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Final ACA Shared Responsibility Regulations Released

Plan sponsors now have the final piece of the puzzle needed to finalize their 2015 pay-or-play strategies.

The Internal Revenue Service (IRS) and the U.S. Department of the Treasury recently issued the highly anticipated final shared responsibility regulations under the Affordable Care Act (ACA). These regulations provide transition rules for certain employers as well as much-needed clarity for many aspects of the shared responsibility requirements. The final regulations took effect on February 12, 2014 and apply for periods beginning after December 31, 2014. However, employers are permitted to rely on the final regulations earlier than December 31.

This guidance contains important information that will allow employers to finalize their pay-or-play strategy for 2015 and beyond.

Background

Effective in 2015, large employers with 100 or more full-time or full-time-equivalent employees are required to offer affordable health coverage to full-time employees and their dependents. If the coverage does not satisfy minimum value and affordability requirements, the employer will be assessed a penalty if any of its full-time employees purchase insurance from a public health exchange and receives a premium tax credit or cost-sharing reduction. Specifically, if an employer fails to offer health coverage to the required number of full-time employees (generally 95%) and one of its full-time employees goes to a public health exchange and receives a premium tax credit or cost-sharing reduction, the employer will be subject to a nondeductible penalty equal to $2,000 (indexed for inflation) multiplied by each full-time employee employed by the employer (the No Coverage Penalty). Also, if the health coverage that is offered does not meet minimum value and affordability requirements and a full-time employee goes to the public health exchange and receives a premium tax credit or cost-sharing reduction, the employer will be subject to a nondeductible penalty equal to $3,000 (indexed for inflation) multiplied by each full-time employee who goes to a public exchange and receives a tax subsidy (the Inadequate Coverage Penalty).

On January 2, 2013, the IRS released proposed regulations outlining the shared responsibility requirements.[1] On July 2, 2013, the IRS announced a one-year delay for implementation.[2] Final regulations were released on February 10, 2014. Additionally, the IRS has also released a shared responsibility Fact Sheet[3] and Questions/Answers.[4]

Determining Employers Subject to Shared Responsibility Requirements

The ACA requires that large employers—employers employing at least 50 full-time employees or full-time-employee equivalents—comply with the shared responsibility requirements or face possibly paying the No Coverage Penalty or the Inadequate Coverage Penalty. For 2015 only, the 50-employee threshold has been

1. For more information on the proposed regulations, see our February 28, 2013 presentation, “The Road to 2014: ACA Considerations for Employers,” available at http://www.morganlewis.com/index.cfm/publicationID/8CD8F0A9-4F6B-4170-A73A-3451008094D6/fuseaction/publication.detail.

2. For more information on the one-year delay, see our July 3, 2013 LawFlash, “Affordable Care Act Shared Responsibility Penalty Delayed Until 2015,” available at http://www.morganlewis.com/pubs/EB_LF_ACASharedResponsibilityPenaltyDelayedUntil2015_03july13.

3. View the Fact Sheet at http://www.treasury.gov/press-center/press-releases/Documents/Fact%20Sheet%20021014.pdf.

4. View the Questions/Answers at http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act.

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increased to 100 employees. Thus, employers that employ at least 50, but fewer than 100, full-time or full-time equivalent employees will be exempt from the No Coverage Penalty and the Inadequate Coverage Penalty until January 1, 2016, so long as certain requirements are met. Specifically, in order to take advantage of the delayed effective date, such employers must certify that (i) between February 9 and December 31, 2014, the employer did not reduce the size of its workforce and overall hours of service of its employees (other than for a valid business reason); and (ii) from February 9, 2014 through December 31, 2015, the employer did not materially eliminate or materially reduce the health coverage offered, if any, as compared to the coverage offered on February 9, 2014.

Controlled-Group Aggregation. The final regulations maintain that controlled-group members must be aggregated for purposes of determining whether an employer is a large employer. Additionally, the final regulations, consistent with the proposed regulations, also provide that any shared responsibility penalty will be assessed on an employer-by-employer basis and not on a controlled-group basis.

New Large Employers. The final regulations provide that an employer that is close to 50 full-time employees or full-time-equivalent employees will have a transition period before being required to offer ACA-compliant health coverage to full-time employees. Specifically, with respect to employees who were not offered coverage at any point in the prior calendar year, if the employer offers health coverage that provides minimum value by April 1 of the first year during which the employer has 50 or more full-time employees, the employer will not be subject to an assessable payment for January through March of the first year the employer is an applicable large employer.

Foreign Employees. For purposes of determining whether an employer is a large employer under the ACA, the regulations clarify that an employer generally must only take into account employees who performed work in the United States. Thus, if a foreign employer has fewer than 50 full-time employees in the United States, but has more than 50 full-time employees internationally, the foreign employer generally would not be subject to the ACA shared responsibility requirements.

Determining Large Employers for 2015. For 2015, employers may use a six-month period in 2014 to determine whether they cross the 50 or 100 full-time/full-time-equivalent employee threshold. Going forward, large-employer status is determined based on the average number of full-time/full-time-equivalent employees in the prior calendar year (with a special transition rule for 2016 if an employer was under 100 for 2014).

2015 Shared Responsibility Penalty Transition Relief

The proposed regulations indicated that an employer would be treated as offering health coverage to substantially all full-time employees and their dependents if the employer offered health coverage to at least 95% of its full-time employees and their dependents. While the final regulations retain the 95% threshold, for 2015 only, employers will not be subject to the No Coverage Penalty if health coverage is offered to at least 70% of full-time employees and their dependents.

For purposes of calculating any No Coverage Penalty, employers that do not meet the 95% threshold are permitted to disregard the first 30 full-time employees before assessing the penalty. However, for 2015 only, the final regulations indicate that, for purposes of calculating the No Coverage Penalty, employers are permitted to disregard the first 80 full-time employees. This means that, in 2015, the monthly No Coverage Penalty would be 1/12 of $2,000 multiplied by the employer’s total number of full-time employees, minus the first 80 full-time employees.

NOTE: While the final regulations provide a transition period for the No Coverage Penalty, employers may still be subject to the Inadequate Coverage Penalty for failure to offer health coverage that meets minimum value and affordability requirements for each employee who receives a premium tax credit.

Determining Full-Time Employees

The final regulations outline the following two approaches for determining full-time employees:

- **Look-Back Measurement Method.** Under this method, which closely models the proposed regulations, an employer is permitted to determine the status of an employee during a future “stability period” based upon an employee’s hours of service in a prior “measurement period.” The measurement period must generally be at

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least three months, but not more than 12 months, in length. The stability period, however, must be at least six months long, but not shorter than the measurement period.

NOTE: In determining full-time employees for 2015, subject to certain requirements, employers are permitted to use a six-month measurement period, even with a 12-month stability period, on a one-time basis.

- **Monthly Measurement Method.** The final regulations clarify the use of a monthly measurement method whereby employees will be identified as full-time employees using hours of service during each calendar month. The final regulations contain specific requirements regarding how this method may be used.

Using Different Measurement Periods for Different Groups. The final regulations provide that, although employers must generally use the same measurement method for all employees, they are permitted to use either the look-back or monthly measurement method for certain categories of employees. The final regulations limit an employer's ability to use different measurement periods for different groups other than those listed below. An employer is not permitted, for example, to use the look-back measurement method for variable-hour employees and the monthly measurement period for employees with more predictable hours. Employers may use either the look-back or monthly measurement methods for the following types of employees:

- Salaried and hourly employees
- Employees whose primary places of business are in different states
- Union and nonunion employees
- Collectively bargained employees covered by different collective bargaining agreements

The final regulations also clarify that different employers in a controlled group may use different measurement periods for the same categories of employees.

Factors Used for Determining Whether a New Hire Is a Full-Time or Variable-Hour Employee. The final regulations outline the criteria to be used when determining whether a new employee is full time or variable hour when using the look-back measurement method. Factors to consider include, but are not limited to, whether the employee is replacing an employee who was not a full-time employee, the extent to which employees in the same or comparable positions are or are not full-time employees, and whether the job was advertised, or otherwise communicated to the new hire or otherwise documented, as requiring hours of service that would average 30 or more per week.

Rehire Rules Following Breaks in Service. The final regulations shorten the period of time that an employee may be treated as a new hire following a break in service. Under the proposed regulations, an employee could be treated as a new hire if the employee did not have an hour of service with the employer for a period of at least 26 consecutive weeks before the rehire date. The final regulations shorten this time period to 13 weeks for employers other than educational organizations.

Employees Who Change Categories of Employment. The final regulations contain specific requirements for employees who change categories of employment, which will cause them to move between measurement methods. For example, if an employee goes from hourly status (with a look-back measurement period) to full-time status (with a monthly measurement period), there are specific and detailed requirements that must be followed.

Seasonal Employees. Under both the proposed and final regulations, the look-back measurement method may be applied to seasonal employees in the same way that it is applied to variable-hour employees. However, the final regulations clarify the definition of "seasonal employee" and indicate that seasonal employees are those for whom customary annual employment is six months or less. The reference to "customary" means that, by the nature of the position, the employee hired in such a position will typically work six months or less and the period of time will begin at approximately the same time during each calendar year.

Change to Definition of "Dependent"

In order to avoid a No Coverage Penalty and the Inadequate Coverage Penalty, employers are required to offer

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health coverage to the dependents of eligible full-time employees. The final regulations provide that dependents include biological children and adopted children (including those placed for adoption) until they attain age 26. The definition of “dependent” does not include an employee’s spouse, and, unlike the proposed regulations, the final regulations do not require coverage of stepchildren or foster children.

Employers will not generally be subject to a shared responsibility penalty in 2015 if they fail to offer dependent coverage until 2016. However, this transition rule is only available if an employer did not previously offer dependent coverage during 2013 or 2014.

Transition Relief for Non-Calendar-Year Plans

The final regulations permit employers that sponsor non-calendar-year plans to delay required implementation of the shared responsibility requirements until the first day of the 2015 plan year if certain requirements are satisfied. Specifically, the plans must have been in existence on December 27, 2012, and the employer cannot have made a change to the plan year of the plan on or after that date. Below is a description of the transition relief.

- **Existing Employees with Coverage.** For employees eligible to participate in a health plan as of February 9, 2014 (even if such employees did not elect coverage), employers are not required to offer compliant coverage until the first day of the plan year starting in 2015.
- **Coverage for All Employees.** If an employer offered a health plan to at least 1/3 of all employees during the most recent open enrollment period ending on or before February 9, 2014 or covered at least 1/4 of all employees on any day during the 12-month period ending on February 9, 2014, the employer is not required to offer coverage until the first day of the plan year starting in 2015.
- **Coverage for Full-Time Employees.** If an employer offered heath coverage to at least 1/2 of ACA full-time employees during the most recent open enrollment period ending on or before February 9, 2014 or at least 1/3 of all ACA full-time employees on any day during the 12-month period ending on February 9, 2014, the employer is not required to offer coverage until the first day of the plan year starting in 2015.

Determining If Coverage Meets Affordability Requirements

As described above, an employer could be subject to an Inadequate Coverage Penalty if the healthcare options offered to employees are not “affordable” and if at least one employee enrolls in coverage on an exchange. In general, coverage is considered affordable if the employee contribution for the lowest-cost single coverage does not exceed 9.5% of the employee’s household income. However, because most employers will not know the household income of their employees, the final regulations maintain safe harbors for purposes of determining affordability. The three safe harbors are the (i) IRS Form W-2 wages safe harbor, (ii) the rate of pay safe harbor, and (iii) the federal poverty line safe harbor. If the employer satisfies the requirements for one of the safe harbors, the offer of coverage will be considered to be “affordable.” Each safe harbor method is discussed briefly below.

- **IRS Form W-2 Wages Safe Harbor.** Under this method, coverage is affordable if it does not exceed 9.5% of the wages paid to the employee by the employer, as reported in Box 1 of IRS Form W-2, for the calendar year.
- **Rate of Pay Safe Harbor.** Under this method, coverage is affordable if it does not exceed 9.5% of an amount equal to 130 hours times an hourly employee’s rate of pay during the beginning of the coverage period (or 9.5% of a salaried employee’s monthly salary). While the proposed regulations did not permit employers to use this safe harbor method if an employer reduced an hourly employee’s rate of pay during the year, the final regulations permit employers to use this safe harbor in such a situation, so long as the premium does not exceed 9.5% of the reduced amount. This safe harbor cannot be used if monthly salary is reduced, even if the reduction is a result of reduced work hours.
- **Federal Poverty Line Safe Harbor.** Under this safe harbor, an offer of coverage is affordable if the employee’s required contribution for the calendar month for the lowest self-only coverage does not exceed 9.5% of a monthly amount determined as the federal poverty line for a single individual for the applicable calendar year, divided by 12.

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Next Steps

Now that the final regulations have been issued, employers have the information needed to implement their ACA strategy. Many employers were waiting on the final regulations to make sure their compliance strategies were consistent with the regulations. Employers should now move quickly to make plans for 2015 compliance or determine that they can postpone compliance until 2016.

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