

April 1, 2013

Employer Shared Responsibility (ESR) Provisions under the ACA

Part II

Treasury and the IRS released proposed regulations on the new Employer Shared Responsibility (ESR) provisions (a/k/a Play or Pay, Employer Mandate or IRC Section 4980H) under the ACA on December 28, 2012.¹ On January 2, 2013 we published a Quick Start Overview intended to provide a high level summary of the proposed guidance to help you hit the ground running in 2013 as you prepare for 2014.

This Part II on ESR focuses on:

- **Identifying Full-Time Employees for ESR Purposes**
- **Applying the Safe Harbor Measurement, Stability, and Administration Periods**

QUICK SUMMARY OF CODE SECTION 4980H

Starting in 2014, employers employing at least a certain number of employees will be subject to the Employer Shared Responsibility provisions under section 4980H of the Internal Revenue Code (added to the Code by the Affordable Care Act, or ACA). Under these provisions, if such employers do not offer affordable health coverage that provides a minimum level of coverage to substantially all full-time employees, they may be subject to an Employer Shared Responsibility (ESR) payment/assessment if at least one of their full-time employees receives a premium tax credit for purchasing individual coverage in an insurance Exchange.

With employer shared responsibility penalties coming into play in 2014, effective planning for many employers will require use of IRS safe harbors for identifying full-time employees. Furthermore, for most employers, advance identification of full-time employees will begin this year – 2013.

To be subject to the Employer Shared Responsibility provisions, an employer must have at least 50 full-time employees or a combination of full-time and part-time employees that is equivalent to at least 50 full-time employees.

¹ 26 USC §4980H. The Treasury Department and the IRS have published four notices prior to this proposed rule addressing issues under section 4980H. Each notice outlined potential approaches to future guidance, and each requested public comments. See Notice 2011-36 (2011-21 IRB 792), Notice 2011-73 (2011-40 IRB 474), Notice 2012-17 (2012-9 IRB 430), and Notice 2012-58 (2012-41 IRB 436).

IDENTIFYING FULL-TIME EMPLOYEES

Full-Time Employee Defined

For Employer Shared Responsibility purposes:

- Full-time (FT) employee means an employee who averages at least 30 hours of service per week for a calendar month
- 130 hours of service in a calendar month is the equivalent of at least 30 hours of service per week (1560 hours of service annually)
- Full-time (FT) employee is not the same as a full-time equivalent (FTE) employee used to determine employer size and whether the employer meets the ESR threshold
- Therefore, non-FT employees used to calculate FTE employees are not counted for coverage or penalty purposes under ESR

Hours of Service

- An employee's hours of service include time paid for: vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence
- Hours worked outside the US are disregarded
- For hourly employees: the actual hours of service must be tracked
- For non-hourly employees (i.e., exempt or salaried employees) – an employer may use one of three methods to measure hours of service:
 - Track actual hours of service
 - 8 hours of service/day is credited if at least one hour worked that day
 - 40 hours of service/week is credited if at least one hour worked that week
- If an 8 hour or 40 hour equivalency method is used, then it must generally reflect actual hours worked

APPLYING OPTIONAL IRS SAFE HARBOR DETERMINATION PERIODS

Determining full-time employee status on a monthly basis may cause practical difficulties for employers, employees, and Health Insurance Marketplaces. For employers, these difficulties include uncertainty and inability to predictably identify which employees are full-time employees to whom coverage must be provided to avoid a potential liability. This problem is particularly acute if employees have varying hours or employment schedules (for example, employees

whose hours vary from month to month). A month-by-month determination may also result in employees moving in and out of employer coverage (and potentially Health Insurance Marketplace coverage) as frequently as monthly. This result would be undesirable from both the employee's and the employer's perspective, and would also create administrative challenges for the Marketplaces.

To address these concerns, and to give employers flexible and workable options and greater predictability, the proposed regulation outlines a potential optional look-back measurement method as an alternative to a month-by-month method of determining full-time employee status.

In General

- Look back “Measurement Period” is a period chosen by the employer for counting hours of service to determine FT employee status – that is, eligibility for group health plan coverage
- “Stability Period” is a period chosen by the employer during which coverage is provided based on FT status in the Measurement Period (regardless of actual employee status during the Stability Period)
- “Administrative Period” is a period chosen by the employer to allow time for enrollment and disenrollment between MP and SP

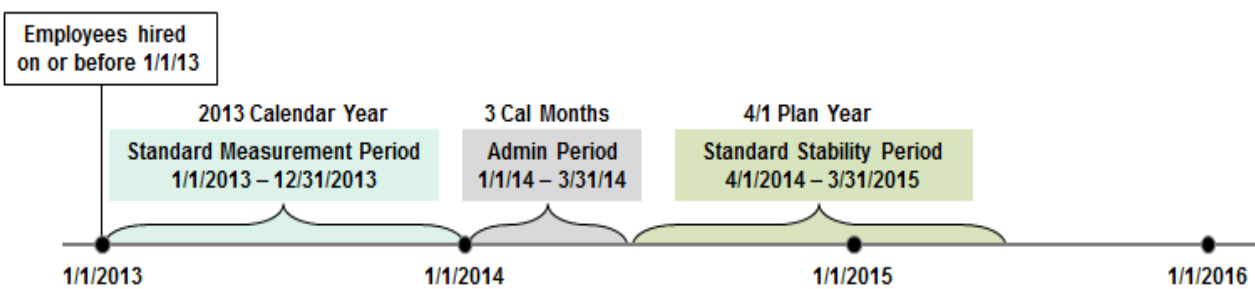
Ongoing Employee Measurement Periods

These periods usually relate to the plan year and annual enrollment period for the plan.

- Ongoing Employee is an employee that has been employed for at least one Standard Measurement Period (SMP)
- Standard Measurement Period (SMP): is a look back period chosen by the employer that is at least 3 months but no more than 12 months in length
 - This calendar-based measurement period can be adjusted for weekly, bi-weekly or semi-monthly payroll periods that do not end exactly on the last day of the applicable measurement period
- Standard Stability Period (SSP): is a period chosen by the employer that is the greater of 6 calendar months or the length of the SMP. It follows the SMP and precedes any SAP. An employee maintains the status attained during the SMP throughout the SSP
- Standard Administrative Period (SAP): is an optional period chosen by the employer between the SMP and SSP, which cannot exceed 90 days, used to review hours of service, communicate with employees and offer enrollment to FT employees, as applicable

EXAMPLE 1: Determining Full-Time Ongoing Employees as of Jan. 1, 2014

Facts: Employer maintains an April 1 fiscal plan year group health plan with a 30 hour per week eligibility requirement. It uses a 12-month calendar year “standard measurement period” to determine full-time “ongoing employees” as of each January 1st. The employer counts as “full-time” all employees who worked an average of at least 130 hours per month during the prior calendar year.



Result:

- ✓ On Dec. 31, 2013, employer “looks back” and identifies employees employed on or before Jan. 1, 2013 who worked at least 1560 hours during calendar year 2013.
- ✓ Assuming the employee is still employed on Jan. 1, 2014, the employer must offer coverage or pay penalties during the 12-month stability period beginning April 1, 2014 as long as the employee remains employed.
- ✓ The employer uses a 90 day “administrative period” to offer coverage and enroll the ongoing employee.

Transitional Measurement Period for 2013 Only

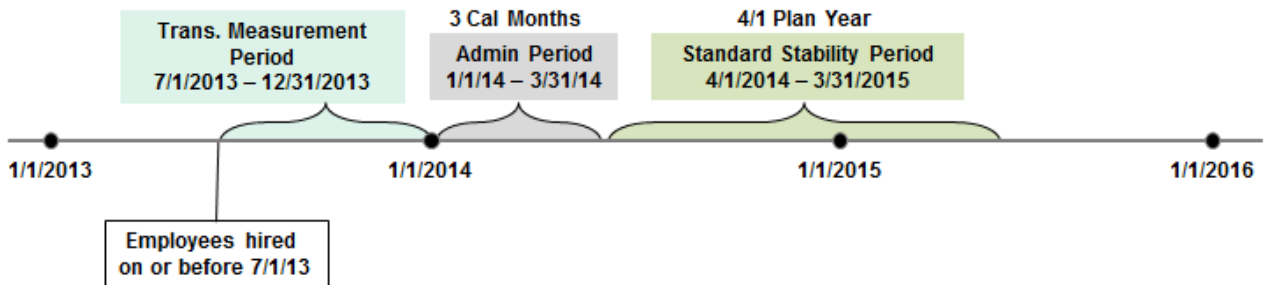
Ordinarily, the IRS safe harbor determination rules require employers using a 12 month Standard Stability Period to use a Standard Measurement Period of 12 months as well. However, the proposed IRS guidance provides a transition rule for 2013 to give employers time to implement the safe harbor rules.

Employers that plan to use a 12 month Standard Stability Period (SSP) for ongoing employees starting in 2014 may use a Transitional Measurement Period (TMP) that is only available in 2013. The TMP:

- May be shorter than 12 months but cannot be less than 6 months
- Must begin no later than July 1, 2013 and
- Must end no earlier than 90 days before the first day of the plan year beginning in 2014

EXAMPLE 2: Determining Full-Time Ongoing Employees as of Jan. 1, 2014 Using 6-Month Transitional Measurement Period Beginning in 2013

Facts: Employer maintains an April 1 fiscal plan year group health plan with a 30 hour per week eligibility requirement. Employer will use a 12-month “standard stability period” beginning on April 1, 2014. To determine “ongoing employees” as of Jan. 1, 2014, employer elects to use the Transitional Measurement Period in 2013 (rather than the full 2013 calendar year) and counts as “full-time” all employees who worked an average of at least 130 hours per month during the period July 1, 2013 to Dec. 31, 2013.



Result:

- ✓ On Dec. 31, 2013, employer “looks back” and identifies employees employed on or before July 1, 2013 who worked at least **780 hours** during the 6 month period.
- ✓ Assuming the employee is still employed on Jan. 1, 2014, the employer must offer coverage or pay penalties during the 12-month stability period beginning April 1, 2014 as long as the employee remains employed.
- ✓ The employer uses a 90 day “administrative period” to offer coverage and enroll the ongoing employee.

New Full-time Employees

The proposed regulations provide that, for an employee who is reasonably expected at his or her start date to be employed on average 30 hours of service per week (and who is not a seasonal employee), an employer that sponsors a group health plan that offers coverage to the employee at or before the conclusion of the employee’s initial three calendar months of employment will not be subject to an assessable payment under IRC section 4980H by reason of its failure to offer coverage to the employee for up to the initial three calendar months of employment.

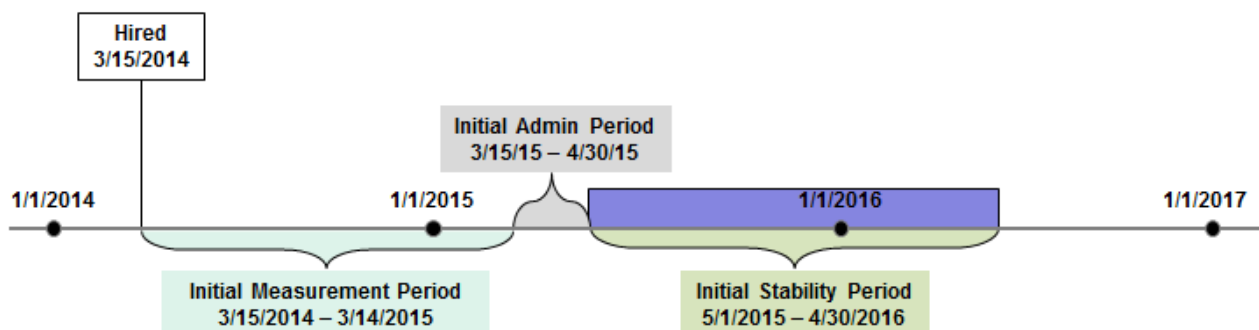
New Variable Hour Employee Measurement Periods

These periods will relate to the new variable hour employee's date of hire.

- New Variable Hour Employee: is a new employee that has been employed for less than one Standard Measurement Period (SMP) and, as of the start date, the employer is unable to determine if the new employee is reasonably expected to be employed on average 30 or more hours of service per week
 - Beginning 1/1/2015, the employer must assume the new variable hour employee will be employed for the entire measurement period
- Initial Measurement Period (IMP): is a look back period chosen by the employer that is at least 3 months but no more than 12 months in length that starts no later than the first of the month following the employee's start date
- Initial Stability Period (ISP): is a period chosen by the employer that must be the same length as the SSP for ongoing employees
- Initial Administrative period (IAP): is an optional period chosen by the employer between the IMP and ISP, which cannot exceed 90 days, used to review hours of service, communicate with employees and offer enrollment to FT employees, as applicable
 - Combined IMP and AP cannot exceed 13 months plus a fraction of a month

EXAMPLE 3: Determining New "Variable Hour" Employees Hired in 2014

Facts: Employer uses a 12-month "Initial Measurement Period" for new variable hour employees employed on or after Jan. 1, 2014. "Variable-hour" employees are those whom the employer cannot reasonably determine on their start date will average at least 30 hours of service per week over the course of the Initial Measurement Period.



Result: Employee starts work 3/15/2014.

- ✓ On 3/14/15, employer “look backs” to see if employee worked at least 1560 hours over the 12-month period Initial Measurement Period.
- ✓ If so, employer must offer coverage or pay penalties during the 12-month “Initial Stability Period” as long as the employee remains employed.
- ✓ The employer uses an “Initial Administrative Period” that, when combined with the Initial Measurement Period, is 13 months (and a fraction of a month) to offer coverage and enroll the new variable hour employee.

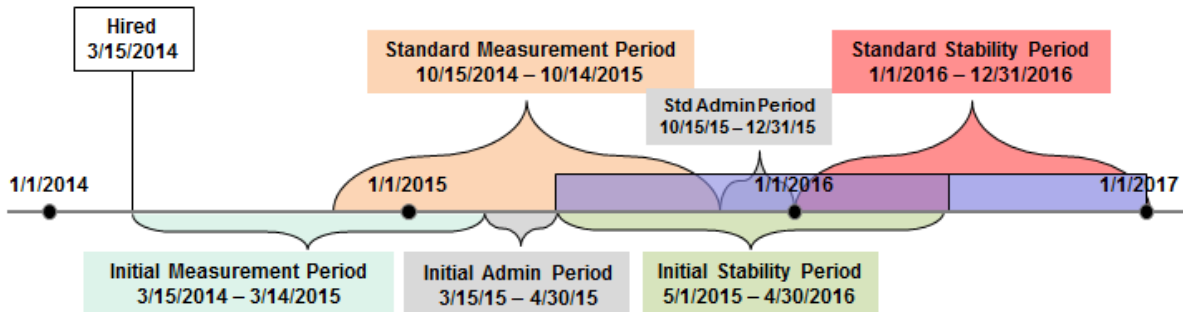
Transition from New Variable Hour Employee to Ongoing Employee Status

New variable hour employees cannot remain new employees forever. Eventually, the new variable hour employee will have worked for the employer long enough to be considered an ongoing employee. Therefore, the proposed guidance related to transitioning new variable hour status to ongoing employee status.

- Once employed for an entire SMP, employers must test new variable hour employees for FT status under the SMP for ongoing employees
- This creates some overlap of measurement periods for the new employee. The IMP and the SMP will likely be tested at the same time during some months
- If as a result of this testing the new employee meets FT status under the SMP for ongoing employees:
 - The employer must treat the new employee as FT as of the start of the SSP for ongoing employees
 - Even if the initial stability period (ISP) that applies to the new employee has not yet expired

EXAMPLE 4: Transition from New Variable Hour to Ongoing Employee Status

Facts: Employer maintains a calendar year group health plan with a 30 hour per week eligibility requirement. Employer uses a 12-month “Initial Measurement Period” for new variable hour employees employed on or after Jan. 1, 2014. Employer also uses a 12-month “Standard Measurement Period” beginning each October 15th to measure ongoing employees. To determine “ongoing employees” as of Jan. 1, 2016, employer counts as “full-time” all employees who worked an average of at least 130 hours per month during the period Oct. 15, 2014 to Oct. 14, 2015.



Result: Employee starts work 3/15/2014.

- ✓ On 3/14/15, the employer “looks back” and determines that the new variable hour employee worked at least 1560 hours over the 12-month Initial Measurement Period.
- ✓ The employer must offer coverage or pay penalties during the 12-month “Initial Stability Period” ending 4/30/16 as long as the employee remains employed.
- ✓ The employee enrolls during the Initial Administrative Period for coverage effective 5/1/15 through 4/30/16.
- ✓ At the same time, employer tests the employee’s hours of service again at the close of Standard Measurement Period ending 10/14/15 and determines the employee worked at least 1560 hours during the Standard Measurement Period ended 10/14/15.
- ✓ The employee is now an ongoing employee and the employer must offer coverage from 5/1/16 through 12/31/16 – the balance of the Standard Stability Period for ongoing employees.

PUTTING IT ALL TOGETHER FOR 2014

As you can see, for most employers advance identification of full-time employees will begin this year – 2013. This means that employers must start NOW to develop a strategy for 2013 with regard to ESR compliance.

The January 2, 2013 Quick Start Summary that you received from me previously in combination with this April 1, 2013 Part II summary will provide you with the information necessary to assess your ESR compliance needs and to prepare an action plan. Your 2013 action plan should include:

- Determining, based on 2013 payroll numbers converted to full-time equivalent (FTE) employees, whether your business will be considered a large employer subject to ESR in 2014. If you have 50 or more FTE employees of which at least 30 are full-time employees with 130 hours of service per month, your business is solidly in the ESR game.
- Assessing WHEN ESR will apply to your business’ group health plan (GHP) – either January 1, 2014 or the first 1st plan year/renewal date in 2014. Remember that non-calendar year plans must also comply by January 1, 2014 UNLESS the plan meets

either the 33% offer or 25% enrollment tests based on dates in 2012 and taking into account all employees of the business.

- Reviewing your GHP eligibility provisions for compliance with the 30 hours of service per week / 130 hours per month and the 90 day maximum waiting period requirements and assessing the impact of these provisions on your GHP.
- Reviewing the structure of your business' work force and its use of full-time, part-time, per diem, temporary, and seasonal employees and employee turnover rate to assess the need for variable hour rules for new hires.
- Crafting a customized solution and response specific to your business, taking into account your GHP's current plan year, plan design, contribution strategy and the structure and culture of your business' work force.
- Determining applicable safe harbor measurement, stability and administration periods to identify full-time employees (both ongoing employees and new variable hour employees) and including those periods as part of any revised eligibility provisions for your GHP. Note that these periods may include "short" or "run-in" periods beginning in 2013 as your GHP transitions to its 2014 plan year.
- Locating, reviewing and revising your GHP's existing ERISA plan document and health plan SPD(s). The ESR provisions WILL require amendments to your GHP documents in 2013. Your GHP's legal documentation MUST include up to date eligibility provisions indicating which employees are eligible for GHP coverage, when and for how long, including applicable measurement periods for ongoing and variable hour employees.

If you do not have ERISA plan documents for your GHP, or you have ancient/inadequate ERISA documentation, NOW is the time to have these documents prepared with appropriate, ESR-compliant provisions. Your legal plan documentation and your enrollment/payroll records will be your ONLY defense against IRS penalty assessments.

Please contact me if you have any questions.

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