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Labor and Employment Alert: Employer Pay or Play Penalties in 2015

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Summary

The employer pay or play penalties were originally scheduled to apply in 2014 but the IRS gave employers a one-year reprieve. Final regulations and FAQs published February 10, 2014 explain how the penalties will work in 2015 and provide several helpful transitional rules.

Is your company an applicable large employer?

The pay or play penalties only apply to "applicable large employers." An "applicable large employer" is an employer with at least 50 full-time and full-time equivalent employees in the preceding calendar year. In determining "applicable large employer" status, you must aggregate employees of entities in: (a) a controlled group of corporations; (b) trades or businesses under common control; and (c) an affiliated service group. If you have a question as to whether your business is an applicable large employer (i.e., will be subject to the pay or play penalties in 2015), please let us know. If you are an applicable large employer and you don't have a compliance strategy, you could inadvertently trigger costly penalties.

Applicable large employer transitional rules

- In 2015, the threshold for applicable large employer status is 100 (rather than 50) full-time and full-time equivalent employees, provided that:
  - The employer doesn't reduce its workforce or overall number of hours simply to avoid application of the penalties; and
  - The employer does not eliminate or materially reduce any health benefits in effect on February 9, 2014.

  There will be a process (not yet published) for an employer to certify that it meets these conditions. If it does, an employer with fewer than 100 employees will not be subject to the pay or play penalties in 2015 but it will still need to report information about full-time employees and plan coverage to the IRS and the employees. Caution: Remember that employees of all affiliated entities are included in the count.

- For purposes of determining applicable large employer status in 2015, you have the option to count employees over a period of at least six consecutive months (rather than the entire year of 2014).

What are the pay or play penalties?

Although employees of all affiliated entities are included in the count for purposes of determining applicable large employer status, penalties apply separately to each entity (called a "member") in the affiliated group. An applicable large employer member will be subject to two types of pay or play penalties starting in 2015, the no-offer penalty and the unaffordable/inadequate coverage penalty.

No-offer penalty

The no-offer penalty is imposed when an applicable large employer member fails to offer health coverage to substantially all of its full-time employees (and their children) and one or more of its full-time employees buys health insurance on an exchange with premium assistance. On an annual basis, the no-offer penalty equals $2,000 times [the number of full-time employees employed by the member minus the member's ratable share of 30].

No-offer penalty transitional rules

- In 2015, an applicable large employer member will be deemed to have offered health coverage to substantially all of its full-time employees (and will avoid the no-offer penalty) if it offers health coverage to at least 70% of its full-time employees. After 2015, the applicable large employer member would have to offer coverage to at least 95% of its full-time employees in order to avoid the no-offer penalty.

  For example, in order for an applicable large employer member with 200 full-time employees to avoid the no-offer penalty, it would have to offer health coverage to at least 140 full-time employees (70% of 200) in 2015 and 190 full-time employees (95% of 200) in 2016.

- In 2015, you substitute 80 for 30 in the no-offer penalty calculation. That can reduce the no-offer penalty by up to $100,000 ($2,000 x 50).

The children to whom coverage must be offered are an employee's children by birth, adoption and placement for adoption – and the coverage must be available through the last day of the month of a child's 26th birthday. (If you currently end a child's coverage on the child's 26th birthday, a transitional rule may give you until 2016 to amend your plan to extend coverage to the last day of the month.) Although most employers offer health coverage to employees' stepchildren, you won't be subject to the no-offer penalty for failing to offer coverage to employees' stepchildren. The IRS listened to comments and decided that you also do not have to offer coverage to foster children.

Unaffordable/inadequate coverage penalty

The unaffordable/inadequate coverage penalty is imposed when an applicable large employer member offers medical coverage that is unaffordable or inadequate (i.e., doesn't provide minimum value) and one or more of its full-time employees buys health insurance on an exchange with premium assistance. On an annual basis, the unaffordable/inadequate coverage penalty equals $3,000 times the number of the member's full-time employees who are getting premium assistance.

Who are your full-time employees?

A full-time employee is an employee who works an average of at least 30 hours per week (130 hours per month). An hour of service is an hour for which an employee is entitled to payment from any member of the affiliated group. This includes both work time and paid time off (such as vacation and paid leave) but excludes hours for services performed outside the United States.

The final regulations provide two methods of determining whether employees must be treated as full-time, the monthly measurement method (new) and the look-back measurement method (similar to the system proposed on December 28, 2012). An applicable large employer member must choose one (and only one) of the two methods for specified categories of employees. Employees may be divided into categories based on the following characteristics:

- 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 places of employment are in different states.

The requirement that you use just one method for an entire category of employees means that you cannot, for example, use the monthly method for hourly employees you expect to work full-time and the look-back measurement method for hourly employees you expect to work part-time. But you could use the monthly method for all of your salaried employees in Ohio, a 6 month look-back method for all hourly Ohio employees covered by a particular CBA agreement, a 12 month look-back method for all hourly Ohio employees covered by a different CBA agreement, and a different 12 month look-back method for non-bargained hourly Ohio employees. Note, you can still set different eligibility standards for plan participation for different classes of employees within the same category, but this new requirement may have ramifications for promotion and demotion situations. The IRS also provided additional guidance on some types of employees for whom tracking hours is problematic (such as adjunct faculty and on-call employees).

Monthly measurement method of identifying full-time employees

Under the monthly measurement method, an employee is classified as full-time in the first month he or she has 130 hours of service. However the final regulations provide a limited non-assessment period: As long as health coverage is offered within three months after the employee first works 130 hours in a month, no penalties will be imposed with respect to that employee. For example, if an employee who first had 130 hours of service during the month of April 2015, is offered coverage by July 1, 2015, no penalties will apply. But if coverage is not offered by July 1 in the example, penalties will apply for those first 3 months (April – June). The limited non-assessment period applies only once during an employee's employment period. A rehired employee can be treated as a new employee (with a new employment period) only if he or she did not have any hours of service for at least 13 weeks (26 weeks for educational organizations).

The monthly measurement method can be adjusted to accommodate payroll periods overlapping calendar months. An employee's status for a month may be based on hours over a four-week or five-week period. One hundred twenty (120) hours is considered full-time in a four-week "month" and one hundred fifty (150) hours is considered full-time in a five-week "month." The four-week or five-week period must contain the week that includes the first day of the month or the week that includes the last day of the month, but not both.

Look-back measurement method for identifying full-time employees

Under the look-back measurement method, the employer establishes three consecutive periods.

1. Measurement period: A new employee reasonably expected to work full-time must be offered coverage after a waiting period of no more than 90 days. The full-time or part-time status of other new employees (employees expected to work part-time, variable hour employees and seasonal employees) will be based on hours of service in a measurement period. A full-time employee is an employee who works an average of at least 30 hours per week (130 hours per month) during the measurement period. The employer must pick a measurement period of between three and 12 months.
   - If an employee terminates employment (or has no hours of service) for 13 weeks and subsequently returns to work, the employee may be treated as a new employee. For educational organizations, the break must be at least 26 weeks (rather than 13 weeks).
   - If an employee terminates employment (or has no hours of service) for a period that is shorter than 13 weeks and then subsequently returns to work, he or she must be treated as a continuing employee. For example, if the rehire is in the same measurement period, the rehired employee gets credit for hours before the termination.
   - A seasonal employee is an employee who is hired into a position for which the customary annual employment is six months or less, with work commencing in the same general time each year. Note that paid interns will not necessarily be seasonal employees.
   - Weeks of unpaid FMLA and military leave are excluded from the denominator of the fraction in computing average hours during the measurement period. Educational organizations also have to exclude employment break periods (i.e., periods of at least four weeks during which an employee has no hours of service).
2. Administrative period: The administrative period follows the measurement period. During the administrative period, the employer tallies hours during the measurement period and provides enrollment materials to any employees determined to be full-time.
3. Stability period: The stability period follows the administrative period. Any employee who was determined to be full-time based on hours during the measurement period must be treated as full-time throughout the stability period (unless he or she terminates employment). The stability period for

employees determined to be full-time must be at least six (6) months and no shorter than the measurement period.

A more complete summary of the rules is available here.

Look-back measurement period transitional rule

If an employer wants to have a 12-month standard stability period starting in 2015, the employer would normally need to have a 12-month standard measurement period starting in 2014 or even 2013. However, the IRS will permit you to use a six-month transitional measurement period in 2014, even if you plan to use a 12-month standard stability period in 2015. This transitional measurement period:

- may be shorter than 12 months but cannot be less than 6 months;
- must begin no later than July 1, 2014; and
- must end no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2015.

Temporary workers

It is not always clear which entity is the common law employer of temporary workers supplied by a staffing company. If your company uses workers supplied by a staffing company under circumstances where there is some risk that the IRS might view the workers are your common law employees, you should consider the following special rule: The IRS will treat a staffing company's offer of coverage to its employees as if it was an offer of coverage by your company if your company pays a higher rate to the staffing company for temporary workers who actually elect to enroll in the staffing company's health plan.

Grace period for payment of employee contributions

Normally, an employee makes his or her contribution for health coverage by payroll deduction. However, there are situations where pay is not sufficient to withhold the employee's contribution for health coverage (e.g., tipped employees, reduced work schedules and leaves of absence). The final regulations retain the grace period requirement in the proposed regulations: An employer may bill the employee for missed contributions and will not be treated as failing to offer health coverage if the employer ends health coverage because the employee fails to pay the required contribution – but only if the employer allows a 30-day grace period consistent with the grace period for COBRA premiums.

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This alert is a summary and cannot include all details that may be relevant to your situation. The special rules and exceptions in the final regulations are too numerous to summarize in this alert. We can work with you on an individual basis to pinpoint the specific rules that are relevant to your company's situation. As always, please contact us if you want more information on these rules or other employee benefits matters.