each full-time employee in excess of 30 for each month.

Substantial Compliance Provision

Recognizing that some flexibility or margin of error is necessary so that employers are not penalized for inadvertent errors, both the proposed regulations and the final regulations contain a substantial compliance provision. This provision essentially provides that an applicable large employer will be treated as offering its full-time employees (and their dependents) minimum essential coverage if it offers such coverage to all but 5 percent of its full-time employees (or, if greater, five full-time employees). This safe harbor is applicable regardless of whether the omission of coverage to the 5 percent of full-time employees is intentional or inadvertent.

The final regulations provide additional relief with regard to this substantial compliance rule. For each calendar month during 2015 and any calendar months during the 2015 plan year that falls in 2016, an applicable large employer that offers coverage to at least 70 percent of its full-time employees will not be subject to an assessable payment for failing to offer minimum essential group health coverage. After the 2015 plan year, this additional relief expires and the regular substantial compliance provision (95 percent rule) applies.

Determination of Full-Time Employee for Purposes of the Assessable Payment on Failure to Provide Minimum Essential Coverage

Since the assessable payment on the failure to provide minimum essential group health coverage is calculated based on all full-time employees of an employer for a given calendar month, the determination of whether an employee is full time or part time during a particular month is critical.

Recognizing that it would be administratively challenging for an employer to determine who its full-time employees are on a monthly basis, especially for employees who have employment schedules or hours of service that vary month-to-month, the proposed and final regulations allow employers to adopt a look-back method for determining full-time status. The look-back method, which was introduced in prior IRS guidance, allows an employer to determine an employee's full-time status by looking back at a measurement period.

If an employee is determined to be a full-time employee during the measurement period, then the employer must treat the employee as a full-time employee during the first stability period that ends after the measurement period and any administrative period. An employer is permitted to use an administrative period of up to 90 days between the measurement period and stability period to determine whether any employees are full-time employees.

The following are some additional rules that employers should be aware of in determining full-time employees under the look-back method:

1. A stability period must be at least six months and no shorter than the measurement period.
2. For ongoing employees, an employer may establish a standard measurement period of between three and 12 months. The employer must designate the beginning and end of the standard measurement period. An employer may use different measurement periods for certain classifications of employees (i.e., collectively bargained employees, salaried employees and hourly employees, and employees located in different states).
3. For new employees, if an employee is reasonably expected to be a full-time employee at his or her start date, the new employee must be offered coverage within three months of employment. For new variable hour, part-time and seasonal employees, an employer may establish 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. The stability period must be the same length as the stability period for ongoing periods.
4. Transition Relief: The IRS recognizes that employers that want to establish a 12-month measurement period and a 12-month stability period for 2015 are facing time constraints. Accordingly, for stability periods beginning in 2015 only, employers may adopt a transition measurement period that is shorter than 12 months but no less than 6 months long and begins no later than July 1, 2014, and ends no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2015.

Clarifications of Final Regulations

The final regulations clarify that an employer is permitted to use the monthly measurement method and now provides guidance for employers who would like to use a combination of both the monthly measurement method and the look-back measurement method. For example, the final regulations now permit, in limited circumstances, an employer to begin applying the monthly measurement method to an employee who changes employment status to a position in which the employee is not expected to be employed on average at least 30 hours per week. If the requirements are satisfied, this new rule would allow employers to cease offering coverage to certain employees who change employment status before the end of the stability period.

The final regulations further clarify that employers should be using the common law employee standard in determining who is a full-time employee. This means that employers should be reviewing any individuals that they treat as independent contractors to ensure that such individuals have not been misclassified.

The final regulations provide additional guidance on how to account for hours of service for adjunct faculty, on-call hours, seasonal employees, bona fide volunteers and student employees.

Calculation of Assessable Payment on the Failure to Provide Affordable Coverage

If any full-time employee of a large employer receives a premium tax credit or cost-sharing reduction and the employer offers coverage that is unaffordable or does not provide minimum value, then the large employer must pay a monthly assessable payment. The payment is the lesser of: (1) 1/12 of $2,000 for each full-time employee (minus 30), or (2) 1/12 of $3,000 for each full-time employee who receives a premium tax credit and who also purchases health coverage through an exchange.

Determination of Affordable Coverage

Coverage under an employer-sponsored plan is affordable to an employee if the employee's required contribution to the plan does not exceed 9.5 percent of the employee's household income for the taxable year. Household income for this purpose includes the modified adjusted gross income of the employee and any members of the employee's family (spouse and dependents) who are required to file a federal income tax return. Since it would be difficult for an employer to ascertain an employee's household income for a taxable year, the proposed regulations contain three safe harbors. An employer-sponsored plan will be considered "affordable" if:

1. Form W-2 Safe Harbor: the employee's contribution for the calendar year for the employer's lowest cost of self-only coverage that provides minimum value during the entire calendar year does not exceed 9.5 percent of the employee's Form W-2 wages for the calendar year. For an employee who was not a full-time employee for the entire calendar year, the employee's Form W-2 wages are permitted to be adjusted to reflect the period when the employee was offered coverage and this adjusted wage amount is compared to the employee share of the premium during that period. The final regulations have confirmed that an employee's prior year Form W-2 may not be used for this safe harbor;
2. Rate of Pay Safe Harbor: the employee's contribution for the month for the employer's lowest cost of self-only coverage that provides minimum value does not exceed 9.5 percent of an amount equal to the employee's hourly rate of pay as of the first day of the coverage period multiplied by 130 hours. The final regulations confirm that the rate of pay safe harbor is not altered by an employee's leave of absence or reduction in hours worked in certain circumstances; or
3. Federal Poverty Line Safe Harbor: the employee's contribution for the calendar month for the applicable large employer member's lowest cost of self-only coverage that provides minimum value does not exceed 9.5 percent of the federal poverty line for a single individual for the most recently published poverty guidelines as of the first day of the plan year of the applicable large employer member's health plan. Unlike the previous two safe harbors, which require employers to gather salary information about each employee, this is a design-based safe harbor. What this means is that an employer can set the employee contribution rate in advance and know that the plan will be considered affordable. For 2014, the federal poverty threshold for one person is $11,670. Accordingly, if an employee is required to contribute less than $1,108.65 per year ($11,670 x .095) toward the lowest cost of self-only coverage, the plan falls within this safe harbor and is considered to be "affordable."

Determination of Minimum Value

An employer-sponsored plan provides "minimum value" if the plan pays at least 60 percent of the total allowed costs of benefit provided under the plan. The Treasury Department issued guidance, which is consistent with rules promulgated by the Department of Health and Human Services (HHS), setting out three alternative approaches to determine whether a plan provides minimum value:

1. For plans with standard cost-sharing features — Utilize the minimum value calculator made available by HHS and the Treasury Department by entering information about an employer-sponsored plan's benefits, coverage of services, and cost-sharing terms.
2. For plans with specified cost-sharing amounts — Match any of the design-based safe harbors:
    - Plan with a $3,500 integrated medical and drug deductible, 80 percent cost-sharing, and a $6,000 maximum out-of-pocket limit for employee cost-sharing.
    - Plan with a $4,500 integrated medical and drug deductible, 70percent cost-sharing, a $6,400 maximum out-of-pocket limit, and a $500 employer HSA contribution.
    - Plan with a $3,500 medical deductible, $0 drug deductible, 60percent medical cost-sharing, 75 percent drug cost-sharing, a $6,400 maximum out-of-pocket limit, and drug co-pays of $10/$20/$50 for the first, second and third

drug tiers, with 75 percent coinsurance for specialty drugs.

3. For plans with nonstandard features, engage an actuary to certify that the plan satisfies the minimum value requirement.

Transition Rules

The final regulations extend most of the transition relief that was contained in the proposed regulations. Specifically, the final regulations provide the following transition relief:

1. A non-calendar year plan is provided relief for the period before the first day of the 2015 plan year if one of the following transition rules applies:
    - A large employer is provided relief for those employees (whenever hired) who would be eligible for coverage effective beginning on the first day of the 2015 plan year under the eligibility provisions of the plan as in effect on February 9, 2014 provided the applicable large employer (i) maintained a non-calendar year as of December 27, 2012, (ii) the plan's plan year was not modified after December 27, 2012, to begin at a later calendar date, and (iii) the employee's described in (i) is offered affordable coverage that provides minimum value no later than the first day of the 2015 plan year; or
    - A larger employer is provided relief for all employees (full-time and part-time) provided the applicable large employer: (i) maintained a non-calendar year plan as of December 27, 2012 (or that maintained two or more non-calendar year plans that have the same plan year as of December 27, 2012), (ii) the plan's plan year was not modified after December 27, 2012, to begin at a later calendar date, and (iii) if the employer either (a) had, as of any date in the 12 months ending on February 9, 2014, at least one quarter of its employees covered under those non-calendar year plans, or (b) offered coverage under those plans to one third or more of its employees during the open enrollment period that ended most recently before February 9, 2014; or
    - A large employer is provided relief for all its full-time employees provided the applicable large employer: (i) maintained a non-calendar year plan as of December 27, 2012 (or that maintained two or more non-calendar year plans that have the same plan year as of December 27, 2012), (ii) the plan's plan year was not modified after December 27, 2012 to begin at a later calendar date, and (iii) if the employer either (a) had, as of any date in the 12 months ending on February 9, 2014, at least one third of its full-time employees covered under those non-calendar year plans, or (b) offered coverage under those plans to one half or more of its full-time employees during the open enrollment period that ended most recently before February 9, 2014.
2. Shorter measurement periods permitted for stability periods starting during 2015: As described above, for stability periods beginning in 2015 only, employers may adopt a transition measurement period that is shorter than 12 months but no less than six months long and begins no later than July 1, 2014, and ends no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2015.
3. Shorter period for determining applicable large employer status for 2015: As described above, for 2015, an employer is permitted to determine its large employer status by using a shorter period of time in 2014 that is at least equal to six consecutive calendar months.
4. Applicable large employers with fewer than 100 full-time employees (including full-time equivalents): The deadline for complying with the employer shared responsibility provisions has been extended to first day of the plan year beginning in 2016 if: (a) the employer maintains on average at least 50 full-time employees (including FTEs) but fewer than 100 full-time employees on business days during 2014, (b) during the period beginning on February 9, 2014, and ending on December 31, 2014, the employer does not reduce the size of its workforce or the overall hours of service of its employees in order to satisfy the workforce size requirement, and (c) during the coverage maintenance period the employer does not eliminate or materially reduce the health coverage, if any, it offered as of February 9, 2014.

Next Steps for Employers

With the release of the final regulations, employers must take action now to determine if they are a large employer and subject to the assessable payments that are effective January 1, 2015. Steps taken by large employers in 2014, such as implementing administrative schemes to identify full-time employees and planning to avoid being subject to the assessable payments, will position the employer to best avoid these assessable payments in 2015.

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1. The IRS issued Notice 2013-45 which provides that no assessable payments will apply for 2014.

Authors

