Proskauer

special report

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On January 2, 2013, the Department of Treasury and Internal Revenue Service (collectively "IRS") published proposed regulations ("Proposed Regulations") on the Affordable Care Act's employer shared responsibility provisions, also known as the "Play or Pay" mandate. Starting in 2014, the mandate requires large employers (generally those with 50 or more full-time employees, including full-time equivalent employees) to either "play" by offering affordable health coverage to their full-time employees and their dependents, or "pay" a penalty if the employer fails to provide affordable health coverage and at least one full-time employee receives a premium tax credit to help purchase coverage through an Affordable Insurance Exchange ("Exchange").

In general, there are two potential penalties (both non-deductible for tax purposes) that could be imposed on an employer for failure to satisfy the mandate. The first penalty, known as the "no coverage" penalty, is based on whether an employer fails to offer group health plan coverage to its full-time employees and their dependents. In this case, the annual penalty is $2,000 per full-time employee (minus 30 full-time employees) if at least one employee receives a premium tax credit for Exchange coverage. The second penalty, known as the "unaffordability" penalty, applies when an employer offers coverage that fails to meet certain affordability and minimum value requirements. In that case, the annual penalty is $3,000 for each full-time employee who receives a premium tax credit for Exchange coverage, but no more than what the "no coverage" penalty would be if it applied. The Proposed Regulations clarify that an applicable large employer may avoid the "no coverage" penalty by offering coverage to all but 5% of its full-time employees and their dependents. However, if any of the employees in the small group of full-time employees who are not offered coverage receives premium tax credits for Exchange coverage, the employer will be required to pay the "unaffordability" penalty for that employee.

The IRS also released a series of questions and answers providing additional guidance to employers. The Proposed Regulations and the questions and answers may be found here: http://www.irs.gov/pub/newsroom/reg-138006-12.pdf, and http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act.

The Proposed Regulations are complex and expansive, and contain some of the most significant guidance for employers under the Affordable Care Act to date. The Proposed Regulations clarify various issues related to the implementation of the mandate, such as

how the rules apply to entities treated as a single employer under section 414(b), (c), (m), or (o) of the Internal Revenue Code (a “controlled group"), as well as provide transition relief in several areas, including relief for non-calendar year plans and small employers that may be on the cusp of the 50 full-time employee threshold. Employers may rely on the Proposed Regulations until final regulations are released.

Interested parties should consider filing comments on the Proposed Regulations. Comments are due March 18, 2013 and a hearing is scheduled for April 23, 2013. Final guidance is expected shortly thereafter.

Executive Summary

The Proposed Regulations cover the relevant issues by addressing three basic topics:

- **Applicable Large Employers**. The Proposed Regulations define which employers are applicable large employers, and therefore subject to the rules. Generally, these are employers that employ 50 or more full-time employees, including full-time equivalent employees. Therefore, the Proposed Regulations explain the rules for identifying full-time employees and full-time equivalent employees.

- **Full-Time Employees**. An employer is potentially subject to a penalty only with respect to its "full-time employees," which do not include full-time equivalents (such as part-time employees). Therefore, the Proposed Regulations include detailed rules to help employers make these judgments.

- **Shared Responsibility Payments**. The Proposed Regulations explain how to calculate any penalties and the circumstances under which they are imposed. The Proposed Regulations also explain how penalties are assessed and collected by the Internal Revenue Service.

In general, the type of employer that should be most concerned with the possibility of a Play or Pay penalty is one with employees who are considered full-time under the mandate (using a 30 hour per week or 130 hour per month standard), but are not offered employer-sponsored health coverage, or are offered coverage that is either unaffordable or does not provide minimum value. An employer in this position should use 2013 to identify which of its employees will be full-time and eligible for a federal premium credit (based on household income) on January 1, 2014, and whether to offer those employees affordable health coverage or risk becoming liable for a penalty.

Below we summarize the relevant rules and suggest steps employers should consider while preparing for 2014 and beyond.

Identifying Those Employers Subject to the Play or Pay Mandate

The starting point for understanding the Play or Pay mandate is to understand which employers are potentially liable for a penalty. The Proposed Regulations refer to these employers as "applicable large employers."

Applicable Large Employer

An employer is an applicable large employer for a calendar year if it employed an average of at least 50 full-time employees on the employer's business days during the preceding calendar year. Solely for purposes of determining applicable large employer status (but not for penalty purposes), the hours of service of full-time equivalent employees (e.g., part-time employees) are included in the calculation.

> **Example:** During each month of 2013, an employer has 20 full-time employees, each of whom averages 35 hours of service per week, and 40 part-time employees, each of whom averages 90 hours of service per month. In this example, each of the 20 employees who average 35 hours of service per week count as one full-time employee for each month. To determine the average number of full-time equivalent employees for each month, take the total hours of service of the part-time employees (up to 120 hours of service per employee) and divide by 120. The result is that the employer has 30 full-time equivalent employees each month (40 × 90 ÷ 120 = 30). By adding the two categories of employees together, the employer would have 50 full-time and full-time equivalent employees. Therefore, the employer is an applicable large employer for 2014.

The Play or Pay mandate applies to all common law employers, including tax exempt entities and government entities (such as Federal, State, local or Indian tribal government entities). However, for purposes of determining applicable large employer status, and for penalty purposes, hours worked outside of the United States are disregarded, provided that the associated compensation constitutes foreign source income.

> **Treatment of Employees in U.S. Territories:** The Secretary of Health and Human Services provided guidance on various issues concerning employees in the U.S. territories (Puerto Rico, American Samoa, Guam, Northern Mariana Island, and U.S. Virgin Islands) in a letter to governors on December 10, 2012.
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> In the letter, HHS recognizes that although the Act's insurance market reforms (e.g., coverage for adult children, elimination of lifetime limits, and essential health benefits) generally apply to the territories, certain tax provisions (including premium tax credits and the Play or Pay mandate) do not automatically apply to the territories. The letter provides guidance on these and other issues, although each territory's tax code must be analyzed to determine which of the Affordable Care Act's tax provisions may apply.
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> **Relief for Employers Close to the 50 Full-Time Employee Threshold in 2013:** An employer may determine whether it is an applicable large employer for 2014 by determining whether it employed an average of at least 50 full-time employees on its business days during any consecutive six-month period in 2013.
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> For example, an employer could use the period from March through August, 2013 to determine its applicable large employer status and, if it is an applicable large employer, use the period from September through December, 2013 to make any needed adjustments to its plan (or to establish a plan) in order to comply with the Play or Pay mandate.

Limited Exception for Seasonal Employees

Seasonal employees' hours are included when determining applicable large employer status; however, an employer will not be an applicable large employer if it employed 50 or more full-time employees for no more than 120 days in the preceding calendar year, and the employees causing it to reach or exceed the 50 full-time employee threshold were seasonal employees employed no more than 120 days during the preceding calendar year. For these purposes, four calendar months may be treated as the equivalent of 120 days. The four calendar months and the 120 days are not required to be consecutive. Until further guidance is issued, an employer may use a reasonable, good faith interpretation of existing U.S. Department of Labor guidance on the definition of seasonal employees.

> **Example:** An employer employs 40 full-time employees for all of 2013. In addition, the employer also has 80 seasonal full-time employees who work from September through December 2013. The employer has 40 full-time employees during each of eight calendar months of 2013, and 120 full-time employees during each of four calendar months of 2013, resulting in an average of 66 full-time employees (rounding fractions down). However, the employer's workforce equaled or exceeded 50 full-time employees (including seasonal workers) for no more than four calendar months in 2013, and the number of full-time employees would be less than 50 during those months if seasonal workers were disregarded. Accordingly, the employer is not an applicable large employer for 2014.

Controlled Groups

For purposes of determining applicable large employer status, all members of a tax controlled group are treated as a single employer. However, each member of a controlled group is treated as a separate entity for purposes of determining the liability for, or amount of, a penalty.

> **Example:** For 2013 and 2014, corporation P owns 100 percent of all classes of stock of corporations S and T. For every calendar month in 2013, P has 10 full-time employees, S has 40 full-time employees and T has 60 full-time employees. P, S, and T are a controlled group of corporations. Because P, S and T have a combined total of 110 full-time employees during 2013, they are each potentially liable for a Play or Pay penalty in 2014.
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> For 2014, S offers coverage to its full-time employees, whereas P and T do not. P has 3 full-time employees who receive a premium tax credit to pay for the cost of the employee's coverage purchased through an Exchange. P's penalty is based on P's full-time employees. P's employee's receipt of a premium tax credit does not trigger a penalty on T with respect to T's full-time employees.
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> Other rules regarding application of the penalty to controlled groups are discussed below.

Successor Employers

The Proposed Regulations provide that for purposes of determining applicable large employer status an employer includes a predecessor employer; however, the Proposed Regulations do not address the specific rules for identifying a predecessor employer, or the corresponding successor employer. Until further guidance is issued, employers may rely upon a reasonable, good faith interpretation of existing IRS guidance on predecessor (and successor) employers for purposes of determining applicable large employer status. The guidance also clarifies that for purposes of assessment and collection of a Play or Pay penalty (but not for determining applicable large employer status), State law may provide for liability of a successor employer for a penalty which has been, or could have been, imposed on a predecessor employer. In that case, the liability could be assessed, paid, and collected from the successor employer in accordance with IRS rules on transferred assets.

> **Successor Liability in Corporate Transactions:** Under the Proposed Regulations, liability for a penalty is determined after the end of each calendar year. Therefore, an employer should consider the possibility of post-closing liability in any transaction, and ensure that the transaction document contains the appropriate representations and allocates responsibility for any Play or Pay penalties accordingly.

New Employers

The Proposed Regulations provide that an employer not in existence during an entire preceding calendar year is an applicable large employer for the current calendar year if it is reasonably expected to employ an average of at least 50 full-time employees (taking into account the hours of part-time employees) on its business days during the current calendar year.

> **Example:** On January 1, 2013, Corporation B has three employees. However, its owners purchased a factory intended to open later that year that will employ approximately 100 employees. By March 15, 2013, Corporation B has more than 75 full-time employees. Because Corporation B can reasonably be expected to employ on average at least 50 full-time employees on business days during 2013, and actually employs an average of at least 50 full-time employees on its business days during 2013, Corporation B is an applicable large employer.

Identifying Employees who are Full-Time under the Play or Pay Mandate

Once it is clear that an employer is an applicable large employer, the employer must identify those full-time employees whose coverage (or lack of coverage) would trigger a possible penalty. For this purpose, full-time employee equivalents are not counted. Penalties are applied only with respect to actual full-time employees. "Employee" is defined by the common law standard and, as such, certain individuals such as "leased employees" are excluded. Also, penalties apply on a monthly basis which, technically, requires employers to identify full-time employees for each month. Because this can be a very cumbersome and burdensome process, the Proposed Regulations use special rules to identify full-time employees. These rules are different from the rules for determining whether an employer is an applicable large employer.

Hours of Service Rules

Under the mandate, a full-time employee is an employee who is employed on average at least 30 hours of service per week or 130 hours per month. Hours of service include paid time off due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. An employee's hours worked outside of the United States are disregarded, provided that the compensation for those hours of service constitutes foreign source income.

With respect to part-time employees whose hours are not tracked, the Proposed Regulations require an employer to use one of two available "equivalency methods" to estimate an employee's hours of service. Under the equivalency methods, an employer may either credit 8 hours of service per day if an employee works at least one hour, or credit 40 hours of service per week if an employee works at least 1 hour per week, provided that the hours credited generally reflect the actual hours worked. However, the Proposed Regulations prohibit use of the days-worked or weeks-worked equivalency methods if the result would be to substantially understate an employee's hours of service in a manner that would cause that employee not to be treated as a full-time employee. For example, an employee who worked 12 hours per day for 3 days one week could be credited with 40 hours that week, but could not be credited with only 8 hours of service per day under an equivalency method (because that would make it look like the employee only worked 24 hours during that week).

As discussed below, these credited hours will be averaged to determine whether the employee works (or is credited with) an average of at least 30 hours of service per week during a "look-back measurement period."

Adjunct Faculty, Commissioned Employees

Employers with adjunct faculty members, employees paid on commission, and analogous employment positions must use a reasonable method for crediting hours of service. For example, with respect to an adjunct faculty member, a reasonable method might take into account hours that are necessary to perform the employee's duties, such as class preparation time.

Look-Back Measurement Method for Identifying Full-Time Employees

To assist employers in identifying full-time employees and to ease the difficulties on employers, employees and the Exchanges that would be created by determining eligibility for coverage on a monthly basis, the Proposed Regulations provide an optional look-back measurement method so that an employer can assess its potential for liability under the mandate. Under the look-back measurement method, there is an "initial" measurement period for new employees and a "standard" measurement period for "ongoing employees." Ongoing employees are employees who have worked for the employer for at least one "standard" measurement period (defined below).

> **Transition Relief for Employees Enrolling in Exchange Coverage:** The Proposed Regulations permit an employer to amend its cafeteria plan to allow a one-time change to a cafeteria plan election for employees who opt for Exchange coverage during 2014.

1. Ongoing Employees

For ongoing employees, consistent with prior IRS guidance, the Proposed Regulations provide that an employer may determine whether an employee worked an average of at least 30 hours of service per week by looking back at a defined period of 3 to 12 consecutive calendar months, as chosen by the employer (the "standard measurement period"). If an employee is determined to work full-time during a standard measurement period, then the employee is treated as full-time during the "standard stability period" so long as he remains employed during that period and regardless of the hours actually worked. In general, the standard stability period must be the longer of six months following the standard measurement period or the number of months in the measurement period (taking into account any applicable "administrative period" as discussed below).

Employers have flexibility when choosing the measurement, stability and administrative periods for ongoing employees, provided that the determination is made on a uniform and consistent basis for all employees in the same category. For these purposes, the four permissible categories are: collectively bargained employees and non-collectively bargained employees; each group of collectively bargained employees covered by a separate collective bargaining agreement; salaried employees and hourly employees; and employees whose primary place of employment are in different States.

> **Example:** An employer uses a calendar year standard stability period and a 12-month standard measurement period that begins each October 15, so that it can use an administrative period from October 15 through December 31 of each year to determine which employees worked full-time during the measurement period. The plan's eligibility provisions require employees to work on average at least 30 hours per week during the standard measurement period to be eligible for coverage during the standard stability period. As of January 1, 2014, Employee A and Employee B have been employed by their employer for several years. Employee A worked full-time during the October 15, 2012 – October 14, 2013 standard measurement period. Employee B did not work full-time during that same period.
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> In this example, Employee A and Employee B are ongoing employees with respect to the calendar year 2014 stability period because they were employed during the entirety of the standard measurement period. Employee A is eligible for coverage for the entire 2014 stability period because he worked full-time during the measurement period. However, Employee B is not required to be offered coverage in 2014 (including the October 15, 2014 – December 31, 2014 administrative period, because Employee B did not work full-time during the measurement period.

2. Administrative Period for Ongoing Employees

An administrative period is available to accommodate employers that might need some time between the standard measurement period and the standard stability period in order to determine which employees are eligible for coverage and for other administrative purposes. The administrative safe harbor is a period of not more than 90 days between the end of the standard measurement period and the start of the standard stability period and may neither reduce nor lengthen the measurement period or the stability period.

To prevent an administrative period from creating a potential gap in coverage, it must overlap with the prior stability period, so that ongoing full-time employees will continue to be offered coverage during the administrative period. For example, an employee entitled to coverage for a stability period that is calendar year 2014 will be covered during any administrative period in 2014 (see Employee A in the example above – he is covered during the administrative period from October 15, 2014 through December 31, 2014, because he is a full-time employee for purposes of the 2014 calendar year stability period).

3. New Full-Time Employees

If a new employee is reasonably expected to work full-time at date of hire and is not a seasonal employee, then at least for the first three months following an employee's date of hire, an employer will not be liable for a penalty solely by reason of failing to offer coverage to the employee during that three-month period. This coordinates with the Act's rule limiting waiting periods to no greater than 90 days starting in 2014.

> **Coordination with 90-day limit on waiting periods:** For plan years starting in 2014, a group health plan may not apply a waiting period greater than 90 days once the employee meets the plan's substantive eligibility conditions (such as being in an eligible job classification or achieving job-related licensure requirements specified in the plan's terms).

If, based on the facts and circumstances at time of hire, it cannot be determined that an employee is reasonably expected to work on average at least 30 hours per week, the employee is a variable hour employee. A new employee who is expected to work full-time initially may be a variable hour employee if, based on the facts and circumstances, the period of full-time employment is reasonably expected to be of limited duration and it cannot be determined that the employee is reasonably expected to work full-time on average over the initial measurement period.

For example, a variable hour employee would include a retail worker hired full-time for the holiday season who is reasonably expected to continue working after the holiday season but is not reasonably expected to work full-time for the portion of the initial measurement period remaining after the holiday season, so that it cannot be determined at the time of hire that the employee is reasonably expected to work full-time during the initial measurement period.

> **Transition Relief for High Turnover Employees:** Until January 1, 2015, an employer may rely on a reasonable expectation that the duration of an employee's employment will be limited and not result in the employee working on average at least 30 hours per week during the initial measurement period. Starting January 1, 2015, and except in the case of seasonal employees, employers must assume that although an employee's hours of service might be expected to vary, the employee will continue to be employed for the entire initial measurement period. Despite this transition relief, the status of any individual employee as a variable hour employee cannot be based on employer expectations regarding aggregate turnover. Rather, the facts and circumstances must indicate that the individual employee's employment is reasonably expected to be of limited duration within the initial measurement period.

4. New Variable Hour and Seasonal Employees

If an employer uses the optional look-back measurement method for its ongoing employees, it may also do so for its new variable hour and seasonal employees in a manner consistent with the rules for ongoing employees. However, the initial measurement and administrative periods combined may not extend beyond the end of the month beginning on or after the employee's one-year anniversary (totaling, at most, 13 months and a fraction of a month). To accommodate employers that may wish to use a 12-month stability period for new variable hour and seasonal employees and an administrative period that exceeds one month, an employer is permitted to use an 11-month measurement period (in lieu of the 12-month measurement period that would ordinarily be required) and still comply with the general rule that the initial measurement period and administrative period combined may not extend beyond the last day of the first month beginning on or after the employee's one-year anniversary.

An employer that complies with these rules will be able to determine when a new variable hour or seasonal employee will be considered full-time under the mandate, and decide whether to offer the employee coverage before the employee will potentially become eligible for a premium tax credit, thereby avoiding a potential penalty with respect to the employee.

5. Administrative Period for New Variable Hour and Seasonal Employees

As is permitted for ongoing employees, an employer may use an administrative period before the start of the initial stability period following an employee's initial measurement period. The administrative period must not exceed 90 days in total, and includes all periods between the new employee's date of hire and the employee's eligibility date, other than the initial measurement period. Thus, for example, if the employer begins the initial measurement period on the first day of the month following a new variable hour or seasonal employee's date of hire, the period between the employee's start date and the first day of the next month must be taken into account in applying the 90-day limit on the administrative period. Similarly, if there is a period between the end of the initial measurement period and the date the employee is first offered coverage under the plan, that period must be taken into account in applying the 90-day limit on the administrative period.

In addition, the initial measurement period and administrative period together cannot extend beyond the last day of the first calendar month beginning on or after the first anniversary of the employee's date of hire. For example, if an employer uses a 12-month initial measurement period for a new variable hour employee, and begins that initial measurement period on the first day of the first calendar month following the employee's start date, the period between the end of the initial measurement period and the offer of coverage must not exceed one month (assuming the variable hour employee works full-time during the initial measurement period).

6. Special Rules for Initial Stability Periods

An employee determined to work full-time during the initial measurement period must be treated as a full-time employee for the entire initial stability period, even if the employee is determined to be a part-time employee during the following standard measurement period. In that case, the employer may treat the employee as a part-time employee only after the end of the initial stability period. In other words, an employer must continue to offer coverage to an employee during the employee's initial stability period, even if the

initial stability period overlaps with a standard stability period during which the employee would not be considered full-time.

> **Example:** An employer uses a 12-month initial measurement period for an employee hired July 1, 2013. If the employer's standard measurement period operates on a calendar year basis, the employee's first standard measurement period starts January 1, 2014. The employee works an average of at least 30 hours per week during the initial measurement period, but not during the standard measurement period. Based on the initial measurement period, the employee is eligible for coverage from July 1, 2014 through June 30, 2015, even though the calendar year 2014 standard measurement period indicates that the employer would not have to offer coverage at any time during 2015.

> **Transition Relief for Stability Periods Starting in 2014:** Because the Play or Pay mandate is effective for months beginning after December 31, 2013, an employer that intends to adopt a 12-month measurement period, and in turn a 12-month stability period, will face time constraints in doing so. Therefore, for stability periods beginning in 2014, the IRS will permit (but not require) employers to adopt a transition measurement period that is between 6-12 months long, begins no later than July 1, 2013, and ends no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2014.
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> For example, an employer with a calendar year plan could use a measurement period from April 15, 2013 through October 14, 2013 (six months), followed by an administrative period ending on December 31, 2013.

7. Changes in Employment Status

The Proposed Regulations address the treatment of new variable or seasonal employees who have a change in employment status during the initial measurement period (e.g., a promotion into a position in which employees are reasonably expected to be employed on average 30 hours of service per week). A new variable hour or seasonal employee who has a change in employment status during an initial measurement period is generally treated as a full-time employee as of the first day of the fourth month following the change in employment status (or by the start of the initial stability period, if sooner and the employee worked full-time during the initial measurement period).

The change in employment status rule only applies to new variable hour and seasonal employees. A change in employment status for an ongoing employee does not change the employee's status as a full-time employee or non full-time employee during the stability period.

Rehired Employees or Employees Returning From a Leave of Absence

The IRS recognizes that an employee might work for the same employer on and off during different periods (e.g., due to unpaid leaves of absence, or when an employee is terminated and later rehired). The Proposed Regulations permit an employer to treat a returning employee as a new employee if the employee returns to work after a period of at least 26 consecutive weeks where no hours of service were credited.

Alternatively, if the period with no credited hours of service is between 4 and 26 weeks and is longer than the employee's term of employment, an employer may treat a returning employee as a new employee. For example, if an employee works three weeks, terminates employment, and is rehired by that employer ten weeks after terminating employment, the rehired employee is treated as a new employee because the ten-week period with no credited hours of service is longer than the immediately preceding three-week period of employment.

An employee treated as a continuing employee (as opposed to an employee who is treated as terminated and rehired), will return to the measurement and stability period that would have applied had the employee not experienced the period of leave. An employee who returns to work during a stability period where the employee would be treated as a full-time employee must be offered coverage upon resumption of services, or, if later, as soon as administratively practicable.

Special Unpaid Leave

For periods of unpaid leave subject to FMLA or USERRA, and for unpaid leave on account of jury duty ("special unpaid leave"), the Proposed Regulations require an employer to determine the average hours of service per week for the employee during the applicable measurement period excluding special unpaid leave period and use that average as the average for the entire measurement period.

Alternatively, the employer may choose to treat 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.

Employees of Educational Institutions

Additional requirements apply to employment break periods for employees of an educational organization. For this purpose, an employment break period is a period of at least four consecutive weeks (disregarding special unpaid leave) during which an employee is not credited with an hour of service.

The Proposed Regulations require applicable large employers that are educational organizations to treat employment break periods related to non-working weeks or months under the academic calendar as periods of special unpaid leave, as described above. Accordingly, an educational organization must either determine the average hours of service per week for the employee during the measurement period excluding the employment break period and use that average as the average for the entire measurement period, or treat employees as credited with hours of service for the employment break period 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 part of an employment break period. In no event must an educational organization credit an employee with more than 501 hours of service in any calendar year for any employment break period (disregarding any periods of special unpaid leave subject to FMLA or USERRA, or on account of jury duty).

The Proposed Regulations contain anti-abuse rules designed to prevent the application of this rule (e.g., an employee's hours of service during an employment break period are disregarded if they would prevent an employee from otherwise being treated as a full-time employee in accordance with the rules for employees of educational institutions).

Temporary Staffing Agencies

The Proposed Regulations do not provide specific relief for temporary staffing agencies, which may face difficulty determining full-time employee status due to the nature of their employees' work schedules. The regulators recognize that although many employees of temporary staffing agencies will likely be variable hour employees, such employees are not inherently variable hour employees (e.g., highly-skilled technical or professional workers on long term assignments). It is anticipated that the rules discussed above regarding unpaid leaves of absence will resolve some issues. Additionally, the preamble to the Proposed Regulations specifically noted that the IRS is aware of "various structures" being considered under which employers might use temporary staffing agencies (or other staffing agencies) purporting to be the common law employer to evade application of the shared responsibility payment provisions. Therefore, it is anticipated that the final regulations will contain a specific anti-abuse rule to address these potential situations.

Multiemployer Plans

The IRS declined to provide any blanket exclusions in the Proposed Regulations for employees covered under a multiemployer plan that is maintained pursuant to a collective bargaining agreement. Instead, the Proposed Regulations offer transition relief while the IRS continues to seek comments on the application of the mandate to employers participating in multiemployer plans.

> **Transition Relief for Multiemployer Plans:** Through 2014, employers that make contributions pursuant to a multiemployer plan pursuant to a collective bargaining agreement under which coverage is offered to full-time employees and their dependents are not liable for a penalty if the coverage satisfies the affordability and minimum coverage requirements.

Identifying an Employer's Liability for Shared Responsibility Payments

Effective for months starting after December 31, 2013, an applicable large employer may be liable for a non-deductible excise tax penalty if it fails to satisfy either the Coverage Test or the Affordability Test.

- **Coverage Test.** An employer will fail this test if it does not offer "minimum essential coverage under an eligible employer sponsored plan" to at least 95 percent of its full-time employees and their dependents, and at least one full-time employee receives a premium tax credit. For smaller employers (less than 100 full-time employees), an offer of coverage to all but 5 or fewer full-time employees and their dependents will suffice.

- **Affordability Test.** An employer that offers "minimum essential coverage under an eligible employer sponsored plan" to all full-time employees (or to at least 95 percent of its full-time employees and their dependents), but has at least one full-time employee who receives a premium tax credit because coverage was not offered to that employee or the coverage offered was not "affordable" or did not provide "minimum value."

- "Minimum essential coverage under an eligible employer sponsored plan" includes coverage offered under any self-insured group health plan, and any health insurance coverage offered by an employer to an employee that is offered in the small or large group market (excluding limited scope dental or vision benefits offered under a separate insurance contract), regardless of whether the coverage offered is affordable to the employee or provides minimum value.

- Coverage is "affordable" if the employee's required contribution for self-only coverage does not exceed 9.5 percent of the employee's household income for the year (see below for several alternatives available to employers other than household income, one of which permits an employer to substitute an employee's annual wages, as reported in Box 1 of Form W-2, in lieu of household income).

- A health plan provides "minimum value" if its share of the total allowed costs of benefits provided under the plan is at least 60 percent of those costs. Employer contributions to an HSA and amounts newly made available under an HRA may be taken into account in determining minimum value.

- "Dependent" means an employee's child under age 26, and includes natural, adopted, foster, and step-children. Spouses are excluded from the definition of dependent, and a spouse's or a child's receipt of a premium tax credit cannot trigger a penalty on an employer.

Transition Relief for Dependent Coverage: An employer that takes steps during its 2014 plan year toward complying with the requirement to offer dependent coverage will not be subject to a penalty solely on account of failing to offer dependent coverage. For plan years starting in 2015, an employer must offer coverage to its full-time employees and their children up to age 26 to satisfy the Coverage and Affordability tests.

NOTE: Employers are not required to offer spousal coverage, and the receipt of a premium tax credit by an employee's spouse or dependent will not result in a penalty.

Transition Relief for Non-Calendar Year Plans: The Proposed Regulations offer relief to non-calendar year plans that were in place on December 27, 2012, indicating that the Play or Pay mandate will be effective for plan years beginning on or after January 1, 2014. To qualify, the plan must have been offered to at least one third of employees (full-time and part-time) at the most recent open enrollment (or any date between October 31-December 31, 2012) or cover at least 25 percent of employees, and the employer must offer affordable coverage that provides minimum value to full-time employees starting with the 2014 plan year.

Penalty Amounts

The annual penalty for failing the Coverage Test is equal to the number of full-time employees (minus 30 full-time employees) multiplied by $2,000, if at least one full-time employee receives a premium tax credit. The annual penalty for failing the Affordability

Test is equal to the number of full-time employees who receive a premium tax credit multiplied by $3,000. The penalty for failing the Affordability Test cannot exceed the penalty for failing the Coverage Test – in other words, the payment for an employer that offers coverage can never exceed the payment that employer would owe if it did not offer any coverage. Penalties are calculated on a monthly basis, and will be indexed for inflation after 2014.

Annual Open Enrollment Requirement

To avoid potential penalties, an employer must permit employees to enroll (or decline coverage) at least once each plan year. In addition, an employer may not render an employee ineligible for a premium tax credit by requiring employees to enroll in unaffordable coverage. However, an employer will not be treated as failing to offer coverage if that coverage is terminated due to the employee's failing to make a timely payment of the employee portion of the premium. For this purpose, the Proposed Regulations incorporate certain of the COBRA rules regarding when premium payments are timely made.

Controlled Groups

The 30 full-time employee reduction under the Coverage Test is allocated across each member company (*i.e.*, on an EIN-by-EIN basis) based on size.

> **Example:** Employers A and B are members of the same tax controlled group. Employer A employs 40 full-time employees each month of 2015. Employer B employs 35 full-time employees in each month in 2015. Employer A does not offer any group health plan coverage and becomes liable for a penalty due to a full-time employee receiving a premium tax credit. Employer B complies with the Play or Pay mandate. In this example, Employer A is subject to a penalty of $48,000, which is equal to 24 × $2,000 (40 full-time employees reduced by 16 (its allocable share of the 30-employee offset ((40 ÷ 75) × 30 = 16)) and then multiplied by $2,000).

Under the Affordability Test, if an employee is employed by more than one member of a controlled group during a calendar month, the liability for the penalty is allocated among the different members in accordance with the number of hours of service the employee had from each such member for that calendar month.

Affordability Safe Harbors

An employer that complies with the Coverage Test and the minimum value portion of the Affordability Test may use one or more of the following safe harbor alternatives in lieu of household income when assessing whether coverage is affordable.

1. Form W-2 Safe Harbor

Coverage is affordable under the W-2 safe harbor if an employee's required contribution for self-only coverage (excluding COBRA coverage) does not exceed 9.5 percent of the employee's Form W-2 wages (as reported in Box 1). Application of this safe harbor is determined after the end of the calendar year and on an employee-by-employee basis, taking into account the Form W-2 wages and the required employee contribution for that year.

To qualify for the W-2 safe harbor, the employee's required contribution must remain a consistent amount or percentage during the year, meaning that an employer is not permitted to make discretionary adjustments to the required employee contribution for a pay period. However, an employer may require a contribution that is based on a consistent percentage of all Form W-2 wages and subject to a dollar limit specified by the employer (e.g., an employer may set the contribution for self-only coverage at 9.5 percent of wages up to $100). The W-2 safe harbor is prorated for partial periods of coverage.

2. Rate of Pay Safe Harbor

Coverage is affordable under the rate of pay safe harbor if an employee's required monthly contribution for self-only coverage does not exceed 9.5 percent of an amount equal to 130 hours multiplied by the employee's hourly rate of pay. For salaried employees, monthly salary is used instead of 130 multiplied by the hourly rate of pay.

3. Federal Poverty Line Safe Harbor

Coverage is affordable under the Federal poverty line safe harbor if the employee's required monthly contribution for self-only coverage does not exceed 9.5 percent of a monthly amount determined as the Federal poverty line for a single individual for the applicable calendar year, divided by 12. For this purpose, the applicable Federal poverty line is the Federal poverty line for the State in which the employee is employed.

COBRA Qualified Beneficiaries

Under the Proposed Regulations, a failure to offer COBRA coverage could potentially trigger a penalty on an employer under the Coverage Test or the Affordability Test (in addition to any COBRA excise tax penalty for the failure). Although a failure to offer COBRA coverage in one instance may not trigger a penalty under the Coverage Test if the employer otherwise offers coverage to at least 95 percent of full-time employees, a penalty under the Affordability Test could apply if the qualified beneficiary is not offered coverage or it is unaffordable.

The safe harbor tests appear to solve most issues involving COBRA continuation, such that periods during which an active employee is a COBRA qualified beneficiary (e.g., due to a reduction in hours) and is required to pay the full COBRA premium (102% of the full cost of coverage) will not trigger a penalty under the Affordability Test; however, the Proposed Regulations are not entirely clear on this point. Hopefully, further guidance will help clarify this issue.

Employer Reporting Obligation

The IRS will contact employers after the end of each calendar year to inform them of their potential liability and provide an opportunity for a response. Starting in 2015 (for coverage offered on or after January 1, 2014), employers will be required to file information returns identifying their full-time employees and describing the coverage offered, if any.

Next Steps

Employers should focus now on preparing for 2014 and beyond. Below are some key decision points and possible strategies that employers may want to consider as they prepare for the Play or Pay mandate.

- Is my company an "applicable large employer"? What can I do now to fit within the exemption?
    - Employers should review their workforce to identify all full-time employees (i.e., those working 30 hours per week or 130 hours per month).
    - For employers with variable hour or seasonal employees, consider using the safe-harbor methods for counting full-time employees established by the Proposed Rules.
    - Employers with workforces that are hovering around the 50 full-time employee threshold may want to consider restructuring their workforce or downsizing so they do not exceed the "applicable large employer" threshold.
- Should I Play or Pay?
    - Identify your Full-Time Employees. Employers should evaluate the cost of "playing" versus "paying" and whether to use a combination of strategies for different groups of full-time employees and their dependents. Be sure to consider tax implications as well as employee relations and labor issues in connection with any decision.
        - In considering whether to play or pay, employers should determine whether they meet the "all or substantially all" coverage test (i.e., whether coverage is offered to at least 95% of all full-time employees).
        - Employers should review all eligibility exclusions for employees working in excess of 30 hours and consider amending plan eligibility rules to extend coverage to all employees working 30 hours or more per week so as to avoid the "no coverage" penalty.
        - Employers that currently do not offer dependent health coverage should take steps in 2014 toward doing so if they wish to avoid potential penalties.
    - Start Strategizing.
        - Employers should evaluate their group health plans to determine whether their current health arrangements provide minimum value and the level of employee premium contributions are “affordable.”
        - In lieu of drastic eligibility coverage changes, employers may want to consider restructuring their workforce by hiring more part-time employees because part-time employees (so long as they work less than 30 hours per week) are not included in the penalty equation.

- Of course, there are a number of labor, employment, benefits and other legal and business issues aside from health care reform that need to be considered before engaging in any workforce realignment.

Please contact your Proskauer lawyer or any member of our Health Care Reform Task Force should you have questions regarding the above or would like assistance in preparing comments to submit on the Proposed Regulations.

Please feel free to contact your regular Proskauer lawyer or any member of our Health Care Reform Task Force if you have any questions or need any assistance in evaluating these important new proposed regulations. In addition, if you have any questions regarding the matters discussed in this report, please contact any of the lawyers listed below:

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