



NAVIGATING THE EMPLOYER PENALTY PROVISIONS IN 2014

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Beginning in 2014, employers with 50 or more full-time equivalent employees will need to offer their full-time employees affordable, minimum value health insurance options or face possible penalties. These requirements are often referred to as the “Play or Pay Provisions”. Proposed regulations implementing the Play or Pay Provisions were released in late December 2012. Comments were due by March 18, 2013. The following are answers to frequently asked questions from employers regarding the Plan or Pay provisions based on the proposed regulations and guidance received to date. This information should not be a substitute for legal advice and employers should speak with their attorney regarding their own individualized situation.

1. Is an employer required to provide full-time employees with insurance in 2014?

No; however, starting on January 1, 2014, employers with 50 or more full-time equivalents (“FTEs”) will be penalized if they do not provide affordable, minimum value insurance to full-time employees and at least one of their full-time employees qualifies and receives a Federal subsidy. An employer who does not offer health insurance to full-time employees will be penalized \$2,000 for each full-time employee it has over 30. For example, an employer with 60 FTEs, including 40 full-time employees, who does not offer health insurance to any of its full-time employees would pay \$20,000 in 2014 if one of its full-time employees qualifies for and receives a Federal subsidy. If none of the full-time employees receive the Federal subsidy the employer would pay no penalty.

The proposed rules provide that an employer will be treated as offering its full-time employees coverage if it offers coverage to all but five percent or, if greater, five of its full time employees regardless of whether such failure to provide coverage to these full-time employees is inadvertent or intentional. Thus, an employer could exclude up to the greater of 5% or 5 of its full-time employees from coverage and not be penalized.

2. How does an employer determine how many FTEs it has?

An employer will determine its FTEs based on the number of FTEs it employed in the preceding calendar year. The employer counts the number of employees it has

working 30 or more hours per week or 130 or more hours in January. Next, the employer must add together the number of hours its non-full time employees worked during January up to a maximum of 120 hours per employee and divide by 120. The employer must then repeat this process for each month in the calendar year so it has 24 numbers. Last, the employer adds these 24 numbers and divides by 12. The resulting number is the number of FTEs the employer has.

With respect to counting the number of hours an employee works, the proposed regulations provide rules for hourly employees and non-hourly employees. For employees paid on an hourly basis, the employers must calculate actual hours of service from records of hours worked and hours for which payment is made or due for vacation, holidays, illness, or other paid leave of absence. For employees not paid on an hourly basis, employers are permitted to calculate the number of hours of service using one of three methods (i) counting actual hours of service, (ii) using a days-worked equivalency method whereby the employee is credited with 8 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 (iii) using a weeks-worked equivalency of 40 hour 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. The proposed rules prohibit the use of days-worked or weeks-worked equivalency if the result would be to substantially understate an employee's hours such that he/she would not be considered full-time. An employer may use a different method for different classifications of non-hourly employees so long as the classifications are reasonable.

3. An employer has an ownership interest in several companies. None of them alone have 50 FTEs. Is the employer subject to the Play or Pay Provisions?

The IRS rules regarding common ownership apply. To the extent there is enough common ownership among the companies the IRS will aggregate them for purposes of determining whether the employer has 50 or more FTEs. For example, if the employer owns 100% of three companies and each company employs 20 FTEs, the companies will be subject to the Play or Pay Provisions as they will be deemed to have 60 FTEs. The common ownership rules are complex. Employers with this issue are encouraged to contact their tax and legal advisors for assistance.

4. How are seasonal, temporary or leased employees treated? Are they counted for purposes of determining whether an employer has 50 FTEs and are they considered employees for purposes of the Play or Pay Provisions?

Seasonal employees must be counted when determining the number of FTEs. If the employer has 50 or more FTEs solely because of seasonal employment it can avoid the Play or Pay Provisions if its census goes over 50 FTEs for 120 days or fewer during the calendar year and the employees in excess of 50 employed during the 120 day or less period qualify as seasonal employees.

The proposed rules do not specifically address temporary or leased employees; however, they do defer to the common law definition of employee for determining whether an employer must offer the individual coverage. Employers should consult with their legal counsel to determine who their common law employees are.

5. What if an employer does not have 50 FTEs, will it be penalized for not providing insurance in 2014?

No. The Play or Pay Provisions only apply to large employers with 50 or more FTEs.

6. What is the definition of “full-time employee” for purposes of the Play or Pay Provisions?

A full-time employee under the Affordable Care Act is an employee who is reasonably expected to work on average 30 or more hours per week.

The proposed rule clarifies that all hours of service must be counted, including hours for which the employee is paid but is not necessarily working such as vacation, sick leave, jury duty, military leave, and other paid time off.

7. An employer has employees with variable hours. How does it determine whether they are full-time employees?

Whether an employee is full-time and must be offered insurance to avoid the penalty is a monthly decision under the Affordable Care Act. To assist employers in determining in advance whether a variable hour employee is full-time, the proposed regulations allow employers to use a “measurement period” during which time the employer would determine whether the employee qualifies as a full-time employee. The employer could then apply that determination to a “stability period.” This allows the employer to determine in advance which variable hour employees qualify as “full-time” and must be offered insurance for the corresponding stability period.

The measurement period can be a minimum of three months but no longer than 12 months. Employees who work on average 30 or more hours per week (or 130 hours per month) during the measurement period are considered full-time employees for the corresponding stability period during which time they must be offered health insurance or the employer will be penalized. The employer may determine the stability period but it cannot be shorter than 6 months, must not be shorter than the measurement period, and must start within 90 days of the end of the measurement period. In addition, those employees not determined to be full-time employees during the measurement period can only be denied coverage for a period of time equal to the measurement period. Below is an example:

Company employs 20 employees whose hours vary from week to week.
To determine who will be a full-time employee in 2014 to whom it must

offer health insurance, Company uses a measurement period of 10/15/12 through 10/14/13. Employees who work an average of 30 or more hours per week, or 130 or more hours per month, during this 12 month measurement period will be offered insurance for the 12 month stability period of 1/1/14 through 12/31/14. Employees who did not work an average of 30 or more hours per week during this measurement period will not be offered insurance during the 2014 calendar year.

New or seasonal employees who experience a change in employment status and become full-time employees during their initial measurement period must be treated as full-time employees on 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 or 130 hour per month 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 proposed rules also address situations where an employee is rehired or returns from an unpaid leave. Under the proposed regulations, if the period for which no hours of service are credited is at least 26 consecutive weeks, an employer may treat a returning or rehired employee as a new employee. The employer may also choose to apply a rule of parity to returning or rehired employees which allows the employer to treat the employee as a new employee if the period of non credited hours of service is less than 26 weeks but is at least 4 weeks and is longer than the employee's period of employment immediately preceding that period with no credited hours of service. This rule applies solely for purposes of determining the full-time employee status for employers using a look-back measurement method.

For returning or rehired employees who cannot be treated as new employees but must be treated as continuing employees, the employees must be treated as full-time employees for the remainder of the stability period if they were considered full-time when their employment terminated or they went on unpaid leave. Additionally, for purposes of determining their eligibility for the upcoming stability period, the period of time during which they had no hours of service, is not counted for purposes of determining whether the employee is a full-time employee averaging 30 or more hours per week.

8. Can I choose a different measurement period for different employees?

The measurement period must be the same for similarly situated employees but can vary based on collective bargaining status, location by State, the company that employs the employees, and hourly v. salary.

9. Can an employer reduce employee hours below 30 hours per week to avoid having to provide them with insurance under the Play or Pay Provisions?

Currently nothing in the law prohibits an employer from revising its policies to limit employee hours to less than 30 hours per week and 130 hours per month. Employers should ensure they are applying this policy on a non-discriminatory basis.

10. If an employer is subject to the Play or Pay Provisions must it also offer dependent coverage?

Yes. The proposed rules require employers to offer employees and their dependents coverage to avoid the penalty. "Dependent" is defined as an employee's child who is under 26 years of age. Other individuals who may qualify as dependents under the IRS definition for tax purposes and spouses do not have to be offered coverage.

11. Can an employer avoid the penalty in 2014 simply by offering health insurance to its full time employees?

No. Employers with 50 or more FTEs who offer health insurance may be penalized in 2014 if the health insurance they offer is not "affordable" or of a "minimum value." Health insurance is "affordable" if the premium charged to the employee for the single plan (regardless of whether he/she has the single or family plan) is not more than 9.5% of the employee's household income. In addition, health insurance will satisfy the "minimum value" criteria if the health insurance plan has an actuarial value of 60% (a bronze level plan), meaning the plan's share of total allowed costs for covered benefits is at least 60%.

An employer who does not offer an affordable, minimum value plan to full-time employees will be penalized if one of its full-time employees qualifies for and receives a Federal subsidy. The penalty, however, is different from the penalty for not offering any health insurance. An employer who offers health insurance that is not affordable or of a minimum value will pay \$3,000 for each full-time employee who qualifies for and receives a Federal subsidy as long as this penalty would not be larger than the penalty for not providing any insurance. For example, an employer with 60 FTEs, 40 of whom are full-time, offers insurance but it is not affordable and the employer has 5 full-time employees who receive a Federal subsidy. This employer would pay a penalty of \$15,000. If, however, this employer had 15 full-time employees who receive a Federal subsidy, the penalty would be \$45,000. Because this is greater than the \$20,000 penalty it would pay for providing no insurance in this example, the employer would pay the lesser penalty of \$20,000.

12. If an employer offers more than one plan option, must the employee's contribution rate for each single coverage option be not more than 9.5% of the employee's household income?

No. The employer's coverage will be deemed affordable if the employee's required contribution for the lowest cost single coverage offered by the employer is not

more than 9.5% of his/her household income even if the employee chooses a higher cost option.

13. How does an employer know if its plan is affordable if it does not know the employee's household income?

Employers only know for certain what they pay an employee and can't be expected to know the employee's household income as it will include income from a variety of sources, including rental income or a spouse's income. The IRS has developed three safe harbors to assist employers in planning which allows an employer to avoid the penalty if they can meet any one of the following:

- **W-2 Wages:** The employee does not have to pay more than 9.5% of his/her W-2 wages toward the cost of the employer's single coverage. In most cases this will be a conservative estimate as household income will often be higher than an employee's W-2 wages. While this safe harbor is useful, it does not allow employers to predict with absolute certainty whether their insurance is affordable as it does not allow an employer to use prior years' W-2 wages. This causes issues since the employee's wages can change from year to year and W-2 wages does not include cafeteria plan and other elections, such as 401(k) contributions, which are also subject to change.
- **Rate of Pay:** The rate of pay safe harbor allows an employer to determine a monthly salary amount for each employee and if the employee's monthly contribution rate is equal to or less than 9.5% of the monthly salary rate the coverage is deemed affordable. For salaried employees, their monthly salary would be used. For hourly employees, the monthly salary would be determined by multiplying their hourly rate of pay by 130. The rate of pay safe harbor cannot be used for employees whose hourly wage or salary is reduced during the year.
- **Federal Poverty Line:** An employer can set its employee contribution rate at 9.5% or less of the Federal poverty line for a single individual as stated in the most recently published poverty guidelines as of the first day of the plan year. The Federal Poverty Line in 2013 is \$11,490. If it remained the same in 2014, an employer's insurance would be deemed affordable if the employee did not have to pay more than \$90.96 per month toward the cost of the cheapest single plan offered by the employer. This will likely be the easiest safe harbor for employers to use; however, it likely results in the most conservative estimate.

14. How do I determine if my plan meets the minimum value criteria?

Fully-insured plans should start by asking their agent or insurance carrier whether they can provide them with a determination of whether the plan meets the minimum

value criteria. If this information is not available or if the plan is self funded, employers have three options:

- HHS has developed a minimum value calculator available at <http://cciio.cms.gov/resources/files/mv-calculator-final-2-20-2013.xlsm>
The calculator allows employers to enter information about their health plan benefits, including cost sharing terms and covered services.
- HHS and IRS are in the process of developing a variety of design-based checklists that employers can use to determine minimum value. If an employer's plan is more generous than any one of the checklists, the plan is treated as providing minimum value.
- An employer may seek certification by an actuary to determine whether its plan meets the minimum value requirements. This is necessary if the plan has nonstandard features which preclude the use of the calculator or checklists

15. Are the amounts employers contribute to health savings accounts or health reimbursement arrangements considered in determining whether the insurance is of a minimum value?

Yes. The Affordable Care Act requires HHS to take into account amounts contributed to an HSA when determining whether the coverage meets the minimum value requirement. Additionally, the IRS indicates amounts contributed to integrated health reimbursement arrangements (an HRA that offsets the cost of cost-sharing under the major medical plan) will be considered.

16. How will an employer know if a full-time employee has received a Federal subsidy which may subject the employer to a penalty?

Employees may receive a subsidy if (a) they have no health insurance available through their employer or their employer's health insurance is not affordable or of a minimum value, (b) the employee's household income is between 100% and 400% of the Federal poverty level, and (c) the employee is not eligible for Medicaid. The new statewide Exchange will be responsible for notifying employers if their employees receive a Federal subsidy for which the employer may be penalized. Employers will have an opportunity to appeal.

17. What steps should an employer take now to prepare for 2014?

Employers should begin discussing their specific situations with their benefits, tax and legal advisors. Employers can begin preparing for 2014 by first determining how many FTEs they have and whether they are in a commonly controlled group of companies which may impact this analysis. Second, employers with at least 50 FTEs

should determine which employees are reasonably expected to work 30 or more hours per week, which of these employees are not currently being offered insurance, and the impact of providing insurance to these additional employees. For employers who do not offer any employees health insurance, the employers should determine what their penalties will be if they continued this policy and the estimated cost of offering coverage in the future. Third, employers with variable hour employees should choose a measurement period for assessing which variable hour employees will qualify as full-time employees to whom insurance will need to be offered in 2014 to avoid a penalty. Fourth, employers can begin assessing whether their coverage is affordable by evaluating their contribution strategy in light of the three available safe harbors (W-2, rate of pay, and federal poverty line). An employer who wants to avoid paying a penalty for not providing affordable coverage should determine what its contribution rate must be so that the lowest paid full-time employee does not have to pay more than 9.5% of his/her W-2 wages or monthly salary toward the cost of the employer's single plan. The employer can then estimate how its costs may increase in 2014 if it is required to increase its contribution rate toward single coverage. Fifth, employers should discuss options for minimizing the impact of the Pay or Pay Provisions with their benefits, tax and legal advisors.

Notice: The foregoing is intended to provide general information about significant legal issues and should not be construed as legal advice regarding any specific facts or circumstances. You are encouraged to consult with appropriate legal counsel to address specific legal questions. This update is provided for informational purposes only.