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Health Care Reform Management Alert Series

Employer Mandate Final Regulations Contain Many Clarifications and Some Transition Relief

Issue 77

By Jennifer A. Kraft and Benjamin J. Conley

This is the seventy-seventh issue in our series of alerts for employers on selected topics in health care reform. (Click here to access our general summary of health care reform and other issues in this series) This series of Health Care Reform Management Alerts is designed to provide an in-depth analysis of certain aspects of health care reform and how it will impact your employer-sponsored plans.

HOT NEWS!

- *Mandate delayed for smaller employers*
- *Penalty relief for employers who offer coverage to at least 70% of full-time employees*
- *Staffing agency guidance*
- *Seasonal employee guidance*
- *Additional delay for dependent coverage*

On February 12, 2014, the Department of the Treasury published in the Federal Register *final regulations* under the Affordable Care Act's Employer Shared Responsibility requirement (more commonly referred to as the "employer mandate"). The IRS also posted a *Q&A* addressing the final regulations. The final regulations contain a number of clarifications as well as various forms of transition relief that were intended to assist employers in ramping up for the employer mandate, which generally goes into effect on *January 1, 2015*. This alert primarily focuses on those changes/clarifications, including:

- *Is My Business Subject to the Employer Mandate? - Determining Applicable Large Employer Status*
- *What Hours Must be Counted? - Defining Hours of Service*
- *Who Must Be Offered Coverage? - Identifying Full-Time Employees*
- *When is Coverage Affordable?*
- *What if an Employer Cannot Obtain an Insurance Policy?*
- *What if Coverage is Offered by a Different Organization (e.g., PEO, Multiemployer Plan)?*
- *Which Dependents Must Be Offered Coverage?*

For more background and an in-depth discussion of what the employer mandate generally requires, see *Issue 48* in our alert series.

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Is My Business Subject to the Employer Mandate? - Determining Applicable Large Employer Status for New Businesses

Generally, the determination of whether a business, that was not in existence throughout the preceding calendar year, is an applicable large employer for the current year is based on the average number of employees that the employer reasonably expects to employ on business days in the current year. The final regulations contain several clarifications and transition rules intended to assist new businesses in determining whether they would be considered an applicable large employer. For instance, the final regulations clarify that an employer is treated as not having been in existence throughout the prior year only if the employer was not in existence *on any business day* in the prior year. A new employer typically would be an applicable large employer for the current year if the employer is reasonably expected to, and actually does, employ an average of at least 50 full-time employees (including FTEs) on business days during the current calendar year. For employers first coming into existence in 2015 there is transition relief. The new employer is not an applicable large employer provided that the employer expects to employ and actually employs fewer than 100 full-time employees (including FTEs).

Other Transition Relief: No penalty for first three months in first year as applicable large employer. An applicable large employer will not be subject to a penalty as long as it offers minimum value coverage no later than April 1 of the first year in which it is an applicable large employer. If the employer fails to offer coverage by April 1, it would be subject to a penalty for the first three months of the year (in addition to any month going forward in which it fails to offer coverage).

Shorter measurement period for 2015 applicable large employer determination. Employers may calculate applicable large employer status over a shorter period of time for purposes of the 2015 calendar year. Rather than looking back to all months in 2014 to determine applicable large employer status, employers are permitted to measure over any six consecutive months. The IRS considered, but failed to adopt, a special rule for school districts, meaning a school district could include the summer months in its chosen six month measurement window to determine if it is a large employer. Even so, an educational organization that is an applicable large employer (despite this rule) may not penalize employees because they are not working during the summer months, as discussed in Issue 48.

Employer mandate delayed until 2016 for smaller employers. Employers with 50-99 full-time equivalent employees are not subject to the employer mandate until January 1, 2016 at the earliest, as long as certain conditions are met, including no reductions to the workforce size without a bona fide business reason. (Employers with less than 50 full-time equivalent employees are never subject to the employer mandate.)

What Hours Must be Counted? - Defining Hours of Service

Hours of service are relevant for two purposes under the employer mandate: (1) employers must consider hours of service in calculating full-time equivalents for purposes of determining whether they are applicable large employers, subject to the employer mandate, and (2) an applicable large employer must offer coverage to substantially all of its full-time employees to avoid the penalty. The final regulations largely adopt the definition of hours of service included in the proposed regulations, with a few modifications and clarifications:

- **Hours equivalency for non-hourly employees.** Employers may count hours of service for non-hourly employees by either counting actual hours for which the employee is entitled to pay or by using equivalencies of 8 hours per day or 40 hours per week (unless the effect would be to substantially understate hours worked). The final regulations clarify that employees must be credited with the full 8 or 40 hours of service if the employee works (or is entitled to pay for) even a single hour that day or week, as applicable.
- **Student employees.** The final regulations clarify that hours of service performed by students must generally be counted for purposes of determining applicable large employer status and determining whether a student is a full-time employee. The only exceptions are: (1) hours of service performed by a student in a position subsidized through the federal work study program; or (2) hours of service performed for which the student is not entitled to payment.

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The final regulations contain industry-specific rules for classifying workers as employees and for counting hours of service for certain categories of employees (*e.g.*, adjunct faculty) and types of hours (*e.g.*, layover hours). The preamble to the final regulations indicates that the IRS continues to consider additional rules, but until further guidance is issued, employers of adjunct faculty, airline employees, and on-call employees are to use a reasonable method of crediting hours of service.

Industry-Specific Rules Included in the Final Regulations (not addressed in this alert)

- Adjunct faculty
- Members of religious orders
- Layovers in the airline industry
- On-call hours
- Layover hours
- Commission-based employees
- Educational organizations
- Home care workers
- Real estate agents and direct sellers
- Agricultural workers (employees holding H-2A and H-2B Visas)
- Cruise ship employees

Who Must Be Offered Coverage? - Identifying Full-Time Employees

To avoid the employer mandate penalty, an applicable large employer must offer coverage to full-time employees, generally defined as an employee employed on average at least 30 hours per week or 130 hours per month. The final regulations clarify and elaborate on the two permissible methods for measuring full-time status: the monthly measurement method and the look-back measurement method.

1. **Monthly measurement period.** The monthly measurement period is the default measurement method under the Affordable Care Act. Generally, this method requires employers to offer coverage to any employee for any month in which that employee works 130 hours. Practically, this could prove challenging because: (1) at the beginning of the month the employer does not know how many hours the employee will work; and (2) at the end of the month once the employer has made the determination, it is too late to offer the employee coverage. As such, many employers are considering using the look-back measurement period safe harbor (described below). The final regulations include the following clarifications regarding the monthly measurement period:

   - ***Initial three-month eligibility buffer.*** An employer will not be subject to a penalty for failure to offer coverage immediately as of the date the employee is first otherwise eligible (other than completing the waiting period) as long as the employer offers minimum value coverage within three full calendar months of such date. If the employer fails to offer coverage within three full calendar months, however, the employer will face retroactive liability to the first month in which the employee was otherwise eligible.
   - ***No requirement to recognize special leaves.*** While the look-back measurement period requires employers to credit employees with service during special leaves (FMLA, USERRA and jury duty), no such rule applies for the monthly measurement period.
   - ***Adjustments permitted to align with payroll periods.*** Employers can measure weekly rather than monthly to take into account payroll reporting cycles (which may include four or five weeks, depending on the month). The final regulations contain special rules and adjustments that employers must use if they choose to take advantage of this option.
   - ***Coverage must be offered for entire month to avoid a penalty.*** An employer won't be considered to have satisfied its obligation for any given month unless the employee has been offered coverage for the entire month.

Transition Relief: Offering coverage in January 2015. While employers must generally offer coverage for the entire calendar month to avoid a penalty, an employer will be considered to have offered coverage in January of 2015 as long as coverage is offered no later than the first day of the payroll period that begins in January 2015.

2. **Look-back measurement period.** Generally, the look-back measurement period permits employers to measure hours of service over a period of time ranging between 3 and 12 months for employees classified as variable hour or seasonal

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employees. Employees who are credited with sufficient hours of service during this period are considered full-time employees who would need to be offered coverage for the entirety of a future period (the stability period) regardless of whether the employee's hours drop in the stability period to avoid a penalty. The stability period must be as long as the measurement period, except that it can be no shorter than six months.

Transition Relief: Shorter "look-back" period permitted leading up to 2015 stability period. While the look-back measurement period must generally be the same length as the stability period, for the 2014 to 2015 cycle, employers may use a measurement period as short as 6 months leading up to a 12 month stability period. To take advantage of this transition relief, the measurement period must begin no later than July 1, 2014 (regardless of whether the employer qualifies for the non-calendar year plan year transition relief described below).

Employers may build in an administrative period in-between the measurement and stability period to determine which employees were employed full-time and to hold open enrollment. A similar measurement/stability period would apply for new hires, which must be categorized either as seasonal/variable hour employees or full-time employees. Full-time employees must be offered coverage within three months, while variable hour employees and seasonal employees who work sufficient hours must be offered coverage no later than the first of the month following the 13th month anniversary of their hire date. The final regulations included the following clarifications regarding the look-back measurement period:

- ***Determining full-time status at hire date.*** The proposed regulations permitted employers to make a reasonable determination of an employee's full-time status based on facts and circumstances at the date of hire. The final regulations retain that standard, but provide certain factors that should be taken into consideration, including whether:
    - The employee is replacing an employee who was full-time,
    - Employees in the same or comparable position are full-time, and
    - The job was advertised, documented or communicated as requiring 30 hours or more per week, on average.
- ***Employees of temporary staffing agencies.*** Treasury denied commenters' requests for a generally applicable presumption that employees of a temporary staffing agency are uniformly variable hour employees. Instead, the final regulations offered a series of factors (none of which are determinative) that can be used to determine whether an employee is a variable hour employee, including whether employees in the same position with the temporary staffing firm:
    - Retain the right to reject temporary placements that the temporary staffing firm offers,
    - Typically have periods during which no offer of temporary placement is made,
    - Typically are offered temporary placements for different periods of time, and
    - Typically are offered temporary placements that do not extend beyond 13 weeks.

  The regulations further clarify that temporary staffing agencies (and all employers for that matter) may determine when an employee experiences a separation from service based on: (1) facts and circumstances; and (2) use of a reasonable method that is consistent with the employer's general practices for other purposes (such as COBRA, qualified plan rules, and applicable state law).

- ***Seasonal employees.*** As noted above, seasonal and variable hour employees' hours can be measured over a longer period of time initially. The final regulations provide that a "seasonal employee" means an employee in a position for which the customary annual employment is six months or less. The seasonal period of employment should typically begin each calendar year in approximately the same part of the year (*e.g.*, summer or winter). Even if the duration of employment exceeds six months, that employee might still be a seasonal employee, as long as the period of employment is customarily less than six months.

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Please note that this definition of seasonal employee applies for purposes of the full-time status determination, not for purposes of determining applicable large employer status. The regulations require employers to generally make a reasonable, good faith interpretation of whether an employee is a "seasonal worker" for purposes of the applicable large employer determination.

- ***Rehire rules.*** The proposed regulations permitted employers to treat an employee as experiencing a break-in-service for breaks of 26 weeks or more. The final regulations shorten this period to 13 weeks, except for educational organizations that remain at 26 weeks.
- ***No special treatment for short-term employees or employees in high turnover positions.*** Many commenters had requested that employers be permitted to treat (1) short-term/temporary employees, and (2) employees in high turnover positions, as "variable hour employees" because they were only expected to be employed for a short period of time (even though they were expected to work more than 30 hours per week). The final regulations did not extend such relief, meaning a temporary employee or an employee in a high turnover position who is expected to work 30 hours or more per week must be offered coverage no later than three months following his or her date of hire.
- ***Limited ability to vary measurement method among employees.*** Generally, if an employer decides to use the look-back measurement period method for one group of employees, it must use that method for all groups of employees. That being said, the final regulations clarify that employers can vary the measurement method (between look-back and monthly methods) between employees in the following groups:
    - Salaried and hourly employees
    - Employees with primary places of employment in different states
    - Collectively bargained and non-bargained employees
    - Each group of collectively bargained employees covered by a different CBA

  Notably, employers cannot vary measurement methods outside of these categories. So, for instance, an employer could not use a look-back method for part-timers and a monthly method for full-timers (unless those groups otherwise fell within one of the permissible categories described above).
- ***Termination of coverage following change in position during stability period.*** In certain limited circumstances, an employer can stop offering coverage during the stability period if an employee transfers from a full-time to a part-time position, as long as certain requirements are met. In these circumstances coverage must still continue until the first day of the fourth full calendar month following the date of transfer.

When is Coverage Affordable?

To avoid the penalty, the proposed regulations require that coverage offered to full-time employees must be affordable meaning the employee's portion of the premium for self-only coverage cannot exceed 9.5% of household income. The proposed regulations created three safe harbors: (1) W-2 wages, (2) Rate of Pay and (3) Federal Poverty Line. These safe harbors are retained, but slightly modified or clarified in the final regulations.

- **Different safe harbors for different categories of employees.** An employer may choose to use one or more of these safe harbors for all of its employees or for any reasonable category of employee, provided it does so on uniform and consistent basis for all employees in the category.
- **Rate of pay available even if hourly pay is reduced mid-year.** The preamble to the final regulations provide that the rate of pay safe harbor (which generally locks in affordability at the start of the year based on rate of pay) may still be used, even if the employee's rate of pay reduces during the year. To use this safe harbor, the reduction must have stemmed from a bona fide business reason, and affordability must be recalculated separately for each month, rather than for the entire year. Notably, this change does not appear to have been incorporated into the regulations themselves, but it is clear from the preamble that the IRS would allow such an approach.

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- **Federal Poverty Line guidelines in effect six months before the start of the plan year.** In order to allow employers sufficient time to set premiums and plan for the upcoming plan year, employers may use the Federal Poverty Line guidelines in effect six months before the start of the plan year to establish what premiums would be considered affordable.

What if an Employer Cannot Obtain an Insurance Policy?

Many medium-sized to smaller employers have expressed concern that health insurers may refuse to offer them coverage because they cannot meet the insurer's minimum participation requirements. The final regulations reiterate that minimum participation cannot be used to deny coverage in the large group market, and may only be used to deny coverage in the small group market outside of annual enrollment windows. That being said, we understand that insurers are addressing the underwriting issues caused by low participation through (1) increasing group premiums, or (2) declining to renew policies covering groups with low enrollment. It remains to be seen whether the agencies will adopt additional rules to ease these concerns.

Transition Relief: Delayed effective date for non-calendar year plans. Employers with non-calendar year plans will generally not be required to offer coverage to some or all of their full-time employees until the start of the first plan year beginning after January 1, 2015, assuming certain conditions are met. For example, employers that: (1) were not offering health coverage to their employees on December 27, 2012; or (2) were offering coverage as of December 27, 2012, but changed their plan year after that date, cannot take advantage of this transition relief. Employers with non-calendar year plan years should carefully review this nuanced transition rule to ensure they qualify.

Limited 2015 penalty relief. For 2015 only, an employer can avoid the penalty imposed for failure to offer coverage (i.e., $2,000 multiplied by all full-time employees) as long as the employer offers coverage to at least 70% of its full-time employees. Starting in 2016, this threshold reverts to 95%.

Moreover, to account for the transition relief relating to applicable large employer size (discussed above), employers are permitted to take an 80 employee "deduction" before calculating the penalty for failure to offer coverage. Starting in 2016, this reverts to a 30 employee deduction.

What if Coverage is Offered by a Different Organization?

Applicable large employers are required to offer coverage to any common law, full-time employee, or pay a penalty. In certain instances, employers rely on other organizations/entities to offer coverage on their behalf. Generally speaking, the final regulations permit employers to rely on this offer of coverage to discharge the employer's obligation under the employer mandate, subject to the caveats below.

- **Multiemployer/MEWA plan coverage.** The final regulations confirm that an offer of coverage includes an offer of coverage made on an employer's behalf, such as through a Taft-Hartley multiemployer plan or a MEWA.

Transition Relief: Employers contributing to multiemployer plan coverage can rely on plan eligibility terms. The final regulations extend indefinitely (pending future IRS guidance to the contrary) the transition relief from the proposed regulations that would consider a large employer to be in compliance with the requirement to offer coverage for purposes of any collectively bargained full-time employee if:

- The employer is required, by a collective bargaining agreement or participation agreement, to contribute to the multiemployer plan on the employee's behalf,
- The coverage is offered to the employee in accordance with the plan's eligibility terms,
- The coverage is affordable, and
- The coverage provide minimum value.

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- **PEO/staffing agency coverage.** If a staffing agency or professional employer organization (PEO) offers coverage on behalf of the common law employees of the client employer, the employer will be treated as having offered coverage, but only if the fee the client employer would pay to the PEO/staffing agency for an employee enrolled in the health plan is higher than the fee that would be paid for an employee not enrolled in the health plan. PEOs and staffing agencies should consider possible HIPAA Privacy implications before disclosing who is enrolled in the health plan to client employers.

Which Dependents Must Be Offered Coverage?

The employer mandate requires applicable large employers to offer coverage to full-time employees *and their dependents*. The final regulations, like the proposed regulations provide that dependents only include children and adult children for these purposes, not spouses. The final regulations include the following clarifications as well:

- Dependent does not include stepchildren or foster children.
- Dependent does not include a child who is not a US citizen or national, unless that child is a resident of a country contiguous to the US or is an adopted child.
- A child is a dependent for the entire calendar month in which he or she attains age 26. Note that the adult child mandate, as implemented by the Affordable Care Act for plan years generally beginning in 2011, only requires plans to extend coverage to adult children until their 26th birthday, so this clarification may require employer plan sponsors to revisit their definition of dependent.

Transition Relief: No requirement to offer dependent child coverage in 2015. Employers will not be penalized for failure to offer coverage to dependent children in 2015, as long as they meet certain conditions and take reasonable steps toward offering dependent coverage in 2016.

Jennifer A. Kraft is a partner and *Benjamin J. Conley* is an associate in Seyfarth's Chicago office. If you would like further information, please contact your Seyfarth attorney or Jennifer A. Kraft at *jkraft@seyfarth.com* or Benjamin J. Conley at *bconley@seyfarth.com.*

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