Final rules on ACA's employer mandate include new transition relief

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In brief

The IRS has issued final regulations providing guidance on the Affordable Care Act's employer shared responsibility provisions, sometimes called the 'employer mandate' or the 'pay or play' rules. The final regulations apply for periods after December 31, 2014 to applicable large employers who fail to offer coverage to their full-time employees. The final regulations extend earlier transition rules and provide new ones, in order to help employers comply with the requirements.

Highlights of the final regulations include:

- an extended transition period for employers with fewer than 100 full-time equivalent employees, so they won't be subject to penalties until 2016
- a temporary rule for employers with 100 or more full-time employees, so the largest penalty will not apply for 2015 if the employer offers coverage to at least 70% of its full-time employees (rather than 95% as will be required after 2015)
- final rules for determining full-time employee status reflecting the proposed regulations, including the optional look-back measurement period and stability period, with numerous clarifications and new definitions
- additional guidance for the monthly method of determining full-time status
- rules for determining full-time status for special categories of employment, including a new definition of seasonal employees
- an additional year for employers who do not now offer coverage to their employees' dependents to comply, as long as coverage is offered to the children of employees by the 2016 plan year
- safe harbors for determining if employer-provided coverage is affordable for employees for purposes of the employer penalties

The Treasury Department and the IRS plan to issue final regulations soon intended to simplify and streamline the associated employer reporting requirements.

In detail

Background

The Affordable Care Act — or 'ACA' — adds penalty provisions to the Internal Revenue Code for 'applicable large employers' who don't offer health coverage meeting certain requirements to their full-time employees. An applicable large employer is an employer with at least 50 full-time employees (including full-time equivalent employees).

The 'A Penalty' applies if the employer fails to offer health coverage to its full-time employees (and their dependents) and any employee obtains subsidized coverage on an exchange. The 'A Penalty' is 1/12 of $2,000[1] times the number of the employer's full-time employees (less 30[2]) for any month in which any full-time employee obtains subsidized coverage on an exchange. This penalty does not depend on the number of employees receiving subsidized coverage, but is calculated based on the total number of full-time employees (less 30[2]), including those who are offered coverage by the employer.

The 'B Penalty' applies if the employer offers coverage to its full-time employees and their dependents, but nonetheless, a full-time employee obtains subsidized coverage on an exchange. The 'B Penalty' is 1/12 of $3,000[1] for each month the employee obtains subsidized coverage. This may occur if the coverage offered by the employer does not provide minimum value or is not affordable for that employee, or if the employee was not offered coverage by the employer. The total penalty for all such employees will not be more than the A Penalty for failure to offer coverage.

Many questions arose concerning these rules, including how to determine if an employer is an applicable large employer, how to identify full-time employees, how the penalties are to be assessed, whether relief applies for de minimus violations, and how employers will report information to IRS on the coverage offered to their full-time employees. As a result, the IRS previously delayed the application of the rules until January 1, 2015 or the first day of the 2015 plan year, and also delayed the associated reporting requirements. The final regulations address many of the questions about the shared responsibility provisions and provide new transition rules. Final regulations on the reporting requirements are expected soon.

Transition rules

The final regulations provide a number of transition rules for 2015 as employers begin to comply with the requirements.

Large employers offering coverage to at least 70% of full-time employees

As was proposed, the final regulations assess the A Penalty only if coverage is not offered to at least 95% of the employer's full-time employees. For 2015 only, the threshold for assessing the penalty will be 70%, so employers who offer coverage to at least 70% of their full-time employees in 2015 will not be subject to the A Penalty.

Observation

The B Penalty will apply in 2015 for any of the employer's employees who obtain subsidized coverage on an exchange, including those for whom the coverage offered by the employer is not affordable minimum coverage, and those who are among the up to 30% of employees who are not offered coverage at all.

Delay for mid-size employers

Also for 2015, employers with fewer than 100 full-time and full-time equivalent employees during 2014 will not be subject to the employer shared responsibility penalties, in order to give these mid-size employers additional time to comply. This transition rule only applies if the employer meets several requirements and certifies these facts to the IRS.

Other 2015 rules

Additional transition rules will apply in 2015 for employers with at least 100 full-time employees, including:

- an extension of the penalty provisions' effective date to the first day of the 2015 plan year for certain non-calendar year plans
- a one-year delay in the requirement to offer coverage to full-time employees' children for employers that didn't previously offer dependent coverage but are taking steps to arrange for such coverage to begin in 2016
- the ability to use a six-month measurement period for 2014 to determine full-time status for the 2015 plan year, as long as the measurement period begins by July 1, 2014
- the ability to determine if the employer is a 'large employer' for 2015 because it employed at least 100 full-time equivalent employees by reference to a period of six consecutive months during 2014 (rather than the entire year)
- a special rule for the month of January 2015 treating coverage as

[1] The $2000 and $3000 annual penalty amounts are to be indexed, according to the statute.
[2] 80 in 2015

offered for the entire month if coverage is offered no later than the first day of the first payroll period beginning that month

- Calculation of the penalties in 2015 by excluding 80 of the controlled group's FTEs rather than 30.

In addition to the transition rules, an interim rule treats employer contributions to a multiemployer plan offering affordable minimum coverage as an offer of coverage.

Observation

These transition provisions, some of which were previously proposed, will be helpful to many employers and with respect to many plans. They are available only if the employer meets the requirements for the particular transition rule, however, including prohibitions on changing the plan year after December 27, 2012 for certain of the rules, and meeting various threshold requirements that differ for each transition rule. In addition, even if a transition rule for non-calendar year plans applies, the employer must identify and report its full-time employees and whether the coverage it offers provides minimum value, and the employee portion of premiums, for the entire year 2015, including the period before the employer penalties apply.

Identifying full-time employees

Employers with on average at least 50 (or, for 2015, at least 100) full-time equivalent employees are subject to the employer mandate. These employers must know who their full-time employees are in order to identify who must be offered coverage to avoid triggering penalties. In addition, employers will have to be able to report to IRS their 2015 full-time employees, with the first report likely due early in 2016.

Applicable large employers

Large employer status is determined based on the employer's average number of full-time equivalent employees during the prior calendar year. Full-time employees are those that work on average at least 30 hours a week. For this purpose, the hours of service of part-time employees are taken into account by aggregating the number of hours of service of all part-time employees for each month and dividing by 120 to determine the number of 'full-time equivalent employees' for the month. The determination of whether an employer is an applicable large employer is made by aggregating the hours of service of employees of all members of a controlled group of corporations or businesses under common control. However, penalties are assessed separately against each member of the group.

The regulations provide new guidance for employers not in existence in a preceding year. For the first year of an employer's existence, the determination of whether the employer is an applicable large employer is based on its reasonable expectations of the number of employees it will employ, even if it subsequently has more employees than it initially expected. In addition, if the employer offers minimum value coverage on or before April 1 of the first year it is an applicable large employer, the employer will not be subject to penalties for January through March of that year. A special rule is provided that exempts employers whose workforce exceeds 50 full-time employees for 120 days or fewer during the year if those excess employees are seasonal workers.

Hours of service

Each employee's hours of service are used to determine an employer's full-time employees and full-time equivalent employees for purposes of 'applicable large employer' status, and to identify full-time employees for purposes of the employer mandate. The regulations define hours of service in general and include new rules for crediting hours of service. Like the rules for crediting service under qualified retirement plans, these regulations require that an hour of service be credited for each hour an employee is paid or entitled to payment from the employer (including certain paid time off). For employees paid on an hourly basis, this must be calculated based on the employer's records of actual hours for which payment is made or due. For salaried employees, actual hours may be calculated, or the employer may use an equivalency system crediting eight hours for each day (or 40 hours for each week) for which the employee is required to be paid, unless this would substantially understate the actual hours of service. Different methods may be used for different categories of non-hourly employees, and the equivalency method used for each category of employees may be changed each calendar year.

Full-time employees

Full-time employees are those employed on average at least 30 hours a week determined by aggregating all hours worked for all members of the employer's controlled group. Employers may make this determination for each month under either the monthly measurement period or the look-back measurement method, which uses a measurement period for determining full-time status followed by a stability period during which that status is deemed to be continued. The final regulations adopt a standard of 130 hours of service per calendar month for determining whether an employee is a full-time employee under either method.

Observation

Employers may use different measurement methods and different measurement and stability periods for different specified categories of employees, including salaried and hourly employees, collectively and non-collectively bargained employees, and employees in different states. The final regulations also confirm that different members of the same controlled group may use different measurement methods and different starting and ending dates and lengths of measurement and stability periods than the other members of the group. No other differences are permitted; for example, an employer may not use different methods for variable hour employees and employees with set schedules.

Measurement/stability periods

To create predictability, the regulations finalize the optional lookback/stability method of identifying full-time employees. Under this method, the employer calculates employees' hours of service during a measurement period, and offers coverage to those determined to be full-time during the following stability period. For ongoing employees — that is those who've been employed during a full measurement period — the employer may establish a standard measurement period of between three and 12 months over which service is measured. Employees who work an average of at least 30 hours a week during the measurement period are treated as full-time during the following stability period regardless of the actual number of hours worked. The stability period must generally be at least six months long and no shorter than the measurement period. Employers may also establish an administrative period between the measurement period and the stability period for enrolling employees.

For new hires who are 'reasonably expected to be full-time employees' the employer is not subject to penalties if minimum value coverage is offered by the first day of the month after the employee completes three full calendar months of employment.

Observation

While employers can comply with the regulations if they offer new hires coverage after the first three calendar months of employment, the final regulations require that this coverage be of minimum value. Consequently, to take advantage of this provision, employers may not offer less than minimum value coverage, meaning that simply offering so-called minimum essential coverage won't suffice. In addition, while no penalties may apply during that initial three month period, this does not mean the plan necessarily complies with the ACA limitation on waiting periods, which may not exceed 90 calendar days. Regulations on the ACA 90-day waiting period limit were released on February 20.

For new hires who are not reasonably expected to be full-time employees when hired—variable hour, seasonal and part-time employees—the employer may establish an initial measurement period of three to 12 months beginning on the employee's date of hire during which service is measured. This is followed by a stability period of at least six months during which the employee is treated as full-time if they averaged 30 hours a week or more during their initial measurement period. Complicated rules govern how to transition a new employee to an ongoing employee for purposes of these measurement periods.

Employers may treat employees rehired after a break in service of more than 13 weeks as new hires, and other rules govern employees changing job classifications.

Month by month determinations

Employers may choose *not* to use the measurement/stability period method of identifying full-time employees for some or all employee categories, and instead identify their full-time employees based on those employees' actual hours of service for each calendar month. Under this method, like the look-back method, an employer is not subject to penalties for the first three full calendar months after an employee is hired if the employee is offered minimum value coverage no later than the first day of the fourth month of employment. Special rules apply to employers who wish to measure service based on payroll periods rather than calendar weeks and months, and for rehired employees and employees transferring between jobs or changing status at the same employer.

Observation

Employers will have to identify their full-time employees under either the monthly or the look-back method for each category of employees, and will be required to report this information to the IRS and to the employees as well.

Categories of employees

Seasonal workers and seasonal employees

To determine if an employer has at least 50 full-time employees (i.e., is an applicable large employer), the final rules disregard seasonal workers if the employer's workforce exceeds 50 for 120 days or fewer during the calendar year and the employees in excess of 50 on those days are seasonal workers as defined by the Labor Department.

In addition, the final rules allow employers to treat certain seasonal employees (defined as those whose customary employment is for six months or less, with employment generally starting at the same time of the year), in the same way as 'variable hour' employees, even if they are working 'full-time' during the season.

Independent contractors

The regulations use the common-law standard to determine if a worker is an employee. It had been hoped that the regulations might provide relief for an employer who had been treating workers as independent contractors if the workers are reclassified as employees by the IRS upon examination, similar to the relief offered for purposes of employment taxes. Unfortunately, Treasury and the IRS did not adopt this suggestion.

Observation

Employers should review any independent contractor relationships, as the consequences of a potential reclassification of workers as employees could be quite severe.

Foreign employment

Hours of service are not counted if the compensation for those hours doesn't constitute US source income. Special rules also apply to employees who transfer employment between domestic and foreign employers who are members of a controlled group so that inbound employees may be treated as new employees in some cases and outbound employees may be treated as terminations if the foreign position is expected to continue indefinitely.

Employees hired through temporary staffing agencies

The regulations provide a special rule for employees hired or paid through a temporary staffing agency, but who are the common law employees of the agency's client. In this situation, if the staffing agency offers coverage 'on behalf of' its client, it will be considered an offer of coverage by that client. To take advantage of the rule, the client must pay an extra amount to the staffing agency for employees enrolling in the agency's coverage. The regulations do not allow a presumption that all staffing agency employees may be considered variable hour employees.

Observation

While employees hired through temporary staffing agencies present unique questions and challenges, the regulations offer some flexibility as these firms and their clients work through ACA compliance.

Other categories

Hours of service worked as a 'bona fide volunteer' are not counted as hours of service under the regulations, and special rules apply to members of religious orders, adjunct faculty, and to layover hours for airline employees and on-call hours.

Coverage of dependents

Penalties may be assessed if the applicable large employer fails to offer coverage to an employee's dependents (defined to include children but not the spouse). Under the final regulations, plans may exclude foster children and stepchildren as well as any child who is not a US citizen or national, unless the child is a resident of a country contiguous to the US or is within an exception for adopted children.

Affordability safe harbors

An applicable large employer may be assessed penalties if a full-time employee obtains subsidized coverage on an exchange. Employees may obtain subsidized coverage if they are not offered affordable, minimum coverage by their employers. Whether or not coverage is affordable is determined based on the employee's household income. Solely for purposes of the employer penalties, an employer may deem its coverage to be affordable if it satisfies one of several alternative affordability safe harbors. The use of these safe harbors does not affect an employee's ability to obtain subsidized coverage if the coverage is not actually affordable for the employee based on the family's income.

Observation

These safe harbors may be utilized for any reasonable category of employees, and may permit employers to design their plans to avoid the penalty for coverage that is not affordable, based on information that is readily available to the employer.

W-2 safe harbor

An employer will not be subject to the employer mandate penalties with respect to a particular full-time employee if that employee's required contribution for the calendar year for the employer's lowest cost self-only coverage that provides minimum value is not more than 9.5% of that employee's Form W-2 wages (Box 1) from the employer for the calendar year. This is determined after the end of the calendar year based on the employee's actual wages, and applies only if the employee's required contribution remains a consistent amount or percentage of wages during the year.

Rate of pay safe harbor

An employer's offer of coverage is treated as affordable for a calendar month if the employee's required contribution for the month for the lowest cost self-only coverage that provides minimum value isn't more than 9.5% of the employee's rate of pay. For hourly employees, this is determined by multiplying by 130 hours the lower of the employee's hourly rate of pay as of the first day of the plan year or the employee's lowest rate of pay during the month. For salaried employees, the coverage is deemed to be affordable if the cost doesn't exceed 9.5% of the employee's monthly salary as of the first day of the plan year. The safe harbor for salaried employees is not applicable if the employee's salary is reduced.

Federal poverty line safe harbor

An employer's offer of coverage will be treated as affordable if the employee's cost for the month for the lowest cost self-only option that provides minimum value is not more than 9.5% of the federal poverty line for a single individual for the calendar year divided by 12.

Observation

For 2014, the federal poverty line for a single individual is $11,670. As long as the monthly contribution for the lowest cost self-only option in 2015 is less than $92.39 ($11,670/12 X 9.5%), the coverage would be deemed affordable for purposes of the employer mandate penalties.

Assessment of penalties

Each member of an applicable large employer is liable for its own penalties, calculated on the basis of its own employee population, and is not liable for those of any other entity in the controlled group. The IRS will contact employers to inform them of potential liability and give them an opportunity to respond before a notice and demand for payment is made. This will not occur until after employees' individual tax returns are due for the year claiming premium tax credits, and after the due date for the employer to file the information returns identifying their full-time employees and describing the coverage offered. The penalties are not tax deductible.

The takeaway

Although the regulations give employers some breathing room for 2015, employers can proceed with certainty identifying their full-time employees and reviewing the coverage they offer.

Many employers will move forward with extending coverage to employees who had not been eligible previously, despite the delay. Although the lower threshold for triggering employer penalties provides some comfort, employers are still potentially liable for the 'B penalty' if they don't offer coverage to full-time employees, and employees will be subject to an individual mandate penalty if they don't have adequate coverage.

All employers will need to identify their full-time employees for each month, beginning in January 2015, both for purposes of determining eligibility, as well as for reporting to employees and the IRS. Employers that do not choose to implement the complex though useful measurement/stability rules for identifying full-time employees will need to comply with the rules for month-by-month identification of full-time employees, which will have its own challenges. Employers must thoughtfully consider their healthcare strategies for 2015 and beyond, looking at their corporate structure, types of employees and payroll systems, and healthcare costs. While the regulations provide many helpful methods of compliance and measurement, along with useful examples, they are extremely complicated.

Let's talk

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