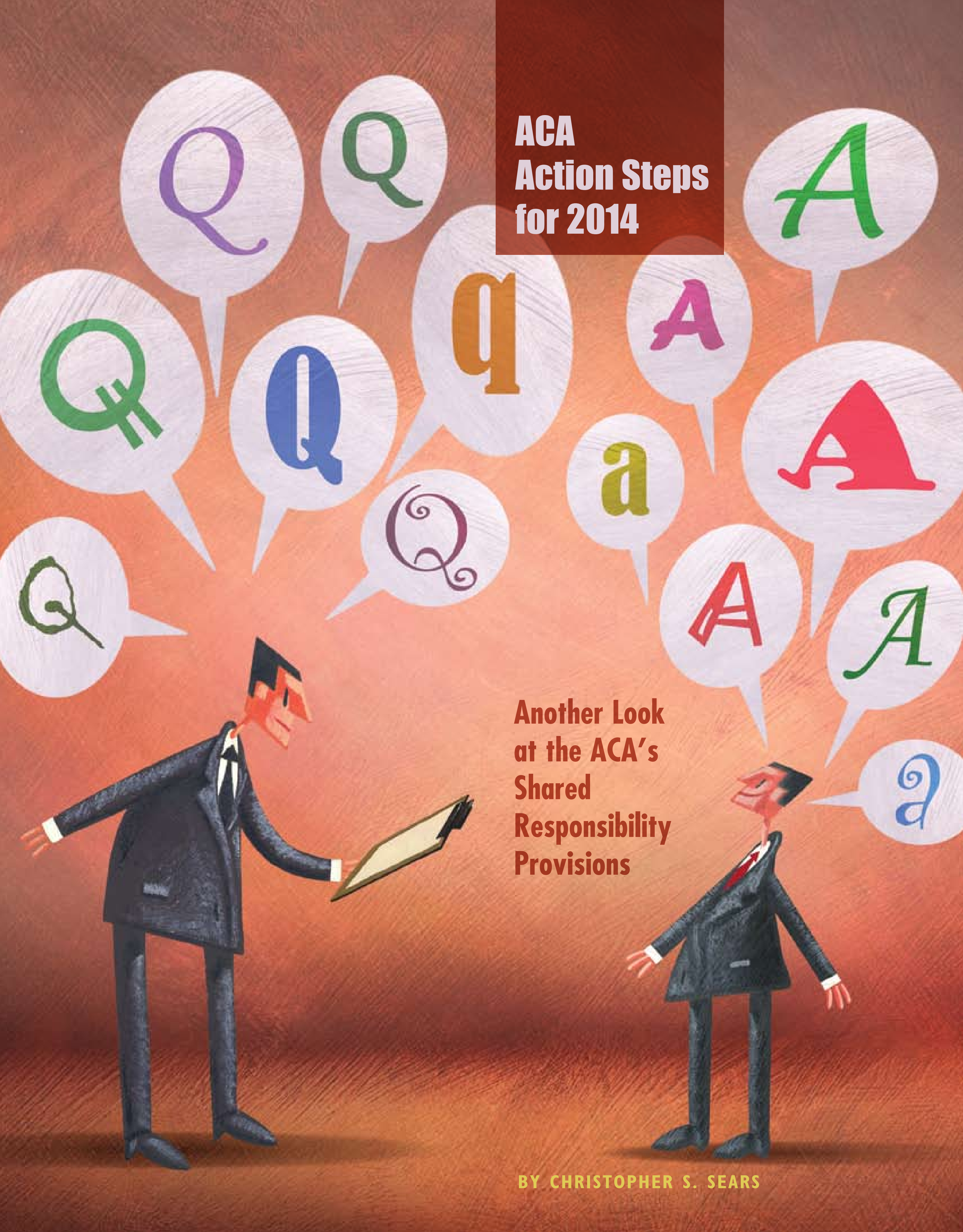
ACA Action Steps for 2014



Another Look at the ACA's Shared Responsibility Provisions

BY CHRISTOPHER S. SEARS

Almost no other piece of legislation has been subjected to as many delays as the Patient Protection and Affordable Care Act of 2010. A year ago, employers were digesting recently proposed regulations on the act's shared responsibility obligations (also known as the "employer penalty" or "pay-or-play" provisions) in anticipation of potential penalties that would begin in 2014. Those plans were delayed when the Obama Administration issued IRS Notice 2013-45 in July 2013, delaying the enforcement of the employer shared responsibility provisions until 2015. Since then, health plan sponsors and their advisors have been waiting for final regulations that will let them know how to prepare for and implement the delayed provisions. Those final regulations were finally released on February 10, 2014, and they generally adopted the approach taken under the proposed regulations, including the availability of a "look-back measurement method" to determine whether employees are "full-time" employees to whom health coverage should be offered to avoid penalties.

BACKGROUND

The ACA's shared responsibility provisions under Internal Revenue Code Section 4980H apply to employers with at least 50 full-time employees (including full-time equivalents). Code Section 4980H provides that these "applicable large employers" will be required to pay penalties if: 1) they do not provide minimum essential health coverage to substantially all of their full-time employees (and their children under age 26); and 2) at least one of their full-time employees receives a premium tax credit or cost-sharing reduction (a "subsidy") for purchasing individual coverage through a health insurance marketplace. An employer might also face a penalty if a full-time employee receives a subsidy on a marketplace policy and the coverage offered to the employee is not "affordable" or does not provide "minimum value." For these purposes, a "full-time employee" is one who is employed to perform at least 30 hours of service per week, on average. Generally, coverage is "affordable" if the employee's share of single-only coverage does not exceed 9.5 percent of his or her household income, and a group health plan provides "minimum value" if it is designed to pay at least 60 percent of the costs incurred under the plan.

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WHAT TO DO IN 2014

Now that the final employer shared responsibility regulations have been issued, employers, including state and local governmental employers, must once again take steps to determine whether they are subject to the shared responsibility provisions and, if so, to determine how they can avoid shared responsibility penalties, if they choose to do so. Employers should consider taking the following steps in 2014 in anticipation of the new effective date for ACA's shared responsibility provisions.

Step 1. Determine if you are an applicable large employer subject to the employer shared responsibility provisions by counting full-time employees (including full-time equivalents) employed for at least a six-month period during 2014. If you are an applicable large employer but you have fewer than 100 full-time employees (including FTEs), determine if you can meet the eligibility criteria for an additional one-year delay. You will need to certify to the IRS that you qualify for this relief.

The shared responsibility provisions do not apply to employers with fewer than, on average, 50 full-time employees (including FTEs) on business days in the prior calendar year. Normally, this determination will be made by looking back 12 months into the prior calendar year and averaging the number of full-time employees and FTEs the employer has in each month over the 12 months. However, to determine the application of the shared responsibility provisions for 2015 only, employers need only look back into 2014 for any consecutive six-month period of their choice to determine whether they averaged fewer than 50 full-time employees (including FTEs). For purposes of determining FTEs in any given month, employers will add the hours of all employees who are not full-time and divide that sum by 120. The product equals the employer's FTEs for the month. If the sum of an employer's full-time employees and FTEs exceeds 50 for 120 days or fewer during the measurement calendar year, and the employees in excess of 50 who were employed during the period of no more than 120 days were seasonal workers, the employer is not considered to employ more than 50 full-time employees (including FTEs) and is not subject to the shared responsibility provisions of PPACA for the succeeding calendar year.

The final regulations went further and delayed the application of the shared responsibility provisions for an additional year for employers with fewer than, on average, 100 full-time employees (including FTEs) on business days in the prior calendar year. Employers need only consider the consecutive six-month period of their choice in 2014 to determine whether they are under the 100 full-time employee threshold to take advantage of the delay. Therefore, employers with fewer than 100 full-time employees in 2014 will not be subject to shared responsibility penalties until 2016. However, this extension is not automatic. First, in addition to meeting the requirement of employing fewer than 100 full-time employees (including FTEs), an employer wanting to delay the application of the employer penalties may not, between February 9, 2014, and December 31, 2014, reduce the size of its workforce or the overall hours of service of its employees (except for bona fide business reasons) in order to reduce its workforce below 100 full-time employees. Second, such employers may not eliminate or materially reduce the health coverage they offer between February 9, 2014, and the last day of their health plan year that begins in 2015. Finally, employers taking advantage of this delay will have to certify in writing to the federal government that they meet the requirements for the delay.

When determining whether an employer meets the under-50 exception, or the under-100 delay, to the shared responsibility rules, all employees in companies that are affiliated through a controlled group or an affiliated service group must be counted. These affiliation rules are found in Code Sections 414(b), (c), and (m). Because the Internal Revenue Service has reserved the application of those rules to governmental entities, governmental employers may apply a reasonable, good faith interpretation of those rules when determining whether they must be combined with other entities for purposes of determining the applicability of PPACA's shared responsibility provisions.

Step 2. Review your group health plan coverage for potential issues under the employer shared responsibility provisions:

1. Does the plan offer coverage to substantially all full-time employees and their children?
2. Is each employee's share of health coverage affordable, and does the plan provide "minimum value"?
3. How does the employer identify "full-time" employees?
4. What are the measurement and stability periods for the first year of implementation (taking into account the transition relief provided) and for ongoing periods? Can human resources staff track an employee's hours of service for the relevant periods?

Does the plan offer coverage to substantially all full-time employees and their children? The shared responsibility provisions provide for assessments on employers in two situations. First, an "A" penalty may be assessed under Code Section 4980H(a) if an applicable large employer member does not offer coverage to at least 95 percent of its full-time employees and the children of those employees. If the applicable large employer member fails to meet this standard and one of its full-time employees qualifies for subsidized health insurance coverage purchased on a health insurance marketplace, the employer's annualized assessment will be $2,000 per full-time employee (minus the first 30 full-time employees). This assessment is applied even to full-time employees to whom the employer actually offers coverage. For 2015 only, employers will avoid the "A" penalty if coverage is offered to only 70 percent of the employer's full-time employees. Even if an employer meets the 70 percent threshold (or 95 percent threshold after 2015) to avoid the "A" penalty, however, it may still be subject to a "B" penalty (discussed below) for any of those full-time employees who are not offered coverage and receive a subsidy on a marketplace policy. If an employer is assessed an "A" penalty in 2015, the employer will be able to deduct 80 (rather than 30) full-time employees from the number of full-time employees to whom the "A" penalty will be applied.

Generally, coverage is "affordable" if the employee's share of single-only coverage does not exceed 9.5 percent of his or her household income.

Avoiding the "A" penalty also requires an employer to offer coverage to the children of full-time employees. Under the proposed shared responsibility regulations, this meant that coverage had to be offered to natural children, adopted children, children placed for adoption, stepchildren, and foster children. The final regulations modified this requirement to exclude foster children and stepchildren. In addition, the final regulations clarify that, for purposes of Code Section 4980H, a child is a dependent for the entire calendar month during which he or she attains age 26.

The final regulations also provide a transition rule for plans that did not cover dependents in their 2013 or 2014 plan years, or that did not cover all of the categories of children required to avoid the "A" penalty in their 2013 or 2014 plan years. To take advantage of this temporary relief, an employer must take steps during the 2014 or 2015 plan years (or both) to extend coverage under the plan to children who were not offered coverage during the 2013 or 2014 plan year.

Is each employee's share of health coverage affordable, and does the plan provide "minimum value"? Even if an employer avoids the "A" penalty, Code Section 4980H(b) contains another potential assessable payment — the "B" penalty. The "B" penalty is assessed when the health coverage offered by an employer to a full-time employee is not "affordable" or does not provide "minimum value," and the full-time employee receives a subsidy for health coverage on a marketplace. A plan provides "minimum value" if its actuarial value is at least 60 percent — in other words, the plan would pay for at least 60 percent of medical expenses, on average, for a standard population and for allowable charges. An employer's coverage is not "affordable" if the employee's share of the premium for self-only coverage under the employer's lowest cost health coverage option is greater than 9.5 percent of the employee's household income ("family" coverage does not have to meet any affordability standard). If an employer's self-only coverage is not affordable for, or does not provide minimum value to, a full-time employee, and that full-time employee qualifies for, and receives, a subsidy for marketplace coverage, the employer will be assessed an annualized penalty of $3,000 for that full-time employee (but not for any other full-time employee who is offered affordable, minimum value coverage). This penalty, unlike the "A" penalty, is assessed on an employee-by-employee basis.

Because employers will rarely know an employee's true household income, the final regulations contain three safe harbors for determining affordability. If an employee's premium share falls within one of the safe harbors, the coverage will be deemed affordable, regardless of the employee's actual household income. Use of any of these safe harbors is optional and an employer may choose to apply the safe

harbors for any reasonable category of employees (e.g., specified job categories, hourly versus salaried employees, and geographic location), provided it does so on a uniform and consistent basis for all employees in a category. The final regulations detail the use of: 1) the Form W-2 safe harbor; 2) the rate-of-pay safe harbor; and 3) the federal poverty line safe harbor.

How does the employer identify "full-time" employees? The employer penalties are tied to offers of coverage to "full-time employees." For purposes of the ACA, "full-time employees" are employed for at least 30 hours of service per week, on average; 130 hours per month is treated as the equivalent of 30 hours of service per week. To calculate hours of service for purposes of determining whether an employee is employed at least 30 hours of service per week (and is, thus, a "full-time employee"), the final regulations define "hours of service." For hourly employees, the employer must count actual hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity, layoff, jury duty, military duty, or leave of absence (i.e., paid time off).

For non-hourly employees, the employer may also count actual hours of service. Alternatively, the employer may use either a days-worked equivalency method that credits an employee with eight hours per day in which an hour of service is performed, or a weeks-worked equivalency method that credits an employee with 40 hours per week in which an hour of service is performed. The method used must be consistent across each employee classification (e.g., hourly versus non-hourly), and an employer may not use a method that would substantially understate an employee's hours of service (causing the employee not to be treated as a full-time employee) or that would understate the hours of service for a substantial number of employees (even if no particular employee's hours of service are understated substantially). All hours of service across affiliated organizations that constitute a controlled group or an affiliated service group must be aggregated.

Governmental employers argued to the IRS that that volunteer service would be discouraged if it required jurisdictions to count volunteer hours when determining whether the individual is a full-time employee for purposes of the ACA's employer penalties. As a result, the final regulations do not require governments to count hours of service performed by bona fide volunteers when determining whether an individual is a full-time employee. Under the final regulations, bona fide volunteers include any volunteer who is an employee of a government entity or a tax-exempt organization and whose only compensation from that entity is in the form of: 1) reimbursements for (or reasonable allowance for) reasonable expenses incurred in the performance of services by volunteers; or 2) reasonable benefits (including length of service awards), and nominal fees, customarily paid by similar entities in connection with the performance of service by volunteers. This new exception will be particularly useful for governmental employers who operate volunteer fire departments where volunteer firefighters or other emergency responders are paid a salary or an hourly wage that is at a lower rate than the rate paid to non-volunteers, or who receive expense reimbursements or other fees each time they respond to a call.

The final regulations also acknowledge situations that are unique to educational organizations, which will be critical to governments that operate institutions of higher education. First, hours of service do not need to be counted for students in positions that are subsidized through the federal work study program or substantially similar programs run by a state or its political subdivisions. However, hours of service performed by other student employees (e.g., for service as lab assistants, food service workers, or resident assistants) do have to be counted, as do hours performed in paid internships or externships. Second, educational institutions must use a reasonable method for crediting hours of service for adjunct faculty and similar positions that are not traditionally paid on an hourly or salaried basis. In many institutions, these individuals are paid a set amount for the number of credit hours they teach each semester. The commentary to the final regulations provides that one (but not the only) reasonable method for crediting hours for such individuals would involve crediting an adjunct faculty member with: 1) 2¼ hours of service (representing a combination of teaching or classroom time and time performing related tasks such as class preparation and grading exams or papers) per week for each hour of teaching or classroom time — in other words, in addition to crediting an hour of service for each hour of teaching in the classroom, this method would credit an additional 1¼ hours for activities such as class preparation and grading — and 2) an hour of service per week for each additional hour outside of the classroom that the faculty member spends performing duties he or she is required to perform (e.g., required office hours or required attendance at faculty meetings). An educational institution may use other methods (such as counting actual hours or determining another reasonable proxy for converting credit hours to hours worked) so long as the method is reasonable.

> A group health plan provides "minimum value" if it is designed to pay at least 60 percent of the costs incurred under the plan.

Reasonable methods of counting hours must be determined for unique categories of employees such as health-care providers in governmental hospitals, resident assistants in governmental higher educational institutions, firefighters, and police officers who may not actually be working but must remain "on call." In those situations, it is not reasonable for an employer to fail to credit an employee with an hour of service for any on-call hour for which payment is made or due, for which the employee is required to remain on-call on the employer's premises (such as an on-call resident in a hospital), or for which the employee's activities while remaining on-call are subject to substantial restrictions that prevent the employee from using the time effectively for the employee's own purposes (such as an on-call police officer who must remain in the jurisdiction and may not use alcohol during his or her on-call hours).

What are the measurement and stability periods for the first year of implementation, and for ongoing periods? Can human resources staff track an employee's hours of service for the relevant periods? Employer penalties are calculated based on the number of full-time employees an applicable large employer has during a given month. The final regulations formally recognize that an employer may determine its full-time employees on a month-by-month basis and will almost certainly have to do so with regard to new full-time employees who have not been employed by an employer for a full standard measurement period (see below).

However, the final regulations also recognize that employers do not generally determine eligibility for their health plans on a month-by-month basis but, rather, on a plan-year basis. Therefore, to avoid the practical difficulties of tracking full-time employees on a month-to-month basis and to align the imposition of employer penalties to an employer's plan-year eligibility standards, the final regulations adopt the structure that was set out in the proposed regulations that permits an employer to use an optional look-back standard measurement period lasting between three and 12 months to determine whether an employee is a full-time employee. The employee's status during the measurement period will dictate the employee's status during a subsequent stability period, regardless of the employee's actual hours of service during that stability period, so long as he or she remains employed. An employer is allowed an administrative period of up to 90 days between its measurement period and its stability period to determine its full-time employees and administer an open enrollment period for the upcoming stability period.

Thus, the measurement period/stability period structure gives an employer certainty for up to 12 months when determining which of its employees should be offered coverage to avoid Code Section 4980H penalties. Measurement periods may be as short as three months or as long as 12 months. Stability periods for employees determined to be full-time must be at least six consecutive months, but no shorter in duration than the associated measurement period. Stability periods for employees who are not determined to be full-time employees may not be longer than the associated measurement period. Realistically, many employers will use uniform 12-month measurement and stability periods. However, employers with workforces that are strongly cyclical may want to consider different lengths and varied measurement and stability periods for different collectively bargained groups, hourly versus salaried employees, and employees in different geographic locations. Under a special transition rule for 2015, an employer may have a measurement period as short as six months in 2014 (so long as it begins by July 1, 2014), but with a corresponding 2015 stability period up to 12 months. After 2015, an employer's measurement period will generally need to be the same length as its stability period.

The structure just described applies only to "ongoing" employees — employees who have been employed for at least one full standard measurement period. Employees who are hired in the middle of standard measurement periods are considered to be "new" employees and are subject to different rules until they become "ongoing" employees. "New" employees are categorized in four groups: full-time, variable-hour, part-time, and seasonal. The determination of the group to which a new employee belongs is made as of the individual's start date. An employer will not be subject to a Code Section 4980H penalty if the new full-time employee is offered coverage by the first day of the fourth full calendar month after the employee's date of hire. This gives an employer a waiting period of up to 90 days before enrolling the full-time employee. Separate rules under the ACA prevent waiting periods of more than 90 days. When an employer cannot determine if an employee is reasonably expected to be employed on average at least 30 hours of service per week during an initial measurement period, based on the facts and circumstances at his or her start date, he or she is a "variable-hour" employee (because the employee's hours are variable or otherwise uncertain). A "part-time employee" is a new employee whom the employer reasonably expects to be employed on average fewer than 30 hours of service per week during an initial measurement period, based on facts and circumstances present on the individual's start date. Finally,

a "seasonal employee" is an employee who is hired into a position for which the customary annual employment is six months or fewer. The reference to "customary" means that, by the nature of the position, an employee in this position typically works for a period of six months or fewer, and that period should begin each calendar year in approximately the same part of the year (e.g., summer or winter). Seasonal employees might include ski instructors during the winter and municipal park workers in the summer.

Determine if you are an applicable large employer subject to the employer shared responsibility provisions by counting full-time employees employed for at least six months during 2014.

With respect to new variable hour, part-time, and seasonal employees, the final regulations allow employers to impose an "initial measurement period" that is unique to each worker. The initial measurement period may be as short as three months or as long as 12 months, and it must start no later than the beginning of the first calendar month following the employee's start date. During the initial measurement period, the employer is not required to offer health coverage to these employees to avoid Code Section 4980H penalties. Instead, after the initial measurement period, an employer will look back over the initial measurement period and determine whether the employee averaged at least 30 hours of service per week. If so, the employer must offer health coverage that provides minimum value to the employee during an associated "stability period." For employers that use a 12-month initial measurement period, the offer of coverage must generally be made in a time period that is slightly longer than a month after the end of the 12-month initial measurement period.

Note that the final regulations also modified the "break-in-service" rules that allow employers to disregard prior hours of service and any characterization as a full-time employee if an employee is not credited with any hours of service for at least 13 weeks. In other words, an employee with a break-in-service of at least 13 weeks may be considered a "new" employee upon return. The proposed regulations required that break to be a full 26 weeks, although the 26-week standard continues to apply to educational organizations.

CONCLUSIONS

As originally issued, the final shared responsibility regulations were more than 220 pages, and they obviously contain much more detail than can be shared in a general article. For example, employers with non-calendar year plan years may be able to take advantage of transition relief that will allow them to avoid penalties until the first day of their plan year that begins in 2015. However, a careful analysis must be done on each of these plans to ensure they meet the complicated provisions of the transition guidance.

The 2014 action steps listed above should provide governmental employers with an initial roadmap to use in beginning preparations for avoiding Code Section 4980H penalties in 2015. However, the regulations should be considered in all of their detail, and consultation with experienced benefits counsel and advisors is highly encouraged. While working toward compliance with these new regulations, governmental employers also need to make sure they are in compliance with other aspects of the ACA such as the payment of transitional reinsurance fees and Patient Centered Outcomes Research Institute fees, amendment of health plan documents to comply with the ACA's coverage mandates (e.g., coverage of clinical trials and preventive care, elimination of waiting periods longer than 90 days, and elimination of preexisting condition exclusions), providing plan participants with summaries of benefits and coverage, and other ACA obligations that are not addressed in this article.

The ACA remains a challenging compliance project for employers, and those that have not begun to consider its impacts should begin to do so immediately. While the federal government's extensions of ACA deadlines seem to have become commonplace, relying on the possibility of future extensions may place an employer in the undesirable position of paying unwanted penalties.

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