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BENEFITS BRIEF

February 25, 2014 www.groom.com

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Agencies Issue Final Regulations Implementing Employer Shared Responsibility and Waiting Period Rules

On February 10, 2014, Treasury and the Internal Revenue Service (the "IRS") issued long-awaited final regulations on the Patient Protection & Affordable Care Act's ("ACA's") Code section 4980H employer shared responsibility provisions. On February 20, 2014, Treasury, the Department of Labor ("DOL"), and the Department of Health and Human Services ("HHS") (together, the "Departments") jointly issued final regulations on the 90-day waiting period limitation added by the ACA to Section 2708 of the Public Health Service Act ("PHSA"), as well as a new set of proposed regulations addressing the maximum length of an orientation period. Although neither set of final regulations deviates significantly from the earlier proposed regulations, there are some important clarifications and a few changes that will impact employers, insurers and administrators, including helpful transition relief. Below, we summarize key provisions of both of these rules and the impact that these rules may have on plan design.

I. <u>Employer Shared Responsibility Final Regulations</u>

The final regulations do not significantly change the fundamental structure or the complexity of the proposed regulations, but do provide more specificity on certain issues. Significantly, the final regulations retain the look-back measurement method set forth in the proposed regulations for determining full-time employee status and create a new, alternative measurement method called the "monthly measurement method."

The final regulations also extend most of the transition relief in the proposed regulations to the 2015 plan year and create new transition relief. Most notably, employers with fewer than 100 full-time and full-time equivalent employees are exempt from the Code section 4980H penalties for the 2015 plan year. Employers with 100 or more full-time and full-time equivalent employees are able to satisfy the requirement to offer coverage to "substantially all" full-time employees and dependents by offering coverage to 70% of full-time employees for the 2015 plan year rather than 95% of full-time employees, which will be required for every plan year thereafter. Also, similar to the proposed regulations, employers may use a shorter measurement period (e.g., 6 months) that begins by July 1, 2014 for a longer 2015 stability period (e.g., 12 months), which gives employers more time to implement the look-back measurement method – otherwise, employers with calendar year plans that wanted to use a 12-month stability period in 2015 would have needed to start the measurement period already.

A. <u>Background</u>

One of the more controversial rules under the ACA is the employer shared responsibility requirement, which is set forth in new Code section 4980H. This rule requires employers to pay an excise tax in the event that an adequate health coverage offering is not made to full-time employees and their dependents and at least one of these employees receives a federal premium tax credit or cost-sharing subsidy for coverage on the public Exchange. There are two possible penalties under Code section 4980H. The first penalty is under Code section 4980H(a), which imposes a penalty on "applicable large employers" (those that employed on average of at least 50 full-time and full-time equivalent employees during the prior calendar year) that fail to offer minimum essential coverage to full-time employees and their dependents, and at least one employee receives a tax credit or cost-sharing subsidy for coverage purchased through the Exchange. The penalty, which is treated as an excise tax for certain purposes, is $2,000 for each full-time employee (after subtracting 30 or, for the 2015 plan year, 80) and is calculated on a monthly basis.

The second penalty is under Code section 4980H(b), which imposes a penalty on applicable large employers that offer minimum essential coverage to full-time employees and their dependents, but the coverage is not affordable (cost of self-only coverage is more than 9.5% of household income) or does not provide minimum value (60% actuarial value of benefits) and a full-time employee receives a tax credit or cost-sharing subsidy for coverage purchased through the Exchange. These employers are required to pay the lesser of a $3,000 annual excise tax penalty for each full-time employee receiving the credit (calculated on a monthly basis) or $2,000 per employee for each full-time employee (after subtracting 30 or, for the 2015 plan year, 80).

On January 2, 2013, the IRS issued proposed regulations on the Code section 4980H provisions, effective January 1, 2014. 78 Fed. Reg. 218. A summary of those proposed regulations is available at http://www.groom.com/resources-734.html. The proposed regulations provided rules to implement the Code section 4980H provisions, including rules on how to determine applicable large employer status, a "substantially all" standard where an employer can avoid the Code section 4980H(a) penalty if it offers coverage to at least 95% of its full-time employees and their dependents, affordability safe harbors, and transition relief for 2014. The major provision of the proposed regulations was a complicated, optional "look-back measurement method" to determine full-time status and the required period of coverage. The look-back measurement method included a measurement period (to track employees' hours), an optional administrative period (to count the hours/offer coverage), and a stability period (during which the employer must offer/not offer coverage). The proposed regulations did not provide any guidance on how employers that do not use the look-back measurement method comply with Code section 4980H.

On July 29, 2013, the IRS delayed the effective date for the employer shared responsibility penalties until 2015. Notice 2013-45.

Below we highlight some of the key changes in the final regulations.

B. Final Regulations

Determining "Full-Time" Employees

The final regulations generally adopt the full-time employee determination rules in the proposed regulations, and as expected (because it is a statutory requirement), keep the definition of full-time employee as an employee who has an average of at least 30 hours of service per week.

The final regulations provide a new measurement method for employers not using the look-back measurement method called the "monthly measurement method" (described below). Many employers already offer coverage to their full-time employees (both salaried and hourly) and assumed under the proposed regulations that they could exclude these employees from testing and only use the look-back measurement method for the segment of employees who are not full-time (typically hourly employees). The proposed regulations were unclear whether this was permitted or whether an employer must use the look-back measurement method for all employees if it used the method for some employees.

The final regulations make it clear that there are only two methods to determine full-time employee status – the monthly measurement method and the look-back measurement method – and that an employer must use the same method for all employees in the same category. The permitted categories are (1) salaried employees and hourly employees, (2) employees whose primary places of employment are in different states, (3) collectively bargained employees and non-collectively bargained employees, and (4) each group of collectively bargained employees covered by a separate collective bargaining agreement. The preamble explicitly states that an employer may not use the look-back measurement method for variable hour/seasonal employees and the monthly measurement method for employees with more predictable hours of service.

From a practical perspective, if the employer offers coverage to all of its full-time employees as defined in the ACA, it is unclear whether there would be any consequences if it, for example, failed to test a group of those full-time employees under the look-back method.

Some other key modifications and guidance in the final regulations are:

- *"Employee" Definition* – The final regulations retain the common law definition of employee and continue to exclude Code section 414(n)(2) leased employees, sole proprietors, partners, and 2% S corporation shareholders. The final regulations also exclude workers described in Code section 3508 (real estate agents and direct sellers).

- *Third Party Offers of Coverage* – Consistent with the Code section 5000A final regulations, which treat coverage provided by a third party, such as a PEO or staffing firm, as minimum essential coverage under an eligible employer-sponsored plan, the final regulations provide that an offer of coverage to an employee performing services for an employer that is a client of a PEO or other employer organization or staffing firm ("third party") made by the third party on behalf of the client employer under a plan established or maintained by the third party, is treated as an offer of coverage made by the client employer, if the fee the client employer would pay to the third party for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay to the third party for the same employee if the he/she didn't enroll in health coverage under the plan.

- *Dependent Definition* – Under the proposed regulations, "dependent" excluded spouses and included, among other children, foster children and stepchildren, even though many employers typically do not offer coverage to foster and stepchildren because they often have coverage from other sources, such as a state agency or the natural parents, respectively. The final regulations continue to exclude spouses from the definition of dependent and also exclude foster children, stepchildren, and children who are not U.S. citizens or nationals (unless that child is a resident of a country contiguous with the U.S. or certain adopted children). The final regulations also provide that a child is a dependent for the entire calendar month that he/she turns age 26.

- *8 Hour/40 Hour Equivalencies* – The proposed regulations provide that, with respect to non-hourly employees, employers may calculate hours by (i) counting actual hours of service from records of hours worked and hours for which payment is made or due, (ii) using a days-worked equivalency (crediting 8 hours a day for each day with an hour of service), or (iii) using a weeks-worked equivalency (crediting 40 hours a week for each week with an hour of service). However, the proposed regulations contain "anti-abuse" rules, which state that employers may not use the days- or weeks-worked equivalency methods if those methods would substantially understate the hours worked. The final regulations expand the 8 hour/day and 40 hour/week equivalency anti-abuse rules to address situations where the equivalency would result in the employer understating the hours of a substantial number of employees. This applies even if the understatement would not cause the employee not to be treated as a full-time employee (because, e.g., it can affect the employer's status as an applicable large employer).

- *Certain Categories of Employees with Unique Hours of Service* – The preamble to the final regulations indicates that the IRS continues to recognize the difficulty in determining hours of service for certain types of employees, such as commissioned salespeople, adjunct faculty, airline employees, and employees with layover hours or on-call hours. Until the issuance of future guidance, an employer must use a reasonable method of crediting hours for these employees that is consistent with Code section 4980H. The preamble gives examples of unreasonable methods and specifies a method that will be deemed reasonable for adjunct professors through 2015.

- *Short-Term and High-Turnover Employees* – Many employers have historically not offered coverage to short-term and high-turnover employees and were hopeful that the final regulations would provide an exception for these employees. However, the final regulations do not contain any special rules for these employees because the IRS is concerned about the potential for abuse. The preamble notes, however, that some of employer's concerns are alleviated through the 3-month rule for new full-time employees and the ability to use an initial measurement period for new variable hour or seasonal employees.

- *Student Interns* – The final regulations do not provide a general exception for student employees except those in a federal work study program. This means that employers that hire full-time paid student interns and do not want to offer these interns coverage will generally need to limit the interns' employment to three full calendar months or less. However, if the full-time interns are unpaid, their hours worked are not counted as an hour of service, and the employer does not need to offer them coverage for Code section 4980H purposes.

- *International Employees* – Under both the monthly measurement method and the look-back measurement method, an employer may treat an employee as terminated if the employee transfers from a domestic applicable large employer to a foreign applicable large employer (including to a different employer within the applicable large employer), but only if the position is anticipated to continue indefinitely or for at least 12 months and substantially all of the compensation the employee receives following the transfer is treated as foreign-sourced income.

Similarly, if the employee had no prior hours of service with the domestic employer and transfers from a foreign applicable large employer (for which it had no U.S.-sourced income) to a domestic applicable large employer, the domestic employer can treat the employee as a newly hired employee. If the employee had prior hours of service with the domestic employer, the period with the foreign employer may be treated as a period of no service, consistent with the rehire/break in service rules (discussed below).

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Monthly Measurement Method

Commenters requested information about how to identify full-time employees if the employer did not use the look-back measurement method. In response, the IRS states that, pursuant to the statute, these employees must be identified based on hours of service for each calendar month. The final regulations call this method the "monthly measurement method" and provide some rules on this determination. It appears that under this method, the employer generally counts the employees' hours during a particular month to see if the employee was full-time (had an average of at least 30 hours of service per week) for that month. It is unclear how this method will work in practice for employers that have employees who work full-time hours one month and non-full-time hours the next month. In that case, the employer may not know the employee's average hours until the next month has already started. Attempting to drop or reinstate coverage on a monthly basis also could raise issues under Public Health Service Act section 2712, which provides that coverage cannot be "canceled" except with prior notice (the agencies have not provided additional guidance on this requirement). Because it is not really practical to cancel coverage in one month and reinstate in the next, it seems likely that the IRS intended for the monthly measurement period to be used "after the fact" as a method to calculate excise tax liability rather than as a plan design method.

Although the final regulations do not specify how this method would work in practice, they do provide rules for certain specific situations:

- *Special Rule for Employee First Eligible for Coverage* – An employer will not be subject to a Code section 4980H(a) penalty if it offers a full-time employee coverage by the 1st day of the 4th full calendar month after the employee is "otherwise eligible" for an offer of coverage. Otherwise eligible for an offer of coverage means the employee meets all conditions to be offered coverage other than the completion of a waiting period. The employer will also not be subject to a Code section 4980H(b) penalty if the coverage offered at that time provides minimum value. This rule may only apply once per period of employment (but can apply again if the employee is treated as a new employee under the rehire rules).

- *Weekly Rule* – The final regulations adopt a "weekly rule" to accommodate payroll periods. Under this rule, an employer can determine full-time status for a calendar month based on hours of service over a successive 4-week period (and, for some months, a 5-week period). The period must contain either the week that includes the 1st day of the month or the week that includes the last day of the month, but not both. In months with 4-week periods, a full-time employee is an employee with at least 120 hours of service. In months with 5-week periods, a full-time employee is an employee with at least 150 hours of service.

The preamble states that regardless of whether an employer uses the weekly rule, to be consistent with Code sections 5000A (individual mandate) and 36B (premium tax credit), which apply on a monthly basis, an employer is only treated as having offered coverage under Code section 4980H for a calendar month if it offers coverage for the entire calendar month.

- *130-Hour Equivalency Rule* – The final regulations retain the 130-hour equivalency rule in the proposed regulations and permit employers to use that rule under this method. Under the 130-hour equivalency rule, an employer may treat 130 hours of service per month as equivalent to 30 hours per week.

- *Rehire/Break in Service Rules* – These rules, described below, apply when the monthly measurement period is used.

- *Special Unpaid Leave and Employment Break Period Rules* – These rules, described below, do not apply when the monthly measurement period is used.

Look-Back Measurement Method

The final regulations do not fundamentally change or, as many employers had hoped, simplify the look-back measurement method. However, the final regulations clarify and make changes to certain requirements. Specifically:

- *Reasonable Expectation of New Employee's Status* – Under both the proposed and final regulations, whether a new employee is a full-time employee or a variable hour employee depends on whether the employee is reasonably expected to be employed on average 30 hours of service per week. The final regulations provide that a reasonable expectation of a new employee's status is based on the facts and circumstances, and relevant factors include (1) whether the employee is replacing a full-time employee or a non-full-time employee, (2) the extent to which ongoing employees in the same or comparable positions have varied above and below an average of 30 hours of service per week during recent measurement periods, and (3) whether the job was advertised, or otherwise communicated to the new hire or otherwise documented, as requiring hours of service that would average 30 or more hours per week or less than 30 hours per week. No single factor is determinative.

- *Variable Hour Employees* – Commenters were concerned that employers would categorize an excessive number of employees as variable hour in order to take advantage of the ability to use an initial measurement method, and thus, recommended that the IRS remove the rules regarding variable hour employees. The IRS did not adopt this suggestion; however, it explicitly set forth factors (described above) to take into account in determining whether at the employee's start date the employer could not determine whether the employee was reasonably expected to be employed on average at least 30 hours of service per week.

- *Definition of "Administrative Period"* – The final regulations revise this definition to reflect the rule in the proposed and final regulations that the administrative period also includes periods between a new variable hour/seasonal employee's start date and the first day of the initial measurement period.

- *Full-Time Employee's Stability Period Longer than the Associated Measurement Period* – The final regulations retain the rules regarding the minimum lengths of a measurement period and stability period. The minimum length of a measurement period is 3 months, and for employees who were full-time during the measurement period, the minimum length of the associated stability period is six months (or, if longer, the length of the measurement period). Some commenters asked for clarification about the start of the next measurement period in cases where the stability period is longer than the measurement period, for example when the measurement period is 3 months but the stability period is 6 months. The preamble clarifies that the next measurement period must begin on a date during the stability period that is the latest date that will not result in any period between the end of that stability period and the beginning of the next stability period.

- *Different Measurement and Stability Periods for Employee Categories* – The final regulations keep the categories specified in the proposed regulations (the categories specified above for different measurement methods) and confirm that different applicable large employer members may use different measurement and stability periods and different measurement methods (i.e., monthly or look-back).

- *Temporary Staffing Firms* – The final regulations set forth factors relevant to the determination of whether a new employee at a temporary staffing firm is a variable hour employee, which generally relate to the typical experience of an employee in that position with the temporary staffing firm.

The preamble also notes that until the IRS issues future guidance, temporary staffing firms (and all employers generally) may determine when an employee has separated from service based on all available facts and circumstances and using a reasonable method that is consistent with the employer's treatment for other purposes, like the qualified plan rules, COBRA, and state law. The IRS will publish future guidance regarding abusive temporary staffing firm arrangements.

- *Seasonal Employees* – The final regulations continue to treat seasonal employees the same as variable hour employees. "Seasonal employee" was not defined in the proposed regulations, but is defined in the final regulations to mean an employee in a position for which the customary annual employment is 6 months or less. The preamble notes that the period of employment should generally begin in the same part of the year each year, like summer or winter, and an employee can still be considered seasonal if the employment period extends beyond customary duration – like ski instructors during a long snow season.

- *Change in Employment Status* – The final regulations retain the change in employment status rule for new variable hour or seasonal employees who experience a material change in position of employment during the initial measurement period. In that case, if the employee would have been reasonably expected to work full-time if he/she had begun employment in the new status, the employer must treat the employee as full-time by (1) the 1st day of the 4th month following the change in employment, or (2) if earlier, the 1st day of the 1st month following the end of the initial measurement period (plus any administrative period) if the employee averaged 30 hours of service or more during the initial measurement period (the 1st/4th month rule). The final regulations extend this rule to seasonal employees who change employment status to a position that, had the employee begun employment in that status, would not have been a seasonal position and employees who have a change in employment status from part-time (newly defined category discussed below) to full-time during the initial measurement period.

The final regulations also contain a special rule that applies when an employee changes from full-time status to part-time status (described below under the Special Rule for Full-Time Employees Who Have Continuously Been Offered Minimum Value Coverage section).

- *New Non-Variable Hour or Seasonal Employees* – The final regulations create a new category of employee – "part-time" – for a new employee who is reasonably expected at his/her start date to not be a full-time employee and is not a variable hour or seasonal employee. The rules that apply to variable hour and seasonal employees also apply to part-time employees.

The final regulations also clarify how full-time employee status is determined for new employees who are not variable hour, seasonal or part-time employees before the employee has been employed for a full standard measurement period, which was not fully explained in the proposed regulations. (The initial measurement period only applies to new variable hour, seasonal, or part-time employees.) The final regulations clarify that, in general, full-time employee status for a new employee who is reasonably expected to be a full-time employee is based on that employee's hours of service each calendar month (but note that an employer is not subject to a penalty for the first 3 full calendar months of employment under the 3-month rule described in the proposed and final regulations). Thus, it appears that, before a new full-time employee is employed for a full standard measurement period, if his/her hours drop below an average of 30 hours per week in a month, the employer would not be required to offer that employee coverage for the next calendar month. However, as noted above, it may not be practical for an employer to offer or take away an offer of coverage on a month to month basis.

- *Initial Measurement Period* – The final regulations clarify that an employer may apply the payroll period rule for purposes of determining an initial measurement period, as long as the initial measurement period begins on the employee's start date or any date between the start date and the later of (1) the 1st day of the 1st calendar month following the employee's start date and (2) the 1st day of the payroll period that starts after the employee's start date.

The final regulations clarify that the initial measurement period does not need to be based on calendar months (e.g., March 1 – April 1) and can be based on non-calendar months (e.g., March 15 – April 15). However, the stability period must be based on calendar months.

- *"Gap Month" Between Stability Periods* – Under the proposed regulations, for certain employees hired immediately after the start of a standard measurement period, there was a "gap" month between the end of the employees' first stability period and the beginning of their next stability period. Many employers were unsure of how to treat employees during this "gap" month. The final regulations address this and provide that the treatment as a full-time employee or not a full-time employee that applied during the employee's first stability period continues to apply until the beginning of the next stability period (i.e., the stability period associated with the employee's first full standard measurement period). Thus, if the employee was offered coverage during his/her first stability period because he/she was full-time during the initial measurement period, the employer must continue coverage during the gap month.

- *Maximum Length of First Stability Period* – Unlike the proposed regulations, the final regulations provide that for a variable hour or seasonal employee who does not average 30 hours of service per week during the initial measurement period, the maximum length for a stability period associated with the initial measurement period is the end of the first full standard measurement period (plus administrative period) during which the employee was employed, rather than the end of the standard measurement period (plus administrative period) in which the initial measurement period ends.

- *"Limited Non-Assessment Period for Certain Employees"* – The final regulations create this new term to describe the limited period where the employer is not subject to a Code section 4980H(a) and/or (b) penalty with respect to an employee, if the employer meets certain requirements specified in the final regulations. These periods are:

    - For an employer's first year as an applicable large employer, the period from January – March of that year with respect to an employee who was not offered coverage by the employer at any point during the prior calendar year, if the employee is offered coverage by April 1 of that year;
    - The first 3 full calendar months after an employee first becomes otherwise eligible for coverage under the monthly measurement method;
    - With respect to a new full-time employee offered coverage following the initial 3 full calendar months of employment;

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- The initial measurement and administrative periods for variable, seasonal and part-time employees;
- The period after a change to full-time status during the initial measurement period (4th/1st month rule described above); and
- The calendar month during which a full-time employee is hired (if the start date is not the 1st of the month) or a full-time employee terminates (if the employee would have been offered coverage had the employee been employed for the entire month).

Employees Transferring Between Different Types of Measurement Methods

As described above, employers must use the same measurement method for employees except for the limited permitted categories specified in the final regulations. When an employee transfers from a position for which the employer is using the look-back measurement period to a position for which the employer is using the monthly measurement period or vice versa, the final regulations provide complicated rules that apply to these employees. In the preamble, the IRS recognizes that these rules are complex and states that it may issue further guidance.

Rehire and Break in Service Rules

The final regulations keep the rehire and break in services rules in the proposed regulations, but change the definition of a break in service (for purposes of determining whether an employer must treat a returning employee as an ongoing employee) from 26 weeks to 13 weeks (except the 26-week threshold still applies for educational organizations). This is a favorable change for employers. The final regulations also retain the optional rule of parity rules. These rules apply under both the monthly and look-back measurement methods and provide that, for "no service" periods of less than 13 weeks (26 weeks for an educational organization employee), the employer may apply an optional rule of parity and treat the employee as a new employee if the "no service" period is at least 4 but less than 13 weeks long, and is longer than the period of employment. For example, if the employee works 3 weeks, terminates for 10 weeks, and is rehired, the employee may be treated as new.

Special Unpaid Leave and Employment Break Periods

The final regulations retain the averaging rules for special unpaid leave (FMLA, military, and jury duty leave) and, for educational organizations, employment break periods. Under these rules, for a continuing employee who resumes after a special unpaid leave (FMLA, USERRA, jury duty) (or, for an educational organization employee, an employment break period), the employer must determine the average hours of service per week for the employee excluding the special unpaid leave period (or, for an educational organization employee, an employment break period) and use that average as the average for the entire measurement period. Alternatively, the employer may credit the employee with hours of service for the special unpaid leave period (or, for an educational organization employee, an employment break 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 special unpaid leave (or, for an educational organization employee, an employment break period). Fortunately, the final regulations do not extend the educational organization employment break period rule to employers that are not educational organizations, as some commenters requested, which would have required non-educational organizations to apply the averaging rules for certain other employment break periods besides special unpaid leave. This is good news for employers; however, the IRS stated in the preamble that it may extend the employment break period rule in other guidance. The special unpaid leave (and educational organization employment break period rules) only apply under the look-back measurement method and not the monthly measurement method.

Affordability

Under the statute, affordability is based on Code section 36B, which measures affordability based on the employee's household income. Recognizing that it is difficult for an employer to know an employee's household income, the proposed regulations provided three affordability safe harbors – Form W-2 wages, rate of pay, and federal poverty line. The final regulations retain these safe harbors, with some modifications.

As provided in proposed regulations, an employer may use one safe harbor for all of its employees or use different safe harbors for different "reasonable categories" of employees. The final regulation provide that "reasonable categories" include (1) specified job categories, (2) nature of compensation (salaried v. hourly), (3) geographic location, and (4) similar bona fide business criteria.

- *Form W-2 Wages Safe Harbor* –Under this safe harbor, the employer must offer minimum essential coverage to full-time employees (and their dependents) under an eligible employer-sponsored plan, and the required employee contribution for self-only coverage for the lowest cost option that provides minimum value must not exceed 9.5% of the employee's Form W-2 wages for that calendar year. Commenters requested that employers be allowed to add salary reduction elections under a 401(k) plan or a cafeteria plan back into W-2 wages to determine affordability. The IRS stated that, to be consistent with the premium tax credit rules in Code section 36B, which do not add those reductions back in to household income, the final regulations do not adopt this suggestion.

- *Rate of Pay Safe Harbor* – Under this safe harbor, the employer may take the hourly rate of pay for each hourly employee who is eligible, multiply that by 130 and determine affordability based on the monthly wage. Coverage will be considered affordable if the employee's required monthly contribution is no more than 9.5% percent of the monthly wage. Unlike the proposed regulations, the final regulations permit an employer to use the rate of pay safe harbor even if an hourly employee's hourly rate of pay is reduced during the year. The safe harbor is available for salaried employees, but only to the extent that monthly salary is not reduced.

- *Federal Poverty Line Safe Harbor* – Under this safe harbor, if the self-only cost of coverage does not exceed 9.5% of the most recently published federal poverty level for a single individual, coverage will be considered affordable. Under the proposed regulations, the relevant federal poverty line is the current year's federal poverty line. To provide employers with adequate time to establish premium amounts in advance of open enrollment, the final regulations permit employers to use the federal poverty guidelines in effect six months prior to the beginning of the plan year.

Offers of Coverage

Like the proposed regulations, the final regulations do not contain any specific rules for an employer to demonstrate that it made an offer of coverage and, instead, refer to the Code's general substantiation and recordkeeping requirements.

- *Effective Opportunity to Accept/Decline Coverage* – The proposed regulations provided that an employee must have an effective opportunity to accept coverage or decline coverage that does not provide minimum value or is not affordable. Many employers who require mandatory coverage unless the employee has other coverage interpreted this to mean that it could continue mandatory coverage, as long as the mandatory coverage provided minimum value and was affordable based on either household income or an affordability safe harbor.

The final regulations provide that an effective opportunity to decline coverage is not required for an offer of coverage that provides minimum value and *is offered either at no cost to the employee or at a cost, for any calendar month, of no more than 9.5% of the monthly federal poverty line amount for a single individual* (the annual amount divided by 12). (It appears this calculation is based on the current year's federal poverty line and not the federal poverty line in effect 6 months prior to the beginning of the plan year, as permitted under the federal poverty line safe harbor.) This severely limits the employer's ability to require mandatory coverage because it means the lowest cost premium for mandatory self-only coverage must be no more than 9.5% of the federal poverty line, which is a very low amount. For example, in 2014, 9.5% of the monthly federal poverty line is $92.38.

Also, many employers have plans that provide that if an employee does not participate in open enrollment, his/her coverage elections from the prior year remain for the next plan year. Helpfully, the final regulations clarify that an employee's election of coverage from a prior year that continues for every succeeding plan year unless the employee affirmatively opts out of the plan is considered an offer of coverage.

- *Employees Employed by Multiple Applicable Large Employer Members* – The final regulations provide that for employees who are employed by more than one applicable large employer member for a calendar month, an offer of coverage by one applicable large employer member is treated as an offer of coverage by all applicable large employers for that calendar month.

- *Collective Bargaining* – The final regulations provide that an offer of coverage made by an employer during the collective bargaining process between an employer and a union that is not accepted by the union is not an offer of coverage.

- *Multiemployer and Single Employer Taft-Hartley Plans and MEWAs* – The final regulations clarify that an offer of coverage includes an offer of coverage made by a multiemployer or single-employer Taft-Hartley plan or a MEWA to an employee on behalf of a contributing employer.

- *Third Party Offers of Coverage* – As noted above, the final regulations provide that an offer of coverage to an employee performing services for an employer that is a client of a PEO or other employer organization or staffing firm ("third party") made by the third party on behalf of the client employer under a plan established or maintained by the third party, is treated as an offer of coverage made by the client employer, if the fee the client employer would pay to the third party for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay to the third party for the same employee if he/she didn't enroll in health coverage under the plan.

Assessment and Payment of the Penalty

Consistent with the proposed regulations, the final regulations provide that the IRS will contact employers to inform them of their potential liability and provide them an opportunity to respond before assessing the liability or demanding payment. The preamble to the final regulations further provides that the IRS anticipates that it will issue additional guidance providing that the contact for a given calendar year will not occur until after the employees' individual tax returns are due for that year claiming the tax credits (typically, April 15) and after the due date for employers to file Code section 6056 information returns (typically, March 31 if filing electronically).

The final regulations do not adopt commenters' suggestions that employers be permitted to aggregate applicable large employer members within the applicable large employer to determine the Code section 4980H(a) penalty (e.g., so that the group as whole could meet the 95% (70% in 2015, as described below) substantially all test).

The proposed regulations provided that if an employee was the employee of more than one applicable large employer member in a calendar month, the 4980H(b) penalty is allocated in accordance with the number of hours of service the employee had with each member for that calendar month. The final regulations modify this rule and provide that the member for whom the employee had the greatest number of hours of service for that month is the member that treats the employee as its full-time employee for purposes of both the 4980H(a) and (b) penalties. If the employee has the same number of hours of service, the members can treat one of the members as the employer for that month.

Transition Relief and Interim Guidance

The final regulations extend much of the transition relief and interim guidance in the proposed regulations and also provide additional transition relief. Specifically, the final regulations:

- Do not extend the relief for non-calendar year cafeteria plan years beginning in 2014 to allow changes in salary reduction elections.

- Extend the following transition relief in the proposed regulations:
    - For fiscal year plans, no penalty is imposed on an employer prior to the first day of the plan year that begins in 2015 as long as the employer offers affordable coverage that provides minimum value by the first day of the 2015 plan year. Similar rules apply for employers that provide a significant percentage of their employees' coverage under fiscal year plans.
    - Allow a shorter measurement period for a stability period starting in 2015.
    - For the 2015 calendar year, an employer may determine whether it is an applicable large employer by determining whether it employed an average of at least 50 full-time and full-time equivalent employees during any consecutive 6 month period in 2014 (instead of the entire year).
    - An employer will generally not be subject to a penalty for failing to offer dependent coverage for plan years that begin in 2015 if the plan takes steps during its 2014 plan year to add dependent coverage.
    - The final regulations continue the interim guidance in the proposed regulations for employers that are required by a collective bargaining agreement to contribute to a multiemployer plan.

- Create new transition relief:
    - There is no 4980H(a) or (b) penalty for all of 2015 (plus, for fiscal year plans, the portion of the plan year that falls in 2016) for employers with fewer than 100 full-time and full-time equivalent employees in 2014.
    - Generally, the proposed and final rules provide that an employer is not subject to a 4980H(a) penalty if it offers coverage to 95% of its full-time employees (and their dependents). However, new 2015 transition relief provides that for each calendar month in 2015 (and, for fiscal year plans, any month during 2015 plan year that falls in 2016), the 95% requirement is reduced to 70%.
    - Generally, the 4980H(a) penalty is based on the number of full-time and full-time equivalent employees minus the first 30. The transition relief provides that for 2015 (and, for fiscal year plans,

any month in the 2015 plan year that falls in 2016), the penalty will be calculated by reducing the number of full-time employees by 80 rather than 30.

- An employer will be treated as having offered coverage to a full-time employee for January 2015 as long as the employer offers coverage to the full-time employee no later than the first day of the first payroll period that begins in January 2015.

II. 90-Day Waiting Period Final Regulations

The final regulations continue to define "waiting period" as the period that must pass before coverage for an individual who is otherwise eligible to enroll under the terms of a group health plan can become effective. The final regulations provide that being otherwise eligible to enroll in a plan means having met the plan's eligibility conditions, which includes satisfying a "reasonable and bona fide employment-based eligibility period."

A. Background

PHSA section 2708 provides that a group health plan or health insurance issuer offering group health insurance coverage shall not apply any waiting period that exceeds 90 days. PHSA section 2704(b)(4) defines a waiting period as the period that must pass with respect to an individual before the individual is eligible to be covered for benefits under the terms of the plan. PHSA section 2708 applies to both grandfathered and non-grandfathered group health plans and group health insurance coverage for plan years beginning on or after January 1, 2014.

On March 21, 2013, the Departments issued proposed regulations on the waiting period limitation rules. 78 Fed. Reg. 17313. Under the 2013 proposed regulations, a group health plan and a health insurance issuer offering group health insurance coverage may not apply any waiting period that exceeds 90 days. The 2013 proposed regulations defined "waiting period" as the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective. Under the 2013 proposed regulations, being otherwise eligible to enroll in a plan means having met the plan's substantive eligibility conditions. The 2013 proposed regulations also addressed the application of waiting periods to certain plan eligibility conditions.

B. Final Regulations and New Proposed Regulations

General Rule, Definition of "Waiting Period"

Consistent with the proposed regulations, the final regulations provide that a group health plan, and a health insurance issuer offering group health insurance coverage, may not apply a waiting period that exceeds 90 days. The consequence of violating this limitation is that the group health plan will be subject to a $100 per day per failure excise tax under Code section 4980D up to statutory maximums, and will be required to report and pay any tax due on Form 8928. The preamble to the final regulations notes that nothing in the final regulations requires a plan or issuer to have any waiting period, or prevents a plan or issuer from having a waiting period that is shorter than 90 days. Coverage will comply with the 90-day waiting period limitation if, under the terms of the plan, an individual can elect coverage that becomes effective on a date that does not exceed 90 days. The plan or issuer will not be considered to violate the waiting period rules merely because individuals may take additional time (beyond the end of the 90-day waiting period) to elect coverage.

The final regulations continue to define "waiting period" as "the period that must pass before coverage for an individual who is otherwise eligible to enroll under the terms of a group health plan can become effective."

Consistent with the proposed regulations, the final regulations clarify that if an individual enrolls as a late enrollee or special enrollee, any period before the late or special enrollment is not a waiting period.

<u>Relationship Between Plan's Eligibility Criteria and 90-Day Waiting Period</u>

The final regulations, like the proposed regulations, include rules governing the relationship between a plan's eligibility criteria and the 90-day waiting period limitation. They provide that being otherwise eligible to enroll under the terms of a group health plan means having met the plan's substantive eligibility conditions. They include two examples of a plan's substantive eligibility conditions from the proposed regulations– being in an eligible job classification and achieving job-related licensure requirements – and add one new example: satisfying a "reasonable and bona fide employment-based orientation period." They explain that the 90-day waiting period limitation does not require the plan sponsor to offer coverage to a particular individual or class (such as part-time employees). Rather, the final regulations prohibit requiring otherwise eligible individuals to wait more than 90 days before their coverage becomes effective. The final regulations include the following rules relating to eligibility criteria:

- *Eligibility Conditions Based Solely on Lapse of Time* – The final regulations provide that eligibility conditions that are based solely on the lapse of a time period are permissible for no more than 90 days.

- *All Other Eligibility Conditions* – Other conditions for eligibility – i.e. those that are not based solely on the lapse of a time period – are generally permissible, unless the condition is designed to avoid compliance with the 90-day waiting period limitation.

- ***NEW:*** *Satisfaction of a Reasonable and Bona Fide Employment-Based Orientation Period* – The final regulations add a <u>new</u> example of permissible substantive eligibility conditions: the satisfaction of a reasonable and bona fide employment-based orientation period. While the final regulations do not specify when the duration of an orientation period would not be "reasonable or bona fide," proposed regulations, published simultaneously with the final regulations on this discrete issue, propose one month as the maximum length of any such orientation period, which means a period that begins on any day of a calendar month and is determined by adding one calendar month and then subtracting one calendar day. 79 Fed. Reg. 10320 (February 24, 2014). Comments on these proposed regulations are due on April 25, 2014.

- *Number of Hours of Service Per Period (Applied to Variable-Hour Employees)* – The final regulations retain the proposed regulations' approach and provide that if a group health plan conditions eligibility on an employee regularly having a specified number of hours of service per period (or working full-time), and the plan cannot determine that a newly-hired employee is reasonably expected to regularly work that number of hours per period (or full-time), the plan may take a reasonable period of time (no more than 12 months and beginning on a date between the employee's start date and the first day of the first calendar month after the employee's start date) to determine whether the employee meets the plan's eligibility condition. This is consistent with the timeframe under Code section 4980H and its regulations. Unless a waiting period of greater than 90 days is imposed in addition to a measurement period, the time period for determining whether a variable-hour employee meets the plan's hours of service per period eligibility condition will <u>not</u> be considered designed to avoid compliance with the 90-day waiting period rule, if coverage is made effective no later than 13 months from the employee's start date (plus, if the start date is not the first day of a calendar month, the time remaining until the first day of the next calendar month).

- *Cumulative Hours of Service Requirements* – Consistent with the proposed regulations, under the final regulations, if a group health plan or group health insurance issuer conditions eligibility on the completion by an employee of a number of cumulative hours of service, the eligibility condition is not considered to be designed to avoid compliance with the 90-day waiting period rule if the cumulative hours-of-service requirement does not exceed 1,200 hours. The plan's waiting period must begin on the first day after the employee satisfies the plan's cumulative hours-of-service requirement and may not exceed 90 days. In addition, the provision is designed to be a one-time eligibility requirement only: the final regulations do not permit the plan to, for example, re-apply such a requirement to the same individual each year.

- *All Calendar Days Are Counted* – Under the final regulations, after an individual is determined to be otherwise eligible for coverage under the terms of the plan, a waiting period may not extend beyond 90 days. The final regulations provide that all calendar days are counted beginning on the enrollment date, including weekends and holidays.

Rehired Employees and Employees Moving Between Ineligible and Eligible Job Classifications

Under the final regulations, a former employee who is rehired may be treated as newly eligible for coverage upon rehire. Therefore, a plan or issuer may require that individual to meet the plan's eligibility criteria and to satisfy the plan's waiting period again, as long as it is reasonable under the circumstances. The final regulations provide that the same analysis would apply to an individual who moves to a job classification that is ineligible for coverage under the plan, but then later moves back to an eligible job classification.

Issuer Safe Harbor

The final regulations provide that an issuer can rely on the eligibility information reported to it by an employer and will not be considered to violate the final regulations in administering the 90-day waiting period limitation if: (1) the issuer requires the plan sponsor to make a representation regarding the terms of any eligibility conditions or waiting periods imposed by the plan sponsor before an individual is eligible to become covered under the terms of the plan (and requires the plan sponsor to update this representation with any applicable changes); and (2) the issuer has no specific knowledge of the imposition of a waiting period that would exceed the permitted 90-day period.

Effective Date

The 90-day waiting period provisions of the final regulations apply to group health plans and group health insurance issuers for plan years beginning on or after January 1, 2015. The preamble to the final regulations states that for plan years beginning in 2014, the Departments will consider compliance with either the proposed regulations or the final regulations to constitute compliance with PHSA section 2708.

Conforming Changes to Existing Regulations

The final regulations include conforming amendments to the 2004 HIPAA regulations implementing PHSA section 2701, to remove provisions superseded by the prohibition on preexisting conditions and the implementing regulations, including elimination of the requirement to issue certificates of creditable coverage.

III. Conclusion

The ACA's employer shared responsibility and waiting period requirements are designed to encourage employers to make coverage that satisfies minimum value and affordability criteria available to full-time employees and to make coverage available to all eligible employees on a timely basis. Unfortunately, the regulations implementing these requirements are complex, and will require employers to invest time and resources in order to monitor, track and report the hours that employees work and the coverage that is offered.

The penalties for noncompliance are significant: the heftiest penalty for failure to comply with the employer shared responsibility rules requires employers to pay $2,000 multiplied by each full-time employee less 30 (or 80 for 2015), and the penalty for violating the waiting period rules could be as high as $500,000. And**,** the final regulations do not provide much time to comply. The transition relief set forth in the employer shared responsibility rules is helpful, but even with the transition relief, employers are required to begin counting the hours that full-time employees work this year if they want to use the look-back measurement method. The waiting period rules are effective for plan years beginning on or after January 1, 2014, so group health plans need to comply with the waiting period rules as set forth in the ACA immediately. However, prior to plan years beginning on or after January 1, 2015, plans can choose whether to follow the proposed or final regulations.

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Please contact your regular Groom attorney or one of the attorneys in the health and welfare practice group to determine how the final rules may apply to your business.