EMPLOYEE BENEFITS

PENALTIES AND MEASURING PERIODS FOR LARGE EMPLOYERS

How to Assess Potential Liability under the Affordable Care Act

by Deborah L. Grace

Under the Affordable Care Act ("ACA"), a large employer is subject to penalties if it fails to offer to full-time employees and their dependents health coverage or if the coverage that it offers is not affordable or does not provide minimum value. These new "shared responsibility" rules are effective as of January 1, 2014, and apply to all large employers, including non-profits and governmental entities. A prior article described the rules for determining if a business is a large employer, which is defined as an employer that employed an average of at least 50 full-time and full-time equivalent employees on business days during the preceding calendar year. This article describes the potential penalties under the shared responsibility rules of Section 4980H of the Internal Revenue Code ("Code") and the proposed regulations issued by the Internal Revenue Service in December 2012, and focuses on the rules for determining whether an employee is a full-time employee for purposes of the penalties. A future client alert will address the affordability safe harbors under the regulations, and determining if an employer's health plan provides minimum value. For purposes of this article, the term "employer" means a large employer under Code Section 4980H, and any coverage provided by the employer is assumed to constitute minimum essential coverage.

When Will an Employer be Subject to a Penalty?

While the ACA does not require that an employer offer health care coverage to a full-time employee (and the employee's dependents), employers that do not offer coverage or offer to their full-time employees coverage that is not affordable will be assessed a penalty if one or more full-time employees are certified to the employer as having received a premium tax credit or cost-sharing reduction with respect to that employee's purchase of health insurance on an Exchange. The amount of the penalty varies depending on whether it is assessed due to the employer's failure to offer coverage or the offering of non-affordable coverage.

What is the Penalty for Failure to Offer Minimum Essential Health Care Coverage?

If, in any month, an employer fails to offer its full-time employees and their dependents the opportunity to enroll in a health care plan that provides minimum essential coverage, and one full-time employee is certified as having received the premium tax credit or cost-sharing reduction, then the employer will be assessed a penalty for that month equal to the product of $166.66 (1/12 of the annual amount, which is $2,000 for 2014, and is indexed for inflation) multiplied by the number of full-time employees that the employer employs during the month less 30. For example, if Company A has 55 full-time employees in March 2014, and it does not offer health care coverage to any of its full-time employees during that month, and one of its full-time employees obtained a premium tax credit to purchase coverage on an Exchange, then Company A would owe a penalty for the month of March of $4,166.50 (55 full-time employees less 30 x $166.66). The penalty is calculated separately for each month that Company A does not offer coverage and it is certified to Company A that a full-time employee obtained coverage on the Exchange through either a premium tax credit or a cost-sharing reduction.

Ninety-five percent coverage rule. An employer 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). This rule applies regardless of whether the failure to offer coverage was inadvertent. Unfortunately, compliance with this rule does not avoid all penalties. If an employer who complies with the 95% coverage rule has a full-time employee who was not offered coverage and the employee received a premium tax credit or cost-sharing reduction, then the employer will be assessed the same penalty that is assessed against an employer who offers coverage that is not affordable, as explained below.

Coverage of the employee's dependents. An employee's dependents include an employee's child who is under age 26, but does not include the employee's spouse. Employers that currently offer coverage only to their employees and not to dependents have one additional year to take steps toward satisfying the requirement that coverage be offered to full-time employees' dependents. For plan years beginning in 2014, such employers will not be liable for a penalty under Code Section 4980H solely on account of a failure to offer coverage to the dependents for that plan year.

What is the Penalty for Failure to Offer Coverage that is Affordable or that does not Provide Minimum Value?

If the employer does not offer affordable coverage or it offers coverage that does not provide minimum value, and one full-time employee is certified to the employer as having received a premium tax credit or cost-sharing reduction with respect to the employee's purchase of health insurance on an Exchange, then the employer is liable for a penalty based on the number of its full-time employees receiving the premium tax credit or cost-sharing reduction for the month multiplied by $250 (1/12 of the annual amount, which is $3,000 in 2014, which will be indexed for inflation). The amount assessed for failure to offer affordable coverage or for offering coverage that fails to provide minimum value cannot exceed the amount that would be imposed if the employer did not offer coverage to its full-time employees.

What is a "Full-time" Employee for Purposes of the Penalties?

A "full-time" employee is one who is employed by the employer on average at least 30 hours of service per week or 130 hours of service per calendar month.

Recognizing that determining full-time employee status on a monthly basis may cause practical difficulties for employers, employees, and the Exchanges, the proposed Code Section 4980H regulations allow an

employer to determine full-time status during a look-back measurement period. Any employee who is determined to be a full-time employee during the look-back period will be counted as a full-time employee during the following stability period even if the employee's hours of service are reduced during the stability period.

How does an Employer Apply the Look-back Measurement Period and the Stability Period for Ongoing Employees?

An employer has the option to determine each ongoing employee's full-time status by looking back at a measurement period of not less than three but not more than 12 consecutive months, as chosen by the employer. The measurement period that the employer chooses to apply to ongoing employees is referred to as the "standard" measurement period. An ongoing employee is one who was employed by the employer for at least one complete standard measurement period. The employer may choose to add an administrative period (which may not exceed 90 days) between the measurement period and the stability period. The stability period is a period that immediately follows the standard measurement period (and any applicable administrative period), the duration of which would be at least the greater of 6 consecutive calendar months or the length of the standard measurement period. The stability period may be no longer than the associated standard measurement period. Any administrative period between the standard measurement period and the stability period may neither reduce nor lengthen the measurement period or the stability period, and it must overlap with the prior stability period.

If the employer determines that an ongoing employee was employed on average at least 30 hours of service per week during the standard measurement period, then the employer treats the employee as a full-time employee during the subsequent stability period. If the employer determines that the ongoing 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 immediately following stability period.

For example, a large employer with a calendar year heath care plan might use a look-back standard measurement period that begins on October 15th, a stability period of the calendar year, and an administrative period of October 15th to December 31st. If, during the standard measurement period that began on October 15, 2012 and ends on October 14, 2013, an ongoing employee completes on average 30 hours of service per week, then during the stability period beginning on January 1, 2014 and ending on December 31, 2014, the employee would be a full-time employee for purposes of the potential penalties under Code Section 4890H. The employer could use the administrative period of October 15, 2013 to December 31, 2013 to determine the employee's average hours of service during the standard measurement period and to offer coverage to the employee.

As an alternative, an employer could use 6-month standard measurement periods starting each May 15th and November 15th with 6-month stability periods that begin on January 1st and July 1st, and administrative periods of May 15th through June 30th and November 15th though December 31st. We expect that most employers will elect to use 12-month standard measurement and stability periods instead of 6-month periods so to simplify administration.

Once an ongoing employee is determined to be a full-time employee for a stability period, a change in the employee's job position during the stability period, such as a change to a position that involves a lower level of service, does not affect the employee's status as full-time for the remainder of the stability period. Likewise, an employee who was determined to be employed on a non-full-time basis may be treated as not a full-time employee during the stability period even if the employee's hours are increased during the stability period. Of course, an employer could elect to offer coverage to the employee who during the stability period is moved to a job position under which the employee works on average more than 30 hours of service per week.

Employers have some flexibility when establishing these measuring periods. An employer may use different standard measurement periods, stability periods, and administrative periods for the following categories of employees: (1) each group of collectively bargained employees covered by a separate collective bargaining agreement, (2) collectively bargained and non-collectively bargained employees, (3) salaried employees and hourly employees, and (4) employees whose primary places of employment are in different states. In addition, an employer may make adjustments at the beginning and end of the measurement period to coincide with the beginning and ending of regular payroll periods if the employer's payroll periods are one week, two weeks, or semimonthly in duration.

Special transitional rule for 2014. Solely for purposes of stability periods beginning in 2014, an employer may use a look-back measurement period that is shorter than 12 months so long as the measurement period is at least 6 months, and it 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. For example, an employer with a calendar year plan that uses a 12-month stability period beginning on January 1, 2014, could use a 6-month measurement period that begins on April 15, 2013, and an administrative period that starts on October 15, 2013 and ends on December 31, 2013.

How does an Employer Determine if a New Employee is Full-time?

The method used to determine whether a new employee is full-time will vary depending upon whether the new employee is reasonably expected to work on average at least 30 hours of service or is a variable hour employee or a seasonal employee.

Employees reasonably expected to work full-time. If a newly hired employee is expected to work on average 30 hours of service per week (and is not a seasonal employee), then the employer must offer coverage to the employee at or before the conclusion of the employee's initial three calendar months of employment or otherwise be subject to possible penalty.

New variable hour and seasonal employees. If an employer uses the look-back measurement method to determine the full-time status of its ongoing employees, the employer may also use a similar process with a

measurement period, a stability period and an optional administrative period for its new variable hour and seasonal employees.

Who is a variable hour employee? A new employee is a variable hour employee if, based on the facts and circumstances at the employee's start date, the employer cannot determine that the employee is reasonably expected to be employed on average at least 30 hours per week. For example, if the new employee replaces an employee who was not employed on average at least 30 hours per week, it would be reasonable to classify this new employee as a variable employee upon hire. A new employee who is expected to be employed 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 be employed on average at least 30 hours per week over the initial measurement period. For example, an employee hired to work 45 hours per week at a retail location during the months of November and December, with the expectation that after the holidays the individual would continue working a schedule of 25 hours or less per week, would qualify as a variable hour employee.

Who is a seasonal employee? A seasonal employee is one who performs services on a seasonal basis as defined by the Secretary of Labor, including migrant and seasonal agricultural workers, and retail workers employed exclusively during holiday seasons. The term seasonal employee is not limited to agricultural or retail workers, and would include individuals whose employment "is of the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year." Until further guidance is issued, an employer may apply a reasonable good faith interpretation of this definition.

What is the measurement period and stability period for new variable hour and seasonal employees? For a new variable hour or seasonal employee, an employer may use an initial measurement period of between 3 and 12 months and an administrative period of up to 90 days. The initial measurement period must begin on any date between the employee's start date and the first day of the first calendar month following the employee's start date. The initial 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). If an employer complies with these rules and the employee's position is not materially changed during the initial measurement period, then no penalty will be assessed with respect to the new variable hours or seasonal employee during the initial measurement period or the administrative period.

During the initial measurement period, the employer measures the hours of service for the new variable hour employee or seasonal employee and determines whether the employee was employed an average of 30 or more hours of service per week during this period. If an employee is determined to be a full-time employee during the initial measurement period, then the new employee must be offered coverage during the new employee stability period or else the employer could be liable for a penalty. The new employee's stability period must be the same length as the stability period for ongoing employees. In addition, this stability period must be at least 6 months and is no shorter in duration than the initial measurement period.

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 new employee stability period that follows the initial measurement period. For an employee who is not full-time, this stability period must not be more than one month longer than the initial measurement period and must not exceed the remainder of the standard measurement period (plus any associated administrative period) in which the initial measurement period ends.

Examples of Allowable Initial Measurement and Stability Periods. For ongoing employees, Employer G uses a 12-month standard measurement period beginning October 15th, and a 12-month standard stability period beginning January 1st. For newly hired employees, Employer G uses a 12-month initial measurement period that begins on an employee's start date, and an administrative period that begins at the end of the 12-month initial measurement period and ends as of the end of the first calendar month that began after the end of the 12-month initial measurement period. An employee's initial stability period would be the 12-month period beginning immediately after the administrative period. Employee N is hired on May 15, 2013; his 12-month initial measurement period would end on May 14, 2014, and the administrative period would end on June 30, 2014. If Employee N worked on average 30 hours of service per week during his initial measurement period ending on May 14, 2014, then Employee G would need to offer coverage to Employee N during the initial stability period beginning July 1, 2014 through June 30, 2015, or else be subject to possible penalties.

As an alternative, Employer G could use an 11-month initial measurement period that begins on the employee's start date, and an administrative period that begins on the end of the initial measurement period and ends on the last day of the second calendar month beginning after the end of the initial measurement period. Using this testing scheme, Employee N, who is hired on May 15, 2013, would have an initial measurement period that ends on April 14, 2014. The administrative period would run from April 15, 2014 through June 30, 2014. If Employee N works on average 30 hours per week during these 11 months, Employer G would offer Employee N coverage during the initial stability period beginning on July 1, 2014 and ending June 30, 2015, to avoid a possible penalty.

Transitioning coverage for a new employee who becomes an ongoing employee. Once a new variable hour employee or new seasonal employee has been employed for an entire standard measurement period, the employer must test the employee for full-time employee status, beginning with that standard measurement period, at the same time and under the same conditions as apply to other ongoing employees. For example, if Employee N were found to have worked on

average 28 hours of service during the standard measurement period that began October 15, 2013 through October 14, 2014, then Employer G would not be liable for a penalty if it did not offer coverage to Employee N for the portion of the 2015 standard stability period beginning July 1, 2015 (after the end of Employee N's initial stability period) through December 31, 2015.

Material change in status during the initial measurement period. If a new variable hour or seasonal employee's position is changed during the employee's initial measurement period such that, if the employee had begun employment in the new position the employee would have reasonably been expected to be employed on average at least 30 hours of service per week, then the date on which the employer could be liable if coverage is not offered to the employee is modified. If the employer does not offer coverage by 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 associated with the initial measurement period), then the employer could be subject to a penalty.

The regulations include rules for calculating full-time status when an employee is rehired after termination of employment or resumes service after other absence, including rules for determining breaks in service for employees of educational organizations.

What is an Hour of Service?

Consistent with longstanding Department of Labor Rules, hours of service include both hours for which the employee is paid for services performed and also hours for which the employee is paid and no services are performed due to vacation, holiday, illness, disability, layoff, jury duty, military duty or leave of absence. If an employee is paid on an hourly basis, then the employer must use those hours to determine if the employee's status for the month is full-time.

Use of equivalencies for non-hourly employees. If an employee is not paid on an hourly basis, then the employer may use one of the following methods to determine the hours that the employee worked: (i) count actual hours worked by the employee; (ii) credit 8 hours of service for any day that the employee would be credited with at least 1 hour of service; or (iii) credit 40 hours for each week that the employee would be credited with at least 1 hour of service. An employer cannot use an equivalency method if it would result in understating an employee's hours. For example, if an employee usually works three 10 hour days a week, the employer cannot use the days-worked equivalency, since that would understate the employee's hours.

How will an Employer Receive Certification that a Full-time Employee Enrolled in an Exchange and Received Either a Premium Tax Credit or a Cost-sharing Reduction?

The Secretary of Health and Human Services ("HHS") has the authority to determine whether individuals are eligible to enroll in qualified health plans through the Exchange, and whether they are eligible for a premium tax credit. It is anticipated that process will be established by HHS to certify to the employer the names of the employees who have received a premium tax credit or cost-sharing reduction, and the IRS will use this information to determine the employer's liability under Code Section 4980H with the employer having the right to challenge the assessment of the penalty.

Next Steps.

For purposes of the ACA penalties, an employer will need to classify each employee as full-time or not full-time. For employers who currently determine eligibility for health care coverage based on the employee working on average 32, 35 or 40 hours per week, the employer will want to gather information now about the hours that its ongoing employees work, so to determine if any of its employees who are not currently eligible for benefits might be considered full-time employees for ACA purposes. As explained above, in any month that a full-time employee is not offered coverage, or is offered coverage that is not affordable or of minimum value, the employer could be liable for a penalty. An employer will want to establish its standard measurement period, its administrative period and its standard stability period. An employer will also want to consider whether its new hires are expected to work on average 30 hours per week or are variable hours or seasonal employees for which it will want to establish initial measurement periods and initial stability periods. Current plan documents should be reviewed and revised to include eligibility provisions consistent with the ACA measuring periods adopted by the employer.

This client alert is published by Dickinson Wright PLLC to inform our clients and friends of important developments in the field of employee benefits law. The content is informational only and does not constitute legal or professional advice. We encourage you to consult a Dickinson Wright attorney if you have specific questions or concerns relating to any of the topics covered in here.

FOR MORE INFORMATION CONTACT:

Deborah L. Grace, is a member in Dickinson Wright's Troy office. She can be reached at 248.433.7217 or dgrace@dickinsonwright.com.

Cynthia A. Moore, is a member and practice department manager in Dickinson Wright's Troy office. She can be reached at 248.433.7295 or cmoore@dickinsonwright. com.