Employer Mandate Explanation

Revised to Include the Changes from the Proposed Regulations

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On December 28, 2012, the Internal Revenue Service (the "IRS") released proposed regulations under Code Section 4980H (54.4980H-1, 2, 3, 4 and 5) relating to the employer shared responsibility provisions (the "Employer Mandate") under Health Care Reform. These regulations follow prior guidance, makes changes, provides clarifications and includes important transition relief. The following has been revised to include these important provisions.

In general:

Beginning in 2014, certain large employers may be subject to a penalty tax for failing to offer health care coverage for all full-time employees (and their dependents), offering minimum essential coverage that is unaffordable, or offering minimum essential coverage under which the plan's share of the total allowed cost of benefits is not at least 60% (referred to as "minimum value"). The penalty tax is due if any full-time employee is certified to the employer as having purchased health insurance through an Exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee, as provided in Code Section 4980H.

What is a large employer for purposes of the employer mandate?

The penalty tax applies to "applicable large employers." An applicable large employer is an employer who employed an average of at least 50 "full-time employees" on business days during the preceding calendar year, as provided in Code Section 4980H(c)(2)(A).

The penalty tax actually consists of two separate taxes. The first applies when the employer fails to offer full-time employees (and their dependents) the opportunity to enroll in an eligible employer-sponsored plan, as provided in Code Section 4980H(a). The second applies when the employer offers eligible employer-sponsored health coverage to full-time employees, but the coverage is not affordable or does not provide minimum value, as provided in Code Section 4080H(b). Both taxes hinge on whether an employer offers eligible employer-sponsored health coverage to "full-time employees (and their dependents)." The amount of each tax is explained below.

The proposed regulations provide transition relief for purposes of the applicable large employer determination for the 2014 calendar year. This relief allows an employer the option to determine its status as an applicable large employer by reference to a period of at least six consecutive calendar months, as chosen by the employer, in the 2013 calendar year (rather than the entire 2013 calendar year). An employer may determine whether it is an applicable large employer for 2014 by determining whether it employed an average of at least 50 full-time employees on business days during any consecutive six month period in 2013. This will allow these employers to choose to use either, or both, a period to prepare to count their employees and a period afterward to ascertain and implement the results of the determination. For example, an employer could use the period from January to February, 2013 to establish its counting method, the period from March through August, 2013 to determine its applicable large employer status and, if it is an applicable large employer, the period from September through December, 2013 to make any needed adjustments to its plan (or to establish a plan) in order to comply with Code Section 4980H.

The proposed regulations also provide that an employer not in existence during an entire preceding calendar year is an applicable large employer for the current calendar year if it is reasonably expected to employ an average of at least 50 full-time employees (taking into account full-time employees) on business days during the current calendar year.

When will the employer mandate apply to an applicable large employer who sponsors a health plan with a noncalender plan or policy year?

The employer mandate is effective January 1, 2014, but the proposed regulations provide for transition relief for members of an applicable large employer with health plan with noncalendar plan or policy years. If any member of an applicable large employer maintains a noncalendar plan or policy year as of December 27, 2012, the relief applies with respect to employees of members of an applicable large employer (whenever hired) who would be eligible for coverage, as of the first day of the first noncalendar plan or policy year of that plan that begins in 2014 (the "2014 plan year") under the eligibility terms of the plan as in effect on December 27, 2012. If an employee described in the preceding sentence is offered affordable, minimum value coverage no later than the first day of the 2014 plan or policy year, no penalty tax payment will be due with respect to that employee for the period prior to the first day of the 2014 plan or policy year.

Further relief is also provided for employers that have a significant percentage of their employees eligible for or covered under one or more noncalendar plan or policy year plans that have the same plan or policy year as of December 27, 2012 and want to offer certain other employees coverage under these plans. Specifically, if a member of an applicable large employer has at least one-quarter of its employees covered under one or more noncalender plan or policy year plans that have the same plan or policy year as of December 27, 2012 or offered coverage under those plans to one-third or more of its employees during the most recent open enrollment period before December 27, 2012, no penalty tax payment will be due for any month prior to the first day of the 2014 plan or policy year of that noncalendar plan or policy year with respect to employees who:

(1) are offered affordable, minimum value coverage no later than the first day of the 2014 plan year of the noncalendar plan or policy year plan, and

(2) would not have been eligible for coverage under any group health plan maintained by the member of the applicable large employer as of December 27, 2012 that has a calendar plan or policy year.

For purposes of this transition relief, a member of the applicable large employer may determine the percentage of its employees covered under a plan with a noncalendar plan or policy year as of the end of the most recent enrollment period or any date between October 31, 2012 and December 27, 2012.

Because no liability will occur whether or not a full-time employee is offered coverage during the portion of the 2013 plan or policy year falling in 2014, the applicable large employer may determine the full-time employees for that period for purposes of reporting requirements after the period has ended, using actual service data rather than the look-back measurement method, and use those determinations for the reporting required at the beginning of 2015 to cover the entire 2014 calendar year.

In addition, the identification of whether the coverage offered provides minimum value and the employee portion of the applicable premium should be available to the employer in time to complete the required reporting. Therefore, because this reporting is essential to the administration of the premium tax credit, applicable large employers will be required to report this information for the entire 2014 calendar year, even if the requirements will not apply during some calendar months in 2014 due to application of the transition rules for noncalendar plan or policy years.

Who is considered an employee and an employer?

The proposed regulations provide that an employee is an individual who is an employee under the common law standard, and an employer is the person that is the employer of an employee under the common law standard.

Under the common law standard, an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. Under the common law standard, an employment relationship exists if an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so. In addition, for purposes of the employer mandate, a sole proprietor, a partner in a partnership, or a 2-percent S corporation shareholder is not considered an employee.

How are full-time and part-time employees counted to determine whether an employer is an "applicable large employer"?

For purposes of determining whether an employer is an applicable large employer, an employer must include not only its full-time employees but also full-time equivalents for employees who work part-time. To calculate full-time equivalents, the employer must add up all the hours of service in a month for employees who are not full-time and divide that aggregate number by 120. The result of that calculation is then added to the number of full-time employees during that month. Then, if the average number of employees for the year is 50 or more, the employer is an applicable large employer, as provided in Code Section 4980H(c)(2)(E).

The proposed regulations clarify that for determining the number of full-time employees for any month for this purpose, the number used is 120. The monthly figure of 130 is used to determine if an employee is full-time to offer coverage.

Code Section 4980H(c)(2)(C)(i) applies the controlled group test, meaning that all entities treated as a single employer under Code Section 414(b), (c), (m), or (o) are treated as a single employer for purposes of Code Section 4980H.

How are hours counted for all purposes?

The proposed regulations provide rules for hourly employees and non-hourly employees. For employees paid on an hourly basis, employers must calculate actual hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. For employees not paid on an hourly basis, employers are permitted to calculate the number of hours of service under any of the following three methods:

(1) counting actual hours of service (as in the case of employees paid on an hourly basis) from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence;

(2) using a days-worked equivalency method whereby the employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service under these service crediting rules; or

(3) using a weeks-worked equivalency of 40 hours of service per week for each week for which the employee would be required to be credited with at least one hour of service under these service crediting rules.

These equivalents are based on DOL regulations (29 CFR 2530.200b-2(a)), modified as described in this preamble and in the proposed regulations.

An employer need not use the same method for all non-hourly employees. Rather, an employer may apply different methods for different classifications of non-hourly employees, so long as the classifications are reasonable and consistently applied. In addition, an employer may change the method of calculating non-hourly employees' hours of service for each calendar year.

Are there any special rules for counting hours?

These proposed regulations address the special issues presented by educational institutions by providing an averaging method for employment break periods that generally would result in an employee who works full-time during the active portions of the academic year being treated as a full-time employee for Code Section 4980H.

Are seasonal employees counted in determining whether an employer is an "applicable large employer?

Under Code Section 4980H(c)(2)(B)(i), a special rule enables an employer that has more than 50 full-time employees solely as a result of seasonal employment to avoid being treated as an applicable employer. Under this rule, an employer will not be considered to employ more than 50 full-time employees if (a) the employer's workforce only exceeds 50 full-time employees for 120 days, or fewer, during the calendar year; and (b) the employees in excess of 50 who were employed during that 120-day (or fewer) period were seasonal workers. "Seasonal worker" means a worker who performs labor or services on a seasonal basis as defined by the DOL, including agricultural workers covered by 29 CFR Section 500.20(s)(1) and retail workers employed exclusively during holiday seasons, as provided in Code Section 4980H(c)(2)(B)(ii).

The proposed regulations provide that, solely for purposes of the seasonal worker exception in determining whether an employer is an applicable large employer, an employer may apply either a period of four calendar months (whether or not consecutive) or a period of 120 days (whether or not consecutive).

Which employees are considered "full-time" for an applicable large employer to be required to offer coverage under the employer mandate?

Under Code Section 4980H(c)(4)(A), a "full-time employee" for any month is an employee who is employed for an average of at least 30 hours of service per week. The proposed regulations would treat 130 hours of service in a calendar month as the monthly equivalent of 30 hours of service per week ((52 x 30) ÷ 12 = 130). This monthly standard takes into account that the average month consists of more than four weeks.

When is a variable hour or seasonal employee considered a full-time employee requiring an applicable large employer to offer coverage?

In the proposed regulations, the IRS describes safe harbor methods that employers may use (but are not required to use) to determine which employees are treated as full-time employees for purposes of the employer mandate described above. These methods can be used to determine whether new, on-going employees or seasonal employees are considered full-time employees for the employer mandate and when an employer must provide coverage or be penalized.

Safe Harbor for new variable hour and seasonal employees: If an employer maintains a group health plan that would offer coverage to the employee only if the employee were determined to be a full-time employee, the employer may use both a measurement period of between three and 12 months and an administrative period of up to 90 days for variable hour and seasonal employees. However, the measurement period and the administrative period combined may not extend beyond the last day of the first calendar month beginning on or after the one-year anniversary of the employee’s start date (totaling, at most, 13 months and a fraction of a month).

Who is a variable hourly employee? A new employee is a variable hour employee if, based on the facts and circumstances at the start date, it cannot be determined that the employee is reasonably expected to work on average at least 30 hours per week. A new employee who is expected to work initially at least 30 hours per week may be a variable hour employee if, based on the facts and circumstances at the start date, the period of employment at more than 30 hours per week is reasonably expected to be of limited duration and it cannot be determined that the employee is reasonably expected to work on average at least 30 hours per week over the initial measurement period (defined below).

Effective as of January 1, 2015, and except in the case of seasonal employees, the proposed regulations provide that the employer will be required to assume for this purpose that although the employee’s hours of service might be expected to vary, the employee will continue to be employed by the employer for the entire initial measurement period; accordingly, the employer will not be permitted to take into account the likelihood that the employee’s employment will terminate before the end of the initial measurement period.

Who is a seasonal employee? Through at least 2014, employers are permitted to use a reasonable, good faith interpretation of the term “seasonal employee.”

What is an “initial measuring period”? For variable hour and seasonal employees, employers are permitted to determine whether the new employee is a full-time employee using an “initial measurement period” of between three and 12 months (as selected by the employer).

The employer measures the hours of service completed by the new employee during the initial measurement period and determines whether the employee completed an average of 30 hours of service per week or more during this period. The stability period for such employees must be the same length as the stability period for ongoing employees (described below). If an employee is determined to be a full-time employee during the initial measurement period, the stability period must be a period of at least six consecutive calendar months that is no shorter in duration than the initial measurement period and that begins after the initial measurement period (and any associated administrative period). The stability period is the first period in which the employer is required to provide health coverage to the employee.

If a new variable hour or seasonal employee is determined not to be a full-time employee during the initial measurement period, the employer is permitted to treat the employee as not a full-time employee during the stability period that follows the initial measurement period. This stability period for such employees must not be more than one month longer than the initial measurement period and, as explained below, must not exceed the remainder of the standard measurement period as defined below (plus any associated administrative period) in which the initial measurement period ends.

Transition from New Employee Rules to Ongoing Employee Rules: Once a new employee, who has been employed for an initial measurement period, has been employed for an entire standard measurement period, the employee must be tested for full-time status, beginning with that standard measurement period, at the same time and under the same conditions as other ongoing employees.

A standard measurement period is a defined time period of not less than three but not more than 12 consecutive calendar months, as chosen by the employer and is used to determine whether ongoing employee are eligible for health coverage.

An employee determined to be a full-time employee during an initial measurement period or standard measurement period must be treated as a full-time employee for the entire associated stability period. This is the case even if the employee is determined to be a full-time employee during the initial measurement period but determined not to be a full-time employee during the overlapping or immediately following standard measurement period. In that case, the employer may treat the employee as not a full-time employee only after the end of the stability period associated with the initial measurement period. Thereafter, the employee's full-time status would be determined in the same manner as that of the employer's other ongoing employees (as described below).

In contrast, if the employee is determined not to be a full-time employee during the initial measurement period, but is determined to be a full-time employee during the overlapping or immediately following standard measurement period, the employee must be treated as a full-time employee for the entire stability period that corresponds to that standard measurement period (even if that stability period begins before the end of the stability period associated with the initial measurement period). Thereafter, the employee's full-time status would be determined in the same manner as that of the employer's other ongoing employees.

Use of an administrative period: In addition to the initial measurement period, the employer is permitted to apply an administrative period before the start of the stability period. This administrative period must not exceed 90 days in total. For this purpose, the administrative period includes all periods between the start date of a new variable hour or seasonal employee and the date the employee is first offered coverage under the employer's group health plan, other than the initial measurement period.

In addition to the specific limits on the initial measurement period (which must not exceed 12 months) and the administrative period (which must not exceed 90 days), there is a limit on the combined length of the initial measurement period and the administrative period applicable for a new variable hour or seasonal employee. Specifically, the initial measurement period and administrative period together cannot extend beyond the last day of the first calendar month beginning on or after the first anniversary of the employee's start date. For example, if an employer uses a 12-month initial measurement period for a new variable hour employee, and begins that initial measurement period on the first day of the first calendar month following the employee's start date, the period between the end of the initial measurement period and the offer of coverage to a new variable hour employee who works full time during the initial measurement period must not exceed one month.

Example (12-Month Initial Measurement Period Followed by 1+ Partial Month Administrative Period): For new variable hour employees, Employer B uses a 12-month initial measurement period that begins on the start date and applies an administrative period from the end of the initial measurement period through the end of the first calendar month beginning on or after the end of the initial measurement period. Employer B hires Employee Y on May 10, 2014. Employee Y's initial measurement period runs from May 10, 2014, through May 9, 2015. Employee Y works an average of 30 hours per week during this initial measurement period. Employer B offers coverage to Employee Y for a stability period that runs from July 1, 2015 through June 30, 2016. Employee Y works an average of 30 hours per week during his initial measurement period and Employer B uses (1) an initial measurement period that does not exceed 12 months; (2) an administrative period totaling not more than 90 days; and (3) a combined initial measurement period and administrative period that does not last beyond the final day of the first calendar month beginning on or after the one-year anniversary of Employee Y's start date. Accordingly, from Employee Y's start date through June 30, 2016, Employer B is not subject to any payment with respect to Employee Y, because Employer B complies with the standards for the initial measurement period and stability periods for a new variable hour employee. Employer B also complies with the law. Employer B must test Employee Y again based on the period from October 15, 2014 through October 14, 2015 (Employer B's first standard measurement period that begins after Employee Y's start date).

Safe harbor for ongoing employees: For this purpose, an "ongoing employee" is generally an employee who has been employed by the employer for at least one complete standard measurement period. An employer determines each ongoing employee's full-time status by looking back at the standard measurement period (a defined time period of not less than three but not more than 12 consecutive calendar months, as chosen by the employer). The employer has the flexibility to determine the months in which the standard measurement period starts and ends, provided that the determination must be made on a uniform and consistent basis for all employees in the same category.

For example, if an employer choses a standard measurement period of 12 months, the employer could choose to make it the calendar year, a non-calendar plan year, or a different 12-month period, such as one that ends shortly before the start of the plan's annual open enrollment season. If the employer determines that an employee averaged at least 30 hours per week during the standard measurement period, then the employer treats the employee as a full-time employee during a subsequent "stability period", regardless of the employee's number of hours of service during the stability period, so long as he or she remained an employee. The stability period is the period in which the employer is required to offer the employee coverage to comply with the employer mandate.

For an employee whom the employer determines to be a full-time employee during the standard measurement period, the stability period would be a period of at least six consecutive calendar months that is no shorter in duration than the standard measurement period and that begins after the standard measurement period (and any applicable administrative period. If the employer determines that the employee did not work full-time during the standard measurement period, the employer would be permitted to treat the employee as not a full-time employee during the stability period that follows, but is not longer than, the standard measurement period.

This means that the employer is not required to offer the employee coverage and would not be penalized.

Employers may use measurement periods and stability periods that differ either in length or in their starting and ending dates for the following categories of employees: (1) collectively bargained employees and noncollectively bargained employees; (2) salaried employees and hourly employees; (3) employees of different entities; and (4) employees located in different States.

Use of an administrative period: Because employers may need time between the standard measurement period and the associated stability period to determine which ongoing employees are eligible for coverage, and to notify and enroll employees, an employer may make time for these administrative steps by having its standard measurement period end before the associated stability period begins. However, any administrative period between the standard measurement period and the stability period may neither reduce nor lengthen the measurement period or the stability period. The administrative period following the standard measurement period may last up to 90 days. To prevent this administrative period from creating any potential gaps in coverage, it will overlap with the prior stability period, so that, during any such administrative period applicable to ongoing employees following a standard measurement period, ongoing employees who are eligible for coverage because of their status as full-time employees based on a prior measurement period would continue to be offered coverage.

Example: Employer W chooses to use a 12-month stability period that begins January 1 and a 12-month standard measurement period that begins October 15. Consistent with the terms of Employer W's group health plan, only an ongoing employee who works full-time (an average of at least 30 hours per week) during the standard measurement period is offered coverage during the stability period associated with that measurement period. Employer W chooses to use an administrative period between the end of the standard measurement period (October 14) and the beginning of the stability period (January 1) to determine which employees worked full-time during the measurement period, notify them of their eligibility for the plan for the calendar year beginning on January 1 and of the coverage available under the plan, answer questions and collect materials from employees, and enroll those employees who elect coverage in the plan. Previously-determined full-time employees already enrolled in coverage continue to be offered coverage through the administrative period.

Employee A and Employee B have been employed by Employer W for several years, continuously from their start date. Employee A worked full-time during the standard measurement period that begins October 15 of Year 1 and ends October 14 of Year 2 and for all prior standard measurement periods. Employee B also worked full-time for all prior standard measurement periods, but is not a full-time employee during the standard measurement period that begins October 15 of Year 1 and ends October 14 of Year 2.

Because Employee A was employed for the entire standard measurement period that begins October 15 of Year 1 and ends October 14 of Year 2, Employee A is an ongoing employee with respect to the stability period running from January 1 through December 31 of Year 3. Because Employee A worked full-time during that standard measurement period, Employee A must be offered coverage for the entire Year 3 stability period (including the administrative period from October 15 through December 31 of Year 3). Because Employee A worked full-time during the prior standard measurement period, Employee A would have been offered coverage for the entire Year 2 stability period, and if enrolled would continue such coverage during the administrative period from October 15 through December 31 of Year 2.

Because Employee B was employed for the entire standard measurement period that begins October 15 of Year 1 and ends October 14 of Year 2, Employee B is also an ongoing employee with respect to the stability period in Year 3. Because Employee B did not work full-time during this standard measurement period, Employee B is not required to be offered coverage for the stability period in Year 3 (including the administrative period from October 15 through December 31 of Year 3). However, because Employee B worked full-time during the prior standard measurement period, Employee B would be offered coverage through the end of the Year 2 stability period, and if enrolled would continue such coverage during the administrative period from October 15 through December 31 of Year 2.

Employer W complies with the standards because the measurement and stability periods are no longer than 12 months, the stability period for ongoing employees who work full-time during the standard measurement period is not shorter than the standard measurement period, the stability period for ongoing employees who do not work full-time during the standard measurement period is no longer than the standard measurement period, and the administrative period is not longer than 90 days.

The proposed regulations indicate that the applicable large employer member may change its standard measurement period and stability period for subsequent years, but generally may not change the standard measurement period or stability period once the standard measurement period has begun.

The proposed regulations address the treatment of new variable or seasonal employees who have a change in employment status during the initial measurement period (for example, in the case of a new variable hour employee who is promoted during the initial measurement period to a position in which employees are reasonably expected to be employed on average 30 hours of service per week). The proposed regulations define a change in employment status as a material change in the position of employment or other employment status that had the employee begun employment in the new position or status would have resulted in the employee being reasonably expected to be employed on average at least 30 hours of service per week. The proposed regulations provide that a new variable hour or seasonal employee who has a change in employment status during an initial measurement period is treated as a full-time employee under Code Section 4980H as of the first day of the fourth month following the change in employment status or, if earlier and the employee averages more than 30 hours of service per week during the initial measurement period, the first day of the first month following the end of the initial measurement period (including any optional administrative period applicable to the initial measurement period). The change in employment status rule only applies to new variable hour and seasonal employees. A change in employment status for an ongoing employee does not change the employee's status as a full-time employee or nonfull-time employee during the stability period.

Employees Retired After Termination of Employment or Resuming Service After Other Absence: Under the proposed regulations, if the period for which no hours of service is credited is at least 26 consecutive weeks, an employer may treat an employee who has an hour of service after that period, for purposes of determining the employee's status as a full-time employee, as having terminated employment and having been rehired as a new employee of the employer.

The employer may also choose to apply a rule of parity for periods of less than 26 weeks. Under the rule of parity, an employee may be treated as having terminated employment and having been rehired as a new employee if the period with no credited hours of service (of less than 26 weeks) is at least four weeks long and is longer than the employee's period of employment immediately preceding that period with no credited hours of service (with the length of that previous period determined with application to that period of these rules governing employee rehires or other resumptions of service).

For an employee who is treated as a continuing employee (as opposed to an employee who is treated as terminated and rehired), the measurement and stability period that would have applied to the employee had the employee not experienced the period of no credited hours of service would continue to apply upon the employee's resumption of service. For example, if the continuing employee returns during a stability period in which the employee is treated as a full-time employee, the employee is treated as a full-time employee upon return and through the end of that stability period. For this purpose, the proposed regulations provide that a continuing employee treated as a full-time employee will be treated as offered coverage upon resumption of services if the employee is offered coverage as of the first day that employee is credited with an hour of service, or, if later, as soon as administratively practicable.

Unpaid leave: The proposed regulations provide a method for averaging hours when applying the look-back measurement method to measurement periods that include special unpaid leave. This method applies only to an employee treated as a continuing employee upon the resumption of services, and not to an employee treated as terminated and rehired. For this purpose, special unpaid leave refers to a period of unpaid leave subject to the Family and Medical Leave Act of 1993 (FMLA), Public Law 103-3, 20 U.S.C. 2601 et. seq., unpaid leave subject to the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), Public Law 103-353, 38 U.S.C. 4301 et. seq., and unpaid leave on account of jury duty.

Under this proposed averaging method, the employer determines the average hours of service per week for the employee during the measurement period excluding the special unpaid leave period and uses that average as the average for the entire measurement period. Alternatively, the employer may choose to treat employees as credited with hours of service for special unpaid leave at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not special unpaid leave.

Additional requirements apply to employment break periods for employees of an educational organization. For this purpose, an employment break period is a period of at least four consecutive weeks (disregarding special unpaid leave) during which an employee is not credited with an hour of service. The proposed regulations provide that the educational organization must apply one of the methods in the preceding paragraph to employment break periods related to or arising out of non-working weeks or months under the academic calendar.

Accordingly, the educational organization must either determine the average hours of service per week for the employee during the measurement period excluding the employment break period and use that average as the average for the entire measurement period, or treat employees as credited with hours of service for the employment break period at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not part of an employment break period. However, the educational organization is not required to credit an employee in any calendar year with more than 501 hours of service for any employment break period (although this 501-hour limit does not apply to, or take into account, hours of service required to be credited for special unpaid leave). The rules governing employment break periods for educational organizations apply only to an employee treated as a continuing employee upon the resumption of services, and not to an employee treated as terminated and rehired.

Temporary Staffing Agencies: The proposed regulations indicate that if an individual hired by a temporary staffing agency as its common law employee can be expected to be offered one or more assignments with different clients each generally lasting no more than two or three months, and if the agency can expect the clients to have different requests with respect to hours of service (some above and some below 30 hours of service per week) and for there to be gaps of time between assignments during which the employee is not requested to provide services, then the employee generally would be a variable hour employee.

Anti-Abuse Rules: Under an anticipated rule, if an individual performs services as an employee of an employer, and also performs the same or similar services for that employer in the individual's purported employment at a temporary staffing agency or other staffing agency of which the employer is a client, then all the hours of service are attributed to the employer for purposes of applying the employer mandate. Similarly, to the extent an individual performs the same or similar services for the same client of two or more temporary staffing agencies or other staffing agencies, it is anticipated that all hours of service for that client are attributed to the client, if the client is the common law employer, or, if not, one of the temporary staffing agencies (or other staffing agencies) that purports to employ the individual with respect to services performed for that client.

Special Transition Rules for 2014: Solely for purposes of stability periods beginning in 2014, employers may adopt a transition measurement period that is shorter than 12 months but that is no less than 6 months long and that begins no later than July 1, 2013 and ends no earlier than 90-days before the first day of the plan year beginning on or after January 1, 2014 (90-days being the maximum permissible administrative period). For example, an employer with a calendar plan or policy year could use a measurement period from April 15, 2013 through October 14, 2013 (six months), followed by an administrative period ending on December 31, 2013. An employer with a plan with a noncalendar plan or policy year beginning April 1 that also elected to implement a 90-day administrative period could use a measurement period from July 1, 2013 through December 31, 2013 (six months), followed by an administrative period ending on March 31, 2014. However, an employer with a fiscal plan year beginning on July 1, 2014 must use a measurement period that is longer than 6 months in order to comply with the requirement that the measurement period begin no later than July 1, 2013 and end no earlier than 90 days before the stability period. For example, the employer could have a 10-month measurement period from June 15, 2013 through April 14, 2014, followed by an administrative period from April 15, 2014 through June 30, 2014. This transition relief is solely for the application of a stability period beginning in 2014 through the end of that stability period (including any portion of the stability period falling in 2015).

What is the penalty tax if an applicable large employer does not offer minimum essential coverage to its full-time employees (and their dependents)?

Beginning in 2014, Code Section 4980H(a) provides that an applicable large employer will pay a penalty tax for any month that—

(1) the employer fails to offer its full-time employees (and their dependents) the opportunity to enroll in "minimum essential coverage" under an "eligible employer-sponsored plan" for that month; and

(2) at least one full-time employee has been certified to the employer as having enrolled for that month in a QHP for which health coverage assistance is allowed or paid.

What is the amount of penalty tax?

Code Section 4980H(a) provides that the penalty tax is equal to the product of the "applicable payment amount" and the number of individuals employed by the employer (less the 30-employee reduction) as full-time employees during the month. The "applicable payment amount" for 2014 is $166.67 with respect to any month (that is, 1/12 of $2,000). The amount will be adjusted for inflation after 2014.

In calculating the liability the applicable large employer, as determined applying these same aggregation rules, is permitted one reduction of 30 full-time employees, and that the reduction must be allocated ratably among the members of the applicable large employer based on each member's number of full-time employees.

The determination of whether an employer is subject to the penalty tax and the amount of any such payment is determined on a member-by-member basis. This liability for, and the amount of, any penalty tax 4980H is computed and assessed separately for each member of the applicable large employer , taking into account that member's offer of coverage (or lack thereof) and based on that member's number of full-time employees. For example, if a parent corporation owns 100 percent of all classes of stock of 20 subsidiary corporations, and the controlled group is an applicable large employer, each of the 21 members of this controlled group (the parent corporation plus 20 subsidiary corporations) is considered separately in computing and assessing the penalty tax. In addition, each of the 21 group members is liable only for its separate penalty tax payment.

What is "minimum essential coverage"?

Under Code Section 5000A(f)(1), the term "minimum essential coverage" means coverage under any of the following: (a) a government-sponsored program, including coverage under Medicare Part A, Medicaid, the CHIP program, and TRICARE; (b) an "eligible employer-sponsored plan;" (c) a health plan offered in the individual market; (d) a grandfathered health plan; or (e) other health benefits coverage (such as a State health benefits risk pool) as HHS recognizes.

What is an "eligible employer-sponsored plan"?

Under Code Section 5000A(f)(2), it means a group health plan or group health insurance coverage offered by an employer to an employee that is (a) a governmental plan, or (b) any other plan or coverage offered in a state's small or large group market.

Under what circumstances will an applicable large employer be subject to the penalty tax if it offers its full-time employees (and their dependents) health coverage?

Beginning in 2014, Code Section 4980H(b)(1) provides that an applicable large employer will pay a penalty tax for any month that:

(1) the employer offers to its full-time employees (and their dependents) the opportunity to enroll in "minimum essential coverage" under an eligible employer-sponsored plan for that month; and

(2) at least one full-time employee of the employer has been certified to the employer as having enrolled for that month in a qualified health plan for which a premium tax credit or cost-sharing reduction is allowed or paid.

If an employee is offered affordable minimum essential coverage under an employer-sponsored plan, then the individual generally is ineligible for a premium tax credit and cost-sharing reductions for health insurance purchased through an Exchange.

The proposed regulations clarify that if an applicable large employer member fails to offer coverage to a full-time employee for any day of a calendar month during which the employee was employed by the employer, the employee is treated as not being offered coverage during that entire month. However, in a calendar month when a full-time employee terminates employment, if the employee would have been offered coverage for the entire month if the employee had been employed for the entire month, the employee is treated as having been offered coverage during that month.

The proposed regulations provide that, if an employee enrolls in coverage but fails to pay the employee's share of the premium on a timely basis, the employer is not required to provide coverage for the period for which the premium is not timely paid, and that employer is treated as having offered that employee coverage for the remainder of the coverage period (typically the remainder of the plan year) for purposes of Code Section 4980H. The regulations generally adopt the provisions applicable for purposes of payment for COBRA continuation coverage, which generally provides a 30-day grace period for payment and also provides rules with respect to timely payments that are not significantly less than the amount required to be paid and for responding to requests by health care providers for confirmation of coverage during the grace period.

Is an applicable large employer required to offer minimum essential coverage to an employee's dependents?

Yes. The proposed regulations provide that an applicable large employer is required to offer minimum essential coverage to an employee's dependents. An employee's dependents are defined for purposes of Code Section 4980H as an employee's child (as defined in Code Section 152(f)(1)) who is under 26 years of age. An offer of coverage to an employee's spouse is not required for purposes of Code Section 4980H because Code Section 4980H refers only to dependents (and not spouses).

The proposed regulations also provide transition relief with respect to dependent coverage for plan years that begin in 2014. Accordingly, any employer that takes steps during its plan year that begins in 2014 toward satisfying the requirements relating to the offering of coverage to full-time employees' dependents will not be liable for any penalty tax solely on account of a failure to offer coverage to the dependents for that plan year. The proposed regulations do not define what steps an employer needs to take.

What percentage of eligible full-time employees (and their dependents) must be offered coverage to avoid any penalty tax?

The proposed regulations provide that an applicable large employer member will be treated as offering coverage to its full-time employees (and their dependents) for a calendar month if, for that month, it offers coverage to all but five percent or, if greater, five of its full-time employees (provided that an employee is treated as having been offered coverage only if the employer also offered coverage to that employee's dependents).

When would employees offered minimum essential coverage by an employer be eligible for a premium tax credit and cost-sharing reductions for health insurance purchased through the Exchange?

Under Code Section 36B(c)(2)(C), employees covered by an employer-sponsored plan will be eligible for the premium tax credit if the plan's share of the total allowed costs of benefits provided under the plan is less than 60% of those costs (that is, the plan does not provide "minimum value"), or the premium exceeds 9.5% of the employee's household income. The employee must seek an affordability waiver from the Exchange. The penalty tax applies for employees receiving an affordability waiver. In order to get the premium tax credit and cost-sharing reduction, however, an employee must decline to enroll in the coverage and purchase coverage through the Exchange instead, as provided under Code Section 36B(c)(2)(C).

The proposed regulations contain three affordability safe harbors, for purposes of determining whether an employer's coverage satisfies the 9.5 percent affordability for purposes of the penalty tax. These safe harbors include the Form W-2 wages safe harbor, the rate of pay affordability safe harbor and the Federal poverty line safe harbor. These safe harbors do not apply for purposes of determining the penalty tax. The safe harbors also would not affect an employee's eligibility for a premium tax credit which would continue to be based on the cost of employer-sponsored coverage relative to an employee's household income. These safe harbors are all optional. An employer may choose to use one or more of these safe harbors for all its employees or for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category.

Form W-2 Wages Safe Harbor: The proposed regulations provide a safe harbor under which an employer could determine affordability for purposes of liability by reference to an employee's wages from that employer. Wages for this purpose would be the total amount of wages as defined in Code Section 3401(a), which is the amount required to be reported in Box 1 of Form W-2, Wage and Tax Statement.

For the proposed Form W-2 wages safe harbor to apply, an employer must meet certain requirements, including:

(1) that the employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan; and

(2) that the required employee contribution toward the self-only premium for the employer's lowest cost coverage that provides minimum value (the employee contribution) not exceed 9.5 percent of the employee's Form W-2 wages for that calendar year.

Application of this safe harbor is determined after the end of the calendar year and on an employee-by-employee basis, taking into account the employee's Form W-2 wages from the employer and the employee contribution. So, for example, the employer determines whether it met the Form W-2 wages safe harbor for 2014 for an employee by looking at that employee's 2014 Form W-2 wages (meaning the wages reported on the 2014 Form W-2 that generally is furnished to the employee in January 2015) and comparing 9.5 percent of that amount to the employee's 2014 employee contribution.

An employer could also use this safe harbor prospectively, at the beginning of the year, to set the employee contribution at a level so that the employee contribution for each employee would not exceed 9.5 percent of that employee's Form W-2 wages for that year (for example, by automatically deducting 9.5 percent, or a lower percentage, from an employee’s Form W-2 wages for each pay period).

If the employee only worked part of the year for the employer, this safe harbor can be applied. Affordability for a part-year period is determined by comparing annual income to an annualized premium. Using this test to determine liability could, in certain cases, result in penalizing employers that offer coverage that would be affordable based on the wages paid to, and premiums charged to, an employee for a given period. For example, if an employee was employed for six months of a calendar year by an employer, and offered coverage for those six months with an employee premium that did not exceed 9.5 percent of the employee’s wages for those six months, and if the employee was not employed by the employer or any other employer for the other six months of the calendar year, the annualized premium may be higher than 9.5 percent of the employee’s Form W-2 wages for the year. The proposed regulations address this issue by providing that, for an employee who was not a full-time employee for the entire calendar year, the Form W-2 wages safe harbor is applied by adjusting the employee’s Form W-2 wages to reflect the period when the employee was offered coverage, and then comparing those adjusted wages to the employee share of the premium during that period. Specifically, the amount of the employee’s compensation for purposes of the safe harbor is determined by multiplying the wages for the calendar year by a fraction equal to the months for which coverage was offered to the employee over the months the employee was employed. That adjusted wage amount is then compared to the employee share of the premium for the months that coverage was offered to determine whether the Form W-2 wages safe harbor was satisfied for that employee. For example, if the employee worked eight months of a calendar year, during five months of which the employee was offered coverage, and received a Form W-2 reflecting Form W-2 wages of $24,000, the adjusted wages would be $24,000 multiplied by 5/8 or $15,000. That $15,000 is then treated as the adjusted Form W-2 wages for purposes of determining whether the employee share of the premium for each of the five months of coverage offered was affordable under the section 4980H safe harbor (meaning the employee would be treated for this purpose as earning $3,000 per month during that five-month period).

Rate of Pay Safe Harbor: The proposed regulations provide a rate of pay safe harbor under which the employer would (1) take the hourly rate of pay for each hourly employee who is eligible to participate in the health plan as of the beginning of the plan year, (2) multiply that rate by 130 hours per month (the benchmark for full-time status for a month under section 4980H), and (3) determine affordability based on the resulting monthly wage amount.

Federal Poverty Line Safe Harbor: The proposed regulations provide that an employer may also rely on a design-based safe harbor using the Federal poverty line (“FPL”) for a single individual. Specifically, for purposes of Code Section 4980H, employer provided coverage offered to an employee is affordable if the employee’s cost for self only coverage under the plan does not exceed 9.5 percent of the FPL for a single individual. For households with families, the amount that is considered to be below the poverty line is higher, so using the amount for a single individual ensures that the employee contribution for affordable coverage is minimized.

When would the penalty tax be assessed?

To be considered minimum essential coverage, the coverage will need to meet an affordability requirement-which compares cost to income and provide minimum value (i.e., it will need to pay at least 60% of the total allowed cost of benefits). The penalty tax is due if any full-time employee is certified to the employer as having purchased health insurance through an Exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee. Employers who provide coverage under an eligible employer-sponsored plan that does not meet the affordability and minimum value requirements may nevertheless avoid the tax to the extent employees actually participate in the plan, as provided under Code Section 36B(c)(2)(C)(iii).

What is the amount of the penalty tax if an applicable large employer does offer coverage to its full-time employees (and their dependents)?

Code Section 4980H(b)(1) provides that the penalty tax is equal to $250 (1/12 of $3,000, adjusted for inflation after 2014) times the number of full-time employees for any month who receive premium tax credits or cost-sharing assistance (this number is not reduced by 30). This penalty tax (assessable payment) is capped at an overall limitation equal to the “applicable payment amount” (1/12 of $2,000, adjusted for inflation after 2014) times the employer's total number of full-time employees, reduced by 30, as provided in Code Section 4980H(b)(2).

How will the minimum value for an employer-sponsored plan be determined?

In IRS Notice 2012-31, the IRS requested comments on several approaches to the minimum value determination, including evaluating plan designs that will cover part or all of 2014 and suggestions for transitional relief for plan years that start before and end in 2014. This determination of minimum value for employer plans will be consistent with previous HHS guidance on “actuarial value,” which is relevant for determining coverage levels for QHPs offered through the Exchanges.

In IRS Notice 2012-31, the IRS described three potential approaches, for determining minimum value. They include:

- **Minimum Value (“MV”) Calculator:** The IRS will develop a MV calculator for use by self-insured plans and insured large group plans. Under this approach, plans with certain standard cost-sharing features (e.g., deductibles, co-insurance, and maximum out-of-pocket costs) will be able to enter information about four core categories of benefits (physician and mid-level practitioner care, hospital and emergency room services, pharmacy benefits, and laboratory and imaging services) into the calculator based on claims data of typical self-insured employer plans. The calculator would also take into consideration the annual employer contributions to a HSA or amounts made available under a HRA, if applicable. Comments are specifically requested on how to adjust for other benefits (e.g., wellness benefits) provided under a plan using the calculator.

- **Design-Based Safe Harbor Checklists:** As an alternative, an array of safe harbor checklists would be provided so plans may compare to their own coverage. The safe harbor checklists would be used to make minimum value determinations for plans that cover all of the four core categories of benefits and services (physician and mid-level practitioner care, hospital and emergency room services, pharmacy benefits, and laboratory and imaging services) and have specified cost-sharing amounts. Each safe harbor checklist would describe the cost-sharing attributes of a plan (e.g., deductibles, co-payments, co-insurance, and maximum out-of-pocket costs) that apply to the four core categories of benefits and services.

- **Actuarial Certification:** The last approach would be available for plans with "nonstandard" features (such as quantitative limits on any of the four categories of benefits, including, for example, a limit on the number of physician visits or covered days in a hospital) since these plans would not be able to use a calculator or the safe harbor checklists. Plans would be able to generate an initial value using a calculator and then engage a certified actuary to make appropriate adjustments that take into consideration the nonstandard features. Plans with nonstandard features of a certain type and magnitude would also have the option of engaging a certified actuary to determine the plan's actuarial value without the use of a calculator.

May an employer allow an employee to change his or her election under a cafeteria plan to enroll in coverage through an exchange and discontinue their employer's coverage?

The proposed regulations provide transition relief from the election rules in proposed IRS Regulations Section 1.125-2 with respect to salary reduction elections under a cafeteria plan for an employer-provided accident and health plan with a fiscal year beginning in 2013. This transition relief applies only to the revocation, modification, or commencement of salary reductions for accident and health coverage offered through a cafeteria plan of an employer with a cafeteria fiscal year plan beginning in 2013 (and does not apply to any other qualified benefit offered through a cafeteria plan).

A member of the applicable large employer is permitted, at its election, to amend one or more of its written cafeteria plans to permit either or both of the following changes in salary reduction elections:

(1) An employee who elected to reduce his or her salary through the cafeteria plan for accident and health plan coverage with a non-calendar plan or policy year beginning in 2013 is allowed to prospectively revoke or change his or her election with respect to the health plan once, during that plan or policy year, without regard to whether the employee experienced a change in status event described in IRS Regulations Section 1.125-4; and

(2) An employee who failed to make a salary reduction election through his or her employer's cafeteria plan for accident and health plan coverage with a non-calendar plan or policy year beginning in 2013 before the deadline in proposed IRS Regulations Section 1.125-2 for making elections for the cafeteria plan year beginning in 2013 is allowed to make a prospective salary reduction election for health coverage on or after the first day of the 2013 plan or policy year of the cafeteria plan, without regard to whether the employee experienced a change in status event described in IRS Regulations Section 1.125-4.

A member of the large employer that wants to permit the change in election rules under this transition relief for non-calendar plan or policy years must incorporate these rules in its written cafeteria plan.

Any there any special transitional rules for large employers participating in a multiemployer plan?

For 2014, the proposed regulation provides a transition rule which specifies that an applicable large employer member will not be treated as failing to offer the opportunity to enroll in minimum essential coverage to a full-time employee (and the employee's dependents) and will not be subject to a penalty tax with respect to a full-time employee if (i) the employer is required to make a contribution to a multiemployer plan with respect to the full-time employee pursuant to a collective bargaining agreement or an appropriate related participation agreement, (ii) coverage under the multiemployer plan is offered to the full-time employee (and the employee's dependents), and (iii) the coverage offered to the full-time employee is affordable and provides minimum value.