HOBBS STRAUS DEAN & WALKER

2120 L Street, NW, Suite 700
Washington, DC 20037

T 202.822.8282
F 202.296.8834

HOBBSSTRAUS.COM

MEMORANDUM

March 5, 2014

To: Tribal Health Clients

From: Hobbs, Straus, Dean & Walker LLP

Re: *IRS Final Rule on the Affordable Care Act's Employer Mandate*

On February 12, 2014, the Internal Revenue Service (IRS) published its Final Rule on the coverage requirements of the Affordable Care Act's (ACA) Employer Mandate.[1] 79 Fed. Reg. 8544 (Feb. 12, 2014). The Employer Mandate requires large employers to offer health coverage that is both affordable and provides minimum value to their full-time employees and their dependents or pay substantial penalties. As previously reported, the Final Rule announced an important delay in the implementation of the Employer Mandate for medium-sized employers (50-99 full-time employees) until January 1, 2016 and provided other transition relief for large employers (100 or more full-time employees) in 2015.

Under the Final Rule, the Employer Mandate will apply to employers with more than 100 full-time employees beginning in 2015, and to employers with 50-99 employees beginning in 2016. This memorandum provides an overview of the Final Rule's requirements, explains the IRS's special transition rules for 2015, and highlights some of the changes made in the Final Rule. Many of these rules are complex, so please do not hesitate to contact us if you have any questions about how these new rules may affect how you or your tribal enterprises provide coverage to your employees.

I. The Employer Mandate Requirements

1. How is an Applicable Large Employer Subject to the Rule Defined?

The Employer Mandate requires that "applicable large employers" offer all full-time employees and their dependents health care coverage that meets certain minimum requirements. Applicable large employers are defined as employers that employed an average of 50 or more full-time employees on business days during the previous calendar year. 26 U.S.C. § 4980H(c)(2); 26 C.F.R. § 54.4980H-2. Employers that employ more

[1] The IRS published a proposed rule on the Employer Mandate's reporting requirements in September 2013, and a final rule is those reporting requirements is expected in the near future.

than 50 full-time employees for less than 120 days out of the year are not considered applicable large employers if these workers are "seasonal workers." 26 U.S.C. § 4980H(c)(2)(B). The Final Rule clarifies that a seasonal worker is one who works in a position for which it is customary to work six months or less. 26 C.F.R. § 54.4980H-1(a)(38)–(39).

2. Which Tribal Entities Are Covered?

Employers that do not employ more than 50 full-time employees may nonetheless be subject to the Employer Mandate if they are part of a group of entities that is treated as a single employer. Entities are treated as a single employer if they would be treated as such under Section 414(b), (c), (m), and (o) of the Internal Revenue Code, known as the ERISA "controlled group" rules. These rules are generally targeted at companies and partnerships that are commonly owned and controlled. If commonly controlled employers have more than 50 full-time employees between them, then each employer must meet the Employer Mandate requirements although penalties will be determined separately for each employer. 26 C.F.R. § 54.4980H-1(a)(5), (16); 79 Fed. Reg. at 8548.

It is unclear at this time how this rule applies to tribal employers, if at all. Many tribes have different entities that employ people, including, for example, the tribal government, tribal commissions, tribal corporations, and gaming operations. In some cases, these different tribal entities have different human resources departments, and different health care coverage options for the people they employ. If the controlled group rules apply, there is the possibility that different tribal employers could be considered part of one applicable large employer. Like the proposed rules, the Final Rule reserved application of how these rules apply to government employers (including tribes), stating in its preamble that "[u]ntil further guidance is issued, those entities may apply a reasonable, good faith interpretation of section 414(b), (c), (m), and (o) in determining their status as an applicable large employer." 79 Fed. Reg. at 8548. There may be a reasonable, good faith argument that the controlled group rules do not on their face apply to governmental entities like tribes. We will be seeking further guidance from IRS on this important issue.

3. How Are Full-Time Employees Defined?

Employees working 30 hours of service a week or more are considered full-time employees. 26 U.S.C. § 4980H(c)(4). The Final Rule states that 130 hours of service in a calendar month is the equivalent of at least 30 hours per week. 26 C.F.R. § 54.4980H-1(a)(21)(ii). For the purpose of determining whether an employer is an applicable large employer, the number of employees includes both the number of full-time employees and the number of "full-time equivalent" (FTE) employees. Generally, the number of FTEs is determined by adding up the number of hours of service performed by part-time employees and dividing this number by 120. 26 U.S.C. 4980H (c)(2)(E); 26 C.F.R. § 54.4980H-1(a)(21). Importantly, "hours of service" that count towards the 30 hour

determination for full time employees includes paid leave, including vacation, holidays and illness.

The Final Rule provides two methods of determining whether an employee is considered a full-time employee. The monthly measurement method counts an employee's hours for a given month. This method is used for determining whether an employer is an applicable large employer as well as for assessing penalties. For assessing penalties, the employer has the option of instead using a "look-back" measurement method. Under this second method, an employer looks to a prior period of service, called the measurement period, to determine whether an employee will be considered full-time for a future period of service, called the stability period. The Final Rule includes detailed information about how to apply both the monthly and the look-back measurement methods. 26 C.F.R. § 54.4980H-3.

4. Affordability and Minimum Value

The Employer Mandate requires that the coverage offered by an employer be both affordable and provide minimum value. Coverage is affordable if the employee's required contribution does not exceed 9.5 percent of household income. Because employers do not generally know employee total household income, the IRS has provided three safe harbors. 26 C.F.R. § 54.4980H-5(e). An employer will not be assessed a penalty if the employee contribution does not exceed 9.5 percent of (1) the employee's W-2 wages for the calendar year; (2) the employee's rate of pay as calculated by his or her hourly wage multiplied by 130 hours per month; or (3) the federal poverty line for a single individual. *Id.*

An employer plan has the required minimum value if the plan covers at least 60 percent of the total permissible costs of the benefits under the plan. 26 U.S.C. § 36B(c)(2)(C)(ii). The Department of Health and Human Services and the IRS have created an online calculator to determine whether a plan provides minimum value.[2]

5. New Employees

The general rule for new employees is that they must be offered coverage beginning the first day after the first full three months of employment in order to avoid a penalty under the Employer mandate. We note, however, that there is an independent requirement in the ACA, Section 2708, that applies to group health plans and requires that they begin offering coverage within 90 days of employment. 42 U.S.C. § 300gg–7. Thus, if an employer uses a group health plan, the plan will require coverage to commence for new employees within 90 days of employment. This requirement applies to self-insured plans, and to grandfathered and non-grandfathered plans alike. 78 Fed. Reg. 17313, 17314 (March 21, 2013).

[2] The minimum value calculator is available at http://www.cms.gov/cciio/resources/regulations-and-guidance/index.html.

II. Employer Mandate Tax Penalties

1. No-Offer Penalty

If an applicable large employer fails to offer coverage to at least 95 percent of full-time employees and their dependents, the IRS will assess what we have termed a "no-offer penalty." 26 U.S.C. § 4980H(a). The penalty is only triggered when a full-time employee who is not offered coverage purchases health insurance on an exchange and receives a premium tax credit or cost-sharing reduction. The payment is assessed monthly and is equal to the number of full-time employees, reduced by 30, multiplied by 1/12 of $2000.[3]

2. No-Value Penalty

If an applicable large employer offers coverage that is not affordable or does not provide minimum value, the IRS assesses what we call a "no-value penalty." 26 U.S.C. § 4980H(b). The penalty is only triggered when a full-time employee rejects offered coverage and purchases health insurance on an exchange and receives a premium tax credit or cost-sharing reduction. The payment is assessed monthly and is equal to the number of full-time employees who actually received credit or subsidy multiplied by 1/12 of $3000.[4] The amount of the no-value penalty for any calendar month is capped at the amount an employer would be assessed for not offering insurance coverage at all under the no-offer penalty.

III. Transition Relief for 2015

The Employer Mandate was initially supposed to take effect on January 1, 2014. On July 9, 2013, the IRS issued a notice delaying the implementation of the Employer Mandate until 2015. *See* IRS Notice 2013-45. Known as "transition relief," this delay was intended to give employers time to prepare to meet the coverage and reporting requirements of the ACA. The preamble to the Final Rule announces additional transition relief, delaying the Employer Mandate until 2016 for medium-sized employers, providing other relief for large employers, and extending a number of special transition rules through 2015.

1. Medium-Sized Employers

The preamble to the Final Rule delays the Employer Mandate for medium-sized employers (50-99 full-time employees) until January 1, 2016. 79 Fed. Reg. at 8574. No penalties will be assessed for the 2015 plan year so long as the employer certifies that (1) it had fewer than 100 employees on business days in 2014; (2) it did not reduce its workforce or hours of service from February 9, 2014 to December 31, 2014 in order to

[3] $2000 is the 4980H(a) payment amount for 2014, and will be adjusted for inflation in future years.
[4] $3000 is the 4980H(b) payment amount for 2014, and will be adjusted for inflation in future years.

qualify for the transition relief; and (3) it has not eliminated or materially reduced any coverage it offered as of February 9, 2014.

2. Large Employers

The preamble to the Final Rule provides that large employers (100 or more full-time employees) will not be assessed penalties for the 2015 plan year so long as they offer coverage to at least 70 percent of their full-time employees. 79 Fed. Reg. at 8575. This is a change from the proposed rule. Beginning in 2016, both medium-sized and large employers must offer coverage to at least 95 percent of their employees (to all but 5%, or if greater, 5 employees).

Large employers that fail to meet the Employer Mandate's requirements will be assessed reduced penalties for the 2015 plan year. *Id.* If an employer fails to offer coverage for at least 70 percent of full-time employees, it will be assessed a no-offer penalty equal to the number of full-time employees, reduced by 80 (rather than the usual 30), and multiplied by 1/12 of $2000. This penalty reduction also reduces the no-value penalties because no-value penalties remain capped at the amount that could be assessed for not offering coverage at all.

3. Special Transition Rules

The preamble to the Final Rule also extended five special transition rules through 2015.

- Non-calendar year plans. Generally, employers that meet certain requirements for non-calendar year plans will not be assessed penalties for months prior to the start of the 2015 plan year so long as they offer coverage that is affordable and provides minimum value on the first day of the 2015 plan year. The preamble to the Final Rule provides detailed information about qualifying for this transition relief. 79 Fed. Reg. 8570–8572.
- Shorter look-back measurement periods. For 2015, employers intending to use the look-back measurement method may use a shorter measurement period to determine the number of full-time employees for a stability period beginning in 2015. 79 Fed. Reg. at 8572. This transition rule allows employers to use a 12-month stability period in 2015 based on a measurement period that is less than 12 months in 2014.
- Shorter period for determining applicable large employer status. Normally, an employer is an applicable large employer based on the number of employees it had in the prior calendar year. For 2015, the preamble to the Final Rule permits employers to choose any consecutive six-month period in 2014 to determine whether more than 50 full-time employees were employed. 79 Fed. Reg. at 8573.

- First pay period rule. For January 2015, an employer will not be assessed a penalty if it offers coverage no later than the first day of the first payroll period that begins in January 2015. *Id.*
- Additional time to add dependent coverage. Employers that take steps during the 2015 plan year to offer coverage to dependents of full-time employees will not be assessed penalties based solely on failure to offer dependent coverage. This transition rule applies when no coverage is offered to dependents, if the coverage offered does not meet the Employer Mandate requirements, or if coverage is offered to some, but not all, dependents. Employers do not qualify for this relief if they previously offed dependent coverage and subsequently revoked coverage. 79 Fed. Reg. at 8573–8574.

IV. Changes in the Final Rule

The Final Rule also contained a number of changes from or clarifications to the proposed rules. Some of these changes are highlighted below.

- New employers. For the purposes of determining new employers, an employer is treated as having been in existence during the prior calendar year if it was in existence on even a single business day during that prior year. 26 C.F.R. § 54.4980H-2(b)(3).
- Transition rule for first year as an applicable large employer. A new employer will not be assessed a penalty if it offers coverage to eligible employees on or before April 1 of the first year in which the employer is considered an applicable large employer. This transition rule only applies the first year an employer qualifies as an applicable large employer and does not apply to employers that qualified as an applicable large employer at some previous time. 26 C.F.R. § 54.4980H-2(b)(5).
- Calculating hours of service for certain categories of workers. The Final Rule excludes from the definition of hours of service particular types of service including hours worked by bona fide volunteers and students in federal work study programs. 26 C.F.R. § 54.4980H-1(a)(24).
- Using equivalency methods to calculate hours of service. The Final Rule, like the proposed rule, provides that for non-hourly employees, employers may calculate hours of service by using equivalencies of 8 hours per day or 40 hours per week unless the equivalencies would result in a substantial understatement of an employee's time. The Final Rule adds that equivalencies may not be used if they would understate hours for a substantial number of employees, even if no

individual employee's hours were substantially understated. 26 C.F.R. § 54.4980H-3(b)(3)(C)(iii).

- Extension of seasonal worker exception to new employers. The Final Rule extends the seasonal worker exception to new employers. This means that a new employer will not be treated as an applicable large employer if it (1) reasonably expects to employ more than 50 full-time employees for 120 days or fewer, and (2) reasonably expects that those employees exceeding 50 full-time workers fit the definition of seasonal employees. 26 C.F.R. § 54.4980H-2(b)(2).
- Defining dependents. Like the proposed rule, the Final Rule states that dependents are children under age 26. The Final Rule also states that step children and foster children are excluded from the definition of dependent. 26 C.F.R. § 54.4980H-1(a)(12).
- Clarification to rate of pay safe harbor. The Final Rule clarifies that when using the rate of pay safe harbor for employees with varied wages, the employee's lowest hourly rate of pay for the month in question is to be used. 26 C.F.R. § 54.4980H-5(e)(2)(iii).
- Clarification to federal poverty line safe harbor. The Final Rule also states that employers using the federal poverty line safe harbor may use guidelines in effect six months prior to the beginning of the plan year. 26 C.F.R. § 54.4980H-1(a)(19).
- Look-back measurement method. The Final Rule incorporates a number of clarifications to the application of the look-back measurement method, including matters regarding variable-hour employees, seasonal employees, and new employees as well as stating that measurement and stability periods of different lengths may be applied to different categories of employees. 26 C.F.R. § 54.4980H-3(d); *see also* 79 Fed. Reg. at 8554–8559.
- Rehire rules and break-in-service rules. The proposed rule stated that in order to consider a prior employee a rehired new employee rather than a continuing employee, there must have been a break in service of at least 26 weeks. The Final Rule shortens the required break in service to 13 weeks except for educational employers. 26 C.F.R. § 4980H-3(c)(4)(iv).
- Employees of more than one applicable large employer member. The Final Rule clarifies that for employees who are the employee of more than one employer in an employer group that is treated as a single entity, an offer by one member of the applicable large employer group is treated as an offer by all members. The Final Rule also states that penalties will be assessed against the member of the

employer group for which the employee has the greatest number of hours of service for that month. 26 C.F.R. § 54.4980H-4(b)(2), (d).

- Offers of coverage on behalf of employers. The Final Rule provides that offers of coverage made on behalf of an employer fulfill the employer's obligation under the Employer Mandate. Such offers of coverage include those made by Taft-Hartley plans or Multiple Employer Welfare Agreements (MEWAs). 26 C.F.R. § 54.4980H-4(b)(2).

For further information, please contact Elliott Milhollin at (202)822-8282 or emilhollin@hobbsstraus.com or Geoff Strommer at (503)242-1745 or gstrommer@hobbsstraus.com.