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Countdown to ACA Compliance: Key Issues under the Employer Mandate

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One of the biggest challenges that an employer faces under the ACA is the "employer mandate," which requires certain employers to offer adequate health coverage to their full-time employees or potentially pay a penalty. This article discusses the key issues that an employer must address in order to determine how best to respond to the employer mandate.

Barack Obama himself said "A good piece of legislation is like . . . a good piece of music. Everybody can recognize it. They say, 'Huh. It works. It makes sense.'"[1] We doubt that the Patient Protection and Affordable Care Act (ACA) is the legislative equivalent of "Stairway to Heaven," but it is probably not as bad as any Milli Vanilli record either.[2] In any case, it is not our mission to determine whether the ACA meets President Obama's musical standard for good legislation. Our mission is simply to help employers understand and respond to it.

To that end, one of the biggest challenges that an employer faces under the ACA is the "employer mandate," which is also sometimes referred to as the "pay or play mandate." Essentially, the employer mandate requires employers, other than those who employ less than 50 full-time employees, to provide adequate health coverage to their full-time employees or potentially pay a penalty. While we cannot cite to formal studies, experience and common-sense suggests to us that there is a lot of confusion about the employer mandate, a little bit of denial, and a fair amount of complacency on the part of employers. We think many employers believe they have nothing to fear because "we cover our full-time employees with a good plan." In reality, they may have plenty to fear, and could be hit with numerous penalties at some point in the future, unless action is taken to address certain key issues. As the employer mandate is effective for many employers beginning January 1, 2015, the time to address these key issues is now.

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The Penalties

Final regulations were issued on the employer mandate on February 12, 2014 (referred to herein as the "final rules").[3] The employer mandate imposes two types of penalties on "applicable large employers."

No Coverage Penalty

The first penalty, sometimes referred to as the "no coverage penalty," applies if an applicable large employer fails to offer "minimum essential coverage," including dependent coverage, to at least 95 percent (or 70 percent, for 2015) of its full-time employees *and* at least one of its full-time employees receives subsidized coverage from a health insurance marketplace. If these conditions exists for any month, the employer will pay a penalty equal to 1/12 of $2,000[4] multiplied by the number of the employer's full-time employees, disregarding the first 30 (or 80, for 2015) full-time employees.[5]

Inadequate Coverage Penalty

The second penalty, sometimes referred to as the "inadequate coverage penalty," applies if an applicable large employer offers minimum essential coverage, including dependent coverage, to its full-time employees that is not "affordable" or does not provide "minimum value" *and* at least one of its full-time employees receives subsidized coverage from a health insurance marketplace. If these conditions exist for any month, the employer will pay a penalty equal to 1/12 of $3,000[6] multiplied by the number of the employer's full-time employees who receive subsidized coverage from the health insurance marketplace.[7] The amount paid under this penalty will not be greater than the amount that would be paid under the no coverage penalty.

For purposes of the penalties, the term "minimum essential coverage" includes coverage under any group health plan sponsored by an employer, unless the plan only provides "excepted benefits." Plans that only provide excepted benefits include hospital indemnity plans, disability income and accident plans, and stand-alone dental and vision plans.[8] Furthermore, an employee is eligible to receive subsidized coverage from a health insurance marketplace only if their household income is between 100 percent and 400 percent of the federal poverty level and one of the following conditions exists: (i) the health coverage offered by their employer is not affordable, (ii) the health coverage offered by their employer fails to provide minimum value, or (iii) their employer does not offer them health coverage. Other important definitions relating to the penalties, such as the definitions of "affordable" and "minimum value," are discussed below.

Practical Application and Key Issues

The practical application of the foregoing is that, in order to avoid all penalties, an applicable large employer must offer health coverage to *all* of its full-time employees, and the health coverage must be affordable and provide minimum value. We say "all" because if the employer offers such coverage to at least 95 percent (or 70 percent, for 2015) of its full-time employees, but less than 100 percent, the employer would avoid the first penalty but not the second penalty if any one of the employees who have not been offered coverage (*i.e.*, one of the remaining five percent or less) receives subsidized coverage from a health insurance marketplace.

Furthermore, one of the trickier aspects for an employer is dealing with its employees who are not always working full-time, for example, its temporary employees, part-time employees, freelance employees and seasonal employees. Depending on the number of hours these employees actually work, they may be considered full-time employees under the final rules thereby potentially subjecting the employer who fails to offer coverage to such individuals to additional penalties.

In order to determine the steps it needs to take to reduce or eliminate penalties, an employer has to address certain key issues, including whether it is an applicable large employer, whether its plan is affordable and provides minimum value, whether its offer of health coverage is valid, and who are its full-time employees. These issues are discussed below.

Whether an Employer is an "Applicable Large Employer" and Related Issues

The first critical step to determining applicability of the employer mandate penalties is whether an employer is considered an "applicable large employer." Subject to the transition rules discussed later, the term "applicable large employer" means, with respect to a given calendar year, an employer that employed an average of at least 50 full-time employees on business days during the preceding calendar year.[9] While this determination may be relatively simple for many employers, some employers that find themselves hovering at or around the "50 full-time employee" threshold may find it to be a bit more challenging. These employers should engage in the following analysis to determine whether they are subject to these rules. Even if an employer "knows" that it is over the applicable threshold, engaging in the following analysis is still necessary to determine its exact compliance obligations and related planning opportunities.

Identify the "Employer"

As an initial matter, an employer should identify which entity, or entities, constitute the "employer." The determination of whether an employer is an applicable large employer is made on a controlled group basis. In other words, all entities that are treated as a single employer under Sections 414(b), (c), (m), or (o) of the Internal Revenue Code will be considered in the aggregate for purposes of determining if an employer is an applicable large employer.[10] As such, an employer cannot avoid application of these rules by splitting up employees among various related entities.

Moreover, while many employers may be somewhat familiar with the common notion that 80 percent common ownership creates a controlled group, in fact controlled groups (and the related concept of affiliated service groups) can be created at even lower common ownership levels. Thus, special attention should be paid to all investments and joint ventures involving related employers.

The determination of controlled group status may be quite complicated, and is based on the particular facts and circumstances of the employer and the application of detailed regulations under the Internal Revenue Code. For that reason, it is advisable that any individuals having an interest in more than one business (and any employers that have affiliates) consult with specialized legal counsel well in advance of January 1, 2015.

While all members of a controlled group are counted for purposes of determining whether an employer is an applicable large employer, the final regulations retain an important concept from the proposed regulations regarding penalty calculations. The final regulations provide that the determination of any employer mandate penalty is made separately for each entity (referred to as an applicable large employer member) that forms the applicable large employer. This continues to be a significant form of relief for many decentralized employers that may have been concerned about one affiliate's actions causing penalties to be based on employees of all controlled group members. This opens the door to some potential planning, as different compliance approaches may be structured for different controlled group entities.

Identify the "Employees"

For purposes of determining whether an individual is an employee, the final rules utilize the common-law standard – which generally means that an employment relationship generally exists when the person for whom the services are performed has the right to control the individual performing the services.[11] The final rules clarify, however, that the following individuals will not be considered employees for purposes of the new rules: leased employees, sole proprietors, partners in a partnership, and two percent S-corporation shareholders.[12] For numerous reasons, it is important for an employer to properly classify its workers as employees or independent contractors. The employer mandate raises the stakes in this regard because improper classification can lead to employer mandate penalties. Employers that utilize staffing firms (or are themselves a staffing firm) should pay particular attention to these rules when identifying their common-law employees.

Counting Hours for Each Employee

The final rules contain guidance on the counting of hours of service for each employee. In general, the "hours of service" that must be counted are as follows: (1) each hour for which the employee is paid, or is entitled to payment, for the performance of duties for the employer; and (2) each hour for which the employee is paid, or entitled to payment, for a period of time during which no duties are performed by reason of vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.[13] Notably, hours of service for each member of the same controlled group are counted for purposes of this calculation.[14] The ACA hours counting rules are patterned after service counting rules applicable to qualified retirement plans, but in certain respects there can be a lack of clarity in how those rules should be applied in the ACA context.

For employees paid on an hourly basis, an employer must count actual hours of service based on the employer's records.[15] For salaried employees and others who are not paid on an hourly basis, an employer may choose to count hours under any of the following methods: (1) counting actual hours of service (just as the employer would for hourly-paid employees); (2) crediting an employee on a days-worked equivalency, by crediting the employee with 8 hours of service for each day for which the employee would be required to work at least one hour of service; or (3) crediting an employee on a weeks-worked equivalency by crediting the employee with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service.[16]

An employer may change its method of crediting hours of service for non-hourly employees each calendar year.[17] An employer may also use different calculation methods for different categories of employees, provided the categories are reasonable and consistently applied.[18] However, an employer is prohibited from using the days-worked or weeks-worked equivalency methods if it would substantially understate the employee's hours of service.[19] For example, an employer cannot use the days-worked equivalency method for an employee who works three days per week for 11 hours per day.

Determine the Number of Full-Time Employees

For the avoidance of doubt, the following subsections only apply for purposes of determining whether an employer is an applicable large employer.

Once an employer has counted the hours for each of its employees, the employer must determine the number of its full-time employees. Under the final rules, an employee is considered a "full-time employee" for a month if the employee averages at least 30 hours of service per week during that month (or 130 hours of service for the month).[20]

Determine the Number of Full-Time Equivalent Employees

Following a calculation of the number of full-time employees, an employer should look at all of its remaining employees for purposes of determining the number of full-time equivalent employees (FTEs).[21] The number of FTEs for each month is determined by calculating the aggregate number of hours of service (not to exceed 120 hours of service per employee) for each non-full-time employees for such month, and dividing the total aggregate hours of service by 120.[22] The result is the total number of FTEs employed for the calendar month.

By way of example, assume that, during each calendar month of 2014, Employer X has 50 part-time employees, each of whom averages 100 hours of service per calendar month. To determine the total number of FTEs for each calendar month, the total hours of service of the part-time employees (but not more than 120 hours of service per employee) are aggregated and divided by 120. The result is that the employer has 41.67 FTEs for each calendar month (50 part-time employees – multiplied by 100 hours of service – divided by 120).[23]

Special Rules for Seasonal and Other Types of Employees

The final rules contain a special exception for certain seasonal workers. If the sum of an employer's workforce exceeds 50 full-time employees and FTEs for 120 days or less during the preceding calendar year, and the employees in excess of 50 who were employed during that period were seasonal workers, then the employer will not be considered an applicable large employer.[24] Note that, for purposes of this calculation, four calendar months may be treated as the equivalent of 120 days.[25]

A "seasonal worker" (as opposed to a "seasonal employee," which is a term that applies for another purpose, as described below) is defined as a worker who performs labor or services on a seasonal basis and retail workers employed exclusively during the holiday season.[26] Under the final rules, an employer is permitted to apply a reasonable, good faith interpretation when classifying employers as seasonal workers.[27]

The final rules also contain special provisions for new employers (*i.e.*, employers with operations for only a partial year), predecessor and successor employers, and foreign employers. Employers should consult with their legal advisor to determine the applicability of these provisions.

Calculate the Total Number of Employees for Applicable Large Employer Status

Following a determination of the number of full-time employees and FTEs, as well as the application of the seasonal worker and other exceptions, an employer should take the sum of each for each calendar month of the prior calendar year and divide the results by 12. If the resulting number is 50 or more, then an employer is an "applicable large employer" for the next calendar year. Notably, an employer's status as an applicable large employer cannot change mid-year – so if an employer's work force is reduced below the threshold for a particular year, it will not change the employer's status as an applicable large employer for that year. The employer should then engage in the analysis described above to determine whether it remains an applicable large employer for purposes of offering qualified health care coverage for the next year.

Special Transition Rule for 2015

The final rules contain a special transition rule whereby certain employers that employ between 50 and 99 full-time employees (including FTEs) on business days during 2014 may not need to comply with the shared responsibility rules until 2016. In other words, an employer who employed 100 or more full-time employees and FTEs during 2014 will be subject to the new requirements beginning January 1, 2015, while an employer who employed between 50 and 99 full-time employees and FTEs during 2014 will be subject to the rules beginning January 1, 2016, provided certain conditions are satisfied.[28]

Whether a Plan is "Affordable"

Generally, a health plan will be considered "affordable" if the employee is required to contribute for the lowest-cost, self-only coverage offered by the plan (the "qualifying coverage") an amount that does not exceed 9.5 percent of the employee's household income for the taxable year.[29] The trouble with this requirement, however, is that most employers will not know its employees' household income for the applicable year. To address this issue, the final rules provide three safe harbors that employers can apply to determine whether the coverage is "affordable": (1) the Form W-2 safe harbor; (2) the rate of pay safe harbor; and (3) the federal poverty line safe harbor. If an employer meets one of the safe harbor methods, the offer of coverage will be deemed affordable to the employee.

The Safe Harbor Methods

An employer may choose to use one or more of the affordability safe harbors, and may use different safe harbors for different categories of employees, provided it does so on a uniform and consistent basis for all employees in a category.[30] Reasonable categories include specified job categories; nature of compensation (for instance, salaried or hourly employees); geographic location; and similar bona fide business criteria. Note that simply listing employees by name, or by other criteria having the same effect, is not considered under the final rules to be a reasonable category.[31]

The Form W-2 Safe Harbor

A plan is deemed to provide affordable coverage under the Form W-2 safe harbor if an employee's contribution for the qualifying coverage does not exceed 9.5 percent of the employee's wages from the employer (and from other members of the employer's controlled group or affiliated service group that provide the employee wages) reported in Box 1 of Form W-2 for the calendar year.[32] Pre-tax reductions to an employee's compensation (such as 401(k) contributions or health plan contributions) are not added back to the employee's Form W-2 wages when determining whether the safe harbor is satisfied.

In order to use the Form W-2 safe harbor, an employer must meet the following requirements:[33]

- First, the Form W-2 safe harbor is applied at the end of the calendar year, using that calendar year's wages, on an employee-by-employee basis.
- Second, an employee's required contribution must remain a consistent amount or percentage (or a combination of both) for all Form W-2 wages during the calendar year (or plan year, if a non-calendar year is used), so that the employer is not permitted to make discretionary adjustments to the required employee contribution for a pay period.
- Third, for an employee not offered coverage for an entire year, the Form W-2 wages are adjusted to reflect the period for which coverage was offered.

The Rate of Pay Safe Harbor

The rate of pay safe harbor generally requires that a plan charge full-time employees no more than 9.5 percent of their rate of pay for qualifying coverage.[34] It is intended to provide employers with a method of satisfying the affordability requirement without the need to scrutinize each employee's wages and hours. The application of this safe harbor varies for hourly and non-hourly employees.

For an hourly employee, the rate of pay safe harbor is satisfied if the employee's required contribution for a month is no more than 9.5 percent of the employee's hourly rate of pay multiplied by 130 hours. The hourly rate of pay must be determined as of the first day of the coverage period (generally, the first day of the plan year or the time at which the employee enrolls in the plan, if later) or, if lower, the employee's lowest hourly rate of pay during the applicable month. The requirement that employers use an employee's lowest hourly rate of pay for the month is intended to discourage employers from lowering the employee's rate of pay following the start of the coverage period. Notably, this affordability calculation is not altered by a leave of absence or reduction in hours worked during the year.

For a non-hourly employee, the rate of pay safe harbor is met if the employee's required contribution for the month does not exceed 9.5 percent of the employee's monthly salary. For this purpose, the employee's monthly salary is determined as of the first day of the coverage period (generally, the first day of the plan year or the time at which the employee enrolls in the plan, if later). However, the rate of pay safe harbor is not available if an employee's monthly salary is reduced, even if the reduction is due to a reduction in the employee's work hours.

Even though this safe harbor is technically calculated on an employee-by-employee basis, it may nonetheless be the most efficient of the safe harbor designs because if the test is satisfied with respect to the lowest paid employee, then it will also be satisfied for the remainder of the employee population. Moreover, this safe harbor can be applied starting at the beginning of the year whereas the Form W-2 safe harbor is applied at the end of the year.

The Federal Poverty Line Safe Harbor

Under the federal poverty line safe harbor, an employer's offer of coverage will be treated as affordable if the employee's required contribution for qualifying coverage for a given month is not more than 9.5 percent of the most recently published federal poverty line for a single individual for the applicable year, divided by 12.[35] According to the final rules, this safe harbor is intended to provide employers a predetermined maximum amount of employee contribution that in all cases will result in the coverage being deemed affordable.

For purposes of the safe harbor, the applicable federal poverty line will depend on the state in which the employee is employed. There are three different federal poverty lines: one for the 48 continental United States (and the District of Columbia); one for Alaska; and one for Hawaii. In addition, the final rules clarify that an employer can use the federal poverty line as in effect six months prior to the beginning of the plan year.

As a practical matter, the federal poverty line safe harbor may be the easiest of the three safe harbors to apply (in particular, by employers with operations in more than one state), but this may be the most expensive way to comply. By way of example, for an employer with operations only within the continental United States, the safe harbor contribution amount for all employees across all office locations would be $92.39 per month (*i.e.*, the applicable federal poverty line for a single individual - $11,670 – multiplied by 9.5 percent – and divided by 12). So long as a full-time employee's required monthly contribution for qualifying coverage does not exceed that amount, the employer's coverage will be deemed affordable. However, given that the maximum employee contribution for a month cannot exceed $92.39 (for 2014 in the continental United States) – presumably a low contribution rate – the costs associated with utilizing this safe harbor (*i.e.*, the employer's share of the cost of coverage) may serve as a deterrent for employers, despite its administrative convenience.

Whether a Plan Provides "Minimum Value"

An employer's health plan will be considered to provide "minimum value" (MV) if the plan's share of the total cost of benefits provided by the plan equals or exceeds 60 percent of such costs.[36] In other words, no more than 40 percent of the total cost of benefits can be passed on to participants. Employees will typically pay costs through such things as co-pays and deductibles. The higher these cost sharing or out-of-pocket expenses, the lower the plan's expected MV percentage will be.

The Department of Treasury and Department of Health and Human Services (HHS) have provided employers with several methods for determining MV:

(1) The MV calculator;

(2) Design-based safe harbors;

(3) Actuarial certification; and

(4) For small group market plans, a metal level.[37]

Minimum Value Calculator

HHS has released a MV calculator that allows an employer to enter certain information about the benefits offered by the health plan, its covered services, and cost-sharing requirements to determine whether the plan provides MV.[38]

Design-Based Safe Harbors

HHS and the IRS are also developing designed-based safe harbors in the form of checklists that are intended to give employers a method for determining whether a plan provides MV, but without the need to perform calculations. If the features of the employer's plan (such as deductibles, out-of-pocket maximums, cost-sharing limits, etc.) are consistent with or more generous than any of the design-based safe harbors, then the plan would be treated as providing MV.

Actuarial Certification

If a plan contains non-standard features that do not lend themselves to use of either of the two methods described above, the employer may use a certified actuary to determine the plan's MV percentage.

Metal Coverage for Small Group Plans

If a small group plan satisfies the requirements for any of the levels of "metal" coverage provided for under the ACA (*i.e.*, a "bronze," "silver," "gold," or "platinum" plan), then it will be deemed to provide MV.

Whether an "Offer" of Coverage Has Been Made

To avoid penalties, the employer must offer health coverage to its full-time employees. An offer of coverage is made if the full-time employee is given an effective opportunity to enroll in health coverage.[39] Auto-enrollments are generally treated as offers of coverage provided the employee is given the opportunity to opt out.

Whether an effective opportunity to enroll (or opt out) has been provided is based on all relevant facts and circumstances. Such facts and circumstances include the adequacy of the offer and the amount of time the employee has to accept the offer. An employer can likely place reasonable conditions on the offer, such as requiring employees to complete a health-related survey.

Dependents

The offer of coverage must include coverage for the full-time employee's dependents. A "dependent" is an employee's biological or adopted child under the age of 26. Step and foster children are not considered dependents, nor are dependent children who are not United States citizens. An employer must offer coverage to the dependent child through the end of the month in which the child attains age 26. In other words, an employer should not drop a dependent from coverage immediately upon attaining age 26. An employer need not undertake an independent investigation to determine the number and ages of dependents and, instead, may rely on the written representations of their employees. Notably, spouses need not be offered coverage.[40]

Controlled Groups

If an employer is part of a controlled group and participates in a health plan maintained by another controlled group member, the offer of coverage by the controlled group member to the employer's full-time employees is treated as an offer of coverage by the employer. For example, if a holding company maintains a health plan in which its operating companies participate, the holding company's offer of coverage to an operating company's employees is treated as an offer by the operating company.[41]

MEWAs and Multiemployer Plans

If an employer participates in a multiple employer welfare arrangement (MEWA) (as may be the case if the employer uses a professional employer organization to provide welfare benefits) or a multiemployer welfare plan (as may be the case if the employer has union employees), offers of coverage under such plans will be treated as being made by the employers who participate in them.[42]

Staffing Firms

An employer may use workers hired through a temporary staffing agency or a professional employer organization (PEO). If the workers are the common law employees of the staffing agency or PEO, the staffing agency or PEO is responsible for offering health coverage to the workers or they may face potential penalties. However, if the workers are the common law employees of the employer, the employer is technically responsible for offering health coverage to the workers, which may not be consistent with the employer's business needs or expectations. Fortunately, in this situation, the offer of coverage from the staffing agency or PEO is treated as the employer's offer, provided the fee the employer pays to the staffing agency or PEO for the worker with health coverage is higher than the fee for the worker without health coverage.[43] As indicated above, if the staffing agency or PEO utilizes a MEWA, the offer of coverage through the MEWA would satisfy the employer's responsibility to offer coverage. An employer's contract with a staffing agency or PEO should be reviewed by legal counsel before January 1, 2015 to ensure that it requires the agency or PEO to provide coverage in accordance with the employer mandate. An employer will also want a provision in the contract pursuant to which it is indemnified for penalties incurred as a result of the staffing agency's or PEO's failure to provide such coverage.

Determining Who is a Full-Time Employee

For purposes of calculating the penalties and/or determining who should receive an offer of coverage, there are two methods for determining full-time employees: the monthly measurement method and the look-back measurement method. While the monthly method might be useful for employers who employ substantially only full-time employees and/or part-timers who consistently work less than 30 hours per week, many employers, particularly those in the retail, hospitality and food service industries, may find the look-back method to be more useful. One of the drawbacks of the look-back method, however, is its complexity and, therefore, employers would be wise to consider both methods. Under both methods, hours are counted in the same manner as described earlier.

Monthly Method

Under the monthly method, an employer counts the number of hours each employee works each month.[44] An employee who averages 30 or more hours per week during a month or is credited with 130 of hours during a month is treated as a full-time employee for that month. An employee does not receive credit for any hours during which he or she is on unpaid leave, including leave under the Family and Medical Leave Act (FMLA) and the Uniformed Services Employment and Reemployment Rights Act (USERRA). In effect, the monthly method requires an employer to determine at the end of the month whether an employee was a full-time employee for such month. Under the monthly method, if a full-time employee is first offered coverage no later than the first day of the fourth calendar month following the date they are otherwise eligible for coverage as a full-time employee, the employer will not be penalized for failing to offer earlier coverage.[45]

Because of its retroactive nature, the practical impact of using the monthly method is to force an employer to offer qualifying coverage to any employee who it believes has the possibility of being treated as a full-time employee during the year. The retroactive nature of the monthly method limits its utility, although, as indicated above, some employers who have workforces comprised primarily of full-time employees and/or part-time employees who never become full-time employees may find it beneficial. In addition, an employer may be able to offer all of its employees a "bronze" or lower level plan (often referred to as a "skinny plan") that provides minimum essential coverage, thereby avoiding the no-coverage penalty. Notably, if the skinny plan is not affordable or does not provide MV (as is more typically the case), the employer still risks being subject to the inadequate coverage penalty, although under these circumstances the inadequate coverage penalty promises to be significantly less than the no coverage penalty. Employers looking to adopt a skinny plan should note that there is ongoing regulatory scrutiny of such plans and should therefore monitor the development of the law in this area.

Look-Back Method

The look-back method allows employers to identify their full-time employees on a prospective basis and, therefore, may be more useful to an employer that has numerous employees who work varying hours. Under the look-back method, an employer determines the number of hours credited to an employee during a "measurement period."[46] Depending on the number of hours the employee is credited with during the measurement period, the employee will be treated as a full-time employee (or a non-full-time employee) during a subsequent "stability period," at which time a full-time employee must be offered coverage to avoid penalties. Different rules apply under the look-back method depending on whether an employee is an ongoing employee or a new hire.

Ongoing Employees

The final rules provide that an "ongoing employee" is someone who has been employed for at least one standard measurement period.[47] In other words, after a person is hired and employed through a standard measurement period, he or she will be treated as an ongoing employee as of the beginning of such measurement period (as well as for subsequent standard measurement periods until the person's employment terminates). A standard measurement period is established by the employer. It may begin on any date, but it cannot be shorter than three months or longer than 12 months. Further, the measurement period need not be based on calendar months (*i.e.*, an employer generally may use the beginning and end of payroll periods as the beginning and end of the measurement period).[48]

If an employee averages at least 30 hours per week or at least 130 hours per month during the standard measurement period, the employee will be treated as a full-time employee during the subsequent standard stability period, regardless of the number of hours he or she works during such stability period.[49] Under these circumstances, the stability period must be based on calendar months and must be the greater of six months or the duration of the standard measurement period.[50]

If the employee does not average at least 30 hours per week or 130 hours per month during the standard measurement period, the employee will be treated as a non-full-time employee during the subsequent standard stability period, regardless of the number of hours he or she works during such stability period. Under these circumstances, the stability period must be based on calendar months and must not exceed the duration of the standard measurement period.[51]

An employer may also establish an "administrative period" of up to 90 days in between the standard measurement period and the standard stability period.[52] An administrative period is useful because, during the administrative period, the employer may determine the full-time status of its employees and make an offer of health coverage to those who have been determined to be full-time employees.

An example of common standard measurement/administrative/stability periods that an employer might use is as follows. Note that the periods must run consecutively.

• Standard Measurement Period	October 15, 2014–October 14, 2015
• Administrative Period	October 15, 2015–December 31, 2015
• Standard Stability Period	January 1, 2016–December 31, 2016

Although every situation is different, most employers will want to select a measurement period of at least 12 months (*i.e.*, the longest measurement period possible) in order to cut down on the number of employees who are treated as full-time employees during the related stability period. The reason is that, in many cases, counting hours over a 12-month period will dilute an employee's hours. Using a 12-month measurement period also enables an employer to use a 12-month stability period which is beneficial for facilitating plan administration.

Generally, the standard measuring period and the standard stability period must be the same for all employees of an employer, although an employer may use different periods for employees in different states, salaried and hourly employees, union and non-union employees, and union employees covered by separate bargaining agreements.[53]

New Hires

A new hire includes anyone who is hired during a standard measurement period. The first thing an employer must do when it hires someone is to classify them as a "full-time employee," a "seasonal employee," a "part-time employee" or a "variable hour employee." Classifying the employee correctly is critically important, as misclassifications may lead to penalties. The employer should identify the person or persons within their organization who is responsible for making the classifications and train them how to make classifications. The responsible person's decisions and the reasons behind them should be documented. Close calls should be discussed with legal advisors and audits of the responsible person's decisions should be periodically performed. Employment materials, including offer letters, job descriptions and employee handbooks, should be reviewed before January 1, 2015 to confirm they have been updated for this important element of

ACA compliance. Additionally, it may be appropriate to provide special training to HR staff involved in the classification of new hires.

A person should be classified as a "full-time employee" if, based on all the facts and circumstances, he or she is reasonably expected to work at least 30 hours per week (or 130 hours per month) beginning on his or her start date.[54] Factors to consider include how the job was advertised and communicated to the employee, whether the employee is replacing a full-time employee and the classification of employees in comparable job positions. The length of the employee's expected employment is disregarded for purposes of determining full-time employee status.[55] Thus, if a new hire is expected to work on a temporary or short-term basis, but is also expected to work at least 30 hours per week during their period of employment, the person may need to be classified as a full-time employee unless another exception applies (*e.g.*, they are a seasonal employee).

A person is a "seasonal employee" if their customary period of work is generally 6 months or less.[56] "Customary" means that the position of employment begins at roughly the same time each year, such as in the winter, spring, summer or fall. Examples of seasonal employees may include holiday retail associates.

A person should be classified as a "part-time employee" if he or she is reasonably expected to work less than 30 hours per week,[57] and as a "variable hour employee" if it cannot be determined how many hours the employee is reasonably expected to work.[58] "Seasonal," "part-time" and "variable" employees are referred to collectively as "non-full-time employees."

When an employer hires a new full-time employee, the employer basically applies the monthly method described above until the employee becomes an ongoing employee. However, when an employer hires a new non-full-time employee, the employer must establish an initial measurement period for the new employee that may begin as late as the first day of the month following the employee's start date and must be between three and 12 months in length.[59] The number of hours credited to the employee during this initial measurement period will determine whether the employee should be treated as a full-time employee (or a non-full-time employee) during the initial stability period. An employer may also establish an administrative period of up to 90 days. However, if the initial measurement period does not begin on the employee's start date, the 90-day administrative period must be reduced by the number of days in between the employee's start date and the start of the initial measurement period. In addition, the administrative period and the initial measurement period together must not extend beyond the last day of the first calendar month which begins on or after the first anniversary of the employee's start date.[60]

If an employee averages at least 30 hours per week or at least 130 hours per month during the initial measurement period, the employee will be treated as a full-time employee during the initial stability period, regardless of the number of hours he or she works during the stability period. Under these circumstances, the length of the initial stability period must be based on calendar months and must be at least equal to the greater of six consecutive calendar months or the duration of the initial measurement period. [61]

If the employee does not average at least 30 hours per week or 130 hours per month during the standard measurement period, the employee will be treated as a non-full-time employee during the initial stability period, regardless of the number of hours he or she works during the stability period. Under these circumstances, the length of the stability period must be based on calendar months and cannot exceed the initial measurement period plus one month. It also cannot exceed the balance of the first standard measurement period (plus administrative period) for which the non-full-time employee has been employed.[62]

If a non-full-time employee has a change in employment status within the company during the initial measurement period (*e.g.*, the employee changes jobs) such that the employee is reasonably expected to work 30 or more hours per week, the employee must be treated as a full-time employee on the first day of the calendar month following the status change. Generally, however, the employer will not incur a penalty with respect to the employee if the employee is offered health coverage by the first day of the fourth month following the employee's change in status.[63]

The rules that an employer establishes for its initial/administrative/stability periods must apply uniformly to all employees, except regarding the categories of employees discussed above with respect to ongoing employees.[64]

The rules on new hires are no doubt complex. The important thing to remember is once an employee is hired, they will have their own initial (measurement/administrative/stability) period unless they are classified as full-time. At some point during such period, the employer's standard (measurement/administrative/stability) period will start. Thus, at some point the employer will be counting hours under both the initial and standard periods. Once the employee's initial period ends, the employee will remain under the employer's standard period (and subsequent standard periods) until the employee's employment ends.

Breaks in Service

Special break in service rules apply in the case of an employee who is terminated and later rehired, or goes out on an unpaid leave of absence.

If an employee incurs a break in service of 13 consecutive weeks or more and then returns to service, the employee should be treated as a new hire under the monthly method or the look-back method.[65] Regardless of which method the employer uses, if the employee returns as a full-time employee following a break in service of 13 consecutive weeks or more, he or she should be offered coverage no later than the first day of the fourth full calendar month following the employee's date of return. If the employee returns as a non-full-time employee, an employer using the look-back method would commence a new initial measurement period for the employee.

If an employee incurs a break in service of less than 13 consecutive weeks, the rules are different. For an employer using the look-back method, an employee who returns during a stability period retains his or her pre-break status. For example, if the employee was treated as a full-time employee during a stability period and then incurs a break of less than 13 weeks, he or she would be treated as a full-time employee upon return from break. If the employee was covered under the employer's health plan pre-break but lost coverage during the break, the returning employee must be offered coverage no later than the first day of the calendar month following his or her return from break. Furthermore, an employee who returns from break is credited with zero hours for the portion of the measurement period during which the employee was on break. The impact is that the employee who goes on break will have a lower number of hours during the measurement period and, therefore, may not qualify as a full-time employee during the subsequent stability period.

For an employer that uses the monthly method, an employee who was a full-time employee and returns from a break of less than 13 consecutive months as a full-time employee must be offered coverage (if coverage was lost during the break) by the first day of the calendar month following his or her return. The typical three-month waiting period does not apply in this case.

As an alternative to the foregoing rules, an employer may apply a "rule of parity" for purposes of determining whether an employee is to be treated as a new hire upon return from break. Under the rule of parity, if an employee's break in service is at least four consecutive weeks (but less than 13 weeks) and longer than his or her pre-break service, the employee can be treated as a new hire upon returning from break.[66] For example, if an employee works for an employer for 10 weeks and then incurs a break of 11 weeks, he or she may be treated as a new hire upon return.

For an employer that uses the look-back method, special unpaid leave rules apply to an employee whose break in service is less than 13 weeks.[67] Special unpaid leaves include jury duty and leaves taken under the FMLA and USERRA. If an employee takes one of the special unpaid leaves during a measurement period, then the employer must either (i) impute the employee's average weekly hours to the period of unpaid leave, using any reasonable method consistently applied, or (ii) disregard the period of the unpaid leave when averaging the employee's hours of services.

As a consequence of the foregoing rules, an employer that uses the look-back method and does not provide health coverage during a full-time employee's leave of absence would need to reconsider this policy, as the look-back method requires coverage to be offered to a full-time employee during the stability period, regardless of the number of hours worked during the stability period. Moreover, before adopting the look-back method, an employer should consider the effect such method may have on employees on leave. Specifically, will employees be more likely to extend their leave when they realize they have a right to affordable health benefits during the entirety of the stability/leave period? This is a question employers should consider as they evaluate the costs and benefits of the look-back method.

Additional Transition Rules for 2015

The final rules provide a variety of transition rules for 2015.[68] For example, for stability periods that begin in 2015, an employer may use a measurement period of between six and 12 months, which begins no later than July 1, 2014, and ends no earlier than 90 days before the start of the 2015 plan year.[69] In effect, this means that employers may use a six-month measurement period for a 12-month stability period in 2015. This may be a particular benefit for employees in certain industries that experience a slowdown in the summer months, including educational institutions. In addition, if an employer maintains its health plan on a non-calendar year basis, the employer will be able to begin compliance with the employer mandate on the first day of the plan year beginning after January 1, 2015, provided certain conditions are satisfied.[70] Further, an employer can apply any six-month period within 2014 (rather than the entire 2014 calendar year) for purposes of determining whether it is an applicable large employer in 2015.[71]

Conclusion

Is it possible that Led Zeppelin was presciently thinking of the ACA when they wrote in Stairway to Heaven that "your head is humming"? Probably not. But anyone's head is likely to be humming after considering all of the foregoing rules. To "game plan" the employer mandate, it is recommended that an employer establish a task force consisting of HR, benefits, systems, financial, and specialized employee benefits legal counsel to deal with the various issues described above. If an employer's health plan currently covers full-time employees (*i.e.*, those who are scheduled to work at least 30 hours per week), is affordable and provides MV, the employer is already well on its way toward minimizing applicable penalties. Among other things, employers should focus on their employees who are not covered by their plan and assess whether any of them could be considered full-time employees. If the answer is affirmative, the employer has options, some of which would include:

- Continuing to exclude those employees from the plan and potentially paying penalties;
- Offering them coverage under the plan;
- Offering them coverage under a separate plan, such as a skinny plan; or
- Using the look-back method to reduce or eliminate the number of uncovered full-time employees.

Unfortunately, the issues are complex and no one size fits all.

Notes

1. Amira, Dan (August, 2011). *Daily Intelligencer.* Retrieved from *www.nymag.com*.

2. "Stairway to Heaven" by Led Zeppelin is often voted the number one rock song by listeners of classic rock radio stations. Milli Vanilli is not.

3. 79 Fed. Reg. 8543 (February 12, 2014) (Regulation).

4. After 2014, the amount of $2,000 will be indexed by the premium adjustment percentage, as defined in Section 1302(c)(4) of the Patient Protection and Affordable Care Act, for the calendar year. *See* Internal Revenue Code (Code) § 4980H(c)(5).

5. Treas. Reg. § 54.4890H-4(a).

6. After 2014, the amount of $3,000 will be indexed by the premium adjustment percentage, as defined in Section 1302(c)(4) of the Patient Protection and Affordable Care Act, for the calendar year. *See* Code § 4980H(c)(5).

7. Treas. Reg. § 54.4890H-5(a).

8. Code § 5000A(f).

9. Treas. Reg. § 54.4980H-1(a)(4).

10. Treas. Reg. § 54.4980H-1(a)(16).

11. Treas. Reg. § 54.4980H-1(a)(15); *see also* Treas. Reg. §31.3401(c)-1(b).

12. Treas. Reg. § 54.4980H-1(a)(15).

13. Treas. Reg. § 54.4980H-1(a)(24)(i). Certain hours of service, such as those that were performed as a bona fide volunteer or as part of a government-sponsored work-study program, are excluded from this calculation. In addition, hours of service will also be excluded to the extent that compensation for those services constitutes non-U.S. source income. Treas. Reg. § 54.4980H-1(a)(24)(ii).

14. Treas. Reg. § 54.4980H-1(a)(24)(iii).

15. Treas. Reg. § 54.4980H-3(b)(2).

16. Treas. Reg. § 54.4980H-3(b)(3).

17. Treas. Reg. § 54.4980H-3(b)(3)(ii).

18. *Id.*

19. Treas. Reg. § 54.4980H-3(b)(3)(iii).

20. Treas. Reg. § 54.4980H-1(a)(21).

21. Treas. Reg. § 54.4980H-2(c)(1).

22. Treas. Reg. § 54.4980H-2(c)(2).

23. The Regulations provided that, in determining the number of FTEs for each calendar month, fractions are taken into account, and should be rounded to the nearest one-hundredth. *See* Treas. Reg. § 54.4980H-2(c)(2).

24. Treas. Reg. § 54.4980H-2(b)(2).

25. *Id.*

26. Treas. Reg. § 54.4980H-1(a)(39).

27. *Id.*

28. The conditions are found in Regulation Preamble § XV.D.6.a; they include the condition that the employer certify its eligibility for transition relief on a prescribed form.

29. Code § 36(B)(c)(2)(C)(i); Treas. Reg. § 1.36B-1(e).

30. Treas. Reg. § 54.4980H-5(e)(2)(i).

31. *Id.*

32. Treas. Reg. § 54.4980H-5(e)(2)(ii).

33. *See generally* Treas. Reg. § 54.4980H-5(e)(2)(ii)(A)-(B).

34. Treas. Reg. § 54.4980H-5(e)(2)(iii).

35. Treas. Reg. § 54.4980H-5(e)(2)(iv).

36. Code §36B(c)(2)(C)(ii); Prop. Reg. § 1.36B-6(a).

37. Prop. Reg. § 1.36B-6(d).

38. The calculator can be found at *www.cms.gov*.

39. Treas. Reg. § 54.4890H-4(b)(1).

40. Treas. Reg. § 54.4890H-1(a)(12).

41. Treas. Reg. § 54.4890H-4(b)(2).

42. *Id.*

43. *Id.*

44. Treas. Reg. § 54.4890H-3(c)(1).

45. Treas. Reg. § 54.4890H-3(c)(2).

46. Treas. Reg. § 54.4890H-3(d)(1)(i).

47. Treas. Reg. § 54.4890H-1(a)(31).

48. *See* Treas. Reg. § 54.4890H-3(d)(1)(ii).

49. Treas. Reg. § 54.4890H-3(d)(1)(i).

50. Treas. Reg. § 54.4890H-3(d)(1)(iii).

51. Treas. Reg. § 54.4890H-3(d)(1)(iv).

52. Treas. Reg. § 54.4890H-3(d)(1)(vi).

53. Treas. Reg. § 54.4890H-3(d)(1)(v).

54. Treas. Reg. § 54.4890H-3(d)(2)(i).

55. Treas. Reg. § 54.4890H-3(d)(2)(ii).

56. Treas. Reg. § 54.4890H-1(a)(38).

57. Treas. Reg. § 54.4890H-1(a)(32).

58. Treas. Reg. § 54.4890H-1(a)(49).

59. Treas. Reg. § 54.4890H-3(d)(3)(i).

60. Treas. Reg. § 54.4890H-3(d)(3)(vi)(B).

61. Treas. Reg. § 54.4890H-3(d)(3)(iii).

62. Treas. Reg. § 54.4890H-3(d)(3)(iv).

63. Treas. Reg. § 54.4890H-3(d)(3)(vii)(A).

64. Treas. Reg. § 54.4890H-3(d)(3)(v).

65. Treas. Reg. § 54.4890H-3(d)(6)(i)(A).

66. Treas. Reg. § 54.4890H-3(d)(6)(iv).

67. Treas. Reg. § 54.4890H-3(d)(6)(i)(B).

68. Regulation Preamble § XV.D.

69. Regulation Preamble § XV.D.2.

70. The conditions are found in Regulation Preamble § XV.D.1; they include the conditions that the employer must have maintained the non-calendar plan as of December 27, 2012.

71. Regulation Preamble § XV.D.3.