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IRS Issues Final Regulations on Employer-Shared Responsibility (Play or Pay)

On February 10, 2014, the IRS issued final regulations on the employer-shared responsibility requirements, often known as “play or pay.” This is the requirement that large employers offer adequate coverage to their full-time employees or pay penalties. The final regulations follow the proposed regulations (which were issued in January 2013) in many respects, but also contain some surprises.

For many employers, the most important part of these regulations is the transition rule – while employers with 100 or more full-time or full-time equivalent employees will still need to meet the play or pay requirements in 2015, those with 50 to 99 full-time or full-time equivalent employees generally do not have to comply until 2016. Note that for an employer with 50 to 99 employees to be eligible for the delay, the employer will have to certify that, during the period beginning on February 9, 2014, and ending on the last day of the plan year that begins in 2015, the employer:

- Has not reduced the size of its workforce or the overall hours of service of its employees so that it could qualify for this delay, and
- Has not eliminated or materially reduced any coverage it had in effect on February 9, 2014. A material reduction means that:
  - The employer’s contribution is less than 95% of the dollar amount of its contribution for single-only coverage on February 9, 2014, or is a smaller percentage than the employer was paying on February 9, 2014.
  - A change was made to the benefits in place on February 9, 2014, that caused the plan to fall below minimum value, or
  - The class of employees or dependents eligible for coverage on February 9, 2014, has been reduced.

It is expected that this certification will be part of the reporting form.

This delay does not affect the effective date of the insurance market rules – employers still must implement the changes required for 2014, including the 90-day maximum for waiting periods, discontinuance of pre-existing condition limitations, removal of annual dollar maximums, and cost-sharing maximums (out-of-pocket and sometimes deductible) limits. Small insured groups still need to offer the 10 essential health benefits at the metal levels (i.e., platinum, gold, silver, and bronze) and use community rating starting in 2014.

Determining if the Employer is Large Enough for Employer-Shared Responsibility Requirements to Apply

In 2015, employers that had 100 or more full-time or full-time equivalent employees in 2014 must offer coverage or pay penalties. In 2016, employers that had 50 or more full-time or full-time equivalent employees in 2015 must offer coverage or pay penalties. Employers with fewer than 50 full-time or full-time equivalent employees will not be required to offer coverage to avoid penalties. Counting is done on a calendar year basis, even for employers that do not operate on a calendar year. In 2014 only, an employer may determine how many full-time and full-time equivalent employees it has over a period of six or more consecutive months, rather than all of 2014. When counting workers:

- Only "common law employees" are counted. This means that sole proprietors, partners, 2% shareholders and leased employees will not be counted. All other employees are counted, including those who are eligible for Medicare and Medicaid and those who are exempt from the individual mandate.
- An employee who averages 30 or more hours per week is considered a full-time employee. An employee who averages fewer than 30 hours per week is counted as a partial employee; these partial employees are then combined to get "full-time equivalent" employees.
- When counting an employee's hours, all hours for which an employee is paid are included. This means that vacation, holiday, sick pay, jury duty pay and paid leave count, as well as pay for hours actually worked. An employer does not need to count the hours of "bona fide" volunteers, which includes many volunteer firemen and volunteers for a non-profit organization. A person is a bona fide volunteer if the person volunteers for a government entity or a 501(c) organization and is not paid, or is only paid a nominal amount (for instance) to cover expenses. An employer does not need to count hours worked by a student under a federal work-study program, but all other hours for which a student is paid must be counted. There is an optional safe harbor for adjunct professors under which the employer would credit 2.25 hours of service for each hour taught. The IRS is still considering special rules for employees who are solely paid commissions. In the meantime, employers are to adapt an existing method in a "reasonable" way – presumably the weekly or daily equivalency method will fit best.
- Employers must count an hourly employee's actual hours. For salaried employees, an employer may use actual hours, daily equivalents (a day with at least one paid hour of service is considered eight hours worked) or weekly equivalents (a week with at least one paid hour of service is considered 40 hours worked).
- Hours worked in the U.S. (those that generate U.S. source income) are counted, whether the worker is a U.S. citizen or not. Conversely, work done overseas by a U.S. citizen does not count.
- Seasonal employees generally must be counted. When deciding if the employer is large, they may be excluded only if:
  - The employer exceeds 100 full-time or full-time equivalent employees for less than 120 days during 2014, and
  - Only seasonal employees (who work less than 120 days per year – whether consecutive or non-consecutive) pushed the employer over the 100-employee threshold.

Note: The 100-employee measure reduces to 50 starting with calculations for 2016.

When deciding if an employer is “large,” all members in the controlled or affiliated service group (basically, entities that are completely or partly owned by the same people or corporations) are combined.

Large Employer Responsibilities and Potential Penalties

If an employer is large enough for the play or pay requirements to apply (100 or more full-time or full-time equivalent employees for 2015 and 50 or more full-time or full-time equivalent employees for 2016 and beyond), two separate requirements, and potential penalties, apply.

Full-time continues to mean 30 or more hours per week. Because the 30-hour requirement is in the law, the IRS says that any change in this threshold will have to be made by Congress.

While seasonal employees need to be counted, most will not need to be offered coverage. A person may be considered seasonal if he or she normally works less than six months per year, at about the same time of year. (This is different than the 120-day measure used when counting employees for purposes of deciding if the employer is “large.”)

When deciding if a particular employee needs to be offered coverage, the employer may either look at the employee’s hours at the end of each month or use a look-back approach. Under the look-back approach, the employer tracks hours during a measurement period chosen by the employer of three to 12 months, which determines whether the employee will be considered full-time for purposes of the following stability period, which generally must be the same length of time. However, for 2015 an employer may use a six-month measurement period beginning no later than July 1, 2014, with a 12-month stability period. The look-back rules are essentially unchanged from the proposed regulations. There is one noteworthy change – if an employee has a fairly short break in service (due to termination of employment or non-FMLA unpaid leave) when the employee returns to work his full-time (or not) status must be restored for the rest of the stability period if his break in service is 13 weeks or less (26 weeks was the period in the proposed regulations), unless the employee works for an educational institution. The 26-week period has been retained for employees of educational institutions.

Minimum Essential Coverage

A large employer must offer “minimum essential” (basic medical) coverage to “most” of its employees or pay a penalty of $2,000 per full-time employee per year. For 2015, “most” means 70% of its employees. For 2016 and later, “most” means 95% of its employees.

If the employer does not meet this requirement, it will owe $2,000 per full-time employee, even on employees who are offered coverage. However, for 2015 the first 80 employees are excluded from this calculation. Beginning in 2016, the first 30 employees may be excluded.

> Example: Acme has 120 full-time employees, but only offers minimum essential coverage to 30 employees. Acme will owe the $2,000 penalty, but for 2015 it may exclude 80 employees so it will only owe 40 x $2,000. For 2016, Acme may only exclude 30 employees from the penalty so it will owe 90 x $2,000.

If an employer is part of a controlled or affiliated service group and the $2,000 penalty for not offering coverage applies, the employers in the group apply the “free” employee exclusion pro rata, even if the penalty only applies to some of the members of the group. Also, if the $2,000 “no-offer” penalty applies, an employer is only penalized for its own employees. For example, Acme is in a controlled/affiliated service group and does not offer coverage to its employees while Baker is in the same controlled/affiliated service group and offers coverage to all of its employees. Baker will not be subject to the penalty and Acme will.

Beginning in 2016, employers must offer minimum essential coverage to dependent children (up to age 26) as well as to full-time employees to avoid the no-offer penalty. Coverage does not have to be offered to spouses. An employer that offered coverage for dependent children in 2013 or 2014 is expected to maintain that eligibility. Coverage does not have to be offered to stepchildren or foster children.

Affordable, Minimum Value Coverage

A large employer must offer coverage that is both “affordable” and “minimum value” to its full-time (30 or more hours per week) employees or pay a penalty of $3,000 per year for each full-time employee who receives a premium tax credit. Therefore, an employer that provides minimum essential coverage to most of its employees and avoids the $2,000 per employee penalty, still may have to pay the $3,000 penalty on an employee who is either in the group that is not offered coverage or who is offered coverage that is not both affordable and minimum value if the employee receives a premium tax credit.

Coverage is considered affordable if the cost of single coverage for the least expensive plan option that provides minimum value does not exceed 9.5% of the employee’s income or Federal Poverty Level (FPL). The cost of single coverage is always the measure of affordability, even if the employee has family coverage. An employer may use any of three safe harbors when measuring the employee’s income:

- The employee’s Box 1 W-2 income for the current year.
- The employee’s rate of pay on the first day of the plan year, multiplied by 130 for hourly employees to create the assumed monthly income.
- The most recently published FPL for a single person (for 2014, FPL for a single person in the 48 contiguous states is $11,670, for Alaska it is $14,580, and for Hawaii it is $13,420).

Coverage is considered minimum value if the actuarial value of the coverage is at least 60%.

Penalties

If an employer owes a penalty, it will be billed by the IRS (most likely during the second quarter following the end of the year). The penalty will not be paid through the employer’s corporate tax return.

Although the penalty is paid annually, the penalty actually is calculated monthly, so if an employer offered coverage for part of the year, its penalty would exclude those months.

Non-Calendar Year Plans

Large employers with non-calendar year plans do not have to provide coverage until the start of the 2015 plan year, but the plan year effective date applies only if they meet a number of requirements. The most significant of these are:

- The employer had a non-calendar year group health plan in place on December 27, 2012.
- The employer has not changed the plan year since December 27, 2012, (this means that most plans that opted for early renewal are not eligible for this delay).

- Affordable, minimum value coverage is offered to most (70%) employees as of the start of the 2015 plan year *and* most employees were eligible under the rules in place on February 9, 2014.
- Affordable, minimum value coverage is offered to most (70%) employees as of the start of the 2015 plan year *and* although most employees were not eligible under the rules in place on February 9, 2014, on at least one day during the period from February 10, 2013, through February 9, 2014, either:
  - One-quarter of its total employees, or one-third of its full-time employees, were covered by a group health plan sponsored by the employer, or
  - Coverage was offered to at least one-third of its total employees, or one-half of its full-time employees, during the open enrollment period that ended most recently before February 9, 2014.

Non-calendar year plans will be required to provide reporting on a calendar year basis.

Next Steps

Each year all employers will need to determine whether they are large enough for the play or pay requirements to apply in the following year. When making this determination, it's important to make sure all common-law employees are counted and that all employees in a family of companies are added together. While an employer has the option of using a six consecutive month period in 2014 to determine if it has enough full-time or full-time equivalent employees to be considered "large," it seems unlikely that this option will be carried over for later years. Employers should be prepared to track hours for all of 2015.

Employers with 100 or more full-time or full-time equivalent employees need to determine how they will count employees' hours in 2015. Employers with calendar year plans that choose to use the look-back/measurement and stability period approach will need to begin tracking hours no later than July 1, 2014, and will need to begin this sooner if they wish to use an administrative period. Detailed, updated information on how to use the look-back option will be provided by the end of February.

Employers with 50 or more full-time or full-time equivalent employees need to determine how they will count employees' hours in 2016. Employers that choose to use the look-back/measurement and stability period approach will probably need to begin tracking hours no later than January 1, 2015, and will need to begin this sooner if they wish to use an administrative period. Employers with 50-99 employees also need to make sure that they can meet, and continue to meet, the requirements that must be met to delay compliance to 2016.

Additional information is available through a U.S. Treasury Department fact sheet.

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