A Look at Final Employer Shared Responsibility Regulations

The IRS final regulations surrounding the Free Rider Penalty under healthcare reform may have consequences for the nation's school districts.

By Susan Relland

On February 10, 2014, the Internal Revenue Service (IRS) released long-awaited final regulations implementing the Employer Shared Responsibility provision (the Free Rider Penalty or employer mandate) under Health Care Reform. In addition to clarifying a number of open issues, the final regulations offer certain transition relief to employers for the 2015 plan year but will require full compliance with the law in 2016.

General Rule and Effective Date

Under Internal Revenue Code (Code) Section 4980H, large employers that do not offer health coverage to full-time employees and their dependent children, or offer coverage that is "inadequate" or "unaffordable," and have at least one employee enroll in Exchange (Market place) coverage and qualify for a federal premium tax credit or cost-sharing reduction, must pay a non-deductible penalty.

While generally effective January 1, 2015, the final regulations provide transition relief for non-calendar year plans in existence on December 27, 2012: for any employee for whom the employer offers "adequate" and "affordable" coverage by the first day of the plan year beginning in 2015, no penalty will be due prior to the beginning of the plan year beginning in 2015. Note that an employer is not eligible for this transition if it modified its plan year after December 27, 2012 to begin at a later date. The regulations include additional requirements an employer must satisfy to be able to take advantage of this transition.

Employer Penalties

The Free Rider Penalty only applies to large employers. A large employer generally is one that employed an average of at least 50 full-time equivalent employees on business days during the preceding year. However, the final regulations provide that employers with 50-99 full-time equivalent employees will not be subject to the penalty until the first day of the plan year that begins on or after January 1, 2016. Although not subject to a penalty in the plan year that begins in 2015, these smaller employers will still need to meet the reporting requirements related to Employer Shared Responsibility for the plan year that begins in 2015.

An employer's number of full-time employees is based on actual hours of service in the prior year. However, for purposes of determining whether an employer is a

large employer in 2015, an employer may use a period of at least six consecutive calendar months, chosen by the employer, in the 2014 calendar year (rather than having to use the entire 2014 calendar year).

Full-Time Employees

Crediting Hours of Service. An employee who averages 30 or more hours a week (or 130 or more hours in a calendar month) is considered a full-time employee. For employees paid a salary or per diem, employers may either credit hours based on actual service records or use a days or weeks worked equivalency. The final regulations clarify that if an employee is entitled to be paid for a single hour in a day or week, the employee must be credited with the full 8 hours for the day (or 40 hours if using the weeks worked equivalency).

Hours Worked for Specific Categories of Employees. The final regulations provide some clarity with respect to the treatment of various categories of employees and the hours that must be captured:

- **Volunteers:** Hours contributed by bona fide volunteers for a government or tax-exempt entity, such as by volunteer firefighters and emergency responders, will not cause these volunteers to be considered full-time employees. This is the case, even if the volunteer receives some payment for the volunteer works, as long as the volunteer work is the only work the volunteer does for the entity and the payment is nominal or only intended to cover the volunteer's expenses.
- **Employees Paid a Stipend:** The proposed regulations discussed the challenges with determining how many hours certain individuals who are paid a stipend have worked, such as adjunct professors. The final regulations provide that adjunct faculty may be credited with 2.25 hours of service for every credit hour they teach (or, to put it another way, an additional 1.25 hours for every credit hour taught). For other types of stipends, the regulations instruct employers to make reasonable, good faith interpretations.
- **On Call Hours:** The IRS continues to consider additional rules for determining hours of service that need to be credited for on-call hours. Until further guidance is issued, employers are instructed to use a reasonable method that is consistent with the 4980H rules generally. The final regulations clarify that it is not reasonable to fail to credit an employee with an hour of service for any on-call hour for which payment is due by the employer, for which the employee is required to remain on-call on the employer's premises, or for which the employee's activities while remaining on call are subject to substantial restrictions that prevent the employee from using the time effectively for the employee's own purposes.

Methods of Calculating Total Hours Worked. The final regulations clarify that there are two methods for calculating whether an employee has worked full-time: the monthly measurement period or the look back measurement period. Using a monthly measurement period, the employer offers coverage to any employee for any month during which the employee works full time. Alternatively, the employer may use a look back measurement period to determine whether an employee averaged 30 or more hours of service per week over a period of 3 to 12 months. If an employee was considered full-time during this "measurement period," the employee must be treated as a full-time employee for benefits purposes for a subsequent "stability period" regardless of the employee's number of hours worked during the stability period.

An employer may only choose to use different methods (i.e., the monthly measurement period or look back measurement period) between the following groups of employees:

- Salaried versus hourly employees;
- Employees with primary places of employment in different states;
- Collectively bargained versus non-bargained employees; or
- Each group of collectively bargained employees covered by a different agreement.

Note that the final regulations do not allow an employer to use the monthly measurement period for employees who are full-time and the look-back measurement period for employees who are part-time.

The general rule is that the stability period must be at least as long as the measurement period, and not shorter than six months. The final regulations provide that, for the first measurement and stability period only, starting with measurements in 2014, an employer may use a six month measurement period with a stability period of 12 months. However, the measurement period must start no later than July 1, 2014. This means that non-calendar year plans will need to measure for more than six months.

4980H(a) Penalty

If the employer does not offer coverage to substantially all full-time employees and their dependent children, and at least one employee enrolls in exchange coverage and qualifies for a premium tax credit, the monthly penalty imposed under Code Section 4980H(a) is 1/12th times $2,000 per employee after the first 30 employees. A transition rule for 2015 increases this number to 80 employees.

Substantially All Full-Time Employees. For the 2015 plan year, an employer will have satisfied the requirement to offer coverage to "substantially all"

employees if it offers coverage to 70% of the employees (decreased from 95% from the proposed regulations) who are considered full-time under the law. Beginning in 2016, the substantially all threshold increases to 95%.

Dependent Children. In order to avoid a penalty, coverage must be offered to full-time employees and their children up to the age 26. The proposed regulations required plans to cover biological, adopted, step, and foster children. The final regulations only require employers to offer coverage to biological and adopted children. In addition, the rules clarify that the employer must offer coverage through the end of the calendar month in which the child turns age 26. This is a departure from the plan design mandate regulations, which only require coverage to be offered until the day the child turns age 26. To provide employers who do not currently offer coverage to children with sufficient time to comply, any employer that takes steps during its plan year that begins in 2015 toward satisfying the requirement to offer dependent child coverage will not be assessed a penalty prior to its plan year beginning in 2016.

4980H(b) Penalty

A second penalty applies if the employer's provided coverage is considered "inadequate" or "unaffordable." This penalty could also be triggered for any full-time employee who is not offered coverage in the situation where the employer satisfies the "substantially all" requirements (70% in 2015 and 95% in 2016) but the employee is not offered coverage and thus falls in the gap (30% for 2015 and 5% for 2016). The amount of this penalty is 1/12th x $3,000 per month per full-time employee who enrolls in exchange coverage and qualifies for a federal premium tax credit. The amount of the penalty is capped at the amount the employer would have had to pay for not offering coverage at all under 4980H(a).

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