Key Considerations in Avoiding and Calculating Penalties Pursuant to the Employer Shared Responsibility Mandate

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Employer Shared Responsibility Mandate

Since 2010, most employers have implemented changes to their group health plans as required under the Patient Protection and Affordable Care Act (PPACA). While PPACA does not explicitly require employers to offer their employees health coverage, employers offering these plans are required to make changes to bring their group health plans into compliance. In many respects, the required changes were in preparation for health insurance Marketplaces and the employer shared responsibility mandate. The employer shared responsibility mandate (the mandate) requires *applicable large employers* to offer, to substantially all of their full-time employees and their dependent children, eligible employer-sponsored coverage or face potential penalties.

In an effort to clarify many aspects of the mandate that went into effect on January 1, 2015, the regulators have issued an immense amount of guidance over an extended period of time. To assist employers in their efforts to fully understand the mandate, Gallagher prepared this comprehensive abstract of the most important aspects of this significant pillar of PPACA.

Applicable Large Employer

The mandate applies to "applicable large employers," which are defined as employers with 50 or more full-time and full-time equivalent (FTE) employees. For employers that are part of a controlled group, the determination is made on a controlled group basis. If the collective employer-members of the controlled group employed an average of at least 50 full-time and FTE employees for each month of the preceding calendar year, the group is an applicable large employer.

When determining the number of employees, only common-law employees are counted. Generally, a common-law employee is an employee subject to the will and control of the employer, not only as to what must be done, but also how it must be done. Sole proprietors, partners in a partnership and more-than-2% S corporation shareholders are not considered employees.

Full-Time Employee.

Solely for purposes of determining employer size, a full-time employee is an employee who is employed an average of 120 or more hours per month.

Full-Time Equivalent Employee.

As stated above, the calculation for applicable large employer also takes FTE employees into account. In order to determine the number of FTEs during business days for each month during the previous calendar year, the employer must look at all employees (including seasonal employees) who were not full-time employees during each month. The number of FTE employees for a given month is then determined by:

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1. Calculating the aggregate number of hours of service (but no more than 120 hours of service for any employee) for all non-full-time employees for that month, and
2. Dividing the total hours of service calculated above by 120.

The resulting number, which may be rounded off to the nearest hundredth, is the number of FTE employees for that calendar month.

Determining Applicable Large Employer Status.

To determine applicable large employer status, the employer determines the number of full-time and FTE employees together for each month in the preceding calendar year as described above. The employer then adds the monthly totals and divides that number by 12. For this calculation, fractions are taken into account when determining the number of FTE employees for each month; however, after adding together the 12-month full-time and FTE employee totals, any resulting fraction is rounded down. For example, if the resulting total number of full-time and FTE employees for a preceding calendar year is 49.9, the resulting number is rounded down to 49. If the monthly average equals or exceeds 50 full-time and FTE employees, the employer is considered an applicable large employer subject to the mandate.

Example: *Assume that Acme employed 25 employees who each worked 120+ hours a month in 2018. In our example, the 25 employees are classified as full-time employees. In addition to these full-time employees, Acme employed 60 part-time employees who worked 60 hours each month in 2018. To determine the number of FTE employees that Acme employed in 2018, Acme aggregates all the hours of service for all part-time employees (3,600) for each month and divides by 120. The resulting number, which is 30, represents Acme's FTE employees for each month, since in our example we assume that every part-time employee worked the same hours in each month of 2018. In this example, Acme would be considered an applicable large employer for 2019 because Acme's average monthly full-time and FTE employees in 2018 is greater than 50. To be specific, for 2018 Acme's average full-time (25) and full-time equivalent employees (30) for each month is equal to 55.*

However, certain individuals, primarily veterans, can be disregarded solely for the purpose of determining whether an employer is an applicable large employer subject to the mandate. Under this exemption, an employee is not taken into account for the applicable large employer determination for any month that he or she has medical coverage provided by any of the uniformed services, including TRICARE, or under certain Veterans' Affairs health care programs.

Seasonal Worker Exception.

When an employer is performing the calculation to determine if it is an applicable large employer, the employer may be entitled to disregard seasonal workers. Seasonal workers may be disregarded if the employer's workforce exceeds 50 full-time and FTE employees for no more than 120 days and the number of employees exceeding 50 during that time were

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seasonal workers. Employers are allowed to use a reasonable good-faith interpretation of the term "seasonal worker" for this purpose and may treat four calendar months as the equivalent of 120 days. In addition, the four calendar months and the 120 days do not have to be consecutive.

Timeframe Used to Calculate Applicable Large Employer Status.

Starting with the 2016 calendar year, employers have been required to determine their status as an applicable large employer based on the entire preceding calendar year.

Transitional Relief for First Time Applicable Large Employers.

Employers who become applicable large employers, by surpassing the 50 full-time and FTE employees threshold for the first time will not be subject to any penalties under the mandate, as long as, they offer their full-time employees coverage that is affordable and meets minimum value by April 1 of the following year. This rule applies only during the first year after an employer first becomes an applicable large employer even if the employer falls under the 50 full-time and FTE employee threshold for a subsequent year.

New Employers.

An employer that was not in existence for the entire prior calendar year is considered an applicable large employer only if the employer is reasonably expected to employ at least 50 full-time and FTE employees during the current calendar year. An employer is treated as not having been in existence throughout the prior calendar year only if the employer was not in existence on any business day during that year.

Determining Who Is a Full-Time Employee

Once an employer makes the determination that it is an applicable large employer, it is essential that the employer identify its full-time employees. An employer identifies its full-time employees based on each employee's hours of service (at least 30 hours per week or 130 hours per month).

Calculating Hours of Service for Hourly Employees.

Generally, "hours of service" include any hour for which an employee is paid or is entitled to payment. This includes periods for which no actual services are performed, such as vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence. A special rule applies when determining whether periods of time associated with paid disability leave count as hours of service. For such purposes, an hour of service includes periods during which an individual retains status as an employee (i.e., employment has not been terminated), is not performing services, and is receiving short or long-term disability payments unless the payments are made from an arrangement to which the employer did not contribute directly or indirectly. For example, if an employee paid for long term disability leave benefits solely with after-tax dollars, the employer would not be considered to have contributed to the arrangement, and the time spent on long-term disability leave would not count as hours of service.

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Calculating Hours of Service for Non-Hourly Employees.

Hours of service for non-hourly employees can be calculated under any of the following three methods:

- **Actual hours** – counting hours worked and hours for which payment is due—even if duties are not performed (i.e., paid time off for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military leave or other leave of absence); or
- **Days-worked equivalency** - crediting employees with eight hours of service for any day during which the employee would be due one hour of service for an actual hour worked or for which payment is due (e.g., if the employee worked for one hour on Monday, the employee would be credited with eight hours of service for Monday); or
- **Weeks-worked equivalency** – crediting employees with 40 hours of service for each week the employee is credited with at least one hour of service or for which payment is due (e.g., if the employee worked for one hour on Monday, the employee would be credited with forty hours of service for that week).

An employer may not use the days-worked equivalency or weeks-worked equivalency method if doing so would result in a substantial understatement of an employee's hours causing the employee not to be considered full-time or understate the service hours of a substantial number of employees.

> **Example:** *Assume an employee actually worked 80 hours during one week and 60 hours during the following week, but no additional hours for the month. In this example, using the weeks-worked equivalency method would result in crediting the employee with only 80 hours of service, but the employee actually worked 140 hours of service and would otherwise be considered as a full-time employee for the month. Thus, it would not be permissible to use the weeks-worked equivalency method for this employee.*

An employer must use one of the three methods above for non-hourly employees, but the employer is not required to use the same method for all non-hourly employees. Employers may use different methods for different categories so long as the categories used are reasonable and consistently applied. Further, an employer may change its method of calculating hours of service for non-hourly employees (or even a sub-group of non-hourly employees) each calendar year.

Who Must Be Offered Coverage Under the Mandate?

Initially, applicable large employers were required to offer health coverage to **all** full-time employees or potentially be subject to a penalty. However, the Internal Revenue Service subsequently stated that it did not want to assess a penalty upon an employer whose intention it was to offer coverage to substantially all of its full-time employees, but failed to offer coverage to a few full-time employees. As such, all applicable large employers must offer minimum essential coverage to all but five percent, or if greater, five of their full-time employees, in order to avoid a penalty for a failure to offer coverage. The five full-time employee alternative is designed to accommodate employers meeting the "applicable large

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employer" definition with a relatively smaller number of full-time employees where an inadvertent error would exceed the five percent margin of error. The margin of error applies to a percentage or number of employees (and their dependent children), regardless of whether the failure to offer coverage was inadvertent.

To be clear, applicable large employers will still be subject to a penalty if any of their full-time employees not offered qualifying coverage receive a premium tax credit from a Marketplace, but this penalty is considerably smaller than the penalty for failing to offer coverage (a detailed discussion of the various penalties under the mandate is included below).

Definition of Dependents.

For purposes of the mandate, dependent is defined as an individual who is:

- A son or daughter of the full-time employee; or
- A legally adopted individual of the full-time employee or an individual who is lawfully placed with the full-time employee for legal adoption.

Under PPACA, these dependents must be offered coverage through the end of the month when they achieve the age of 26. Spouses, foster children, and stepchildren are not considered dependents for purposes of the mandate.

Determination of Who Must Be Offered Coverage

For the purpose of determining whether employees are considered full-time employees for the mandate, employers are permitted to use either the "monthly measurement method" or the "look-back measurement method."

Monthly Measurement Period.

Under the monthly measurement method, an applicable large employer will determine each employee's status by counting that employee's hours for each calendar month. If an employee has 130 or more hours of service in a given month, then that employee is considered a full-time employee.

Initial Employment.

When an employee is initially hired, an employer will not be liable for employer mandate penalties for the first three months the employee is employed if the employee meets the eligibility requirement for the plan, but is not covered because the employee is in a waiting period, so long as the employee is offered coverage no later than the first day of the first month following that three-month period.

Example:

If an employer uses the monthly measurement method and hires a new employee on March 1 and that employee averages 130 hours per month in March, April, and May, the employer will not be subject to any penalties under the mandate for that employee during the months of March, April, and May so long as the employee is offered coverage as of June 1 of that same year. However, it is important to note

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that this rule is separate and distinct from the 90-day waiting period limitation imposed on all employers by PPACA. As such, applicable large employers must be cognizant of the general 90-day waiting period requirement when imposing eligibility requirements.

Rehired Employees.

Under the monthly measurement method, if an employee has a period of at least 13 weeks (26 weeks for an employee of an academic institution) without any credited hours of service, then that employee can be treated as having been terminated and rehired for the purposes of the mandate upon resuming to provide services to the employer. This means that the employee may be subject to a new waiting period prior to gaining coverage under the employer's plan without triggering a penalty under the mandate for the employer.

Continuing Employees.

Under the monthly measurement method, if a rehired employee has a period of less than 13 weeks (26 weeks for an employee of an academic institution) without any credited hours of service, then the employee must be treated as a continuing employee. In this case, the employer must offer coverage as of the first day that the rehired employee is credited with an hour of service, or if later, as soon as administratively practicable in order to avoid penalties under the mandate. Providing coverage on the first day of the calendar month following the day the employee first received credit for an hour of service would satisfy this rule.

Special Unpaid Leave and Employment Breaks.

Employers using the monthly measurement method are not required to provide credit for time off due to unpaid FMLA, USERRA or jury duty leave. However, paid time off for FMLA, USERRA, or jury duty would be considered as "hours of service," and thus included in an individual's full-time employee determination.

Look-Back Measurement Method.

Under the look-back measurement method, an employer may determine the status of an employee as a full-time employee during a future period (referred to as a stability period), based upon the hours of service of the employee in a prior period (referred to as a measurement period).

A measurement period allows employers an opportunity to look-back at the hours worked by an employee to determine health plan eligibility. If an employee is determined to have averaged at least 30 hours per week during a measurement period, that employee must be treated as a full-time employee for the following stability period so long as he or she remains employed and pays premiums, regardless of the number of hours worked. If an employee is determined not to average at least 30 hours per week during a measurement period, the employer may treat the employee as a non-full-time employee for the following stability period, unless the employee has a change in employment status that would otherwise make the employee eligible for coverage.

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A measurement period may be from three months to twelve months in length. The measurement period may be followed by an administrative period of no more than 90 days in length. The administrative period is an optional period that can be used by the employer to perform administrative duties related to counting hours and, where applicable, making an offer of coverage. The stability period follows the measurement period (and administrative period, if applicable). During the stability period employees that have been determined to average at least 30 hours per week during the measurement period must be treated as full-time employees for purpose of the mandate. These periods are generally broken down into two categories – standard and initial. A standard period is used for "ongoing employees," and an "initial period" is used for newly hired employees.

Treatment of Ongoing Variable Hour and Part-Time Employees.

Ongoing variable hour and part-time employees are those employees who have been employed for at least one "standard measurement period." The standard measurement period may be a period from three to twelve months long and must be the same for all ongoing employees. If an employer chooses a twelve-month standard measurement period, the employer may use the calendar year, a non-calendar year plan year or a different twelve-month period that ends prior to the start of the employer's annual enrollment period.

> **Example:** *An employer with a calendar year plan year may use October 15 of one year through October 14 of the following year as its standard measurement period. If an ongoing employee is determined to have averaged at least 30 hours per week during a standard measurement period, the employer must treat that employee as a full-time employee for purposes of medical coverage so long as he or she remains employed and pays any applicable premiums, regardless of the number of hours worked during the following stability period, in order to avoid penalties under the employer mandate.*

In order to avoid penalties under the mandate, coverage must begin as of the first day of the new stability period, which must begin immediately following any administrative period. The administrative period must immediately follow the standard measurement period and can be no longer than 90 days. Moreover, the standard stability period cannot be shorter than the standard measurement period and must be at least six months in duration.

If the employee is determined not to average at least 30 hours per week during a standard measurement period, the employer may treat the employee as non-full-time employee for the following standard stability period.

Treatment of New Variable Hour, Seasonal, and Part-Time Employees.

For new variable hour, seasonal, and part-time employees, employers may determine whether the new employee is a full-time employee using an initial measurement period of no less than 3 consecutive months and no more than 12 consecutive months that begins on the employee's start date or on any date up to and including the first day of the first calendar month following the employee's start date (or on the first day of the first payroll period starting on or after the employee's start date, if later). If the new variable hour, seasonal or part-time employee works on

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average at least 30 hours per week during the initial measurement period, the employee will be considered to be a full-time employee for the following initial stability period. The initial stability period must be the same length as the initial measurement period, but may not be less than six months.

The initial stability period must begin immediately after any initial administrative period. The administrative period can be no longer than 90 days, but the combined length of the initial measurement period and the initial administrative period can be no longer than 13 and a fraction of a month. The final regulations clarify that any period of time between the employee's start date and the beginning of the initial measurement period is also counted toward the 90-day limit on the initial administrative period.

Transition from New Variable Hour or Part-Time Employee to Ongoing Employee.

Once a variable hour or part-time employee has been employed for a full standard measurement period, those employees become "ongoing employees," and the employer must use the same rules for those employees as other ongoing employees. This means that there is likely to be some overlap between an individual's initial measurement period and that individual's first standard measurement period. The employee could thus qualify as a full-time employee during his initial measurement period, but fail to qualify as a full-time employee during his first standard measurement period. If so, the employee will still be entitled to status as a full-time employee during his initial stability period, and would lose status as a full-time employee as of the end of his initial stability period.

Treatment of Full-Time Employees under the Look-Back Method.

If a new non-variable hour, non-seasonal, non-part-time employee is reasonably expected at the start of his or her employment to be a full-time employee, the employee's status is determined based upon the hours of service for each calendar month until that employee becomes an "ongoing" employee. Once a new employee becomes an ongoing employee, the look-back rules for determining status as an ongoing employee apply. In other words, if an employer hires an employee who is reasonably expected to work 40 hours per week, then the employer will classify that employee as a full-time employee and offer coverage under the regular eligibility rules for new employees, but once the employee becomes an "ongoing" employee, the employer will include that employee in the standard measurement period and stability period calculations.

Rehired Employees.

As under the monthly measurement method, under the look-back method, if an employee has a period of at least 13 weeks (26 weeks for an employee of an academic institution) with no credited hours of service, then that employee may be treated as a rehired employee rather than a continuing employee upon resuming employment with for the employer. This means that the employer may begin a new initial measurement period for the employee, who could be viewed as a new variable hour or seasonal employee. Employees who do not qualify as rehired employees under these guidelines will be considered to be continuing employees.

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Continuing Employees.

Employees that are considered continuing employees will retain their status held during the applicable stability period prior to the break in service immediately preceding their return to work. This means that they must be offered coverage upon resumption of services for the employer, if they were previously considered to be full-time employees, in order to avoid a penalty under the mandate. "Upon resumption of services" means that the employer must offer coverage as of the first day that the employee is credited with an hour of service or, if later, as soon as administratively practicable, in order to avoid a penalty under the mandate. The first of the month following the date the employer is credited with an hour of service would satisfy the administratively practicable requirement. If an employee returns during a stability period for which the employee previously declined coverage, the employer will not be required to make a new offer of coverage, but will be considered to have offered coverage for the remainder of the applicable stability period.

Changes in Employment Status.

If an employee begins employment as a seasonal or variable hour employee and has a change in position during his initial measurement period to a position that would have made him a full-time employee (i.e., one that works on average thirty or more hours per week) if originally hired in that position, then the employer will not be subject to a penalty for the months the employee was in an initial measurement period if certain conditions are met. If the employer provides coverage by the first day of the fourth month following the change in employment status, or if earlier, on the first day of the first month following the initial measurement period (if the employee was determined to be a full-time employee based upon an initial measurement period), then the employer would not be subject to a penalty under the mandate for the time the employee was in an initial measurement period.

Example:

If a variable hour employee is hired on January 2, 2018 and thus has an initial measurement period running from January 2, 2018 through January 1, 2019, but is promoted to a full-time position in November 2018 during the initial measurement period, the employer would be required to offer coverage with minimum value as of February 1, 2019 in order to avoid a penalty. However, due to the limitation under PPACA regarding the length of waiting periods, the employer could not impose a waiting period longer than 90 days.

However, if an ongoing employee has a change in status during a stability period (either initial or standard), that change will not impact his or her classification as a full-time or non-full-time employee during the remainder of the stability period unless the employee had been offered coverage effective no later than the fourth month after his or her date of hire. Instead, that change in status will impact the hours during the current standard measurement period. According to the final regulations, this means that if an employee has an increase in hours (but not a change to a position that would otherwise make the employee eligible for coverage), the employee maintains the status earned during the prior measurement period. Likewise, if an employee experiences a decrease in hours, the decrease does not impact the employee's status for the current stability period.

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If, however, the employee had been offered coverage with minimum value since the first day of the calendar month following the employee's initial three full months of employment, then the employer may use the monthly measurement method beginning the first day of the fourth full calendar month following the change in employment status.

Special Unpaid Leave.

An employer that is not an academic institution must either determine an employee's average hours of service for a measurement period by computing the average after excluding any special unpaid leave (defined as unpaid leave for FMLA, USERRA or jury duty) during that measurement period and by using that average as the average for the entire measurement period, or may choose to treat the employee as credited with hours of service for any periods of special unpaid leave during that measurement 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 a period of special unpaid leave.

An employer that is an academic institution must either determine an employee's average hours of service for a measurement period by computing the average after excluding any special unpaid leave (defined as unpaid leave for FMLA, USERRA or jury duty) and a break in employment due to a closure of the institution such as a summer break during that measurement period and by using that average as the average for the entire measurement period, or may choose to treat the employee as credited with hours of service for any periods of special unpaid leave during that measurement 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 a period of special unpaid leave. However, the academic institution employer is not required to exclude (or credit) more than 501 hours of service for employment breaks and leave combined.

Employment Breaks for Employees of Educational Organizations.

Educational organizations generally function on an academic year basis, during which there are periods the organization is not in session. To account for this different structure, educational organizations must credit hours of service for employment break periods of at least four consecutive weeks using one of the methods that apply to special unpaid leave (explained above). The organization may limit the number of hours of service credited for these employment breaks to 501 hours. These special employment break rules do not apply to employees treated as terminated and rehired.

Different Periods may be used for Different Categories of Employees.

Employers may use different measurement, administrative, and stability periods for different categories of employees, but only as long as those categories fall within one of the following:

- Collectively bargained employees and non-collectively bargained employees;
- Collectively bargained employees covered by separate collective bargaining agreements;
- Salaried employees and hourly employees; or
- Employees whose primary places of employment are in different states.

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Rules That Apply to Both Monthly and Look-Back Measurement Methods.

Rule of Parity.

Employers have the option of using a "rule of parity" rather than a 13-week (or 26-week for academic employers) cliff period approach when determining if an employee is a rehired or continuing employee. Under the rule of parity, an employee may be treated as terminated and rehired as a new employee if the employer uses a period of at least 4 consecutive weeks during which the employee is not credited with an hour of service, and the period without any hours of service credited is longer than the period (i.e., the number of weeks) of that employee's period of employment with the applicable large employer, but is shorter than 13 weeks (26 weeks for an academic institution employer).

Example:

If an employee works for ACME for 2 weeks, and terminates employment, but rejoins ACME after 6 weeks, that employee may be treated as terminated and rehired as a new employee under both the monthly and look-back measurement method.

Employees Transferred to International Positions.

Employers may treat employees as having terminated employment when transferred to certain international positions so long as certain conditions are met. Those conditions are as follows:

1. The international position must be with the same applicable large employer (or a member of the same controlled group);
2. The international position must be either anticipated to continue indefinitely or last at least 12 months;
3. Substantially all of the compensation must constitute income from sources outside of the United States; and
4. The rules related to rehired employees are followed (i.e., if the employee has an international position meeting the conditions above for at least 13 weeks, the employee may be treated as a new employee upon return to a domestic position).

On-Call Hours.

One difficult area in calculating hours of service is how to handle "on-call" hours. Under Department of Labor standards, an employee who is required to remain on his or her employer's premises or so close thereto that he or she cannot use the time effectively for his or her own purposes is working while on-call. Questions arise as to whether on-call hours must be counted as hours of service. The final regulations did not provide specific guidance on this issue, but until further guidance is issued, employers of employees who have on-call hours are required to use a reasonable method for crediting hours of service that is consistent with the employer mandate. The final regulations indicate it is not reasonable for an employer to fail to credit an employee with an hour of service for any on-call hour for which payment is

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made or 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.

Hours of Service Outside the U.S.

Hours of service outside the United States are not included in the calculation for determining full-time employee status.

Adjunct Professors.

Until further guidance is issued, the IRS has indicated that academic institutions that compensate adjunct faculty members based on the number of courses, credit hours or students taught may use a reasonable method for crediting hours of service. However, the final regulations include one specific method that the IRS recognizes as reasonable. Under this method, it would be reasonable for an academic institution to credit an adjunct faculty member with 2.25 hours of service per week for each hour of teaching or classroom time and one hour of service each week for each additional hour outside of the classroom spent in performing required duties such as maintaining office hours or attending faculty meetings.

Other Exceptions.

An hour of service does not include any hour of service performed by:

- Bona fide volunteers (e.g., a volunteer firefighter or emergency medical provider who receives expense reimbursements); or
- Members of a religious order who have taken a vow of poverty; or
- Students in positions subsidized through the federal work study or substantially similar program under state or local law ; or
- Unpaid interns or externs.

In general, a bona fide volunteer includes any employee of a governmental entity or a section 501(c) tax exempt organization whose only compensation from that entity or organization is in the form of: (i) reasonable reimbursements of expenses incurred in the performance of services by the volunteer; or, (ii) reasonable benefits (including length of service awards) and nominal fees customarily paid by similar entities in connection with the performance of services by volunteers.

Student Employees.

No general exception for student employees exists under PPACA. All hours of service for which a student employee of an educational organization (or of an outside employer) is paid or entitled to payment in a capacity other than through a federal work study program (or a state or local government's equivalent) are required to be counted as hours of service.

What Constitutes an "Offer" of Coverage?

In order for an applicable large employer to avoid a penalty for failure to make an "offer" of coverage, one of the following requirements must be satisfied:

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- The employee must have an effective opportunity to elect to enroll in the coverage at least once with respect to the plan year; or
- The employee has an effective opportunity to decline to enroll if the coverage does not provide minimum value, or requires an employee contribution for any calendar month of more than 9.86% (for 2019 and indexed in future years) of the Federal Poverty Line.

In addition, coverage must be offered to at least 95% of all full-time employees and their dependent children (for applicable large employers with less then 50 full-time employees, then coverage must be offered to all but five full-time employees). Whether an employee has an effective opportunity to enroll or to decline to enroll is determined based on all the relevant facts and circumstances, including adequacy of notice of the availability of the offer of coverage, the period of time during which acceptance of the offer of coverage may be made, and any other conditions on the offer. An employee's election of coverage from a prior year that continues for the following plan year, unless the employee affirmatively elects to opt out of the plan, constitutes an offer of coverage for purposes of the employee mandate.

For an employer to be deemed to have offered coverage to a particular employee, the coverage offered, if accepted, must be applicable for that month (or that day). If a large employer fails to offer coverage to an employee for **any** day of a calendar month, the employee is deemed to not have been offered coverage for the entire month, subject to two exemptions. First, an employee is treated as having been offered coverage for the entire calendar month in which his or her employment terminates if the employee would have been offered coverage for the entire calendar month if he or she had not terminated employment. Second, an employer is considered to have offered coverage for a calendar month if the employee's start date is on a date other than the first day of the calendar month.

Note that if an employee enrolls for coverage, but then fails to pay his share of the premium, the employer is not required to provide coverage for that period of time. However, the employer is then considered to have offered coverage for the remainder of the coverage period.

Offer of Coverage on Behalf of Another Entity.

For employers that are part of a controlled group, an offer of coverage by one applicable large employer member (an employer that is a part of a controlled group) to an employee for a calendar month is treated as an offer of coverage by all applicable large employer members for that calendar month. In addition, an offer of coverage made to an employee on behalf of a contributing employer under a multiemployer or single employer Taft-Hartley plan or multiple employer welfare arrangement is treated as made by the contributing employer.

Where an offer of coverage is made to an employee performing services for an employer that is a client of a staffing firm or PEO, the offer is treated as made by the client employer for purposes of the mandate if the fee the client employer would pay to the staffing firm or PEO for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay the staffing firm or PEO for the same employee, if the employee did not enroll in health coverage under the plan.

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Penalties Under Healthcare Reform

There are two types of penalties for failure to comply with the employer mandate. The first is for failing to offer minimum essential coverage. The second is for failing to offer coverage that is affordable and provides minimum value. Both are described in greater detail below.

Minimum essential coverage includes coverage under any employer-sponsored health plan, either insured or self-insured, regardless of the type of employer—for-profit, not-for-profit, or governmental. Specialized types of coverage such as separate dental or vision plans, policies covering only specified diseases or conditions, and workers compensation are not considered minimum essential coverage.

Penalty for Failing to Offer Minimum Essential Coverage.

Applicable large employers that do not offer substantially all full-time employees minimum essential coverage will be subject to a significant penalty if just one full-time employee is eligible for the premium tax credit and enrolls for health coverage through a Marketplace. To be eligible for a premium tax credit, the employee must:

1. Be a U.S. citizen or legal resident alien;
2. Have household income between 100% and 400% of the Federal Poverty Guidelines based on family size;
3. Not be eligible for affordable, minimum value coverage from any other source; and
4. Not be enrolled in minimum essential coverage from any source.

To satisfy the minimum essential coverage requirement, the employer plan need not meet an affordability test or be of minimum value. However, the plan must be offered to at least 95% of the applicable large employer's full-time employees, or if greater, all but five of their full-time employees.

For employers that are subject to the mandate in 2019, the annualized penalty for failing to offer minimum essential coverage will be equal to the number of full-time employees minus 30, multiplied by $2,500. *In the future, the penalty amount will be adjusted according to inflation, but the method of calculating the penalty will remain the same.* Note that the $2,500 penalty is an annualized penalty. The penalty is actually assessed on a monthly basis.

Example:

In 2019 an applicable large employer with 100 full-time employees during each of the calendar months fails to offer minimum essential coverage to its full-time employees and their dependent children. One full-time employee purchases coverage through a Marketplace and receives a premium tax credit to assist in the cost of that coverage. In this example, the large employer is faced with a monthly penalty of $14,583. The penalty amount is based on the following calculation: (100-30) x ($2,500/12).

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Penalty for Offering Coverage that is Unaffordable or Fails to Provide Minimum Value.

Here an applicable large employer offers the required percentage (95%) of its full-time employees and their dependent children minimum essential coverage, the employer may still be subject to a penalty. The applicable large employer is subject to a penalty as to each employee determined to be eligible for the premium tax credit who enrolls for health coverage through a Marketplace. This will only happen if the employer-sponsored minimum essential coverage offered to the employee is considered unaffordable to the employee and/or the coverage does not meet the minimum value requirement.

The annualized penalty attributable to each employee certified for coverage through a Marketplace is $3,750 for 2019. *In the future, the penalty amount will be adjusted according to inflation while the method of calculating this penalty will remain the same.* As with the penalty for failing to offer coverage, this penalty is applied on a monthly basis and is multiplied by the number of months each employee is determined eligible for a premium tax credit (excluding the first three months of full-time employment). However, this penalty is capped and cannot be greater than the penalty that would have been assessed if the applicable large employer did not offer coverage.

Example:

Assuming the same large employer above, with 100 full-time employees, offers its employees minimum essential coverage, but that coverage is deemed either unaffordable or fails to provide minimum value and 20 of its employees purchase coverage from a Marketplace and receive a premium tax credit. Under this scenario, the employer would be liable for a monthly penalty of $6,250. The penalty amount is calculated as follows: 20 x $312.50. In the extreme, if each of the 100 full-time employees purchased coverage on a Marketplace with the aid of a premium tax credit, then the penalty would be capped at the $14,583 monthly amount calculated in the preceding section.

Penalties for Members of a Controlled Group.

Each member of a controlled group is responsible for its own employer shared responsibility penalties, but not for the penalties of other members in the controlled group. If a member fails to offer the opportunity to enroll in minimum essential coverage to the requisite percentage of its own full-time employees and their dependent children and is assessed an employer shared responsibility penalty, then the member can apply the 30-employee reduction on a pro-rata basis based on the number of full-time employees employed by each member of the control group. For a member whose pro-rata share is more than zero, but less than one, the rules allow the member to round-up the employee reduction to one.

In cases where a full-time employee works for more than one member of a controlled group, the full-time employee is treated as the employee of the employer member for whom the employee had the greatest number of hours of service for the calendar month. If the full-time employee works an equal number of hours for two or more members, the members have discretion to designate who the employee worked for during the calendar month. If the members do not make a decision, the IRS will make the determination.

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Determining Affordable Coverage

Generally, coverage offered to an employee is considered affordable if the employee's contribution for self-only coverage does not exceed 9.86 percent (for 2019 and indexed in future years) of the employee's household income for the taxable year. Because employers do not know their employees' household incomes, the rules provide for three affordability safe harbors: one based on the employee's Form W-2; a second based on the employee's rate of pay; and, the last based on the federal poverty guidelines for a single individual.

The use of the safe harbors is optional. An employer may use one or more of the safe harbors for all employees or any reasonable category of employees, to the extent it is done on a uniform and consistent basis. Reasonable categories of employees generally include specified job categories, nature of compensation (for example, salaried or hourly), geographic location, and similar bona fide business criteria.

The employer's use of these safe harbors will not affect an employee's eligibility for premium assistance from a Marketplace. Thus, an employer can rely on one of these safe harbors to avoid a penalty for offering full-time employees coverage that is deemed unaffordable without preventing an otherwise eligible employee's eligibility for the premium tax credit through a Marketplace.

Form W-2 Safe Harbor.

Under this safe harbor, the employee contribution toward self-only coverage for the employer's lowest cost coverage providing minimum value cannot exceed 9.86 percent (for 2019 and indexed in future years) of the employee's Form W-2 Box 1 wages for that calendar year. If this condition is satisfied, the employer will not be assessed a penalty with respect to the applicable employee, even if that employee receives a premium tax credit or cost-sharing reduction from a Marketplace due to the coverage being unaffordable based on the employee's household income.

Rate of Pay Safe Harbor.

An applicable large employer satisfies the rate of pay safe harbor with respect to **an hourly employee** for a calendar month if the employee's contribution for the lowest cost self-only coverage that provides minimum value does not exceed 9.86 percent (for 2019 and indexed in future years) of an amount equal to 130 hours multiplied by the lower of the employee's hourly rate of pay as of the first day of the coverage period (generally the first day of the plan year) or the employee's lowest hourly rate of pay during the calendar month.

An applicable large employer satisfies the rate of pay safe harbor with respect to a **non-hourly employee** if the employee's contribution for the calendar month for lowest cost self-only coverage that provides minimum value does not exceed 9.86 percent (for 2019 and indexed in future years) of the employee's monthly salary, as of the first day of the coverage period. However, for a non-hourly employee, if the monthly salary is reduced, even if due to a reduction in work hours, this safe harbor is not available.

Federal Poverty Line Safe Harbor.

An applicable large employer satisfies the federal poverty line safe harbor if the employee's required contribution for the lowest cost self-only coverage that provides minimum value does not exceed 9.86 percent (for 2019 and indexed in future years) of the federal poverty line for a single individual for the applicable calendar year, divided by 12. The applicable federal poverty line is the federal poverty line for the state in which the employee is employed. Moreover, rather than requiring that the applicable poverty level be determined as of the first day of the plan year, the final rules allow the level to be determined as of any day date during the six months preceding the plan year. This will give employers time to calculate the monthly premium cap needed to fall within this safe harbor.

Affordability for Related Individuals.

Under the rules, affordability of plan coverage is determined based on the employee's cost for the employer's lowest cost plan meeting the minimum value requirement. This is without regard to whether the employee has dependents eligible to be enrolled in the employer's plan; the contribution the employer requires employees to make for dependent coverage is not considered in the determination.

Level of Value Employer's Coverage Must Provide

A health plan is deemed to provide minimum value if the percentage of the total allowed cost of benefits provided under the plan is no less than 60%. Employers may choose one of two methods to determine minimum value:

- Use of the MV calculator made available by the regulators, or
- Use of any safe harbor (a design-based checklist) established by HHS and the Internal Revenue Service.

To the extent neither of these options is appropriate for use by the employer because the plan contains non-standard features; the employer can obtain Certification by a member of the American Academy of Actuaries.

Transitional Relief

In the final regulations issued in February 2014, the IRS provided various types of transitional relief to applicable large employers; however, the only remaining transitional relief impacts multiemployer plans as noted below.

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Relief for Multiemployer Plans.

An applicable large employer will not be deemed to have failed to offer the opportunity to enroll in minimum essential coverage to a full-time employee (and dependents) for purposes of the employer mandate if: 1) the employer is required to make a contribution to a multiemployer plan with respect to the full-time employee pursuant to a collective bargaining agreement or an appropriate related participation agreement; 2) coverage under the multiemployer plan is offered to the full-time employee (and their dependents); and 3) the coverage offered to the full-time employee is affordable and provides minimum value. This transitional relief can be relied upon by applicable large employers until further guidance is issued. If and when additional guidance is issued, it will not take effect until January 1 of the calendar year beginning at least six months after the date of issuance of that guidance.

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