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THE AFFORDABLE CARE ACT – WHAT MUNICIPAL EMPLOYERS SHOULD BE THINKING ABOUT NOW

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THE AFFORDABLE CARE ACT[1] - WHAT MUNICIPAL EMPLOYERS SHOULD BE THINKING ABOUT NOW

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Although the Obama administration has delayed implementation of the so-called "play or pay" employer mandate for large employers ("Employer Mandate") until 2015, there are a number of important requirements under the Affordable Care Act ("ACA") that still go into effect in 2014 (or earlier). In addition, although the Employer Mandate has been delayed, employers should continue to develop their strategy and administrative systems for compliance with "play or pay" and the related reporting.

This paper identifies those ACA rules going into effect in 2014 or sooner (as well as some requirements applicable in later years) that are of most interest to municipal employers, and also explains the Employer Mandate, including the safe harbor rules for determining who is a full-time employee under the current proposed regulations.

1. Health Plan Coverage Mandates Effective in 2014

Changes for All Group Health Plans (Whether or Not Grandfathered)

Notwithstanding the delay of the Employer Mandate, group health plans (whether or not "grandfathered"[4]) need to address the following requirements effective January 1, 2014:

- **90-Day Waiting Period Limitation.**

  Effective for plan years beginning on or after January 1, 2014, ACA prohibits group health plans and health insurance issuers from applying a waiting period that exceeds 90 days (the "90-Day Rule").[5]

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[1] Patient Protection and Affordable Care Act, P.L. 111-148, 124 Stat. 119, *amended by* Health Care and Education Reconciliation Act of 2010, P.L. 111-152, 124 Stat. 1029 [hereinafter, collectively, "ACA"].

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[4] In general terms, a "grandfathered" health plan is a group health plan (or insurance coverage) that had at least one individual enrolled on March 23, 2010, and which has not: (i) eliminated benefits to diagnose or treat a condition; (ii) increased cost-sharing requirements beyond certain limits; (iii) decreased the employer's contribution rate by more than a certain amount; or (iv) adopted an overall annual dollar limit that exceeds certain thresholds. A detailed discussion of the "grandfathered" health plan rules is beyond the scope of this paper.

[5] Public Health Services Act ("PHSA") § 2708.

A waiting period is defined as the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective.[6] The proposed regulations make clear that the 90 day period is based on calendar days and coverage must be effective no later than the 91st day after any substantive eligibility conditions are met. A waiting period does not include a "substantive eligibility condition," such as being in an eligible job classification or achieving job-related licensure requirements.[7]

The proposed regulations provide that eligibility conditions which are not based solely on the lapse of a time period do not violate the 90-Day Rule as long as they are not designed to avoid compliance. Eligibility conditions based on hours of service are not designed to avoid compliance in two circumstances described in the proposed regulations: (a) per period hour of service requirements and (b) cumulative hour of service requirements.[8]

A plan has a per period hour of service requirements if (a) eligibility is conditioned on an employee regularly having a specific number of hours of service per period or on an employee working full-time and (b) it cannot be determined at the employee's start date whether the employee is reasonably expected to meet the requirement. In such instance, the plan may take up to twelve months to determine whether the employee meets the requirement. This twelve month period may begin on the employee's start date or any date thereafter up to the first day of the calendar month following the employee's start date. In addition, to meet this rule, coverage must be effective no later than the first day of the calendar month following the thirteen month anniversary of the employee's start date.

A plan has a cumulative hour of service requirement if eligibility is conditioned on an employee completing a number of cumulative hours of service. Such a requirement will be considered not designed to avoid compliance with the 90-Day Rule if the required hours of service do not exceed 1,200. In addition, coverage must be effective (assuming the employee elects coverage) no later than the 91st day after the employee completes the cumulative hour of service requirement.

- **Eliminating Preexisting Condition Limitations**

  Effective for plan years beginning on or after January 1, 2014, group health plans and health insurance issuers are prohibited from applying a preexisting condition exclusion to any individual.[9]

- **Wellness Program Rules.**

  Group health plans (and group health insurance issuers) may not discriminate against

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[6] PHSA § 2704(b)(4); 45 C.F.R. § 147.116(b).

[7] 45 C.F.R. § 147.116(c).

[8] 45 C.F.R. § 147.116(c)(3).

[9] PHSA § 2704(a).

individuals in eligibility, benefits or premiums based on a health factor.

Final regulations under the ACA and HIPAA[10] provide a wellness program exception to this prohibition. These regulations apply to all group coverage (not just nongrandfathered coverage), effective for plan or policy years beginning on or after January 1, 2014. These final regulations are similar to the existing wellness program regulations with a few key distinctions. One distinction is that the final regulations provide that the maximum reward is increased, including an increase to 50 percent for wellness programs that are designed to prevent or reduce tobacco use. Another distinction is that the final regulations divide wellness programs into categories in a slightly different manner than do the existing rules. The final regulations also expand the requirement to offer a reasonable alternative program for wellness programs that require the participant to complete an activity or to meet an outcome-based standard.

- **Coverage of Children to Age 26 for Grandfathered Plans**

  Effective for plan years beginning on or after January 1, 2014, grandfathered plans providing dependent coverage must cover a child to age 26 even if such child is eligible to enroll in employer-sponsored coverage other than coverage provided by the employer of a parent.[11]

Changes for Nongrandfatehred Group Health Plans

In addition, nongrandfathered group health plans will need to address the following requirements effective January 1, 2014:

- **Cost-Sharing Limitations.**

  Effective for plan years beginning on or after January 1, 2014, all group health plans and health insurance issuers must, with respect to non-grandfathered coverage, ensure that the annual out-of-pocket costs (including deductibles) do not exceed the limit that applies to a high deductible health plan under Code section 223, as it may be adjusted from year to year (this maximum is $6,350 for self-coverage and $12,700 for family coverage in 2014).[12] Such limits may be increased by amounts "readily available" for reimbursement under a flexible spending account.

- **Nondiscrimination Against Health Care Providers.**

  Effective for plan years beginning on or after January 1, 2014, group health plans and health insurance issuers may not, with respect to non-grandfathered coverage, discriminate against health care providers who are acting within the scope of their license or certification under

[10] The Health Insurance Portability and Accountability Act of 1996, as amended.

[11] ACA § 1251(a)(4)(B)(ii).

[12] PHSA § 2707(a) & (b). Qualified health plans and issuers in the small group market also must ensure that the annual deductible does not exceed $2,000 for self-coverage and $4,000 for family coverage, with each amount indexed annually beginning in 2015.

applicable state law.[13] The statutory language indicates that this provision shall not require a plan or issuer to contract with any willing health care provider. The legislative history indicates that the provision is intended to benefit practitioners who may have been traditionally excluded from participation, such as alternative medicine practitioners, acupuncturists, and chiropractors.

Penalties

Under PHSA Section 2723(b), the penalty for failure by a governmental group health plan to comply with the coverage mandates described above is $100 a day for each day of noncompliance for each adversely impacted person. There are exceptions for certain failures due to reasonable cause. In the case of a single-employer group health plan, the penalty is imposed on the employer, and in the case of a multiple employer plan, the penalty is imposed on the plan.

Individual Mandate and Marketplace Coverage

Although the Employer Mandate has been delayed until 2015, the requirement that most individuals obtain health coverage or pay a penalty will continue to apply effective January 1, 2014. Because of the delay of the Employer Mandate, enrollment through the health insurance marketplaces, as well as the number of individuals who qualify for a premium tax credit, may increase for 2014. Employers should be thinking carefully about how they will handle employee inquiries about marketplace coverage and how it relates to or is impacted by the health insurance coverage offered by the employer.

2. Other Current and Upcoming Requirements

Employers should already have addressed or should be preparing to address the following requirements:

- **New Fees.**

  Employers with self-insured plans will need to pay a comparative effectiveness (PCORI) fee, which is payable for 7 plan years, with the first payment due July 31, 2013 for many plans.[14] In addition, for three plan years beginning with the plan year beginning on or after January 1, 2014, insurers and self-insured plans on behalf of group health plans will be required to make payments to an applicable reinsurance entity to support the individual insurance market.[15] The fee will be imposed based on the number of enrollees receiving coverage through a contributing entity and will be designed so that the aggregate national annual required contribution is met.

[13] PHSA § 2706(a).

[14] Internal Revenue Code ("IRC") §§ 4375, 4376 and 4377.

[15] PPACA § 1341(b)(3).

- **Written Notice Upon Hiring.**

  Employers must distribute a notice about health insurance marketplaces to employees by October 1, 2013, and thereafter to newly-hired employees upon hire.[16] For 2014, notices will be considered timely provided to new employees if they are provided within 14 days of hire. The Department of Labor has issued model notices that employers may use to meet this obligation.

- **No Discrimination in Favor of Highly Compensated Individuals**

  Currently, under Code section 105(h), the value of amounts that a discriminatory self-insured plan pays or covers for "highly compensated individuals" is taxable to such individuals. For governmental plans, a "highly compensated individual" is (i) one of the five highest paid officers, or (ii) an individual who is among the highest 25 percent of all employees (with certain exclusions allowed). Code section 105(h) prohibits discrimination both in connection with eligibility for benefits and benefits actually provided to highly compensated individuals.

  Originally effective for plan years beginning on or after September 23, 2010, (but *currently in an agency non-enforcement period until final regulations are issued and become effective*), the prohibition on discrimination found in Code section 105(h) is extended to non-grandfathered group health plans that are not self-insured (i.e., fully insured plans) under PHSA section 2716. The penalty for violation of PHSA section 2716 will be the penalty imposed on violations of the ACA health plan coverage mandates described above. This is in contrast to Code section 105(h), which penalizes discrimination in favor of highly compensated individuals in self-insured plans by taxing the recipient of the discriminatory benefit.

- **Automatic Enrollment Rule for Employers with More Than 200 Employees**.

  Employers who have more than 200 full-time employees, and provide one or more health benefits plans or options, will be required to automatically enroll full-time employees in one of the employer's health benefits plans or options (subject to any authorized waiting periods) and to continue the enrollment of current employees in such plan or option.[17] Under FLSA section 18A, employers also will be required to give adequate notice to employees of the automatic enrollment protocol and an opportunity to opt out of such coverage. The Department of Labor has issued guidance indicating that the new rule will not be effective until final regulations are issued, which will not be by 2014.[18]

- **The Cadillac-Plan Tax**.

  For taxable years beginning after December 31, 2017, the ACA imposes an excise tax on

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[16] Fair Labor Standards Act ("FLSA") § 18B.

[17] FLSA § 18A, 29 U.S.C. § 219A.

[18] FAQs About Affordable Care Act Implementation part V, Q&A 3 (Dec. 22, 2010); DOL Technical Release 2012-01 (Feb. 9, 2012).

"Cadillac Plans."[19] Cadillac Plans are plans with a total coverage cost that exceeds $10,200 for individual coverage and $27,500 for other than individual coverage, as such amounts are adjusted for medical inflation since 2010. The Cadillac Plan tax will equal 40 percent of the cost of the coverage on a monthly basis that exceeds the thresholds described above (the excess benefit). The threshold limits are higher for persons in high-risk professions set forth in the ACA, including emergency personnel, and persons in certain jobs related to construction, utilities, and agriculture. In addition, the ACA provides for adjustments to the thresholds for employers whose health care costs are higher because of the age and gender of their employees. Further, the threshold for all coverage under a multiemployer plan is $27,500. The Cadillac Plan tax is imposed on health insurance issuers for insured plans and on the plan administrator for self-insured plans.

3. "Play or Pay" Employer Mandate Effective 2015 And Related Reporting Requirements

Under the "Play or Pay" Employer Mandate of the ACA, large employers must offer affordable, minimum value health coverage to their full-time employees and their children or risk paying a penalty. This requirement had been effective January 1, 2014, with transition rules allowing for a later effective date for certain employers. New transition relief has been provided to the effect that no penalty will be imposed for any months prior to January 2015. It is not clear whether there will be any additional transition relief, such as for fiscal year plans.

The remainder of this paper addresses some of the more commonly asked questions related to the Employer Mandate, including which employers are subject to the mandate, who must be offered coverage to avoid a penalty, the type of coverage that must be offered to avoid said penalty, and the penalties that apply for not offering coverage. This discussion is based on recently issued proposed regulations; the final regulations, when issued, may change the requirements.[20]

In Short, What Is the Employer Mandate?

On January 1, 2015, the Employer Mandate will change the landscape of health care in the U.S. by requiring large employers to offer health coverage to full-time employees and their children up to age 26 or risk paying a penalty.[21] Large employers will be forced to make a choice: to either "play" by offering affordable health coverage that provides minimum value or "pay" by potentially owing a penalty to the Internal Revenue Service if they fail to offer such coverage.[22] This play-or-pay scheme, called "shared responsibility" in the statute, has become known as the Employer Mandate.

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[19] IRC § 4980I.

[20] Shared Responsibility for Employers Regarding Health Coverage, 78 Fed. Reg. 217 (Jan. 2, 2013) (to be codified at 26 CFR pt. 1) [hereinafter "Shared Responsibility"].

[21] IRC § 4980H(a)-(b).

[22] *Id.*

Covered Employers. Only "large employers" are required to comply with the Employer Mandate.[23] Generally speaking, "large employers" are employers that had an average of 50 or more full-time or full-time equivalent employees on business days during the preceding year.[24] "Full-time employees" include all employees who work at least 30 hours on average each week.[25] The number of "full-time equivalent employees" is determined by aggregating the hours worked by all non-full-time employees.[26] In determining large employer status, certain related employers under common control are considered to be a single employer.[27]

Basic Health Coverage Requirement. To "play" under the Employer Mandate, a large employer must offer health coverage that is "minimum essential coverage," is "affordable," and satisfies a "minimum value" requirement to its full-time employees and certain of their dependents.[28] "Minimum essential coverage" includes coverage under an employer-sponsored group health plan, whether it be fully insured or self-insured, but does not include stand-alone dental or vision coverage, or flexible spending accounts.[29] Coverage is "affordable" if an employee's required contribution for the lowest-cost self-only coverage option offered by the employer does not exceed 9.5 percent of the employee's household income.[30] Coverage provides "minimum value" if the plan's share of the actuarially projected cost of covered benefits is at least 60 percent.[31] More detail about these requirements is included in other Q&As below.

Penalty Scenarios. If a large employer does not "play" for some or all of its full-time employees, the employer will have to pay a penalty in two scenarios.[32]

No Group Coverage Offered. The first penalty scenario occurs when an employer does not offer health coverage to "substantially all" of its full-time employees and *any one* of its full-time employees both enrolls in health coverage offered through a State Insurance Exchange, which is also being called a Marketplace (an "Exchange"), and receives a premium tax credit or a cost-sharing subsidy (each an "Exchange subsidy").[33] In this scenario, the employer will owe a

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[23] IRC § 4980H(a)-(b).

[24] IRC § 4980H(c)(2)(A); 26 CFR § 54.4980H-1(a)(4).

[25] IRC § 4980H(c)(4)(A); 26 CFR § 54.4980H-1(a)(18).

[26] IRC § 4980H(c)(2)(E); 26 CFR §§ 54.4980H-1(a)(19), -2(c).

[27] IRC § 4980H(c)(2)(C)(i); 26 CFR § 54.4980H-1(a)(14).

[28] IRC §§ 36B, 4980H(a)-(b).

[29] IRC § 5000A(f).

[30] IRC § 36B(c)(2)(C)(i)(II).

[31] IRC § 36B(c)(2)(C)(ii).

[32] IRC § 4980H(a)-(b).

[33] IRC § 4980H(a).

"no coverage penalty."[34] The no coverage penalty is $2,000 per year (adjusted for inflation) for each of the employer's full-time employees (excluding the first 30).[35]

Inadequate Health Coverage Offered. The second scenario occurs when an employer does provide health coverage to its employees, but such coverage is deemed inadequate for Employer Mandate purposes, either because it is not "affordable," does not provide at least "minimum value," or the employer offers coverage to substantially all (but not all) of its full-time employees and *one or more* of its full-time employees both enrolls in Exchange coverage and receives an Exchange subsidy.[36] In this second scenario, the employer will owe an "inadequate coverage penalty."[37] The inadequate coverage penalty is $3,000 per person and is calculated based only on each full-time employee who receives an Exchange subsidy,—not on the employer's total number of full-time employees.[38] (Furthermore, the penalty is capped each month by the maximum potential "no coverage penalty" discussed above).[39]

Because Exchange subsidies are available only to individuals with household incomes of at least 100 percent and up to 400 percent of the federal poverty line (in 2013, a maximum of $45,960 for an individual and $94,200 for a family of four), employers that pay relatively high wages may not be at risk for the penalty, even if they fail to provide coverage that satisfies the affordability and minimum value requirements.[40] Likewise, because Exchange subsidies are not available to individuals who are eligible for Medicaid, employers may be partially immune to the penalty with respect to their low-wage employees, particularly in states that elect the Medicaid expansion.[41] To be sure, Medicaid eligibility is based on household income.[42] *Caution:* Because an employee's household may have more income than the wages he or she receives from the employer, the employee might not be Medicaid eligible, even though the employer pays a very low wage. Thus, it may be difficult for an employer to assume its low-paid employees will be eligible for Medicaid and not eligible for Exchange subsidies. But for employers with low-wage workforces, examination of the extent to which the workforce is Medicaid eligible may be worth exploring.

In addition, Exchange subsidies will not be available to any employee whose employer offers the employee affordable coverage that provides minimum value.[43] Thus, by "playing" for employees who would otherwise be eligible for an Exchange subsidy, employers can ensure they are not subject to any penalty, even if they don't "play" for all employees.

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[34] *Id.*

[35] IRC § 4980H(c)(1), (5); 26 CFR § 54.4980H-4(d).

[36] IRC § 4980H(b).

[37] *Id.*

[38] *Id.*

[39] IRC § 4980H(b)(2).

[40] IRC § 36B(c)(1)(A).

[41] *Id.*

[42] 42 USC § 1396a.

[43] IRC § 36B(c)(2)(C).

Who Is Eligible for a Premium Tax Credit or Cost-Sharing Subsidy?

As noted above, merely failing to offer full-time employees minimum essential coverage, or coverage that meets the affordability or minimum value requirements, is not enough to trigger liability under the Employer Mandate. Two additional things must occur before any penalty will be assessed. First, one of the employer's full-time employees must enroll in health coverage offered through an Exchange.[44] Second, that full-time employee must receive an Exchange subsidy (a premium tax credit or cost-sharing subsidy).[45] Thus, an employer should consider which of its employees are potentially eligible for an Exchange subsidy when deciding how to comply with the Employer Mandate. It is important to note that the employee must qualify for the Exchange subsidy; receipt of an Exchange subsidy by an employee's dependent (for an example, an adult child who is not a tax dependent of the employee) will not give rise to an Employer Mandate penalty.[46]

Coverage Through an Exchange. In order to be eligible to receive an Exchange subsidy, an individual must enroll in health coverage offered through an Exchange.[47] Under the ACA, an Exchange will be established in each state, either by the state or by the federal government (or a combination of the two).[48] An Exchange is a governmental entity or nonprofit organization that serves as a marketplace for health insurance for individuals and small employers.[49] Health insurance offered through the Exchanges must cover a minimum set of specified benefits and must be issued by an insurer that has complied with certain licensing and regulatory requirements.[50]

Eligibility for an Exchange Subsidy. There are two Exchange subsidies available: the premium tax credit and the cost-sharing subsidy.[51] The premium tax credit is intended to help individuals and families purchase health coverage through an Exchange.[52] The credit is available only to legal U.S. residents whose household income is 100 percent to 400 percent of the federal poverty line (FPL).[53] Legal resident aliens also qualify for the credit if their household income is below 100 percent of the federal poverty line because they are not eligible for Medicaid.[54] Individuals

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[44] IRC § 4980H(a)-(b).

[45] *Id.*

[46] Shared Responsibility, 78 Fed. Reg. at 218.

[47] IRC § 36B(c)(2)(A).

[48] ACA § 1311.

[49] *Id.*

[50] *Id.*

[51] IRC § 36B; ACA § 1402.

[52] IRC § 36B.

[53] IRC § 36B(c)(1)(A).

[54] IRC § 36B(c)(1)(B).

who are eligible for Medicaid, Medicare, or certain other government-sponsored coverage like CHIP or veterans' health care, are not eligible for premium tax credits.[55]

The FPL is set annually by the U.S. Department of Health and Human Services (HHS) and is based on household size.[56] For 2013, the FPL in the continental U.S. is $11,490 for an individual and $23,550 for a family of four; 400 percent of the FPL is $45,960 for an individual and $94,200 for a family of four. The amounts are slightly higher in Alaska and Hawaii.[57]

An employee is not eligible for a premium tax credit if the employee is either (i) enrolled in an employer-sponsored plan or (ii) eligible for an employer-sponsored plan that meets the affordability and minimum value requirements.[58]

Cost-sharing subsidies, which reduce cost-sharing amounts such as copays and deductibles, are available to individuals who have a household income no greater than 250 percent of the FPL and enroll in "silver-level" coverage through an Exchange.[59] An employee whose household income is 200 percent of the FPL may therefore be eligible for a premium tax credit to help defray the cost of monthly insurance premiums, and a cost-sharing subsidy to help reduce the amount of out-of-pocket copays and deductibles to which the Exchange-enrolled employee otherwise would be subject.[60]

"Certification" of Eligibility for an Exchange Subsidy to Employer. The Employer Mandate penalty applies only when the employer has first received "certification" that one or more employees have received an Exchange subsidy.[61] The IRS will provide this certification as part of its process for determining whether an employer is liable for the penalty, which will occur in the calendar year following the year for which the employee received the Exchange subsidy. Under procedures to be issued by the IRS, employers that receive one or more certifications will be given an opportunity to contest the certification before any penalty is assessed.[62]

In addition, Exchanges are required to notify employers that an employee has been determined eligible to receive an Exchange subsidy.[63] The notification provided contemporaneously with the determination will identify the employee, indicate that the employee has been determined eligible to receive an Exchange subsidy, indicate that employer may be liable for an Employer Mandate penalty, and notify the employer of the right to appeal the determination.[64] These

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[55] 26 CFR § 1.36B-2.

[56] Annual Update of the HHS Poverty Guidelines, 78 Fed. Reg. 5,182 (Jan. 24, 2013).

[57] *Id.*

[58] IRC § 36B(c)(2)(C).

[59] ACA, supra note 1, § 1402.

[60] IRC § 36B.

[61] IRC § 4980H(a)-(b).

[62] Shared Responsibility, 78 Fed. Reg. at 235.

[63] ACA § 1411(e)(4)(B)(iii); 45 CFR § 155.310(g).

[64] ACA § 1411(e)(4)(B)-(C).

notices will be useful in giving employers an opportunity to correct erroneous Exchange information and protect against erroneous penalty notices from the IRS. These notices will also be useful in budgeting for any penalties that may be owed.

Which Employers Are Subject to the Employer Mandate?

As noted earlier, beginning January 1, 2015, "large employers" must offer health coverage to full-time employees and their children or risk paying a penalty.[65] The Employer Mandate applies not only to for-profit employers but also to federal, state, local, and Indian tribal governmental entities, as well as to tax-exempt organizations.[66]

An employer is a "large employer" for a calendar year if it employed an average of at least 50 full-time and full-time equivalent employees on business days during the preceding calendar year.[67] The following discussion explains how to determine the employees who must be counted and how to calculate the number of full-time and full-time equivalent employees.

Related Employers in a Controlled Group. Groups of related employers that are in a controlled group are treated as a single employer for purposes of determining large employer status, although Employer Mandate penalties are determined separately for each employer.[68] Whether employers are in a controlled group is determined under the rules of IRC Sections 414(b), (c), (m), and (o).[69] These same rules apply to tax qualified retirement plans and are often called the controlled group rules. The proposed regulations reserve guidance on application of these rules to government entities; until further guidance is issued, government entities may rely on a reasonable good faith interpretation of these controlled group rules. For guidance on what constitutes a reasonable good faith interpretation of these rules, employers should consider IRS guidance issued in the context of IRC Section 403(b) plans.[70] In that context, the IRS has said that the controlled group includes each entity of which at least 80% of the directors, trustees or other individual members of the entity's governing body are either representatives of or directly or indirectly control, or are controlled by, another employer. In addition, an entity is included in the same controlled group as the another employer if such entity receives directly or indirectly at least 80% of its operating funds from the first employer and there is a degree of common management or supervision between the entities. A degree of common management or supervision exists if the entity providing the funds has the power to appoint or nominate officers, senior management or members of the board of directors (or other governing board) of the entity receiving the funds. A degree of common management or supervision also exists if the entity providing the funds is involved in the day-to-day operations of the entity. These rules are similar to the rules that apply to most tax-exempt organizations.[71]

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[65] IRC § 4980H(a)-(b).

[66] Shared Responsibility, 78 Fed. Reg. at 221.

[67] IRC § 4980H(c)(2)(A); 26 CFR § 54.4980H-1(a)(4).

[68] *See* supra note 11

[69] IRC § 4980H(c)(2)(C)(i).

[70] Notice 89-23; 72 Fed. Reg. 41127, (noting that governmental plans may continue to rely on the guidance in Notice 89-23 after the issuance of final regulations governing section 403(b) plans).

[71] *See* Treas. Reg. § 1.414(c)-5.

"Full-Time Employees" and Full-Time Equivalent Employees. For purposes of the Employer Mandate, "employee" is a common law employee and, in general, a full-time employee is a common law employee who is credited with an average of at least 30 hours of service each week or 130 hours of service each calendar month.[72] A more detailed discussion of who is a full-time employee is provided later in the article, including treatment of variable hour employees, seasonal employees, and rehires.

The term "full-time equivalent employee" reflects the number of full-time employees an employer would have based on the hours for all employees who are not full-time employees (under the definition above).[73] To determine the number of full-time equivalent employees for a calendar month, first calculate the aggregate hours of service (including fractional hours, but not including more than 120 for any one employee) for all employees who are not full-time employees for that month.[74] Then, divide the total number of hours worked by non-full-time employees by 120.[75]

> *Example 1:* Employer Y has 40 employees who each have 90 hours of service per calendar month during 2013. This means the employer has 30 full-time equivalent employees for each calendar month in 2013 (40 employees X 90 hours = 3,600 hours; 3,600 hours ÷ 120 hours = 30.

Full-time equivalent employees are counted solely for purposes of determining whether an employer is a large employer.[76] There is no penalty for failing to offer coverage to any employee who is not a full-time employee.[77]

Determining Large Employer Status: To determine whether an employer is a large employer, add the number of full-time employees and the number of full-time equivalent employees for each calendar month of the prior year and divide the total by 12 to determine the average.[78] If this number is 50 or higher, the employer is a "large employer" and is subject to the Employer Mandate, unless an exception applies, as discussed below.[79]

Remember that for the members of a controlled group, this calculation includes employees of all related employers under common control.[80]

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[72] 26 CFR § 54.4980H-1(a)(13), (18).

[73] 26 CFR § 54.4980H-1(a)(19).

[74] 26 CFR § 54.4980H-2(c).

[75] *Id.*

[76] *Id.*

[77] IRC § 4980H(c)(2) (E).

[78] 26 CFR § 54.4980H-2(b).

[79] 26 CFR § 54.4980H-1(a)(4).

[80] IRC § 4980H(c)(2)(C)(i).

Example 2: For each of the first six calendar months of 2014, Employer C has 32 full-time employees and 30 non-full-time employees, who equate to 15 full-time equivalent employees. Employer C's needs increase during the last half of 2014, and all the persons who were non-full-time employees during the first half of the year work enough hours to be full-time employees for each of the last six calendar months. In other words, Employer C has 62 full-time employees for the last six months of 2014. To determine whether Employer C is a large employer for 2015, add the number of full-time and full-time equivalent employees it has for each month of 2014 (47 + 47 + 47 + 47 + 47 + 47 + 62 + 62 + 62 + 62 + 62 + 62), which equals 654 , and then divide the result by 12. This results in Employer C having an average of 54 (54.5 rounded down) full-time or full-time equivalent employees in 2014. Because this number is at least 50, Employer C is treated as a large employer for 2015.

Seasonal Worker Exception. Seasonal workers generally are included in the count of full-time and full-time equivalent employees.[81] However, a special rule applies to employers that exceed the 50 full-time equivalent employee threshold for only part of a year, solely because of a seasonal workforce. If the employer has more than 50 full-time and full-time equivalent employees for periods totaling 120 days or less (or totaling four months or less) during a calendar year, and the full-time and full-time equivalent employees in excess of 50 during that period or periods were seasonal workers, the employer is not subject to the Employer Mandate during the following calendar year.[82] Seasonal workers include individuals employed to do work that is exclusively performed at certain seasons of the year, including, but not limited to, seasonal agricultural workers and retail workers employed only during holiday seasons.[83] Until further guidance is issued, employers are permitted to make a reasonable, good-faith determination of who is a seasonal worker.[84]

Who Must Be Offered Coverage?

Under the Employer Mandate, large employers are required to offer health coverage to full-time employees and certain of their dependents.[85] The following paragraphs describe who falls into the categories of "full-time employees" and "dependents" who must be offered coverage, as well as a special provision that allows employers to avoid the "no coverage" penalty if coverage is offered to "substantially all" full-time employees.

Definition of "Employee." As noted above, under the Employer Mandate, the term "employee" means a common law employee. Generally speaking, an individual who provides services to an employer is a common law employee if the employer has the authority to direct and control the manner in which services will be performed by the employee.[86] An employer need not actually

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[81] IRC § 4980H(c)(2)(B); 26 CFR § 54.4980H-1(a)(34).

[82] IRC § 4980H(c)(2)(B)(i); 26 CFR § 54.4980H-2(b)(2).

[83] IRC § 4980H(c)(2)(B)(ii); 26 CFR § 54.4980H-2(b)(2).

[84] *Id.*

[85] IRC § 4980H(a)-(b).

[86] Shared Responsibility, 78 Fed. Reg. at 221.

direct and control the work; the mere right to do so creates the employment relationship.[87] The special rule that requires leased employees to be treated as employees of the service recipient for purposes of qualified retirement plans does not apply for the Employer Mandate.[88] Rather, whether the leasing company or the client has the obligation to offer coverage to a leased employee is based on which of the two is the common law employer.[89]

Definition of "Full-Time Employee." For purposes of the Employer Mandate, a "full-time employee" is a common law employee who is credited with an average of at least 30 "hours of service" per week for an employer (including all related employers in a controlled group).[90] Employers can elect to treat 130 hours of service in a calendar month as equivalent to 30 hours of service per week.[91] This threshold is different than, for example, the 40-hour threshold for overtime eligibility under the Fair Labor Standards Act.

An employee's "hours of service" include all hours for which the employee is paid or entitled to payment from an employer (including all related employers in a controlled group) for performing services or for holidays, vacation, sick leave, jury duty, layoff, military duty, or other leave of absence.[92] However, hours of service performed outside the U.S. are not taken into account, unless it is the rare case when the compensation for those services is considered U.S. source income for tax purposes.[93]

Coverage for "Substantially All" Full-Time Employees. The statutory language of the Employer Mandate applies a penalty if an employer fails to offer coverage to "its employees."[94] To avoid the harsh result that would come from reading the language to require the employer to cover all of its employees, the proposed regulations treat an employer as having offered coverage to its full-time employees during any month if it offers coverage to all but the greater of five full-time employees or 5 percent of its full-time employees.[95] This proposed rule applies whether the failure to offer coverage is intentional or unintentional, but it does not shield the employer from the penalty for offering inadequate coverage if any of the full-time employees, including those who are not offered coverage at all, receive an Exchange subsidy (a premium tax credit or cost sharing subsidy) for purchasing coverage through an Exchange.[96]

Estimation of Hours for Salaried Employees. In general, an employer must calculate an employee's hours of service based on the actual number of hours for which the employee is

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[87] *Id.*

[88] *Id.*

[89] *Id.*

[90] IRC § 4980H(c)(4); 26 CFR § 54.4980H-1(a)(13), (18).

[91] 26 CFR § 54.4980H-1(a)(18).

[92] 26 CFR § 54.4980H-1(a)(21).

[93] 26 CFR § 54.4980H-1(a)(21)(iii).

[94] IRC § 4980H(a)-(b).

[95] 26 CFR § 54.4980H-4(a).

[96] Shared Responsibility for Employers Regarding Health Coverage, 78 Fed. Reg. at 232-33.

paid.[97] However, in the case of salaried employees (where hours typically are not tracked), employers can estimate an employee's hours of service using either the "days-worked method" and the "weeks-worked method."[98]

Under the days-worked method, each salaried employee is treated as having eight hours of service for each day on which the employee has at least one actual hour of service.[99] Under the weeks-worked method, each salaried employee is treated as having 40 hours of service for each week during which the employee has at least one actual hour of service.[100]

An employer can apply a different estimation method to different categories of salaried employees, as long as the categories used are reasonable and applied consistently.[101] However, an estimation method can be used only if it generally reflects the employee's actual hours of service.[102] For example, if an employee generally works three 10-hour days per week (30 hours of service per week), the days-worked method could not be used because it would understate the employee's hours of service by crediting the employee with only 24 hours of service (3 days x 8 hours of service). This would cause the employee to be treated as a part-time employee rather than a full-time employee.

Nonresident Alien Employees. Employers with a global presence need not offer coverage to employees who work abroad and have no U.S.-source income.[103] Generally, income is not considered to be from a U.S. source if the services to which it relates are performed outside of the U.S. As such, large employers generally do not need to offer coverage to nonresident aliens and U.S. citizens working in another country.[104]

Resident aliens who are paid for services performed in the U.S., however, do receive U.S.-source income.[105] Further, such individuals are eligible for a premium tax credit if their household income is at or below 400 percent of the poverty line and they are not eligible for coverage provided by their home country.[106] Therefore, resident alien employees who work in the U.S. may have to be considered when determining whether an employer owes an Employer Mandate penalty.[107]

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[97] 26 CFR § 54.4980H-3(b)(1).

[98] 26 CFR § 54.4980H-3(b)(2).

[99] 26 CFR § 54.4980H-3(b)(2)(i)(B).

[100] 26 CFR § 54.4980H-3(b)(2)(i)(C).

[101] 26 CFR § 54.4980H-3(b)(2)(ii).

[102] 26 CFR § 54.4980H-3(b)(2)(iii).

[103] 26 CFR §§ 54.4980H-1(a)(21), -3; Shared Responsibility, 78 Fed. Reg. at 224.

[104] *Id.*

[105] *Id.*

[106] IRC § 36B(c)(1)(B).

[107] *Id.*

Definition of "Dependent." As noted, the Employer Mandate requires large employers to offer coverage not only to full-time employees, but also to their "dependents."[108] Significantly, however, the proposed regulations exclude spouses from the definition of dependent; thus, employers need not offer coverage to the spouses of employees in order to avoid a penalty.[109]

The definition of "dependent" includes only an employee's children who are below the age of 26.[110] A child includes a natural, step, or adopted child; a child placed with the employee for adoption; and a foster child.[111] An employee's foster child is an individual who is placed with the employee by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.[112] While the Employer Mandate requires that a foster child be covered up to age 26, the placement or court order would, in most cases, end when the foster child attains the age of majority (age 18 in most states). As such, it would seem that foster children need not be offered coverage after the date on which they cease to meet the definition of "foster child," despite being under age 26 at such time.

Planning Pointer. Due to the increasing cost of coverage, some employers are revising eligibility rules to limit spousal coverage to those spouses who are not eligible for coverage through their own employer. Because employees are likely to prefer having all family members enrolled in the same plan when possible, if many employers in a geographic area restrict spousal coverage, the few employers who do not may find more spouses enrolling, and more dependents as well. Employers should consider whether changes to their own eligibility rules are warranted.

Delinquent Premium Payments. The proposed regulations provide that an employer will be deemed to have offered coverage--and thus not subject to a penalty--if coverage is not offered for part of the year because an employee was initially enrolled for the year but then terminated due to the employee's failure to timely pay premiums. (For these purposes, the proposed regulations incorporate the COBRA rules governing the nonpayment or late payment of premiums to determine when this rule applies.) The employer will be deemed to have offered coverage for the remainder of the "coverage period," which generally is the remainder of the plan year.[113] Thereafter, the employer will again have to offer coverage to the employee.[114]

What Are the Safe Harbors for Determining "Full-Time" Status?

As noted above, for purposes of the Employer Mandate, a "full-time" employee is an employee who is credited with on average at least 30 hours of service per week, or 130 hours of service in a calendar month.[115] The proposed regulations include optional safe harbor methods that

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[108] IRC § 4980H(a)-(b).

[109] 26 CFR § 54.4980H-1(a)(11).

[110] *Id.*

[111] IRC § 152(f)(1).

[112] IRC § 152(f)(1)(C).

[113] 26 CFR § 54.4980H-3(f).

[114] *See id.*

[115] IRC § 4980H(c)(4); 26 CFR § 54.4980H-1(a)(18).

employers may use to determine who is a "full-time" employee.[116] The safe harbors, though complex to apply, allow an employer to determine in advance whether an employee will be considered "full-time" for a later fixed period of time, regardless of the hours actually worked in that later period.[117] The determination is made by looking at hours of service during a "measurement period" and applying the result to a later "stability period."[118]

Obviously, an employer would not need to use a safe harbor for an employee who always works 35 hours per week, because that employee meets the definition of "full-time" employee without the need for further analysis.[119] However, if an employee's hours vary from week to week, or if the employee works only a few months each year, using a safe harbor will allow the employer to know with certainty whether the employee is treated as full-time in deciding what coverage to offer, if any. One safe harbor is available for all ongoing employees,[120] and another for new employees who work variable hours or are seasonal employees.[121] [Interestingly, the preamble to the proposed regulations indicates that use of the new employee safe harbor is limited to employers that use the ongoing employee safe harbor, but there is no such express requirement in the proposed regulations themselves.][122] As there is some administrative burden involved in using the safe harbors, they will be of primary interest to large employers that have a lot of variable hour or seasonal employees and either (1) want to offer coverage only to full-time employees or (2) do not offer coverage and want to limit the amount of their Employer Mandate penalty.

Optional Safe Harbor for Ongoing Employees. Under the ongoing employee safe harbor, an employer looks back to hours of service during a "standard measurement period" of three to 12 months (the length of which is selected by the employer) to determine an ongoing employee's full-time or non-full-time status.[123] For administrative ease, the beginning and ending dates of a standard measurement period may be coordinated with an employer's weekly, biweekly, or semi-monthly payroll periods.[124] For example, a measurement period could begin the day after the payroll period that includes January 1 of a year and end on the last day of the payroll period that includes December 31 of that year.

An employee's status, determined based on hours of service during the standard measurement period, remains in effect for a "stability period."[125] The stability period, also selected by the employer, must be at least six consecutive calendar months and at least as long as the related

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[116] 26 CFR § 54.4980H-3(c).

[117] 26 CFR § 54.4980H-3(c)(1)(i).

[118] 26 CFR § 54.4980H-3(c).

[119] IRC § 4980H(c)(4); 26 CFR § 54.4980H-1(a)(18).

[120] 26 CFR § 54.4980H-3(c)(1).

[121] 26 CFR § 54.4980H-3(c)(3).

[122] 26 CFR § 54.4980H-3(c)(3); Shared Responsibility, 78 Fed. Reg. at 227.

[123] 26 CFR § 54.4980H-3(c)(1).

[124] 26 CFR § 54.4980H-3(c)(1)(ii).

[125] 26 CFR § 54.4980H-3(c)(1)(i).

measurement period (but no longer than the related measurement period if the employee is determined to not be full-time).[126] The employee will retain the same full-time or non-full-time status throughout the stability period, even if the employee's actual hours of service during this period would produce the opposite status.[127] If an employee who is treated as full-time based on the safe harbor terminates employment during the stability period, the employer is not required to continue to offer the employee coverage, except as required by COBRA or similar state law.[128] However, there are special rules that apply to terminated employees who are rehired, which are addressed later in this discussion.

An employer can choose to have an "administrative period" of not more than 90 days.[129] The administrative period gives the employer time to determine which employees are eligible for coverage based on the standard measurement period and to complete any required employee notifications and enrollments prior to the beginning of the stability period.[130] The three periods must overlap in a way that ensures that employees who are consistently treated as full-time employees do not have a break in coverage.[131]

Figure 1 and Example 3 illustrate two full cycles of a 12-month standard measurement period, a 78-day administrative period, and a 12-month stability period that satisfy these requirements.

[126] 26 CFR § 54.4980H-3(c)(1)(iii).

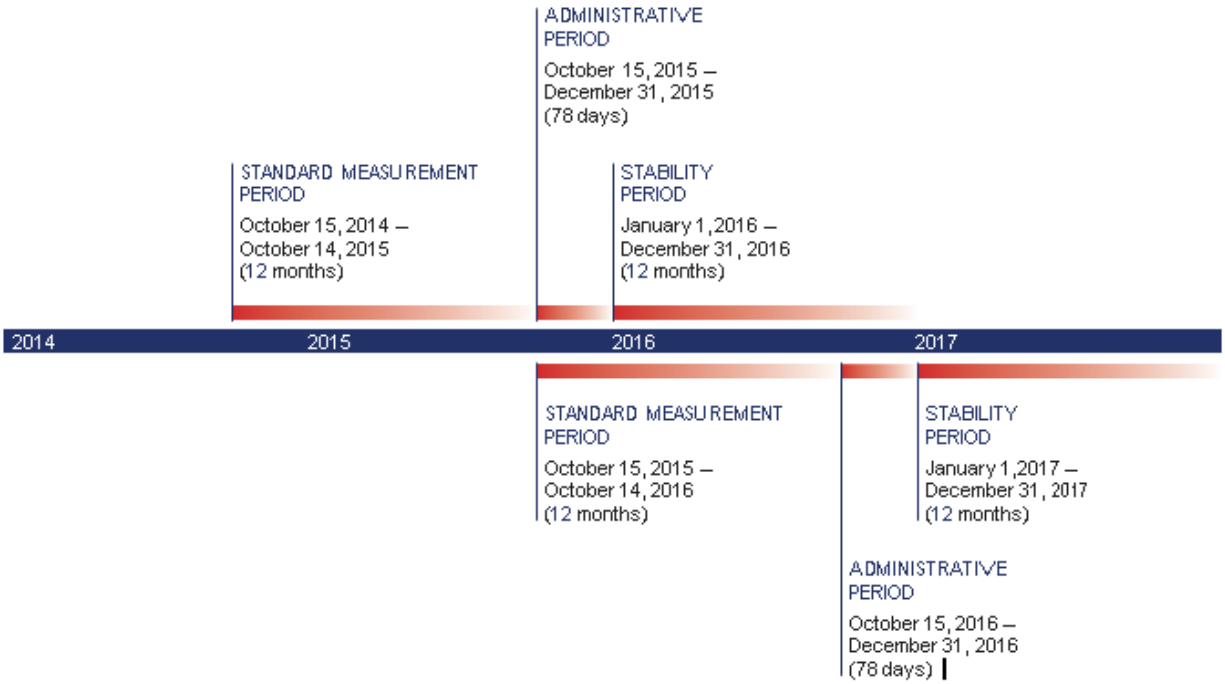
[127] 26 CFR § 54.4980H-3(c)(1)(vii).

[128] 26 CFR § 54.4980H-3(c)(1)(i).

[129] 26 CFR § 54.4980H-3(c)(1)(vi).

[130] Shared Responsibility, 78 Fed. Reg. at 226.

[131] 26 CFR § 54.4980H-3(c)(1)(vi).



Example 3: Employee A averages 30 hours of service per week during the standard measurement periods that begin on each of October 15, 2014, and October 15, 2015. Employee A will be treated as a full-time employee. To avoid a penalty, the employer must offer health coverage to Employee A during the corresponding stability periods (the 2016 and 2017 calendar years) that meets the Employer Mandate requirements. Employee B, on the other hand, averages 30 hours of service per week during the standard measurement period that begins October 15, 2014, but averages fewer than 30 hours per week during the standard measurement period that begins October 15, 2015. To avoid a penalty, the employer must offer health coverage that meets the Employer Mandate requirements to Employee B during the 2016 stability period but not during the 2017 stability period. This means that Employee B must continue to be offered this coverage during the administrative period preceding the 2017 stability period (i.e., October 15, 2016–December 31, 2016) because that period overlaps with the 2016 stability period.

Different Measurement and Stability Periods for Different Categories of Employees. An employer may use measurement and stability periods that differ either in length or in their starting/ending dates for the following categories of employees: (1) collectively bargained and non-collectively bargained employees, (2) each group of collectively bargained employees covered by a separate bargaining agreement, (3) salaried and hourly employees, and

(4) employees employed in different states.[132] Each related employer in a controlled group may determine its own measurement and stability periods.[133]

Optional Safe Harbor for New Hires. Under the proposed regulations, the approach for determining whether a newly hired employee is full-time depends on whether the employee is reasonably expected to be a full-time employee or is, instead, a variable hour or seasonal employee as of the employee's start date.[134]

New Employees Reasonably Expected to be Full-Time. If a newly hired employee is reasonably expected as of his or her start date to be a full-time employee, a large employer must offer the employee health coverage by no later than the first day after the end of the employee's initial three full calendar months of employment or face a potential Employer Mandate penalty.[135] However, it does not appear that compliance with these proposed regulations results in compliance with the separate 90-day maximum waiting period rule that is effective for plan years beginning on or after January 1, 2014, and applies to all health coverage (not just health coverage provided by a large employer to its full-time employees).[136] Because the 90-day maximum waiting period rule carries a $100 per-person per-day penalty, pending further guidance, coverage should be offered no later than the ninety-first day after an employee who is reasonably expected to be full-time becomes eligible in order to satisfy both rules.[137]

New Seasonal and Variable Hour Employees. The proposed regulations also provide a safe harbor for new seasonal and variable hour employees.[138] Interestingly, the preamble to the proposed regulations indicates that use of the new employee safe harbor is limited to employers that use the ongoing employee safe harbor (discussed above), but there is no such requirement in the proposed regulations themselves.[139]

Similar to the ongoing employee safe harbor, under the new employee safe harbor, an employer may determine whether a newly hired variable hour or seasonal employee is full-time or non-full-time based on average weekly hours of service during an "initial measurement period" and then, following an optional administrative period, apply the resulting determination for an initial stability period.[140] An employer using the new employee safe harbor may treat the new variable

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[132] Shared Responsibility, 78 Fed. Reg. at 226.

[133] *Id.*

[134] 26 CFR § 54.4980H-3(c)(2)-(3).

[135] 26 CFR § 54.4980H-3(c)(2).

[136] 26. CFR § 54.9815-2708(a).

[137] IRC § 4980D(b).

[138] 26 CFR § 54.4980H-3(c)(3).

[139] 26 CFR § 54.4980H-3(c)(3); Shared Responsibility, 78 Fed. Reg. at 227.

[140] 26 CFR § 54.4980H-3(c)(3).

hour or seasonal employee as non-full-time during the initial measurement period and any accompanying administrative period.[141]

An employee may be treated as a "variable hour employee" if the employer is unable to determine that the employee is "reasonably expected" to work an average of 30 hours per week or more.[142] For the 2014 calendar year only, an employer may consider the likelihood that an employee's employment will be terminated in determining whether an individual is reasonably expected to work an average of 30 hours or more. After 2014, employers are not permitted to consider the likelihood of termination when determining an employee's status as a variable hour employee.[143]

There is no current definition of "seasonal employee," but employers may use the definition of seasonal worker[144] or any other good faith definition.[145] One option is the definition of "seasonal employee" found in the nondiscrimination rules for self-insured health plans under Internal Revenue Code Section 105(h). Under this definition, a seasonal employee is either (1) an employee whose customary annual employment is less than nine months if other employers in similar work with the same employer (or, if no employees of the employer are in similar work, in similar work in the same industry and location) have substantially more months; or (2) an employee whose customary annual employment is less than seven months.[146]

Initial Measurement and Initial Stability Periods. The initial measurement period may begin on any date between the employee's start date and the first day of the next calendar month and may last for three to 12 months.[147] Because the initial measurement period is unique to each new employee, administration may be cumbersome. However, employers can partially standardize administration by having a single start date for the initial measurement period of all individuals hired during a particular month.[148]

The proposed regulations provide conflicting statements about the length of the stability period for new hires. They first provide that the status determined during the initial measurement period must remain in effect for a stability period that is the same length as the normal stability period that applies for ongoing employees.[149] But then they provide that for an employee who is determined to be full-time during the initial measurement period, the initial stability period must be at least six consecutive calendar months and at least as long as the initial measurement

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[141] 26 CFR § 54.4980H-3(c)(3)(iii).

[142] Shared Responsibility, 78 Fed. Reg. at 227.

[143] *Id.*

[144] *See* discussion in text supra at notes 108-109.

[145] IRC § 4980H(c)(2)(B)(ii); 26 CFR § 54.4980H-1(a)(33).

[146] 26 CFR § 1.105-11(c)(2)(iii)(C).

[147] 26 CFR § 54.4980H-3(c)(3)(i).

[148] *Id.*

[149] *Id.*

period.[150] However, for an employee who is determined to be non-full-time during the initial measurement period, the initial stability period may not be more than one month longer than the initial measurement period.[151] Hopefully, further guidance will clarify how these seemingly contradictory provisions are meant to work together. The stability period also is unique to each new employee.[152]

Subject to certain requirements, an employer can elect to have an administrative period of up to 90 days between the initial measurement period and the related stability period.[153]

Using the new employee safe harbor will also be treated as complying with the 90-day maximum waiting period rule, as long as (1) the effective date of coverage is not later than 13 months from the employee's start date plus, if the employee starts on a day other than the first day of the month, the time remaining until the first day of the next calendar month; (2) in addition to any measurement period of up to 12 months, no more than 90 days elapse prior to the employee's eligibility for coverage; and (3) the plan specifically includes the new employee safe harbor rules, including the measurement, administrative, and stability periods chosen by the employer, as a condition of eligibility.[154]

Different Initial Measurement and Stability Periods for Different Categories of New Hires. An employer may use measurement and stability periods for purposes of this safe harbor that differ in either length or in their starting and ending dates for different categories of employees in the same manner as for the ongoing employee safe harbor discussed above.[155]

Transition to Ongoing Employee Status. Once an employee has been employed for at least one full standard measurement period, the employer must test that employee for full-time status at the same time and under the same conditions that apply for other ongoing employees, as described above.[156] An employee who is determined to be full-time during an initial measurement period or a standard measurement period must be treated as full-time during the entire associated stability period.[157] The obligation to treat the employee as full-time applies even if the employee had an average of at least 30 hours of service per week during the initial measurement period, but not during the overlapping, or immediately following standard measurement period.[158] Similarly, an employee who did not have an average of 30 hours of service during his initial measurement employment but meets that requirement during the following standard measurement period must be treated as full-time during the entire standard

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[150] 26 CFR § 54.4980H-3(c)(3)(ii).

[151] 26 CFR § 54.4980H-3(c)(3)(iii).

[152] 26 CFR § 54.4980H-3(c)(3)(i).

[153] 26 CFR § 54.4980H-3(c)(3)(v).

[154] 26 CFR § 54.9815-2708(c)(3)(i).

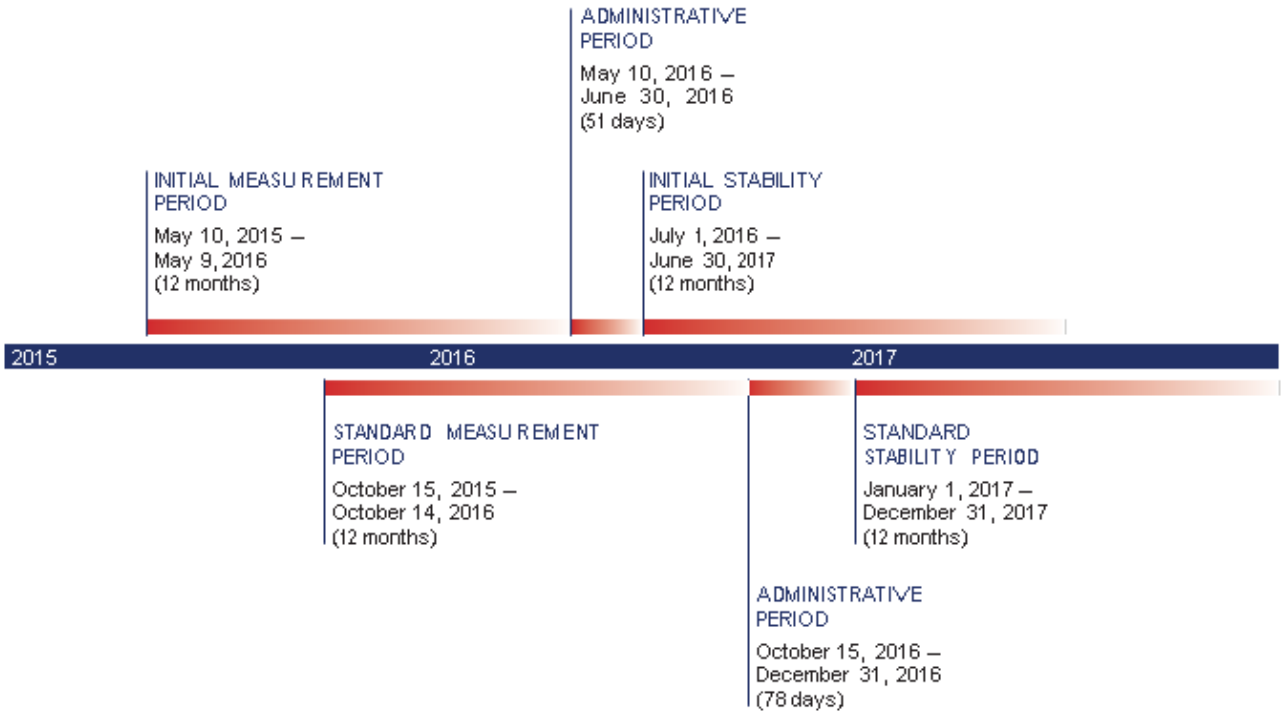
[155] 26 CFR § 54.9815-2708(c)(1), (3)(iv).

[156] 26 CFR § 54.4980H-3(c)(4).

[157] 26 CFR § 54.4980H-3(c)(4)(ii).

[158] *Id.*

stability period, even if that period begins before the initial stability period ends.[159] These rules are illustrated by Figure 2 and Examples 4 and 5, for an employee hired on May 10, 2015.



Example 4: Employee A is hired on May 10, 2015, to work a schedule that varies from week to week. Because she is a new variable-hour employee and the employer is applying the new employee safe harbor, Employee A will be treated as a non-full-time employee during the initial measurement period and administrative period from May 10, 2015, through June 30, 2016. Employee A averages 30 hours of service per week during the initial measurement period that begins on May 10, 2015, and ends May 9, 2016; she will be treated as a full-time employee during the corresponding initial stability period (July 1, 2016, through June 30, 2017). To avoid an Employer Mandate penalty, the employer must offer coverage to Employee A that meets the Employer Mandate requirements during this initial stability period. Because the effective date of coverage is not later than 13 months from Employee A's start date plus the time remaining until the first day of the next calendar month, the 90-day maximum waiting period rule is also met.

Employee A then averages *less than* 30 hours of service per week during the standard measurement period that begins October 15, 2015, and ends October 14, 2016. To avoid a penalty, the employer must offer her health coverage that meets the Employer Mandate requirements all the way through the end of his initial stability period (until June 30, 2017)--even though it overlaps with a standard stability period during which she otherwise would not be treated as full-time.

[159] 26 CFR § 54.4980H-3(c)(4)(iii).

Example 5: Employee B also is hired on May 10, 2015, to work a schedule that varies from week to week. Because he is a new variable-hour employee and the employer is applying the new employee safe harbor, Employee B will be treated as a non-full-time employee during the initial measurement period and administrative period from May 10, 2015, through June 30, 2016. Employee B averages *less than* 30 hours of service per week during the initial measurement period that begins on May 10, 2015, and ends May 9, 2016; he then averages *more than* 30 hours of service per week during the standard measurement period that begins October 15, 2015, and ends October 14, 2016. Although Employee B may be treated as non-full-time from May 10, 2016, through December 31, 2016, he must be treated as a full-time employee for the standard stability period beginning on January 1, 2017, even though that period overlaps with the prior initial stability period during which he was not treated as full-time. To avoid a penalty, the employer must offer Employee B coverage that meets the Employer Mandate requirements during this standard stability period.

Change in Employment Status During Initial Measurement Period. If a newly hired seasonal or variable hour employee ceases to be a seasonal or variable hour employee during the initial measurement period because of a change in employment status or position, and following the change the employee is reasonably expected to be a full-time employee, then the employee must be offered minimum essential coverage no later than the end of the employee's third full calendar month of employment in the new position or, if earlier and the employee averages more than 30 hours of service per week during the initial measurement period, the start of the initial stability period.[160]

Rehires and Breaks in Service. An employee who is not credited with any hours of service with an employer or any related employer in a controlled group for at least 26 consecutive weeks and who later resumes employment with the employer or any related employer in the controlled group may be treated as a new hire for purposes of the rules for determining full-time status.[161] An employer also may treat as a new hire any employee who has no hours of service for a period that is both (1) at least four consecutive weeks and (2) greater than the number of weeks of the employee's prior employment.[162]

An employee who resumes service with an employer or any related employer in a controlled group and is not treated as a new hire must be treated as a continuing employee. If the employer is using the ongoing employee safe harbor, the employee's status (full-time or non-full-time) for the stability period in which the employee resumes service will be based on the employee's average weekly hours of service during the previous standard measurement period.[163]

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[160] 26 CFR § 54.4980H-3(d); Shared Responsibility, 78 Fed. Reg. at 228.

[161] 26 CFR § 54.4980H-3(e); Shared Responsibility, 78 Fed. Reg. at 228-29.

[162] 26 CFR § 54.4980H-3(e)(1).

[163] *Id.*

Special rules apply to employees who are on leave under the Family and Medical Leave Act of 1993 or the Uniformed Services Employment and Reemployment Rights Act of 1994, unpaid leave for jury duty, or an unpaid leave of absence from an educational organization.[164]

It is unclear how the rules will be applied to an employee who terminates employment with one controlled group member and is rehired by another group member, particularly where the members use different measurement periods and stability periods.

What Health Coverage Satisfies the Employer Mandate?

As previously discussed, a large employer may be subject to Employer Mandate penalties if it does not provide health coverage that meets certain requirements to all or substantially all of its full-time employees.[165] In all cases, a large employer will be subject to these penalties only if one or more of its full-time employees gets an Exchange subsidy.[166] To meet the applicable requirements, the employer's coverage must be "minimum essential coverage," "affordable," and provide "minimum value," all as described below.[167]

"Minimum Essential Coverage." In order to avoid a penalty, an employer must offer its full-time employees and their children minimum essential coverage.[168] "Minimum essential coverage" includes an "eligible employer-sponsored plan," which is a group health plan or group health insurance coverage, including COBRA and retiree coverage, offered by an employer (including a governmental employer) to any employee or former employee.[169] If an employer relies on its retiree health coverage to provide minimum essential coverage to rehired individuals, however, that retiree coverage may be subject to the ACA's various plan design mandates and not be treated as a "stand-alone" retiree-only health plan that is exempt from these requirements.[170]

Minimum essential coverage does *not* include: (1) accident or disability income insurance; (2) liability insurance; (3) automobile insurance that pays medical benefits; (4) on-site medical clinics; (5) long-term care, nursing home care, home health care, or community-based care; (6) indemnity insurance; (7) coverage only for vision or dental; (8) workers' compensation; or (9) coverage only for a specific disease or condition.[171]

Under current guidance, employer-sponsored health plans meet the definition of "minimum essential coverage" without having to meet any additional requirements.[172] Of course, both the

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[164] 26 CFR § 54.4980H-3(e)(3).

[165] IRC § 4980H(a)-(b). See text supra at notes 3-28.

[166] *See* text supra at notes 29-52.

[167] IRC § 4980H(a)-(b).

[168] *Id.*

[169] IRC § 5000A(f).

[170] IRC § 9831(a).

[171] IRC § 5000A(f).

[172] IRC § 5000A(f)(1)(B).

ACA and other state and federal laws already impose a variety of requirements on employer-sponsored health plans, and penalties other than the Employer Mandate penalty can apply if those requirements are not met.

"Affordable" Health Coverage. In order to avoid a penalty, the employer must offer coverage to its full-time employees that is "affordable."[173] Employer-sponsored coverage is "affordable" to an employee if the annual employee contribution for the lowest-cost self-only coverage providing minimum value does not exceed 9.5 percent of his or her household income for the taxable year.[174] In this context, "household income" means the total of adjusted gross income required to be reported on a federal income tax return by the employee and members of the employee's household, plus tax-exempt interest, tax-exempt Social Security income, and tax-exempt income earned while living abroad.[175]

Because an employee's household income is generally unknown to employers, the proposed regulations contain three affordability safe harbors intended to make it easier for employers to determine whether their coverage is affordable.[176] These safe harbors allow affordability to be determined by comparing the employee's contribution for the lowest-cost self-only coverage providing minimum value against either:

- 9.5 percent of the employee's W-2, Box 1 wages;
- 9.5 percent of the employee's rate of pay (i.e., monthly salary for salaried employees or hourly rate of pay times 130 hours per month for hourly employees) as of the beginning of the coverage period (typically the first day of the plan year); or
- 9.5 percent of the federal poverty line for a single individual ($11,490 for 2013).[177]

If an employee does not work the entire year for the employer, an adjusted employee contribution and adjusted income amount is used.[178] An employer can elect to use different safe harbors for different categories of employees, as long as the basis for differentiating is uniform and consistent for all employees in a category.[179]

The simplest approach to satisfy the affordability requirement may be to calculate 9.5 percent of the federal poverty line and offer at least one self-only health coverage option that limits employee contributions to that amount.[180] This may not be the most cost-effective approach, however; the other two safe harbors will likely support much higher employee contributions.

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[173] IRC § 4890H(b); 26 CFR § 54.4980H-5(e).

[174] 26 CFR § 54.4980H-5(e)(1).

[175] *Id.*

[176] 26 CFR § 54.4980H-5(e)(2).

[177] *Id.*

[178] *Id.*

[179] 26 CFR § 54.4980H-5(e)(2)(i).

[180] *See* 26 CFR § 54.4980H-5(e)(2)(iv).

Alternatively, employee contributions could be limited to 9.5 percent of the employee's wages for each pay period that is reported in Form W-2, Box 1.[181] However, this alternative could result in very small (or no) employee contributions during pay periods in which the employee works limited (or no) hours.

While not addressed in the proposed guidance, it seems that an employer could use a "greater of" combination of safe harbors for a class of employees. For example, employee contributions could be limited to the greater of 9.5 percent of the employee's Form W-2, Box 1 wages or 9.5 percent of the federal poverty line for a single individual. This alternative ensures that the employee contribution is always at least based on the federal poverty line, but it results in employees who can afford to pay more doing so. In using such a combination, employers should take care to structure the formula in a manner that does not inadvertently result in some employees having annual contributions in excess of any safe harbor.[182]

Coverage That Provides "Minimum Value." Finally, in order to avoid a penalty under the Employer Mandate, the affordable coverage offered by an employer to its full-time employees must provide "minimum value."[183]

Coverage under an eligible employer-sponsored plan provides "minimum value" if the plan's share of the total allowed costs of covered services under the plan is at least 60 percent of the actuarially projected average cost of such services.[184] Employers will be required to determine whether this threshold has been met, and can do this in one of three ways:

1. Using an online minimum value calculator developed by HHS and IRS;

2. Using a checklist of plan characteristics to compare the plan's covered services with a benchmark that meets minimum value; or

3. Having an actuary determine and certify that the plan provides minimum value.

HHS has released a testing version of the minimum value calculator on its web site.[185] Proposed safe harbor plan designs are set forth in preambles to the minimum value regulations.[186]

Under final HHS regulations, minimum value for employer-sponsored group health plans (both fully insured and self-insured) is determined using a standard population based on the population covered by self-insured group health plans.[187] There is no requirement that these plans offer all

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[181] *See* 26 CFR § 54.4980H-5(e)(2)(ii).

[182] *See* 26 CFR § 54.4980H-5(e)(2).

[183] IRC § 4890H(b); 26 CFR § 54.4980H-5(a).

[184] IRC § 36B(c)(2)(C)(ii); 26 CFR § 54.4980H-4(a).

[185] 45 CFR § 156.145; Minimum Value Calculator, http://cciio.cms.gov/resources/files/mv-calculator-final-4-11-2013.xlsm (last visited May 6, 2013).

[186] 76 Fed. Reg. 25909, 25912.

[187] 45 CFR § 156.145(c).

categories of essential health benefits or conform to the essential health benefit benchmarks.[188] However, in order to use the online minimum value calculator or the checklists, a plan may have to follow a standardized structure for coverage and cost-sharing, which would not be the case when using an actuary.[189] Thus, employers will have to compare the cost of hiring an actuary with modifying their plan to make use of the other methods of determining "minimum value."

What Is the Penalty For Noncompliance and How Is It Collected?

An employer may incur a penalty under the Employer Mandate (1) if it fails to offer minimum essential coverage to substantially all of its full-time employees and their children up to age 26,[190] or (2) if it offers coverage, but that coverage is not "affordable," fails to provide "minimum value," or is offered to substantially all (but not all) full-time employees.[191] However, neither penalty will apply unless at least one of the employer's full-time employees enrolls in coverage through an Exchange for which the employee receives an Exchange subsidy.[192]

Failure to Offer Coverage. If an employer fails to offer minimum essential coverage to substantially all of its full-time employees and their children up to age 26, and at least one of its full-time employees enrolls in coverage through an Exchange and receives an Exchange subsidy, the employer will be obligated to pay for each month in which this occurs a nondeductible penalty of $166.67 ($2,000 on an annual basis) for *each* of its full-time employees in excess of 30 for that month.[193] However, as discussed in more detail below, if an employer is a member of a controlled group, it may not be entitled to the full 30-employee exemption because the exemption will be allocated among the controlled group members that are employers.[194]

As noted earlier, to avoid the "no coverage" penalty, an employer need not offer coverage to every full-time employee. Under proposed regulations, an employer need only offer coverage to "substantially all" full-time employees, which is defined as all but the greater of five full-time employees or 5 percent of all full-time employees.[195] The "substantially all" rule applies separately to each employer in a controlled group.[196] For example, one member of the controlled group could offer affordable coverage that meets minimum value to 96 percent of its full-time employees and avoid the "failure to offer coverage" penalty, while another member of the

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[188] 42 USC 300gg-6; 45 CFR § 156.150 (limiting the requirement to provide essential health benefits to health insurance issuers that offer coverage in the individual or small group market).

[189] 45 CFR § 156.145(a)(3).

[190] IRC 4890H(a).

[191] IRC 4890H(b).

[192] IRC 4890H(a)-(b).

[193] IRC § 4980H(a), (c)(1); 26 CFR § 54.4980H-4.

[194] 26 CFR § 54.4980H-4(d).

[195] 26 CFR § 54.4980H-4(a).

[196] *Id.*

controlled group could offer coverage to only 50 percent of its full-time employees and be subject to the penalty.[197]

Making an Effective Offer of Coverage. Under proposed regulations, in order to "offer" coverage, an employer must give a full-time employee an "effective opportunity" to enroll (or decline to enroll) in health coverage at least once each plan year. Whether an employee has an "effective opportunity" is determined based on the facts and circumstances, including whether the employee is adequately informed of the availability of the offer of coverage, the time period to accept or decline, and any other conditions on the offer.[198] Thus, if an employer requires employees to make significant sacrifices to qualify for coverage, it could be at risk of incurring a penalty.

Interestingly, while the regulations appear to require that employees have an effective opportunity to decline coverage at least once each plan year, the preamble to the regulations indicates that this right is limited to offers of coverage that are not minimum value coverage or not affordable.[199] In other words, the preamble language regarding an effective right to decline coverage is narrowly tailored to prevent an employer from rendering an employee ineligible for a premium tax credit by providing mandatory coverage.[200] A plain reading of the proposed regulations themselves yields a broader prohibition on providing mandatory coverage.[201] This broader prohibition may be related to the not-yet-effective automatic enrollment requirement for employers with more than 200 full-time employees, which requires that employees be given an opportunity to opt out of any automatic coverage.[202] It remains to be seen how final regulations will address these various requirements.

As discussed earlier, an employer is treated as having offered coverage to an employee for the remainder of a coverage period (generally, a plan year) if coverage is terminated due to the employee's failure to timely pay premiums.[203] The employee must have been provided a grace period for making payment and must be provided the opportunity to reenroll for the next coverage period.[204]

Calculating the Total "No Coverage" Penalty. In calculating the penalty for a failure to offer coverage, the first 30 full-time employees of the employer are disregarded.[205] For example, if an employer employs 50 full-time employees for every month in a year, fails to offer them

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[197] *See id.*

[198] 26 CFR § 54.4980H-4(b).

[199] Shared Responsibility, 78 Fed. Reg. at 232.

[200] *See id.*

[201] 26 CFR §§ 54.4980H-4(a), -5(a).

[202] ACA § 1511 (adding new Section 18A to the Fair Labor Standards Act of 1938).

[203] 26 CFR § 54.4980H-3(f).

[204] *Id.*

[205] 26 CFR § 54.4980H-4(d).

acceptable health coverage for the entire year, and one of them receives an Exchange subsidy, its annual penalty would equal $40,000 (20 full-time employees multiplied by $2,000).[206]

As noted above, members of the same controlled group of corporations are treated as one employer for purposes of determining whether all of the members will be treated as large employers subject to the Employer Mandate.[207] However, liability for noncompliance and computation of any penalty owed is determined independently for each controlled group member.[208] For purposes of the 30-employee exclusion, however, the controlled group is treated as one employer.[209] The group may take the 30-employee reduction only once, and that reduction will be allocated pro rata among each member according to the number of its full-time employees, provided that each member of the controlled group will be allocated at least one employee reduction (even if there are more than 30 members of the controlled group).[210] For example, if one entity has 80 full-time employees and another controlled group member has 20 full-time employees, the two entities are treated together as having 100 full-time employees for purposes of determining large employer status. The 30-employee reduction would be allocated between the two entities, with the first being allocated 24 employee exclusions (80 percent) and the second being allocated six employee exclusions (20 percent).[211]

An employer must factor in "full-time equivalents" when determining whether it is a "large employer" subject to the Employer Mandate.[212] Full-time equivalents, however, are disregarded when calculating Employer Mandate penalties.[213] Therefore, if an employer is treated as a "large employer" solely because of its full-time equivalents, it will not be subject to a penalty if it has 30 or fewer full-time employees.[214]

Failure to Offer Affordable Coverage that Provides Minimum Value. The second way in which an employer can incur a penalty is if it offers coverage to its full-time employees, but that coverage is not "affordable," fails to provide "minimum value," or is offered to substantially all (but not all) full-time employees, and one or more of its full-time employees enrolls in coverage through an Exchange for which the employee receives an Exchange subsidy.[215]

The "insufficient coverage" penalty is $250 per month for each full-time employee who receives an Exchange subsidy during a month ($3,000 on an annual basis).[216] Unlike the "no coverage"

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[206] *See* IRC § 4980H(a); 26 CFR § 54.4980H-4(a), (d).

[207] 26 CFR § 54.4980H-1(a)(14).

[208] 26 CFR §§ 54.4980H-1(a)(4), (5), (14); -4(a); -5(a).

[209] 26 CFR § 54.4980H-4(d).

[210] *Id.*

[211] *See id.*

[212] IRC § 4980H(c)(2)(E); 26 CFR § 54.4980H-2(c).

[213] 26 CFR §§ 54.4980H-2(b), -4(a), -5(a); Shared Responsibility, 78 Fed. Reg. at 222.

[214] *Id.*; 26 CFR § 54.4980H-4(d).

[215] IRC § 4980H(b); 26 CFR § 54.4980H-5.

[216] *Id.*

penalty, the "insufficient coverage" penalty applies only with respect to the number of full-time employees who get Exchange subsidies, rather than to all full-time employees.[217] However, this penalty is capped on a monthly basis by the amount that the employer would have been required to pay had it failed to offer coverage at all to its full-time employees (i.e., $166.67 multiplied by the number of full-time employees in excess of 30).[218] Thus, an employer who offers coverage to its employees can never pay a larger penalty than it would have paid had it offered no coverage at all.[219]

The "insufficient coverage" penalty is generally imposed solely on the company that employs the full-time employee who receives the Exchange subsidy. However, if the employee works for multiple members of a controlled group, the penalty will be allocated pro rata on the basis of the hours that the employee worked for each employer.[220]

Collection of the Penalty. Penalties under the Employer Mandate will be initially determined by the IRS, which will notify employers of proposed assessments and will give the employer a chance to respond before making a final determination and assessing any penalty.[221] An employer will not be obligated to pay any penalty (nor will any interest begin to accrue) until the penalty is formally assessed and the employer receives a notice and demand for payment from the IRS.[222] In other words, there is no self-reporting obligation (other than the information reporting requirements described below) with respect to these penalties. In addition, because the information reporting for 2015 will not occur until early 2016, employers should expect that the IRS will not send notice of any proposed assessments until mid-2016 at the earliest. Also, because the information reporting and Exchange subsidies apply on a calendar year basis, the IRS is likely to follow the calendar year, rather than the plan year (if different), in conducting compliance activities. If employers expect to owe such penalties for 2015, they should budget to pay them in 2016.

Information Reporting Requirements. Beginning in 2016, large employers will be required to self-report their compliance with the Employer Mandate by submitting information returns to the IRS for each full-time employee. In completing the return, the employer will be required to report certain information, including basic identification information for the employer and its full-time employees, certain details about whether the employer offered its full-time employees and their children coverage and for what period, the monthly cost of the coverage offered, and the portion of the monthly cost paid by the employee.[223] Further, the employer must give a written statement to each full-time employee included in the return, listing the employer's

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[217] *Id.*

[218] IRC § 4980H(b)(2); 26 CFR § 54.4980H-5(a).

[219] *Id.*

[220] 26 CFR § 54.4980H-5(d).

[221] IRC § 4980H(d); Shared Responsibility, 78 Fed. Reg. at 235.

[222] *Id.*

[223] ACA § 1514 (adding new Section 6056 to the IRC); Shared Responsibility, 78 Fed. Reg. at 235-36.

contact information and the information that was provided to the IRS regarding that employee's health coverage.[224]

The IRS has not yet published guidance implementing these reporting requirements, but has indicated that the first information returns will be due in early 2016 to reflect coverage offered in the 2015 calendar year.[225]

In addition, beginning in January 2016, health insurers, self-insured group health plans and certain government entities that provide minimum essential coverage must notify the IRS of who is covered by minimum essential health coverage during each month of the year.[226] Coverage information statements must also be provided to the affected individuals detailing the information reported to the about the individual.

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[224] *Id.*

[225] Notice 2013-45.

[226] ACA § 1502 (adding new Section 6055 to the Internal Revenue Code); Notice 2013-45