PRIORITY *Alert*

New Regulations Help Employers Ease Into Pay or Play

By: Mary V. Bauman, Frank E. Berrodin, James C. Bruinsma, and Tripp W. Vander Wal

On February 12, 2014, the IRS published its long-awaited final regulations to assist employers in compliance with the pay or play penalty under Health Care Reform. The new regulations modify proposed regulations issued more than one year ago and subsequent IRS guidance. Many important issues are addressed, including new transition relief to help employers ease into the pay or play era.

Pay or Play Penalty

Under Health Care Reform's pay or play penalty, large employers with an average of at least 50 full-time employees and full-time employee equivalents in the previous calendar year must offer group health coverage or pay a penalty. The penalty was initially set to take effect as of January 1, 2014 but in July 2013 the IRS announced the effective date would be pushed back one year, until January 1, 2015. There are two different pay or play penalties (also known as employer shared responsibility payments) which apply to large employers:

$2,000 Penalty First, if a large employer *doesn't offer health coverage* to at least 95% of its full-time employees working 30 or more hours per week and at least one low income full-time employee enrolls in health coverage on an exchange and receives a premium credit, the employer must pay an annual penalty of *$2,000* multiplied by all of the employer's full-time employees, disregarding the first 30 full-time employees. The penalty is calculated on a monthly, pro rata basis.

$3,000 Penalty Second, if an employer *does offer health coverage* to at least 95% of its full-time employees but it is not "affordable" (see page 6) or is not of "minimum value" (see *Health Care Reform Priority Alert* issued January 7, 2013) and a low income full-time employee enrolls in health coverage on an exchange and receives a premium

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credit, the employer must pay an annual penalty of *$3,000* for each such full-time employee. This penalty is capped at the maximum amount under the $2,000 penalty.

Key Transition Rules

Large Employer Calculation For purposes of calculating whether an employer is a large employer in 2015, the average number of full-time employees and full-time employee equivalents may be calculated using any six-month consecutive period in 2014 (rather than the entire 2014 calendar year). For subsequent calendar years, the look back must be the entire preceding calendar year.

Mid-Size Employers The penalty will not apply until the first day of an employer's 2016 plan year for employers with an average of 50 to 99 full-time employees and full-time employee equivalents in 2014 (the six-month consecutive period discussed above may be used to calculate this average), if the employer satisfies all of the following conditions:

- The employer does not reduce its workforce during the period of February 9, 2014 to December 31, 2014 solely to qualify for this transition relief (reductions in workforce for "bona fide" business reasons are permissible);
- For the period of February 9, 2014 until the end of the employer's 2015 plan year, the employer does not eliminate or materially reduce any health coverage it offered as of February 9, 2014; and
- The employer certifies that it satisfies these conditions on a form to be provided by the IRS.

Offer of Coverage For the 2015 plan year (this also applies to non-calendar year plans, if the plan year is not changed after February 9, 2014 to begin on a later date), an employer must only offer coverage to 70% of its full-time employees (vs. 95%) in order to avoid the $2,000 penalty. Further, if the employer is subject to the $2,000 penalty, it may calculate the total penalty amount by disregarding its first 80 full-time employees (vs. 30).

Non-Calendar Year Plans Similar to the proposed regulations, the final regulations provide for a delayed effective date for certain employers with non-calendar year plans. The transition relief applies with respect to plans that were in existence on a non-calendar year basis as of December 27, 2012 and have not been subsequently modified to move the plan year start to a date later in the calendar year. With respect to employees eligible for or enrolled in the employer's plan under its terms as in effect on February 9, 2014, the penalty will generally not apply until the first day of the employer's 2015 plan year.

However, if the employer doesn't offer group health coverage to all employees working at least 30 hours per week, the above transition rule may not apply to those ineligible employees who will be considered full-time under the pay or play penalty. As a result, there are two additional transition rules providing a delayed effective date until the first day of the employer's 2015 plan year.

- First, the postponed effective date is available for *all* employees provided that at least one-quarter of all of the employer's employees were covered under the employer's non-calendar year plan as of a date chosen by the employer during the 12 months ending on February 9, 2014, or at least one-third of *all* of the employer's employees were offered coverage under the employer's non-calendar year plan

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during the most recent open enrollment period that ended before February 9, 2014.

- Second, transition relief is available for all full-time employees if the employer either had, as of any date it selects during the 12 months ending on February 9, 2014, at least one-third of its *full-time* employees covered under its non-calendar year plan or offered coverage to at least one-half of its *full-time* employees during the most recent open enrollment period that ended before February 9, 2014. This last rule is new and was added by the final regulations.

Important Issues Addressed

Can any employees be excluded in applying the pay or play rules? The final regulations discuss the status of several categories of employees for purposes of the pay or play rules:

- **Foreign Employees** As in the proposed regulations, the final regulations exclude employees whose compensation is from sources outside the United States. This rule applies regardless of the employee's citizenship. The exclusion is not limited to nonresident aliens.

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Health Care Reform Webinar

New Regulations Help Employers Ease into Pay or Play

Miller Johnson is excited to offer a complimentary webinar on this latest change to Health Care Reform now that the IRS has released final regulations regarding the employer pay or play penalty.

The webinar will focus on:

- An explanation of the key transition relief for employers with 50 to 99 full-time employees and 100 or more full-time employees. These rules will enable employers to postpone the full impact of the law for another year, until 2016.
- A review of the measurement period and stability period rules and a summary of the changes and clarifications to the rules from the new regulations.
- What's still missing–a list of the items where additional guidance is expected.
- Our recommendations of what employers should be doing now and in the coming year to address the pay or play.

Date: Wednesday, February 26, 2014
Time: 1:00 - 2:00 PM EST
Presenters: Mary Bauman and Tripp Vander Wal

To register, visit the www.millerjohnson.com home page Resource Center for a link to register for the event.

- **Employees Holding H-2A and H-2B Visas** Employers in the agricultural industry had requested that holders of H-2A and H-2B visas be exempted from the definition of "employee" for purposes of the pay or play rules. The final regulations rejected this request. The holders of H-2A and H-2B visas are included in the definition of "employee" for purposes of the pay or play rules.

- **Student Employees** A student who is working for an employer as a paid intern or extern is counted as an employee for purposes of the pay or play rules, but an unpaid intern or extern is not counted. Similarly, student employees of an educational organization who are paid for work (other than through a work study program, as discussed below) are counted as employees for the pay or play rules.

Can any hours of service be excluded in applying the pay or play rules? The final regulations generally require that each hour for which an employee is paid be counted for purposes of the pay or play rules. However, here are two exceptions:

- **Volunteer Employees** The hours of service of a "bona fide volunteer" are not counted under the pay or play rules. For this purpose, a person is a "bona fide volunteer" if the person works as an employee of a governmental entity or a tax-exempt organization and only receives the following types of compensation: expense reimbursements or allowances, or reasonable benefits and nominal fees paid by similar entities for services by volunteers. A volunteer firefighter is an example of a "bona fide volunteer."

- **Student Employees on Work-Study Programs** Unlike the rules for student employees discussed above, a student employee's hours of service performed in a federal work-study program (or similar program of a state or other governmental entity) are not counted for purposes of the pay or play rules.

Are there any changes in how hours of service should be tracked? The final regulations continue the same rules for tracking the hours of service for salaried employees and hourly employees. However, new rules were added for employees in specific situations:

- **Adjunct Faculty Members** The final regulations include a safe harbor rule that can be used in determining the hours of service for adjunct faculty members of educational institutions. For at least 2015, an employer can credit these adjunct faculty members with hours of service based upon the following formula:

  - 2.25 hours of service for each credit hour taught during a week; plus

  - An hour of service per week for each additional hour outside the classroom the faculty member spends performing required duties, such as required office hours and faculty meetings.

  The 2.25 hours of service per week is intended to count actual teaching time, and time for class preparation and grading of tests and papers.

- **On-Call Employees** Until further guidance is issued, employers who have on-call employees are required to use a reasonable method for crediting hours of service for on-call employees. A reasonable method requires that the following hours be credited:

  - Each hour for which an on-call employee is paid;

  - Each hour for which an on-call employee is required to remain on the employer's premises; and

  - Each hour for which the employee's activities are significantly limited because of being on-call.

- **Rehired Employees** The final regulations change the rules for determining whether a rehired employee is treated as a new employee for the pay or play rules. Under the final regulations, an employee will generally be treated as a new

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employee only if the employee is absent from work for 13 weeks. However, there is an exception for educational organizations. An employee of an educational organization is required to have a 26-week break in service period to be treated as a new employee.

In addition, the rule of parity permitted by the proposed regulations may continue to be used, but is not required. This rule permits a rehired employee to be treated as a new employee if the employee's period of absence is at least four weeks and exceeded the length of the employee's prior employment.

- **Unpaid Leaves of Absence** Like the proposed regulations, the final regulations include a rule for an employee who takes a "special unpaid leave." This is limited to FMLA leaves, USERRA military leaves and jury duty.

  If the employee takes this type of leave and returns to work for the employer, the employer has two options (which yield the same result) for determining the employee's average hours of service:

  - Determine the employee's average hours of service after excluding the period of the special unpaid leave; or
  - Treat the employee as credited with hours of service during the special unpaid leave using the average weekly rate at which the employee was credited with hours of service during the weeks while the employee was working.

  However, this special rule does not apply in determining whether an employer is a "large employer" under the pay or play rules. Only actual hours worked are counted for that purpose.

How does the pay or play penalty apply to small employers when first becoming a large employer?
The final regulations provide temporary relief in the first year an employer is a large employer. Under this relief, an employer is not subject to the $2,000 penalty for the period of January through March for failing to offer full-time employees coverage, if coverage is offered by April 1. Further, employers are not subject to the $3,000 penalty for the period of January through March if the employer offers coverage during those months which provides "minimum value," even if not "affordable." However, this relief is only available with respect to employees who were not offered coverage during the prior calendar year. If the employer doesn't offer the requisite coverage by April 1, the penalties will apply retroactively for the period of January through March. This relief only applies in the *first* year that

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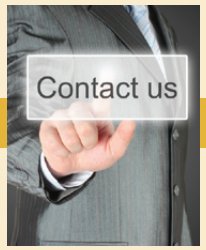

Contact Us

If you have any questions about the articles in this issue, please contact the author. If you have any question on how any proposed Health Care Reform changes will impact your organization, please feel free to contact Mary Bauman, chair of Miller Johnson's Health Care Reform Team, or another member of the team.

If you would like to reprint articles, schedule a speaker, or receive our newsletter and alerts, please send an e-mail to healthcarereformteam@millerjohnson.com.

the employer becomes a large employer, even if the employer later falls below and then crosses back over the large employer threshold.

Were the measurement period/stability period rules modified? The measurement period and stability period rules were not significantly changed. Large employers may adopt an optional three to 12-month measurement period to determine if new hires who are variable hours or seasonal employees work, on average, at least 30 hours per week for purposes of the penalty. If such a new hire works the required hours during the measurement period, the employer must offer the employee the requisite health coverage during a subsequent stability period in order to avoid the penalty. The stability period must be the greater of six months or the length of the measurement period. Employers may establish a similar measurement period and stability period for ongoing employees.

- **Shorter Measurement Period for 2014** After reviewing the rules, most employers are selecting a 12-month measurement period and a 12-month stability period. However, a 12-month measurement period and a 12-month stability period create time constraints for employers for 2015, particularly for plans operating on a calendar year basis (because the 12-month measurement period must begin by no later than January 1, 2014). Consequently, solely for purposes of the stability period beginning in 2015, the regulations permit employers to adopt a measurement period shorter than 12 months as long as two requirements are satisfied. First, the measurement period must be at least six months long. Second, the measurement period must begin by no later than July 1, 2014 and end by no earlier than 90 days before the first day of the 2015 plan year.

- **Seasonal Employees** Newly-hired variable hours and seasonal employees can be subject to an initial measurement period before coverage must be offered. The final regulations state that "seasonal" for this purpose, means the employee is in a position for which the customary annual employment period is six months or less, with the employment period beginning at approximately the same time each year.

- **Full-Time Employees Switching to Part-Time Positions** The proposed regulations indicated that if an employee averaged 30 or more hours per week during a measurement period, the employee must be offered coverage during the entire subsequent stability period even though his or her hours may fall below the 30 hours per week average during the stability period. The final regulations provide an exception where an employee was offered coverage by the first day of the month following his or her first three months of employment and the employee moves from a full-time position to a part-time position. In this situation it may be possible to apply a monthly measurement period to establish the reduction of hours and terminate the employee's coverage before the end of the stability period, provided the employee averages less than 30 hours per week for each month following the transfer.

Did the regulations modify the safe harbor affordability tests? The proposed regulations provided three safe harbors for employers to calculate whether coverage is "affordable." All three affordability safe harbors (Box 1 W-2, rate of pay and federal poverty line) are included in the final regulations. The final regulations provide the following clarification regarding the rate of pay and federal poverty line safe harbors:

- **Rate of Pay** The rate of pay safe harbor is permitted to be used, even if an hourly employee's hourly rate is reduced during the year. If the hourly rate is reduced, the rate of pay safe harbor is applied separately to each calendar month based on the employee's rate of pay for that month. However, the rate of pay safe harbor is *not* available for a year with respect to a salaried employee whose monthly salary is reduced.

- **Federal Poverty Line** Employers are permitted to use the federal poverty line in effect as of the first day of the plan year or the federal poverty line in effect six months before the beginning of the plan year.

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Are There any Special Rules That Apply to Short Term Assignments? There are no special rules applicable to employees hired for short term assignments, other than seasonal employees. Therefore, any employee hired for a specified project or period of time must be counted in the same manner as a regular employee, unless the employee meets the criteria necessary to be a seasonal employee as described above.

Temporary Staffing Agencies The regulations provide no new revelations regarding the application of the pay or play penalty to temporary staffing firms. In general, the same rules that apply to employers regarding classifying employees as variable hours or full-time employees also apply to staffing agencies. Staffing agencies were also not given any additional guidance regarding how to determine whether and when their employees have separated from service; therefore, they must apply the same rules that apply in determining whether their employees have separated from service for purposes of their retirement and other benefit plans (including COBRA). In the preamble, the IRS reiterates its concern regarding potentially abusive practices arising from the use of staffing agencies and suggests that employers should expect future guidance designed to prevent these possible abuses (like splitting employees' hours by using multiple staffing agencies).

The final regulations offer a useful tool to large employers leasing full-time employees through a temporary staffing agency. Where the employer retains the right to direct and control the employees, the employees will likely be considered the common-law employees of the client employer as opposed to the temporary staffing agency for purposes of the pay or play penalty. However, if the temporary staffing agency offers the leased employee group health coverage, the offer will be treated as an offer of coverage made by the client employer for purposes of avoiding the pay or play penalty. This relief is contingent on the temporary staffing agency charging the client employer a higher fee with respect to leased employees enrolling in the staffing agency's health plan. Large employers using temporary staffing agencies will want to review their service agreements to consider this option.

Four Years of Guidance

When we formed the Health Care Reform team back in 2010, we used this in the announcement:

- Because of the complexity and ambiguity of the Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010 signed into law in March 2010, the changes are expected to span eight years in implementation.
- Mary V. Bauman, chair, said *"… we knew our clients deserved to have a more comprehensive and cohesive group serving them since this will have a tremendous impact on them financially and strategically."*

In the past four years, the team has written almost 90 articles, presented to more than 30 different professional groups, and been quoted in business and trade publications more than 20 times.

Visit the Health Care Reform Team pages at www.millerjohnson.com (resources, publications, experience, etc.) since it is a great resource and reference tool.

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