September 30, 2013

Health Care Reform for Employers: A Handy Summary of the "Pay or Play" Rules

Ever since the health care reform law – the Patient Protection and Affordable Care Act – was passed in 2010, we have been working overtime to meet with clients, publish alerts, and present seminars to help employers get themselves in compliance with this new law. Although our families are now feeling a bit neglected, hopefully our clients are better prepared to face this new statutory and regulatory burden.

One of the more complicated components of PPACA is the requirement that certain employers either provide health care coverage to their full-time employees or pay a draconian penalty. This requirement is commonly referred to as the "pay or play" mandate. This mandate was originally slated to go into effect January 1, 2014. It requires that an employer with 50 or more full-time employees must offer affordable health insurance coverage to all of its full-time employees and their dependents or else potentially face significant penalties.

As many of you know, the IRS recently postponed enforcement of this mandate until January 1, 2015. This is great news for employers, who now have extra time to prepare for this complicated law. But the delay is not as helpful as many might think. Compliance preparation still needs to begin immediately.

Summarizing the "pay or play" mandate in a few short pages is a nearly impossible task to do adequately given its complexity. Nevertheless, we have attempted to do so in the attached Memorandum, and we strongly encourage you to give it a read. It is designed to present an explanation of the federal regulatory requirements in plain and understandable English. In other words, everything that the federal regulations are not.

For those who choose not to read the Memorandum, here, in very brief form, is our list of the Top 9 things employers need to know about the "pay or play" mandate.

1. **Applicable Large Employers.** The "pay or play" mandate applies to employers that averaged 50 or more full-time employees during the preceding calendar year. These employers are referred to as "applicable large employers."

2. **Full-Time Employees.** A "full-time employee" is defined as an employee who averages at least 30 hours per week in a given month.

3. **Coverage Mandate.** An applicable large employer is required to offer "minimum essential coverage" to all full-time employees and their dependents (surprisingly, this does not include spouses).

4. **Sledgehammer Penalty.** If an applicable large employer fails to satisfy the mandate to offer coverage to all full-time employees and their dependents, it is subject to a penalty of $2,000 per full-time employee, per year, for all full-time employees (even those that were offered coverage). This is known as the "sledgehammer" penalty.

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5. **Variable-Hour and Seasonal Employees.** For variable-hour and seasonal employees, the IRS has provided a complex method to determine whether they must be offered coverage as "full-time employees." This method requires the employer to look back at the hours the employee worked in the preceding year to determine whether the employee is a "full-time employee."

6. **Minimum Essential Coverage.** "Minimum essential coverage" is defined as coverage that is "affordable" and provides "minimum value."

    a. **Affordable.** Coverage is "affordable" if the employee portion of the premiums for self-only coverage is less than 9.5% of the employee's household income. The IRS has provided several methods for employers to estimate "household income."

    b. **Minimum Value.** "Minimum value" is an actuarial concept. Plans that are fully insured through a reputable insurance company will almost certainly satisfy this requirement. A self-insured plan should work with its third-party administrator to ensure that the plan provides minimum value.

7. **Tackhammer Penalty.** If an applicable large employer offers coverage, but that coverage is not "affordable" and/or does not provide "minimum value," then the employer is subject to the so-called "tackhammer penalty," which is $3,000 per full-time employee, per year. However, unlike the sledgehammer penalty, this penalty applies only to those full-time employees who receive a government subsidy to purchase coverage on a state health insurance exchange.

8. **Fiscal Year Plans.** The IRS will begin enforcing the "pay or play" mandate on January 1, 2015. As a practical matter, this means that many employers with fiscal year plans will need to be in compliance with the mandate before that date. Otherwise, the employer could be required to allow mid-year enrollment in its plan.

9. **Beware of Excise Taxes!** In addition to the "pay or play" mandates and penalties, all employer-sponsored group health plans (regardless of the size of the employer) are subject to a long list of mandates and restrictions that are enforced by an excise tax of $100 per affected individual, per day. This tax can quickly dwarf even the draconian "pay or play" penalties. Because of its importance, we will cover the excise tax separately in a future Alert.

Obviously, there is a lot more to the "pay or play" mandate than we can summarize in a short list. The attached Memorandum contains a more detailed analysis. We hope it is helpful to you.

If you have any questions regarding the impact of health care reform on employers, please feel free to call Eric Namee, Steven Smith, or Brad Schlozman at (316) 267-2000.

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LAW FIRM LLC

MEMORANDUM

HEALTH CARE REFORM FOR EMPLOYERS:
A HANDY SUMMARY OF THE "PAY OR PLAY" RULES

SEPTEMBER 30, 2013

Ever since the health care reform law – the Patient Protection and Affordable Care Act (**"PPACA"**) – was passed in 2010, our firm has been meeting with clients, publishing alerts, and offering seminars to help employers prepare for the law and avoid its heavy penalties. Many have asked us to summarize, in a few pages, PPACA's requirement that certain employers either provide health care coverage to their employees or pay a penalty (occasionally known as the "pay or play" mandate). This Memorandum is intended to do just that. But be warned -- PPACA is extremely complex, and what follows is merely intended as an introduction to some of its basic concepts, rather than a full-blown explanation of the law.

The federal regulations implementing PPACA originally required that, beginning in 2014, an employer with 50 or more full-time employees would be required to offer affordable health insurance coverage to all of its full-time employees and their dependents, with the failure to do so resulting in significant penalties. As many of you know, however, the IRS postponed enforcement of this mandate until January 1, 2015. This is great news for employers, who now have extra time to prepare for this complicated law. But the delay is not as helpful as many might think. Compliance preparation still needs to begin immediately. Moreover, as described in more detail below, for some employers with fiscal year plans, the delay will provide little relief at all.

The employer coverage requirement (i.e., the "pay or play" mandate) is one of the most complex aspects of health care reform, and it is impossible to summarize adequately in only a few pages. What follows, then, is simply a general overview of the "pay or play" regulations and potential penalties. Employers are strongly encouraged to seek the assistance of experienced benefits counsel to ensure that they are in compliance with the law.

Applicable Large Employers

The pay or play requirements only apply to "applicable large employers" – that is, to employers that averaged 50 or more full-time employees during the preceding calendar year. Related employers that are part of a "controlled group" are treated as a single employer when determining applicable large employer status. If the entire controlled group employed at least 50 full-time employees, then each of the employers in the controlled group must comply with the pay or play rules. In light of this, some controlled groups have begun to restructure their ownership to minimize their exposure to the pay or play mandate.

A "full-time employee" is defined as an employee who averages at least 30 hours per week in a given month. Although part-time employees (i.e., employees who average fewer than 30 hours per week) are not full-time and thus need not be offered coverage, they still must be counted as a fraction of a full-time employee when determining whether an employer is an "applicable large employer." The hours worked by part-time employees in a given month are totaled up and divided by 120, and the resulting number is added to the number of full-time employees to determine whether an employer meets the 50-employee threshold for "applicable large employer" status. For example, an employee who works 60 hours in a given month would be treated as one-half of a full-time employee for that month. If four part-time employees each work the 60 hours during the month, those four part-timers would be equal to two full-time employees for the month.

Applicable large employer status is determined based on the number of full-time employees employed during the preceding calendar year. Thus, the employer must calculate the number of full-time employees and full-time equivalents (using the fractional calculations for part-time employees described above) it had in each month of the preceding calendar year. The monthly numbers are then averaged. If the average is at least 50, the employer is an "applicable large employer" and is subject to the pay or play requirements.

Full-Time Employees

An applicable large employer must offer coverage to all of its "full-time employees" and their dependents. Although part-time employees must be counted in determining if an employer is an applicable large employer, those part-time employees do not have to be offered coverage.

Who is considered a full-time employee? Under the Affordable Care Act, a "full-time employee" is defined as an employee who averages at least 30 hours of service per week in a given month. Hours of service include actual hours worked and paid time off for non-working periods such as holidays, vacation, sick leave, layoff, and leaves of absence. Special rules also apply to unpaid leave such as FMLA leave, USERRA leave, or jury duty.

The IRS has provided a "safe harbor" method that employers may use to determine, in advance, which employees qualify as full-time. For *ongoing employees*, an employer may look back at a "Standard Measurement Period" that is between three and twelve consecutive months long. Ongoing employees who average at least 30 hours per week during the Standard Measurement Period are considered to be full-time (and thus must be offered health care coverage) during the subsequent "Stability Period," which must be the longer of six months or the length of the Standard Measurement Period. Employees who average less than 30 hours per week during the Standard Measurement Period can be treated as non-"full-time employees" during the subsequent Stability Period (and thus need not be offered health care coverage). In addition, an applicable large employer is allowed to use an "Administrative Period" of up to 90 days as a buffer between the Standard Measurement Period and the Stability Period. There are many exceptions to the methodology described above, but further details are beyond the scope of this brief summary.

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Here is an example of what these rules look like in chart form:

2013	2014		2015	2016
	Standard Measurement Period for the 2015 Stability Period	A P	2015 Stability Period	
11/1	10/31		1/1	12/31
	Standard Measurement Period for the 2016 Stability Period	A P	2016 Stability Period	
	11/1		10/31 1/1	12/31

A similar safe harbor method is used for *new employees*. A new employee who, at the time of hire, is expected to average at least 30 hours per week, must be treated as full-time and offered coverage no later than 90 days after the start of employment. However, if the new employee is either a "seasonal" or "variable hour" employee (i.e., the new employee's hours are likely to fluctuate and the employer is genuinely unsure whether the employee will average 30 hours per week), the new employee can be tested using measurement and stability periods similar to those used for ongoing employees. Essentially, an employer begins counting the hours of a new variable hour or seasonal employee immediately (or almost immediately) after the new employee starts work. This calculation period is known as the "Initial Measurement Period." The Initial Measurement Period must be between three and twelve months, and must begin no later than the first day of the first month after the new employee's start date. Although the IRS rules contain some flexibility, in general, the subsequent Initial Stability Period will be equal in length to the Initial Measurement Period. If the new employee averages at least 30 hours per week during his/her Initial Measurement Period, then the employee must be offered coverage during the subsequent Initial Stability Period. If the new employee does not average at least 30 hours per week during his/her Initial Measurement Period, then the employee need not be offered coverage during the subsequent Initial Stability Period.

There is one tricky part, though, about measuring the hours of a new employee: the simultaneous counting requirement. Specifically, at the same time that a new employee's hours are being counted as part of the Initial Measurement Period, they also must be counted as part of the regular Standard Measurement Period that applies to ongoing employees. Stated differently, once a new employee has been employed for an entire Standard Measurement Period, the employee (who by now has become an "ongoing employee" rather than a "new employee") must be tested for full-time status using the Standard Measurement Period applicable to all other ongoing employees. During this transition from new employee to ongoing employee, the employee must be given the "best of either" treatment. In other words, if one test causes the employee to be considered "full-time," while the other test does not, the "full-time" result must be followed. Here is what this principle looks like in chart form:

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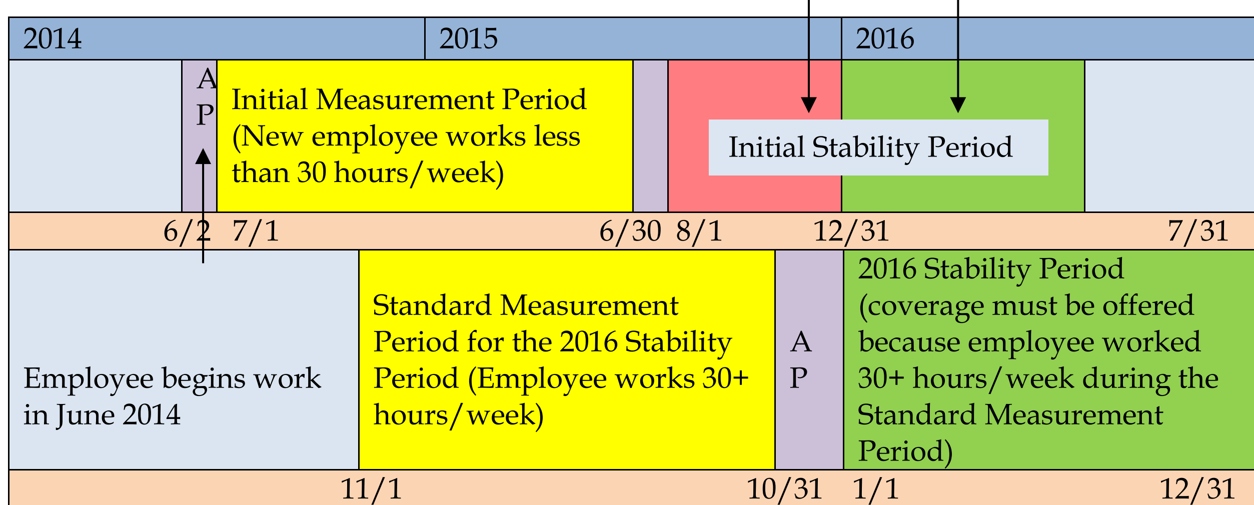

Special rules apply to employees whose employment status changes (e.g., from variable hour to full-time) during their Initial Measurement Period. Special rules also apply to employees who are terminated and later rehired. A description of those special rules, however, is simply not possible in this very brief summary.

The "Sledgehammer" Penalty

If an applicable large employer fails to offer minimum essential coverage to all of its eligible full-time employees and their dependents, and if at least one full-time employee obtains subsidized coverage on an Exchange, the employer is subject to the so-called "sledgehammer penalty." This penalty is $2,000 per year for each of the employer's full-time employees – including full-time employees who did *not* obtain subsidized coverage on an Exchange. The IRS regulations do offer some limited relief: if an employer offers coverage to at least 95% of its full-time employees (or, for employers with less than 100 full-time employees, all but five) and their dependents, the sledgehammer penalty will not apply. The regulations define "dependent" as any child (or step-child) under age 26. Somewhat oddly, though, the employee's spouse is not deemed to be a dependent and thus need not be offered coverage.

The "Tackhammer" Penalty

It is not enough for an applicable large employer simply to offer minimum essential coverage to all of its full-time employees and their dependents. Even if an employer does this, it may still be penalized $3,000 per year for each full-time employee who receives subsidized coverage on an Exchange if the employer's coverage is not "affordable" or does not provide "minimum value," or if the employee is among the five percent (or five employees) not offered coverage.

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This penalty is often referred to as the "tackhammer penalty," and it applies in lieu of the sledgehammer penalty described above.

Coverage is "affordable" for an employee if the employee's share of the premiums for *employee-only* coverage is not more than 9.5% of the employee's household income for the year. (This means that the cost of any other coverage, e.g., family coverage, is irrelevant to the issue of affordability.) Because it is often impractical or impossible for an employer to determine an employee's actual household income, the IRS has provided three safe harbor methods that employers may use as a substitute for household income when determining whether coverage is affordable:

(1) The employee's "Box 1" W-2 wages for the *current year* (which often will make this option impractical because W-2 wages are typically not known until the end of the year);

(2) The employee's rate of pay (i.e., hourly rate multiplied by 130 hours per month, or monthly salary for salaried employees); or

(3) The federal poverty level (below which the employee would qualify for Medicaid). For 2013, the federal poverty level is $11,170 per year, or $930.33 per month.

Coverage is deemed to be "affordable" if the employee's share of the premiums for employee-only coverage does not exceed 9.5% of household income based on any of these safe harbor methods. (For example, 9.5% of household income using the federal poverty level safe harbor is $88.43 per month, so coverage is "affordable" under this method if the employee's share of premiums for employee-only coverage does not exceed $88.43 per month.)

An applicable large employer that chooses not to make its health care coverage "affordable" within the meaning of these safe harbors will not necessarily be subject to a tackhammer penalty. After all, as noted above, the tackhammer penalty will only apply if the cost of coverage exceeds 9.5% of the employee's household income and the employee receives subsidized coverage on the Exchange. But the failure to follow the safe harbors will leave the employer in the dark about the applicability of the tackhammer penalty until such time as the employee and his/her family members file their tax returns.

"Minimum value," meanwhile, is an actuarial concept, and this requirement is satisfied if the plan pays at least 60% of the total allowed costs of benefits. The IRS and the Department of Health and Human Services will be providing an online "minimum value calculator" to help employers make this determination. If a plan is fully insured through a reputable insurance company, it will almost certainly provide minimum value. A self-insured plan should work with its third-party administrator to ensure that it satisfies the minimum value requirement.

Fiscal Year Plans

The IRS will not begin enforcing the pay or play mandate until January 1, 2015. However, as a practical matter, many employers with fiscal year plans will need to be in compliance before that date. Take, for example, an employer with a plan year that runs from July 1, 2014, through June 30, 2015. Technically, that employer does not have to begin offering coverage to its

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full-time employees until January 1, 2015 – halfway through the plan year. But in practice, it may be best for the employer to get into compliance ahead of time. Otherwise, the employer will need to have an additional open enrollment period in the middle of the plan year, during which the previously ineligible employees will be able to enroll for a partial period of the plan year. This could be an administrative headache and some insurers may even balk. The bottom line, though, is that there is no single right answer for fiscal year employers. Many factors may affect an employer's decision whether or not to comply in advance, including the financial costs, the size and makeup of the employer's workforce, and the administrative burden. Fiscal year employers should consult with experienced employee benefits counsel when making this decision.

Excise Taxes

In addition to the sledgehammer and tackhammer penalties, employer-sponsored plans are subject to an excise tax of $100 per day, per affected individual, for failing to meet any one of a long list of mandates. These mandates include the requirement to provide a "Summary of Benefits and Coverage," first-dollar coverage of preventive services (including the much-publicized contraceptive mandate), the prohibition on annual and lifetime limits, cost-sharing restrictions, and a host of other requirements. All of this is independent of the pay or play mandate and applies even to employers with fewer than 50 full-time employees. The excise tax has its own complex set of rules and is beyond the scope of this brief summary, but employers should be aware that it exists and could be imposed even on employers that satisfy the pay or play rules.

Conclusion

As you can see, the pay or play rules are extremely complicated. The penalties for not complying with them are very significant, in some cases potentially draconian. Employers are strongly encouraged to map out their plans sooner than later. It is also essential that employers work with experienced employee benefits counsel in order to ensure that they are in compliance with these rules. The cost of failure will far outweigh the rather minimal cost of obtaining expert guidance.

If you have any questions regarding the impact of health care reform on employers, please feel free to call Eric Namee, Steven Smith, or Brad Schlozman at (316) 267-2000.

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