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Employer Penalty – Identifying Full-Time Employees

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Effective Jan. 1, 2014, the Affordable Care Act (ACA) imposes a penalty on large employers that do not offer minimum essential coverage to "substantially all" full-time employees and dependents. Large employers that do offer coverage may still be liable for a penalty if the coverage is unaffordable or does not provide minimum value.

On Jan. 2, 2013, the Internal Revenue Service (IRS) released long-awaited proposed regulations on ACA's employer penalty provisions. Although the proposed regulations are not final, employers may rely on them until further guidance is issued.

The proposed regulations provide guidance on an optional method for identifying full-time employees for purposes of determining and calculating an employer's potential liability for a shared responsibility payment.

LIABILITY FOR PENALTIES

ACA's employer penalty is referred to as the "employer shared responsibility payment." It requires large employers to either "play" by offering health coverage to their full-time employees and dependents that is affordable and provides minimum value or "pay" a substantial excise tax. The amount of the excise tax generally depends on whether or not an employer offers coverage to substantially all of its full-time employees and dependents.

- In 2014, the monthly penalty assessed on employers that do not offer coverage to substantially all of their full-time employees and dependents will be equal to the number of full-time employees (minus 30) multiplied by 1/12 of $2,000.
- In 2014, the monthly penalty assessed on employers that offer health coverage to at least 95 percent of their full-time employees and dependents will be 1/12 of $3,000 for each full-time employee who receives a premium tax credit or cost-sharing reduction under an exchange plan for any applicable month. However, the total penalty for the employer would be limited to the total number of the company's full-time employees (minus 30) multiplied by 1/12 of $2,000 for any applicable month. This penalty is triggered when a full-time employee is not offered coverage or when the coverage is unaffordable or does not provide minimum value.

A large employer is only liable for a shared responsibility payment under ACA if one or more of its full-time employees receive an applicable premium tax credit or cost-sharing reduction for coverage under a state-based insurance exchange.

WHO IS A FULL-TIME EMPLOYEE?

A full-time employee is an employee who was employed on average at least **30 hours of service per week.** The proposed regulations treat **130 hours of service in a calendar month** as the monthly equivalent of 30 hours per service per week.

To determine an employee's hours of service, an employer must count:

- Each hour for which the employee is paid, or entitled to payment, for the performance of duties for the employer; and
- Each hour for which an employee is paid, or entitled to payment, by the employer on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military leave or leave of absence.

OPTIONAL SAFE HARBOR METHOD

ACA suggests that the determination of full-time employee status, and application of the pay or play penalty, involves a month-to-month analysis. However, the IRS recognizes that applying these rules on a monthly basis could cause practical difficulties for employers, particularly with respect to employees with varying hours or employment schedules, and could result in employees moving in and out of employer coverage on a monthly basis.

To address these concerns, and to give employers flexible and workable options and greater predictability, the IRS proposed an optional look-back measurement method as an alternative to the month-to-month method for determining full-time employee status. This safe harbor method was described in previous IRS guidance, such as IRS Notice 2012-58. The proposed regulations incorporate this guidance, with some modifications.

This safe harbor method involves a ***measurement period*** for counting hours of service, a ***stability period*** when coverage may need to be provided depending on an employee's full-time status and an ***administrative period*** that allows time for enrollment and disenrollment. An employer has discretion in deciding how long these periods will last, subject to specified IRS parameters.

-*Ongoing Employees*

For ongoing employees, an employer determines each employee's full-time status by looking back at a ***measurement period*** lasting between ***3 to 12 consecutive calendar months***, as chosen by the employer, to determine whether the employee averaged at least 30 hours of service per week during this period. The measurement period selected by the employer is referred to as the standard measurement period. Employers may make certain adjustments to the beginning and end of the standard measurement period to accommodate weekly, bi-weekly or semi-monthly payroll periods.

If the employee was employed for at least 30 hours of service per week during the standard measurement period, he or she is considered a full-time employee for a set period into the future, known as the ***stability period.*** The stability period must be ***at least six calendar months following the measurement period and must be at least as long as the standard measurement period***. The employee would be treated as a full-time employee during the stability period, regardless of the hours worked during that period, as long as he or she remained employed.

If an employer determines that an employee did not work full-time during the standard measurement period, the employer may treat the employee as not a full-time employee during the stability period that follows (but is not longer than) the standard measurement period.

Because employers may need time between the measurement and stability periods to determine which ongoing employees are eligible for coverage and to notify and enroll employees, employers may use an ***administrative period*** between the standard measurement and stability periods. The administrative period following a standard measurement period can last up to ***90 days***. The administrative period must overlap with the prior stability period to prevent any gaps in coverage for employees enrolled in coverage because of their full-time status during a prior measurement period.

-New Employees Expected to Work Full Time

An employer will not be subject to a penalty for not offering coverage to new full-time employees during the first three calendar months of employment. This rule applies where an employee is reasonably expected at his or her start date to work full time and the employer sponsors a group health plan (that meets ACA's affordability and minimum value standards) and offers coverage to the employee at or before the conclusion of the employee's initial three calendar months of employment.

-New Variable Hour or Seasonal Employees

A new employee is a variable hour employee if, based on the facts and circumstances at the start date, it cannot be determined that the employee is reasonably expected to work on average at least 30 hours per week.

Through at least 2014, employers are permitted to use a reasonable, good faith interpretation of the term "seasonal employee."

If an employer maintains a group health plan that would offer coverage to an employee only if he or she is determined to have full-time status, the employer may use an ***initial measurement period*** lasting between ***3 and 12 months*** (the same as allowed for ongoing employees) to determine whether new variable hour or seasonal employees are full-time employees. The employer measures the hours of service completed by the new employee during the initial measurement period and determines whether the employee completed an average of 30 hours of service per week or more during this period. During this measurement period, the employer would not be subject to a shared responsibility penalty under ACA with respect to these employees.

The employer may also use an ***administrative period*** of up to ***90 days***. However, the initial measurement period and the administrative period combined cannot extend beyond the last day of the first calendar month beginning on or after the one-year anniversary of the employee's start date (totaling, at most, ***13 months*** and a fraction of a month).

As in the case of a standard measurement period for ongoing employees, if an employee is determined to be a ***full-time*** employee during the initial measurement period, the ***stability period*** must be a period of ***at least six consecutive calendar months that is no shorter in duration than the initial measurement period*** and that begins after the initial measurement period (and any associated administrative period).

If a new variable hour or seasonal employee is determined ***not to be a full-time*** employee during the initial measurement period, the employer may treat the employee as not a full-time employee during the stability period that follows the initial measurement period. This ***stability period must not be more than one month longer than the initial measurement period and must not exceed the remainder of the standard measurement period (plus any associated administrative period) in which the initial measurement period ends.***

-*Rehired Employees and Employees Returning from Leave*

The proposed regulations include guidance for employers on how to classify an employee who earns an hour or more of service after the employee terminates employment (or has a period of absence). If an employee goes at least 26 consecutive weeks without an hour of service and then earns an hour of service, he or she may be treated as a new employee for purposes of determining the employee's full-time status. The employer may apply a rule of parity for periods of less than 26 weeks. Under the rule of parity, an employee is treated as a new employee if the period with no credited hours of service is at least four weeks long and is longer than the employee's period of employment immediately before the period with no credited hours of service.

For an employee who is treated as a continuing employee, the measurement and stability periods that would have applied to the employee had he or she not experienced the break in service would continue to apply upon the employee's resumption of service.

-*Special Unpaid Leave - FMLA Leave, USERRA Leave and Jury Duty Leave*

The proposed regulations include a method for averaging hours when measurement periods include special unpaid leave – leave under the Family and Medical Leave Act (FMLA) or the Uniformed Services Employment and Reemployment Rights Act (USERRA) and leave for jury duty. This method only applies to an employee who is treated as a continuing employee upon resuming services for the employer, and not to an employee who is treated as terminated and rehired.

Under the averaging method, the employer either:

- Determines the average hours of service per week for the employee during the measurement period excluding the special unpaid leave period and uses that average as the average for the entire measurement period; or
- Treats employees as credited with hours of service for special unpaid leave at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not special unpaid leave.

-*2013 Transition Relief*

Employers that intend to utilize the look-back measurement method for determining full-time status for 2014 will need to begin their measurement periods in 2013 to have corresponding stability periods in 2014. The IRS recognizes that employers that intend to adopt a 12-month measurement period and a 12-month stability period will face time constraints.

Under the proposed regulations' transition relief, solely for purposes of ***stability periods beginning in 2014***, employers may adopt a transition measurement period that:

- Is shorter than 12 months, but not less than 6 months long; and
- Begins no later than July 1, 2013, and ends no earlier than 90 days before the first day of the first plan year beginning on or after Jan. 1, 2014.

For example, an employer with a calendar year plan could use a measurement period from April 15, 2013, through Oct. 14, 2013 (six months), followed by an administrative period ending on Dec. 31, 2013. An employer with a fiscal year plan beginning April 1 that also elected to implement a 90-day administrative period could use a measurement period from July 1, 2013, through Dec. 31, 2013 (six months), followed by an administrative period ending on March 31, 2014.

This Legislative Brief is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.