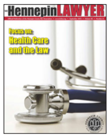
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The Affordable Care Act's Employer Mandate: Guide to Advising Large Employers

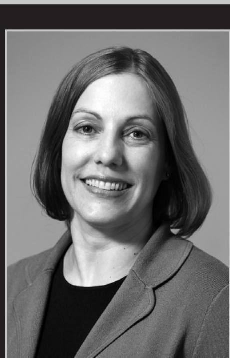
Are you overwhelmed by the seemingly never-ending stream of health care reform regulations and guidance being issued? Are clients asking you what parts of the Affordable Care Act (ACA) apply to them and what exactly they should be doing to prepare for health care reform?

Though this article will focus on the obligations required of large employers, as defined by the Act, portions of this law impact employers of all sizes. This is because the law itself creates a new health insurance exchange which offers individuals and employers a choice of health care plans. As of 2014, small employers can participate in the exchange program. By 2015, states have the option to define the upper limit for small employers as between 50 and 100 employees. By 2016, small employers must be defined as employing up to 100 employees. Employers can continue to provide coverage outside of the exchanges at their own choosing.

In spite of the considerable controversy and politically-charged rhetoric, including a nationally-debated Supreme Court decision on its constitutionality, the employer-shared responsibility portion (also referred to as the employer or "pay or play" mandate) of the Patient Protection and Affordable Care Act which was signed into law on March 23, 2010, will officially become a reality for most employers and their counsel on January 1, 2015. Pub.L. 111–148, 124 Stat. 119, to be codified as amended at scattered sections of the Internal Revenue Code and in 42 U.S.C. This implementation date was recently changed from January 1, 2014 due to concerns from employers that the reporting requirements were too complex and that systems could not be implemented in time to assure compliance with the law.

Though the details continue to evolve, the Internal Revenue Service (IRS) and Department of the Treasury provided considerable guidance in disseminating the proposed regulations, "Shared Responsibility for Employers Regarding Health Coverage," on January 2, 2013. While these proposed regulations have not yet been finalized, the IRS has indicated that taxpayers may rely on them for purposes of compliance with the employer-shared responsibility provisions. Even if the final regulations are more restrictive than the guidance in the proposed regulations, the final regulations will be applied prospectively, and employers will be given sufficient time to come into compliance with the final regulations.

Conscientious counsel would be wise to familiarize themselves with these proposed regulations as soon as possible, so they can begin to counsel their clients on the obliga-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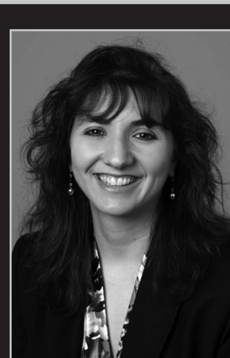
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tions associated with the employer-shared responsibility portion of the ACA. This article will outline the basic elements of the employer-shared responsibility portion of the ACA; who it applies to; when it applies; and the penalties employers will face if they fail to meet their obligation to provide minimum essential health coverage that is affordable and provides minimum value to substantially all employees. We also offer practical tips for practitioners and their clients to contemplate as they begin to navigate their obligations under the employer mandate.

Which Employers Are Subject to "Pay or Play?"

One of the most controversial features of the ACA lies in the per employee penalty provisions, or the "pay or play mandate." Beginning in 2014, the pay or play mandate will require applicable large employers (those employing on average at least 50 full-time equivalent employees (FTEEs) on business days during the preceding calendar year) to offer minimum essential, minimum value and affordable health coverage to at least 95 percent of their full-time employees (those working on average at least 30 hours per week) and their dependents, or be subject to penalties. Penalties will be computed and assessed on a monthly basis, and will be assessed separately for each employer within a controlled group. In a later section of this article, we will examine the specific definitions associated with these terms, as well as the related penalties; however, the important aspect to understand at this juncture is that these penalty provisions only apply if an employer meets the definition of an "applicable large employer" and then only when the employer fails to provide minimum essential coverage that is affordable and offers the requisite minimum value. Each of these concepts will be explored below.

Who Is an "Applicable Large Employer?"

Like other federal employment laws, only certain employers, referred to as applicable large employers, are subject to the pay or play obligations under the ACA. An "applicable large employer" is defined in the proposed regulations as an employer that employed an average of at least 50 "full time employees," including "full-time equivalent" (FTE) employees on business days during the preceding calendar year based on a specified look-back time, referred to as the "determination period."[1]

Establish the Determination Period

Employers must first establish the determination period to be used for counting employees to determine applicable large employer status under the pay or play mandate. Once the employer mandate provisions go into effect in January 2014, employers will be required to look back at each calendar month in the preceding calendar year and count actual hours of service. However, for the first year only, the regulations allow employers to designate a shorter employee counting period (any consecutive six-month period in 2013) in which to determine whether an average of at least 50 full-time (and FTE) employees were employed. This one-time concession provides an opportunity for counsel and their clients to creatively think about application of the employer mandate provisions before the regulations officially go into effect.

An example of this application will best illustrate this point. Assume that from January 1 to June 30, 2014, a company employed fewer than 50 full-time employees, but, it employed more than 50 full-time employees from July 1 to December 31, 2014. Though the more recent six-month period would bring the employer within the definition of an applicable large employer, the employer has the option to choose the first six months of 2014 as its determination period, thereby excluding itself from the employer mandate for the 2015 calendar year.

Practice Tip #1: To the extent that employers determine they are not an applicable large employer in the first year of the Act because they employed fewer than 50 full-time (or full-time equivalent) employees during any six-month period in 2014, it would be prudent for counsel to remind their clients to keep a record of the calculation they performed in order to support their decision in the event that the IRS requests an explanation at a later time.

Who Are "Employees?"

Once the determination period has been set, the employer must next determine which workers are considered "employees," as defined by the proposed regulations. The employer-shared responsibility regulations define an "employee" under the common law definition which recognizes that an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is accomplished. Notably, because this definition requires only that the employer has the right to control the services, even if it never actually directs or controls services, it differs considerably from the definition, and interpretation, of "employee" under other employment laws, such as the Fair Labor Standards Act.[2] Under the proposed rule's definition of employee, neither a sole proprietor, nor a partner in a partnership, nor a two-percent S corporation shareholder would be considered an employee, but an individual who provides services as both an employee and a non-employee, such as a company director, would be considered an employee for purposes of determining status as an applicable large employer.

Practice Tip #2: To the extent that employers hire independent contractors, counsel should consider advising clients to use independent contractor agreements to govern those relationships. Moreover, in crafting such agreements, provisions that allow for the employer's retention of the right to control that worker's services should be avoided.

Who Are "Full Time Employees?"

Only full-time employees, and full-time equivalent employees, must be included in the calculation for determining whether an employer is an applicable large employer. An employee will be considered to work full-time only if he or she is employed an average of at least 30 hours of service per week, or 130 hours in a calendar month. Hours of service includes all hours for which employees are paid or entitled to payment, even when no work is performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. For hourly employees, employers can count actual hours worked in making this determination, while non-hourly employees' hours can either be determined by counting actual hours, or using a days-worked or weeks-worked equivalency method to make the same calculation. Notably, "hours worked" does not include any hours worked outside of the United States, so if your company, or your client's company, employs workers overseas, those hours should not be included in the calculation.

Practice Tip #3: Many employee handbooks provide that employees who work less than 32 hours per week are considered part-time employees and therefore do not qualify for health care benefits. If your client's organization defines employees in this manner, the definition will need to be changed as it relates to providing the benefit of health care coverage; however, other benefits not covered by the ACA can remain at 32 hours.

Who Are "Full-Time Equivalent Employees?"

In addition to full-time employees, employers must also count FTEEs in their calculation for purposes of determining whether an employer is an applicable large employer. This means all employees (including seasonal employees) who were not full-time employees for any month in the preceding calendar year must be included in calculating the employer's FTEEs count for that month by (1) calculating the aggregate number of hours of service for all employees who did not work at least 30 hours per week for that month, and (2) dividing the total hours of service by 120.

For example, if, in a given calendar month the number of hours of all employees who individually worked less than 30 hours per week aggregated a total of 1,500 hours of service, that employer must add 12.5 FTEEs for that month (1,500/120) to the overall calculation of employees.

Practice Tip #4: Counsel should advise clients who are close to employing 50 full-time employees in any given month to pay particular attention to the number of hours worked by part-time staff because the aggregate number of hours worked may push the employer over the 50 full-time employee threshold and expose the organization to pay or play penalties.

There is a seasonal worker exception to this rule. Where an employer's workforce exceeds 50 full-time employees for 120 days or less during the preceding calendar year, but only because of seasonal workers, the employer is not deemed to be an applicable large employer. Seasonal workers are defined in the regulations as workers who perform labor or services on a seasonal basis and retail workers employed exclusively during the holiday seasons. The regulations also state that for purposes of this particular exception, four calendar months may be treated as the equivalent of 120 days, and that the 120 days are not required to be consecutive.

How Are Employees of a Controlled Group Treated?

All employees of a controlled group, or affiliated service group, are taken into account in determining whether the group together constitutes an applicable large employer. In general, this means if a parent company owns 80 percent or more of the equity in a subsidiary, or if the same five or fewer persons own 80 percent or more of the equity in another company and collectively own more than 50 percent of both companies, the companies will be considered controlled groups and all employees of the controlled group must be combined together for purposes of calculating whether an employer is above or below the 50 FTEE threshold.

In most cases, it will be readily apparent whether an employer meets the definition of an applicable large employer; however, those small-to-medium-sized employers who have a fluctuating number of full and/or part-time employees that hover close to the 50-employee mark will need to perform a more in-depth calculation to determine if they are obligated to comply with the employer mandate portion of the ACA.

What Constitutes Minimum Essential Coverage?

Once a determination is made that an employer qualifies as an applicable large employer, the next question in the analysis is whether the employer's health coverage provides minimum essential coverage. The proposed regulations define minimum essential coverage as coverage under certain government programs such as Medicare Part A, coverage under an employer-sponsored plan, plans in the individual market, grandfathered health plans and other coverage recognized by the Department of Health and Human Services.

What Constitutes "Affordable" Health Coverage?

The next question in the analysis is whether the employer's health coverage is "affordable." Coverage for an employee under an employer-sponsored plan is "affordable" if the employee's required contribution for self-only coverage does not exceed 9.5 percent of the employee's household income for the taxable year.

Because most employers will not know an employee's household income at the outset, the proposed regulations offer three affordability safe harbor provisions, (1) the Form W-2 safe harbor; (2) the rate of pay safe harbor; and (3) the federal poverty line safe harbor. These safe harbors are all optional and employers may choose one or more of them for all employees, or any reasonable category of employees, so long as the employer uniformly and consistently applies the same safe harbor for all employees in a particular category. If an employer uses one of these methods, then they will not face affordability penalties under the ACA as long as the employee's share of the cost of health coverage does not exceed 9.5 percent of the employee's [household] income for the taxable year.

The Form W-2 Safe Harbor

The Form W-2 safe harbor allows an employer to determine affordability by reference to an employee's wages as reported in Box 1 of Form W-2 for the calendar year. To qualify for this safe harbor, the employer must: (1) offer at least 95 percent of its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan; and (2) the employee's contribution toward the self-only premium for the lowest cost coverage available must not exceed 9.5 percent of the employee's Form W-2 wages for that calendar year, as determined after the end of the calendar year and on an employee-by-employee basis. While applied at the end of the calendar year, an employer can also use the W-2 safe harbor prospectively to set the employee contribution at a level such that it would never exceed 9.5 percent of that employee's W-2 wages for that year. A more detailed analysis must be conducted in cases where the employee is employed for less than a full year by the same employer.

The Rate of Pay Safe Harbor

Under the rate of pay safe harbor, employers (1) take the hourly rate of pay for each hourly employee who is eligible to participate in the health plan as of the beginning of the plan year, (2) multiply that rate by 130 hours per month (for salaried employees, monthly salary would be used instead of hourly rate of pay x 130 hours), and (3) determine affordability based on the resulting monthly wage amount. The employee's monthly contribution amount for the self-only premium is "affordable" under this safe harbor, only if it is equal to or lower than 9.5 percent of the computed monthly wages. An employer can only rely on this safe harbor provision with respect to an employee for 2015, if it does not reduce the employee's wages during 2015.

This provision may be attractive to some employers because it allows them the opportunity to make the affordability determination for a group of similarly-paid employees, instead of having to perform a separate analysis based on each employee's wages and hours. For example, all hourly employees who earn $20.00 per hour would have computed monthly wages of $2,600 per month ($20.00 x 130), and could not be charged more than $247 in self-only premiums per month. Similarly, salaried employees who earn $10,000/month could not be required to pay more than $950 in self-only premiums on a monthly basis.

The Federal Poverty Line Safe Harbor

A third safe harbor provision is available which would allow an employer to rely on a design-based safe harbor using the federal poverty line for a single individual. This provision was offered in response to public concern that determinations of affordability should disregard employees whose income would otherwise qualify for coverage under Medicaid. Under this method, employer-provided coverage is affordable if the employee's cost for self-only coverage under the plan does not exceed 9.5 percent of the federal poverty line for a single individual. Employers are permitted to use the most recently-published poverty guidelines as of the first day of the plan year. As of January 24, 2013, the federal poverty line for the 48 contiguous states, plus Washington, D.C., was $11,490 for a single-person household.

Practical Tip #5: Given the various safe harbor provisions available on the issue of "affordability," counsel should encourage clients to analyze each safe harbor provision and determine which one is most appropriate for that employer's specific situation, e.g., a larger employer may prefer the Rate of Pay Safe Harbor provision because it avoids having to make individual calculations for each employee on affordability.

What is Considered "Minimum Value" Coverage?

The next consideration for employers who wish to avoid the pay or play penalty is to determine whether the coverage offered by the employer-sponsored health plan provides "minimum value." If the coverage offered by an applicable large employer fails to provide minimum value, an employee may be eligible to receive a premium tax credit, which would likely trigger a penalty. To provide minimum value, the employer's plan must pay on average at least 60 percent of covered health costs. There are several methodologies to determine whether an employer-sponsored plan provides minimum value:

1. Calculators. The Department of Health and Human Services and the IRS have released minimum and actuarial value calculators that employers can use to analyze plan designs to determine if they provide minimum value.
2. Design-based safe harbors. The Department of Health and Human Services is developing a checklist that will provide a simple, straightforward way to ascertain if the employer-sponsored plan provides minimum value without the use of any calculations.
3. Plans with nonstandard features are allowed certification by a certified actuary that the plan provides minimum value.

To Whom Must Applicable Large Employers Offer Health Coverage?

The proposed regulations require that applicable large employers offer health coverage to at least 95 percent of their full-time employees and dependents. In certain circumstances, employers will need to count an employee's hours to determine if the employee is a full-time employee (one employed an average of at least 30 hours of service per week). The proposed regulations provide a look-back safe harbor measurement method for determination of full-time employee status as an alternative to a month-by-month method of determining full-time employee status for ongoing employees. The counting rules for ongoing employees and new hires differ.

Ongoing Employees

For ongoing employees, an employer may look back at a standard measurement period (a defined period between 3 and 12 consecutive months chosen by the employer). If an employee was employed on average at least 30 hours/week during this standard measurement period, the employer must treat the employee as a full-time employee for the subsequent stability period (a period of time defined as the greater of six months or the standard measurement period) regardless of the employee's actual hours of service, so long as he or she remains an employee.

An employer may also choose to add an administrative period of up to 90 days between the measurement and stability periods so it has time to determine which employees are eligible for coverage, and notify and enroll such employees.

There are many technical requirements in the proposed regulations related to the standard measurement, administrative, and stability periods that practitioners and their clients will need to become familiar with as they determine which full-time employees must be offered coverage.

New Employees

Different measurement requirements apply to new employees (those who have not been employed for a complete standard measurement period), depending on whether they are full-time, variable, or seasonal. "New full-time employees" are those reasonably expected to work on average 30 hours/week when they are hired. "New variable hour employees" are those that employers cannot determine whether they are reasonably expected to work on average at least 30 hours/week.

According to the recently-released waiting period proposed regulations, new full-time employees must be offered health coverage within 90 days. The pay or play regulations provide that employers will not be assessed a penalty unless coverage is offered after the conclusion of the employee's initial three calendar months of employment.

For counting the hours of new variable hour and seasonal employees, an employer may use an initial measurement period of between 3 and 12 consecutive calendar months, and an administrative period of up to 90 days. If a variable or seasonal employee works on a full-time basis during the initial measurement period, then the employee must be treated as a full-time employee during the subsequent stability period. The proposed regulations contain many technical requirements on counting variable and seasonal employees' hours, so practitioners and their clients should be sure they are familiar with the specifics of the proposed regulations.

Once a new employee has been employed for an initial measurement period, and has been employed for a standard measurement period, the employee must be tested for full-time status at the same time and under the same conditions as other ongoing employees.

Inevitably, counting new hire hours will be cumbersome for employers at first, because each new variable hour and seasonal employee will have his or her own initial measurement period. But after the initial measurement period is over, the process will become more routine and those employees will begin to be counted along with all other ongoing employees on an annual basis.

What Are the Penalties and When Do They Apply?

An applicable large employer will be subject to pay or play penalties if it does not provide minimum essential coverage, or if it provides minimum essential coverage, but that coverage is not affordable or does not provide minimum value. There are different penalties for each of these two requirements.

A. If the applicable large employer offers no health coverage.

If the employer does not offer any coverage, and if at least one employee enrolls in an exchange plan and receives a premium tax credit, the employer could be responsible for an annual penalty of $2,000 per each full-time employee, after the first 30 employees. This is the larger of the two penalties because if just one employee receives a subsidy on the exchange, the employer is obligated to pay a $2,000 penalty for each full-time employee, less the first 30. For example, if an employer has 1,030 employees and does not offer health coverage and at least one full-time employee enrolls in an exchange plan and receives a premium tax credit, the annual penalty is $2,000 x (1,030 – 30), or $2 million.

B. If the applicable large employer offers health coverage, but it either is not affordable or does not offer minimum value.

If the employer offers minimum essential coverage to at least 95 percent of its full-time employees and their dependents, but the coverage is not "affordable" or does not offer minimum value, the employer could be responsible for an annual penalty of $3,000 per each full-time employee who enrolls in an exchange plan and receives a premium tax credit, but not more than $2,000 per each full-time employee, ignoring the first 30 employees. This penalty is expected to be smaller because it is assessed only for those employees who receive a subsidy on the exchange.

For example, if an employer offers minimum essential health coverage but that coverage is not affordable, and if the employer has 1,030 employees and 4 full-time employees get a subsidy on the exchange, the annual penalty is $3,000 x 4, or $12,000.

What Can Employers Do to Prepare?

The first thing employers must do is to determine whether they are applicable large employers subject to the pay or play mandate. If they are, they need to then decide whether to offer (or continue offering) health care to their full-time employees. If an applicable large employer offers minimum essential coverage that is affordable and provides minimum value, it should not be subject to pay or play penalties. But if the applicable large employer's health coverage does not meet the definition of minimum essential coverage, or the coverage is not affordable or does not provide minimum value, and at least one full-time employee receives a subsidy on an exchange, the applicable large employer will be assessed a penalty.

All employers, even small employers not subject to the pay or play mandate, will be responsible for disseminating exchange information to their employees. All employers covered by the Fair Labor Standards Act (in general, employers that employ one or more employees who are engaged in, or produce goods for, interstate commerce) must provide their employees with a marketplace notice by October 1, 2013. The Wage and Hour Division of the Department of Labor provides an online tool to assist employers in determining whether this requirement applies. Affected employers must provide written notice to all employees, notifying them about upcoming coverage options through the health care marketplace (exchange). The Department of Labor has posted model notices on its website, and may update those model notices as the posting requirement draws near.

Conclusion

Without question, the ACA is a vast and multi-layered piece of legislation that will impact many aspects of our current health-care, legal, and tax systems. Significantly, this article focuses exclusively on the pay or play mandate and its impact on employers in the workplace. As the effective date of major provisions of the ACA draws nearer, clients will seek advice about whether and how they should comply with its provisions. As practitioners, we will have to be prepared to answer questions, or know where to consult resources, to interpret this complicated and constantly-evolving law and associated regulations. This article, and the companion articles contained in this edition of *The Hennepin Lawyer*, will provide a good starting point in that process. Other helpful resources include: (1) the IRS website, which contains a plethora of helpful information, including "Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act;" *www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act*;" and (2) the website for the Department of Health and Human Services, *www.hhs.gov*. Kaiser Permanente also has many resources that may be of value to practitioners and employers on its website; *http://kff.org/health-reform*. Like other sophisticated pieces of federal legislation, in time, the provisions and obligations of the ACA will become as mainstream in the workplace as application of the FMLA and ADA.

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[1] This eligibility calculation differs from other federal laws that require calculations of a similar nature. For example, an employer is obligated to comply with the Family Medical Leave Act when it employs 50 or more full-time employees in 20 or more calendar weeks in the subject or preceding calendar year.

[2] Under the Fair Labor Standards Act, an employee is defined simply as "any individual who is employed by an employer." The U.S. Supreme Court has applied the Economic Realities test to that definition which tends to focus on the "whole activity" surrounding the employment relationship in determining whether workers are employees, and not just whether the employer has the right to control or direct services. Rutherford Food Corp. v. McComb, 331 U.S. 722 (1947).