Patterson Belknap Webb & Tyler LLP

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Final Employer "Play or Pay" Mandate Guidance: Employer Action Needed

The federal health care reform law enacted in 2010, known as the Affordable Care Act, added a provision to the Internal Revenue Code ("Code") (Code Section 4980H) that, beginning on January 1, 2015, may subject employers to an excise tax penalty if a covered employer fails to offer health plan coverage to a sufficient number of its employees and their dependents or offers coverage that is deemed unaffordable or fails to provide a prescribed minimum level of benefit value. This new penalty provision, formally known as the "employer shared responsibility penalty," is often referred to as the "employer play or pay" mandate. In this Alert, these new rules are referred to as the "Employer Mandate."

The Internal Revenue Service and U.S. Treasury Department recently issued final regulations and related frequently asked questions concerning the Employer Mandate (collectively, the "Final Regulations"). The rules are complex and can require detailed consideration of the nature of an employer's workforce, including the hours of service worked by employees. We previously issued an **Alert in March 2013** that described then proposed regulations under the Employer Mandate. As the Final Regulations generally follow the proposed regulations, much of the terminology and operational rules under the proposed regulations and discussed in our prior Alert has been carried forward into the Final Regulations and this Alert. However, the Final Regulations provide for some important changes and clarifications from the proposed rules, which are highlighted in this Alert. This Alert is intended to provide an overview of the key provisions of the Final Regulations, including some helpful transition rules, to assist employers in understanding the Employer Mandate requirements that apply beginning in 2015.[1]

A. WHAT IS THE EMPLOYER MANDATE PENALTY?

A penalty under the Employer Mandate can apply, on a calendar month by calendar month basis, if:

(i) at least one full-time employee ("FT employee") of an "applicable large employer" is certified as having received a financial subsidy (in the form of a premium tax credit or cost-sharing reduction payment) to help pay the premium for health plan coverage under the newly established health insurance exchanges or marketplaces ("Exchanges");[2] and

[1] The Employer Mandate was originally scheduled to take effect on January 1, 2014, however, the IRS and Treasury Department, on July 9, 2013, delayed the effective date to January 1, 2015, subject, as applicable, to various transition rules (**described in Section F of this Alert**) that may have the effect of further delaying the effective date of the Employer Mandate requirements for certain employers.

[2] Under the Affordable Care Act, federal government-provided subsidies are available to assist employees in paying for health coverage they obtain through the Exchanges. To be eligible for an Exchange-based premium subsidy, an employee must:

(i) have annual "household income" (*i.e.*, annual "adjusted gross income" of the employee, employee's spouse and the employee's dependents who are required to file a federal income tax return with certain modifications (*e.g.*, adding back tax-exempt interest)) of at least 100% and no more than 400% of the federal poverty level ("FPL") for the employee's family size. For instance, in 2014, the FPL for all states (except Hawaii and Alaska where the FPL is slightly higher) for a single individual is $11,670, and $23,850 for a family of four;

(ii) not be eligible for employer health plan coverage that is "affordable" (*i.e.*, for purposes of determining eligibility for the Exchange-based subsidies, based on the employee's cost of the least expensive employee-only employer-provided coverage being no more than 9.5% of the employee's household income) and that meets the minimum value requirements;

(ii) either:

(a) the employer fails to offer its FT employees (and their dependents) the opportunity to enroll in aneligible employer-sponsored plan[3] (referred to here as the "**failure to offer coverage penalty**"), or

(b) the employer offers its FT employees (and their dependents) the opportunity to enroll in an eligible employer-sponsored plan but coverage under such plan is considered "unaffordable" or fails to provide "minimum value" (herein referred to as the "**unaffordable coverage/minimum value penalty**").[4]

What Is the "Failure To Offer Coverage Penalty"?

As noted, if a covered employer fails to offer its FT employees (and their dependents) eligible employer-sponsored health plan coverage and one or more of its FT employees receives subsidized health coverage through the health insurance Exchanges, the employer will be subject to an excise tax penalty. For purposes of determining whether such penalty applies, an employer will be treated as "offering" coverage to its FT employees (and their dependents) for a given calendar month only if for that month it offers qualifying coverage to at least 95% of its FT employees (or, if it results in a lower number of covered employees, all but five of its FT employees) and such employees' dependents. The permitted exclusion of up to 5% of an employer's FT employees (or, if greater, five FT employees) applies regardless of whether the failure to offer coverage to FT employees was intentional or inadvertent. See, **Transition Relief** in Section F below for a special rule that provides for a lower coverage percentage for 2015.

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An employee will be treated as being offered coverage for purposes of the Employer Mandate only if the employee has been given an effective opportunity to accept or decline coverage. An employee need not be given an effective opportunity to decline coverage if the coverage offered provides minimum value and is offered either at no cost to the employee or at a cost, for any calendar month, no greater than 9.5% of the monthly amount of the federal poverty line ("FPL") for a single individual for the applicable calendar year (i.e., the FPL divided by 12). An election of coverage by an employee for a prior year that continues

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(iii) not be actually enrolled in employer health plan coverage, even if that coverage is "unaffordable" or fails the minimum value test;

(iv) not be eligible for health coverage under a government-sponsored program, such as Medicare or Medicaid; and

(v) if married at the end of the relevant calendar year, file a joint income tax return for such year.

Although the Exchange-based subsidies are provided by the federal government, employers will be interested as to which,if any, of its employees may be eligible for the premium subsidies because, as described in this Alert, the imposition of penalties under the Employer Mandate is dependent in the first instance on at least one FT employee obtaining subsidized Exchange-based coverage, and in the case of the "unaffordable coverage/minimum value penalty," such penalty amount is based directly on the number of FT employees receiving subsidized Exchange-based coverage.

[3] The Employer Mandate requires, under the Final Regulations, the opportunity to enroll in "minimum essential coverage," which, under separate regulations governing the tax penalty imposed on individuals for failing to obtain minimum essential health coverage, includes generally coverage under an employer-sponsored group health plan (that meets certain health care market reforms under the Affordable Care Act), but excludes certain limited specialized coverage, such as coverage only for vision or dental care. In this Alert, we have assumed that employer-sponsored group health plan coverage (other than certain limited scope vision or dental care plans) would qualify as "minimum essential coverage" for purposes of the Employer Mandate.

[4] In calculating the failure to offer penalty and the unaffordable coverage/minimum value penalty (described herein), only FT employees are taken into account; part-time employees are disregarded for purposes of such penalties.

under the plan for succeeding plan years unless the employee affirmatively opts out of the plan will constitute an offer of coverage for purposes of the Employer Mandate.

Dependent Coverage

The requirement to provide "dependent coverage" means qualifying coverage also needs to be provided for a FT employee's children, as defined under the Code, who are under age 26. Employers are permitted to rely on the representations of employees as to the identity and ages of their children, unless they have knowledge to the contrary. Significantly, an employee's "dependents" do not include the employee's spouse.

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For purposes of determining a FT employee's dependents, foster children and stepchildren are excluded. The final rules clarify that a child is a dependent for the entire calendar month in which he or she attains age 26. Special rules apply to determine dependent status with respect to children who are not U.S. citizens or U.S. nationals.

How Is The "Failure To Offer Coverage Penalty" Calculated?

The failure to offer coverage penalty is, on an annual basis, calculated as follows: annual penalty = total number of FT employees (reduced by 30 FT employees)[5] x $2,000 (as adjusted for inflation beginning in 2015).[6]

Example. Company A does not offer eligible health plan coverage to its FT employees and their dependents (*i.e.*, fails to offer coverage to more than 5% of its FT employees (or, if a greater amount, fails to offer coverage to more than five FT employees)). Company A for 2016 has 100 FT employees, 25 of whom receive subsidized health coverage through the insurance Exchanges, and 20 part-time employees. The annual failure to offer coverage penalty is 70 (100 FT employees (part-time employees are disregarded) less 30) x $2,000 (adjusted for inflation) = $140,000 penalty tax. The penalty amount is not dependent on how many FT employees receive subsidized health coverage through the Exchanges — so long as at least one FT employee receives subsidized Exchange-based coverage the penalty will apply. Note: The **Transition Relief** rules described in Section F below may impact the penalty calculation for 2015.

What Is The "Unaffordable Coverage/Minimum Value Penalty"?

The "unaffordable coverage/minimum value penalty" applies if the employer offers its FT employees (and their dependents) the opportunity to enroll in coverage under an eligible employer-sponsored health plan but such coverage is unaffordable or fails to provide minimum value, and at least one FT employee receives subsidized health coverage through the health insurance Exchanges. In addition, if an employer offers qualifying coverage meeting the affordability and minimum value requirements but such coverage is provided to less than 100% of its FT employees (and their dependents), but coverage is offered to a sufficient number of FT employees and their dependents to avoid

[5] In applying the 30 FT employees exclusion when calculating the "failure to offer coverage penalty," in the case of employers that are part of a controlled group or affiliated service group, the 30 FT employees exclusion is allocated pro rata (on the basis of the number of FT employees employed by each employer for the calendar month) among the members of such group, with fractions less than one rounded up to the next highest whole number.

[6] Both the "failure to offer coverage" and "unaffordable coverage/minimum value" penalties are determined on a monthly basis, and therefore, the per FT employee penalty amount is, subject to inflation adjustments starting in 2015, $166.67 per month in the case of the failure to offer coverage penalty and $250 per month in the case of the unaffordable coverage/minimum value penalty.

the "failure to offer coverage penalty" (described above), the employer will still be subject to the unaffordable coverage penalty with respect to the excluded FT employees to the extent such employees receive subsidized Exchange-based coverage. A health plan will be considered to provide the required "minimum value" if the plan pays at least 60% of the total cost of allowed benefits. Applicable guidance provides that a plan's "minimum value" may be determined pursuant to:

(i) a minimum value calculator developed by the IRS and the U.S. Department of Health and Human Services;

(ii) certain regulatory-prescribed safe harbor plan designs; or

(iii) certification by an actuary.

When Is Coverage "Unaffordable"?

Under the Employer Mandate, coverage is "unaffordable" if the employee's share of the premium for the lowest cost, self-only coverage under the employer's health plan exceeds 9.5% of the employee's household income. Significantly, the employee's share of the premium cost for other coverage types (*e.g.*, family or dependent coverage) is not relevant in determining whether coverage is "affordable" for purposes of the Employer Mandate.

Affordability Safe Harbors

Recognizing the difficulty employers would have in determining an employee's household income, the Final Regulations offer three "affordability" safe harbors that an employer may use in complying with the affordable coverage requirement, provided the employer offers its FT employees and their dependents the opportunity to enroll in employer-sponsored coverage that provides minimum value with respect to the self-only coverage so offered to the employee. An employer may elect to use the same safe harbor for all its employees or different safe harbors with respect to reasonable categories of employees provided such safe harbors are applied on a uniform and consistent basis for all such employees within a category.

The three affordability safe harbors are as follows:

(i) **Form W-2 Safe Harbor.** Coverage will be treated as affordable if the employee's contribution toward the premium for the lowest cost, self-only coverage option that provides minimum value does not exceed 9.5% of the employee's Form W-2 wages (*i.e.*, the wages reported in box 1 of Form W-2) for the calendar year. Under the W-2 safe harbor, pre-tax salary deferrals under a Code section 401(k) or 403(b) retirement plan or Code section 125 cafeteria plan or transportation fringe benefits arrangement (such as transit check and parking benefits) are not added back to determine W-2 safe harbor wages.[7] Special rules apply under the Final Regulations for determining the W-2 wages of employees who are offered coverage for less than the full calendar year (*e.g.*, due to termination of employment mid-year).

(ii) **Rate of Pay Safe Harbor.** Coverage is affordable if an employee's contribution for a calendar month for the lowest cost, self-only coverage option that provides minimum value does not exceed 9.5% of

[7] Thus, the W-2 safe harbor compensation calculation is different than the rule that applies regarding pre-tax salary deferrals when determining compensation under qualified pension, 401(k) and 403(b) plans.

the employee's monthly wages determined as follows: (a) for hourly employees, multiply the employee's hourly rate of pay as of the beginning of the plan year or, if less, the lowest hourly rate during the month by 130 hours, and (b) for salaried employees, the employee's monthly salary rate as of the beginning of the plan year would be used. However, if the employer reduces the monthly salary of the employee after the beginning of the plan year, the rate of pay safe harbor may not be used for such employee for the calendar month (or months) for which such salary is reduced.

(iii) **Federal Poverty Line Safe Harbor.** Coverage is affordable if the employee's contribution for the lowest cost, self-only coverage option that provides minimum value does not exceed 9.5% of the "federal poverty line" for a single individual in the state where the employee is employed. For purpose of this safe harbor, the Final Regulations clarify that employers may use the federal poverty guidelines in effect within six months before the beginning of the plan year. Based on the federal poverty guidelines for 2014, the income threshold for a single individual in all states, except Hawaii and Alaska (separate slightly higher income thresholds apply in Hawaii and Alaska), is $11,670. Thus, the federal poverty line affordability safe harbor for 2014 would require an annual employee contribution for self-only coverage that does not exceed $1,108.65 ($11,670 x 9.5%), or $92.39 per month.

How Is The "Unaffordable Coverage/Minimum Value Penalty" Calculated?

The unaffordable coverage/minimum value penalty is, on an annual basis, calculated as follows: annual penalty = total number of FT employees who received subsidized coverage through the health insurance Exchanges x $3,000[8] (adjusted for inflation beginning in 2015). Such penalty, however, is capped at the penalty amount that would otherwise apply if the employer was subject to the failure to offer coverage penalty.

Example. Employer A offers in 2016 coverage to all of its FT employees and their dependents (and thus avoids the failure to offer coverage penalty), but such coverage does not satisfy the affordability and minimum value tests. Employer A for such year has 100 FT employees, 25 of whom receive subsidized coverage through the Exchanges, and 20 part-time employees. Thus, the unaffordable coverage/minimum value penalty is calculated as follows: 25 (number of FT employees who receive subsidized Exchange coverage) x $3,000 (adjusted for inflation beginning in 2015) = $75,000. The failure to offer coverage penalty cap (70 x $2,000 (adjusted for inflation beginning in 2015) = $140,000) would not apply in this example.

Example. Company Z, for 2016, has 200 FT employees and offers health plan coverage that meets the affordability and minimum value requirements to 190 of its FT employees (*i.e.*, 95% of its FT employees). Accordingly, such offer of coverage is sufficient to avoid the failure to offer coverage penalty, but leaves 10 FT employees who are not offered affordable/minimum value employer health plan coverage. Thus, if any of these 10 FT employees obtains subsidized health coverage through the Exchanges, Company Z will be subject to an annual Employer Mandate penalty of $3,000 (adjusted for inflation beginning in 2015) for each such employee who receives subsidized Exchange coverage.

B. WHAT IS AN "APPLICABLE LARGE EMPLOYER"?

An "applicable large employer" is, with respect to a calendar year, an employer that employed an average of at least

[8] As noted above, the unaffordable coverage/minimum value penalty applies and is calculated on a monthly basis, and thus the penalty per FT employee who receives subsidized Exchange-based health coverage is $250 (adjusted for inflation beginning in 2015) per month.

50 FT employees (including "full-time equivalent employees" ("FTE employees")), described below, on business days during the ***preceding*** calendar year. An applicable large employer can include for-profit, non-profit and governmental entities. See, **Transition Relief** in Section F below for a special rule that applies a 100 FT employees (including FTE employees) threshold for 2015.

In calculating whether the 50 FT and FTE employees threshold is met for a calendar year, the Final Regulations provide that the number of FT and FTE employees are determined for each calendar month in the preceding calendar year and then the sum of such monthly amounts is divided by 12 (rounded down to the next lowest whole number). If the result of such calculation is less than 50, the employer is not an applicable large employer for the current calendar year. However, if the result is 50 or more, the employer is an applicable large employer and therefore subject to the Employer Mandate for the calendar year, unless a special seasonal worker exception applies.[9]

Combined Calculation for Aggregated Employers

For purposes of determining whether an employer is an applicable large employer (based on employing at least 50 FT employees and FTE employees in the preceding calendar year), all entities that are part of a controlled group (which may include corporate and unincorporated entities) or an affiliated service group (reflecting entities that are service-based organizations that have certain ownership and service interrelationships) are treated as an aggregated single employer. The Final Regulations do not address the application of the controlled group and affiliated service group rules under the Employer Mandate to churches, conventions or associations of churches or governmental entities, and until further guidance is issued, such entities may apply a reasonable, good faith interpretation of the employer aggregation rules in determining their status as an applicable large employer.

The employer aggregation rules can have a significant impact in that a small employer (*i.e.*, with less than 50 FT and FTE employees) could nonetheless be treated as an applicable large employer, and therefore, subject to the Employer Mandate. For example, if a controlled group of entities consists of three employers having 25, 20 and 15 FT and FTE employees, respectively, because such employers are aggregated as members of the same controlled group and treated as a single employer having at least 50 FT and FTE employees, then each such employer would be considered an applicable large employer subject to the Employer Mandate, notwithstanding that, if analyzed on an individual employer basis, none of these employers would be subject to the Employer Mandate.

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If an employer was not in existence during the preceding calendar year, a newly established employer will be an applicable large employer during its first calendar year if it reasonable expects to employ an average of at least 50 FT employees during the current calendar year and it actually employs such

[9] Under the seasonal worker exception, if the sum of the employer's FT and FTE employees during the preceding calendar year exceeds 50 for 120 days or less (or, alternatively, for four calendar months or less during the preceding calendar year), in each case whether or not consecutive, and the employees in excess of 50 who were employed during that 120-day (or four calendar month) period are all seasonal workers, the employer will not be treated as an applicable large employer for the current calendar year. As to whether an employee is a "seasonal worker," the Final Regulations provide that employers may apply a reasonable, good faith interpretation of the statutory definition and certain U.S. Department of Labor ("DOL") regulations which provide generally that a seasonal worker is an individual who performs labor on a seasonal basis, which is of a kind exclusively performed at certain seasons or periods of the year, and that, from its nature, may not be continuous or carried on throughout the year (*e.g.*, retail workers employed exclusively during holiday seasons). The Final Regulations further note that employers may apply a reasonable good faith interpretation of the term "seasonal worker" and of applicable DOL regulations by analogy to workers and employment positions not otherwise covered under such DOL regulations (*i.e.*, workers in nonagricultural positions).

number of employees during that calendar year. The Final Regulations clarify that an employer is treated as not in existence during the prior calendar year only if it was not in existence on any business day in such prior year. The employer's reasonable expectations as to the size and nature of its workforce for the initial calendar year is made at the time the business comes into existence, even if subsequent events cause the actual number of FT and FTE employees to exceed the reasonably expected number.

The Final Regulations also provide a special transition rule for an employer's initial year as an applicable large employer. Under this rule, in the case of an employee who was not offered coverage at any time in the preceding calendar year, if the applicable large employer offers coverage to the employee on or before April 1 of the first calendar year for which the employer is an applicable large employer, the employer will not be subject to an Employer Mandate penalty for the period January through March of such year, provided, with respect to the unaffordable coverage/minimum value penalty, the coverage offered by April 1 provides minimum value.

C. WHO IS A FT EMPLOYEE AND FTE EMPLOYEE?

FT Employee

A FT employee for a calendar month is an employee who is employed on average at least 30 hours of service per week or at least 130 hours of service per calendar month. For these purposes, an employee means a common law employee, and thus, would not include a leased employee (*i.e.*, who is not otherwise a common law employee of the employer receiving such leased employee's services) or an independent contractor, or a partner in a partnership.

FTE Employee

Solely for purposes of determining whether an employer is an applicable large employer, FTE employees of an employer count in the calculation of whether the employer meets the "at least 50 FT and FTE employees" threshold. A FTE employee is a combination of employees, each of whom individually is not treated as a FT employee (*i.e.*, because such employee does not work at least 30 hours of service per week or 130 hours of service per calendar month). The number of FTE employees is determined for each calendar month as follows: aggregate the number of hours of service for all "part-time" employees for such month (but not more than 120 hours of service for any such employee) and divide the total by 120, with such result constituting the number of FTE employees for such month. Fractions are taken into account in making each monthly calculation (rounding to the nearest one hundredth), but are disregarded in calculating the final annual FT and FTE employee amount.

Example. Company Z has 35 FT employees for a calendar month (*i.e.*, employees who work on average at least 30 hours of service per week or 130 hours of service per month) and a number of part-time employees whose aggregate hours of service for the month equals 1,800 hours of service (taking into account no more than 120 hours for any such part-time employee). Thus, Company Z would have 15 FTE employees for such month (1,800 ÷ 120 = 15 FTE employees), that when added to the 35 FT employees would result in Company Z having at least 50 FT and FTE employees for the month. Therefore, if the same FT and FTE employee count applied for the other calendar months in the same calendar year, then Company Z would be an applicable large employer for the following calendar year, even though it had only 35 FT employees.

D. HOW ARE HOURS OF SERVICE COUNTED?

As discussed above, FT and FTE employee status is determined based on credited "hours of service." Under the Final Regulations, an employee's hours of service include (i) each hour for which the employee is paid or entitled to payment for the performance of duties for the employer and (ii) each hour for which an employee is paid or entitled to payment by the employer for periods for which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or paid leave of absence (collectively, "paid non-work activities"). This hours of service definition is generally the same as the one applicable in the context of a qualified retirement plan.

Method for Counting Hours of Service

In the case of employees paid on an hourly basis, employers must calculate actual hours of service worked and hours attributable to paid non-work activities. For other employees (*i.e.*, salaried employees), an employer may determine hours of service using any of the following three methods: (i) counting actual hours of service (in a manner similar to hourly employees); (ii) using a days-worked equivalency method whereby an employee is credited with 8 hours of service for each day the employee would otherwise be credited with at least one hour of service; and (iii) using a weeks-worked equivalency method whereby an employee is credited with 40 hours of service for each week in which the employee would otherwise be credited with at least one hour of service. In determining an employee's FT employee status, all hours of service performed for all entities that are part of the same controlled group or affiliated service group are taken into account.

While an employer must use one of the three hours of service counting methods for its salaried employees, it need not use the same method every year or with respect to different employee categories so long as the categories are reasonable and consistently applied. However, notwithstanding the availability of the days-worked or weeks-worked equivalency methods to calculate hours of service, if the use of an equivalency method would result in a substantial understatement of an employee's actual hours of service, such that the employee would not be treated as a FT employee, then such method may not be used. For instance, if an employee worked three 10-hour days per week, the use of the days-worked equivalency method would be prohibited because it would substantially understate the employee's hours of service per week and treat the employee as not a FT employee (30 hours actually worked vs. 24 hours of service credited under the days-worked equivalency (8 hours/day x 3 days worked for which one hour of service would be credited)).

Non-U.S. Service

In the case of employees working outside the United States, hours of service for purposes of the Employer Mandate do not include services performed outside the U.S. to the extent the compensation for such services constitutes foreign source income under the Code. Such treatment of services performed outside the U.S. applies without regard to the employee's citizenship or residency. Thus, employees working in other countries, even if they are U.S. citizens, generally would not have hours of services, and therefore would not be FT employees for purposes of determining an employer's status as an applicable large employer or potential Employer Mandate penalties. However, all hours of service for which an employee receives income from U.S. sources will be taken into account. The key element is the location where the employee's services are performed. If the employee is paid for performing services outside the U.S., then to that extent those services generally will not be taken into account in determining the employee's hours of services for purposes of the Employer Mandate. Finally, the Final Regulations provide special hours counting rules for teachers and other employees of educational organizations due to the unique consequences of working during an

academic year that involves periods in which the organization is not in session and for employees who are transferred to positions outside the U.S.

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Excluded Hours of Service

Under the Final Regulations, hours of service performed by (i) a bona fide volunteer, (ii) a student in a federal (or similar state or local government) work-study program, or (iii) until further IRS guidance is issued, an individual who is subject to a vow of poverty as a member of an order where the work involves the tasks usually required of an active member of the order, are disregarded for purposes of the Employer Mandate. For these purposes, a bona fide volunteer is an employee of a governmental entity or an organization that is tax-exempt under Code Section 501(c) who either receives no compensation or receives compensation in the form of reimbursement or reasonable allowance for reasonable expenses incurred in performing volunteer services or reasonable benefits or nominal fees customarily paid in similar situations for volunteer services.

Special Hours Crediting; Adjunct Faculty

With respect to employees in industries where the calculation of hours of service are challenging (such as adjunct faculty, airline employees or traveling salespersons), the Final Regulations authorize, until further IRS guidance is issued, employers of such employees to use a reasonable method of crediting hours of service consistent with the purpose of the Employer Mandate. In the context of adjunct faculty, and until further guidance is issued (but in no event may such future guidance that restricts the use of this method become effective before 2016), a reasonable method of crediting hours of service may involve (i) 2¼ hours of service per week for each hour of teaching or classroom time (i.e., reflecting an additional 1¼ hours for activities such as class preparation and grading papers and exams) and (ii) one hour per week for each additional hour of service performed outside the classroom (such as for faculty meetings and required office hours).

E. WHAT METHODS MAY BE USED TO DETERMINE FT EMPLOYEE STATUS?

As noted above, in determining whether an employer is an applicable large employer (and, therefore, subject to the Employer Mandate), the employer's FT employees (and FTE employees) are determined in the calendar year preceding the calendar year for which the applicable large employer determination is being made. In addition to the determination of FT employee status for applicable large employer purposes, employers will need to identify their FT employees for purposes of applying the Employer Mandate penalty rules and determining whether any penalties apply for a given month and, as applicable, the amount of such penalties. It is the timing of this latter FT employee determination that can be difficult for many employers.

Monthly Measurement Method

For employers whose workforces are relatively stable and consist solely or substantially of employees who clearly meet the FT employee hours of service threshold, making a FT employee determination in "real time" on a monthly basis may not pose significant administrative problems. In this regard, the Final Regulations permit the use of a "monthly measurement method." Under this method, FT employees will be identified based on the hours of

service credited in each current calendar month. Under the monthly measurement method, if an employee is first offered coverage no later than the first day of the fourth full calendar month after the date the employee is otherwise eligible for coverage for the first time (*i.e.*, all conditions to coverage are met except for the imposition of a permissible waiting period), then no Employer Mandate penalty will apply for the period of the three full calendar months preceding the latest date coverage may be offered (provided, in the case of the unaffordable coverage/minimum value penalty, the employee is otherwise eligible for coverage that provides minimum value).[10]

Look-Back Measurement/Stability Period Method

However, for many employers that employ employees who work a variable schedule or whose hours of service may fluctuate week to week or month to month, such employers may encounter difficulties in being able to timely identify which of its employees are FT employees and thus should be offered coverage under the employer's health plan. This uncertainty and unpredictability in assessing who is a FT employee for given month can lead to a failure to timely offer eligible FT employees affordable/minimum value health plan coverage with the consequence that the employer could become subject to the Employer Mandate penalties despite otherwise desiring to avoid such penalties.

To assist employers in this regard, the Final Regulations, reflecting the earlier proposed regulations, offer employers the option to use a look-back measurement period and make its FT employee determinations during such measurement period that will then apply to a subsequent period, known as a "stability period." This optional measurement/stability period method is applied separately to an employer's "ongoing employees" and newly hired "variable hour employees." Further, employers may designate measurement and stability periods that differ in length or their starting and ending dates among the members of an aggregated controlled or affiliated service group of employers, as well as for the following different categories of employees: (i) collectively bargained vs. non-collectively bargained employees, (ii) each group of collectively bargained employees covered by a separate collective bargaining agreement, (iii) salaried vs. hourly employees, and (iv) employees whose primary places of employment are in different states.

Ongoing Employees

In applying the measurement/stability period method to ongoing employees, an employer will need to establish a look-back measurement period, which is a period of at least three but not more than 12 consecutive months. This measurement period for ongoing employees is referred to as the "standard measurement period." (A special transition rule, described below under **Transition Relief**, at Section F of this Alert, is available for determining the standard measurement period with respect to the stability period beginning in 2015.) The related stability period is a period that immediately follows the standard measurement period (or, as applicable, any "administrative period," described below) that is equal to the greater of six consecutive calendar months or the length of the standard measurement period. It can be expected that most employers will choose to apply a 12-month stability period in order to facilitate plan administration and conform to the annual negotiation of their health insurance contracts and open enrollment periods. An ongoing employee is an employee who is employed by an employer for at least one full standard measurement period.

[10] With respect to employees for whom FT employee status is determined using the monthly measurement method, the employer may make such determination based on hours of service credited over successive one-week periods, which weekly periods for a calendar month must contain either the week that includes the first day of the month or the week that includes the last day of the month, but not both. Under this weekly period rule, FT employee status for certain calendar months will be based on hours of service credited over a four-week period (in which case, an employee with at least 120 hours of service is a FT employee for that month) and for other calendar months over a five-week period (in which case, an employee with at least 150 hours of service is a FT employee for that month).

Administrative Period

To further assist employers in making determinations of their employees' FT employee status and timely offering coverage to those FT employees, the Final Regulations also permit employers to establish an "administrative period" immediately following the end of a standard measurement period and prior to the beginning of the related stability period. The purpose of an administrative period is to afford employers time to finalize their FT employee determinations with respect to a related measurement period, provide notices and other information to FT employees regarding the availability of coverage, and enable eligible FT employees to make health plan coverage elections for the upcoming stability period. The administrative period may be up to 90 days but it may neither reduce nor lengthen the related standard measurement period or stability period.

If an ongoing employee is determined to be a FT employee under a standard measurement period, then such employee is treated as a FT employee during the entire related stability period, regardless of the number of hours of service the employee performs during the stability period, or, if applicable, the related administrative period, provided the individual remains an employee in such stability period. Similarly, if an employee is determined to not be a FT employee during the standard measurement period, the employer may treat the employee as not a FT employee during the entire related stability period, regardless of the number of hours of service the employee performs during the stability period or, if applicable, the related administrative period.

As an example, a standard measurement period, stability period and administrative period could be implemented as follows:[11]

Standard Measurement Period	12-month period measured from October 3, 2014 – October 2, 2015
Administrative Period	90-day period beginning October 3, 2015 – December 31, 2015
Stability Period	12-month period beginning January 1, 2016 – December 31, 2016

New Employees

Special rules apply in determining a new employee's status as a FT employee. For a newly hired employee who is reasonably expected as of his or her start date to work on average at least 30 hours of service per week, and who is not otherwise a "seasonal employee," the employer will not be subject to an Employer Mandate penalty with respect to such employee for the period ending with the third full calendar month of employment if the employee is otherwise eligible for an offer of coverage under the employer's group health plan for such months and the employee is offered coverage by the employer by the first day of the fourth full calendar month of employment (if then employed), and in the case of the unaffordable coverage/minimum value penalty, the coverage offered provides minimum value. For these purposes, an employee is considered to be "otherwise eligible to be offered coverage" under the employer's plan for a calendar month if, under the plan's terms in effect for such month, the employee meets all of the coverage eligibility conditions under the plan other than the completion of a permissible waiting period (determined in accordance with applicable health care reform rules). If coverage is not so offered to such a new FT employee, the employer may be subject to an Employer Mandate penalty with respect to such employee for the initial three calendar months of employment as well as future months for which health plan coverage is not offered to the employee.

[11] See the discussion below under the heading **Transition Relief**, at Section F of this Alert, for alternative rules available for establishing a shorter standard measurement period for the stability period commencing in 2015.

In the case of a newly hired employee who is a "variable hour" employee, the employer may, if it uses the standard measurement period/stability period measurement method for its ongoing employees, also use a similar methodology involving an initial measurement period, an administrative period and related stability period to determine the FT employee status of its new variable hour employees. A separate initial measurement period and related stability period would apply for each new variable hour employee. A new employee is a variable hour employee if, based on the facts and circumstances at the employee's start date, it cannot be determined that the employee is reasonably expected to work on average at least 30 hours of service per week during the initial measurement period.

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Under the Final Regulations, a seasonal employee is an employee in a position for which the customary annual employment is six months or less. In this regard, customary means that by the nature of the position an employee in this position typically works for a period of six months or less and the period should begin each calendar year in the same part of the year.

In determining whether a new employee is reasonably expected to be a FT employee (or will otherwise be a variable hour employee), the following factors to consider include whether the employee is replacing an employee who was a FT employee or a variable hour employee, the extent to which employees in the same or comparable positions are or are not FT employees, and whether the job was advertised or communicated to the new employee as requiring hours of service at a FT employee level. In making this determination, an employer may not take into account the likelihood that the employee will terminate employment before the end of the applicable initial measurement period for the new employee. In addition, the Final Regulations clarify that educational organization employers (i.e., an organization whose primary function is the presentation of formal instruction, maintains a regular faculty and curriculum and has a regularly enrolled student body) may not take into account the likelihood of an employment break period (i.e., period of at least four consecutive weeks (other than certain unpaid leave) when an employee of an educational organization has no hours of service) in determining their reasonable expectations of a new employee's FT employee status.

Initial Measurement Period

The initial measurement period for a new variable hour employee is a period of 3 to 12 consecutive months, which need not be calendar months. An administrative period of up to 90 days may be added at the end of the initial measurement period. However, the initial measurement period and administrative period combined may not extend beyond the last day of the first calendar month beginning on or after the one-year anniversary of the employee's start date. Therefore, the total of the initial measurement period and administrative period for a new variable hour employee may not exceed 13 months and, as applicable, a fraction of a month. Thus, if the initial measurement period is a 12-month period beginning on the variable employee's start date, the related administrative period could begin following the initial measurement period and continue through the end of the first calendar month that begins on or immediately following the one-year anniversary of the initial measurement period start date. The initial measurement period may also begin on the first day of the calendar month immediately following the employee's start date or, if later, the first day of the first payroll period beginning on or after the employee's start date, in which case any applicable administrative period following the initial measurement period will be slightly shorter than would be the case if the initial measurement period begins on the employee's start date. The stability period for a new variable hour employee must be based on calendar months and be the same length as the stability period for ongoing employees.

If a new variable hour or new seasonal employee is determined not to be a FT employee during the initial measurement period, the employer may treat the employee as not a FT employee during the related stability period. After the FT employee status determination of the new variable hour employee is made for the initial measurement period, the employer will next determine the employee's FT employee status in the same manner as is applicable in the case of its other ongoing employees (*i.e.*, applying the relevant standard measurement period and related stability period). Thus, after a new variable hour employee's FT employee status is determined under the employee's initial measurement period, such employee will be treated as an ongoing employee whose FT employee status is determined beginning with the standard measurement period that commences on or after the employee's start date.

The following example illustrates the use of an initial measurement period and related administrative period for a new variable hour employee and then such employee's transition to an ongoing employee and the use of a standard measurement period to determine the employee's FT employee status during those respective measurement periods.

Example. Assume an Employer uses a 12-month initial measurement period beginning on the variable hour employee's employment start date, applies an administrative period that begins after the initial measurement period and continues through the end of the first calendar month beginning on or after the end of the initial measurement period, and uses a 12-month stability period. John Smith, a new variable hour employee, commences employment on February 20, 2015. Accordingly, he would be tested for FT employee status during the initial measurement period beginning February 20, 2015 and ending February 19, 2016, and then, if determined to be a FT employee during such initial measurement period, would be treated as a FT employee for the stability period commencing April 1, 2016 through March 31, 2017 (reflecting an administrative period beginning February 20, 2016 through March 31, 2016).

Assume further, the Employer uses a standard measurement period beginning November 1 through October 31, an administrative period from November 1 through December 31, and a 12-month stability period based on the calendar year. Thus, John Smith would, after being tested for FT employee status during his initial measurement period, next be tested with the ongoing employees for the standard measurement period that begins after Smith's start date. Therefore, Smith would be tested for FT employee status during the standard measurement period beginning on November 1, 2015 and ending on October 31, 2016, and if determined to be a FT employee during such standard measurement period he would be treated as a FT employee for the entire stability period associated with that standard measurement period (*i.e.*, calendar year 2017). Thus, Smith would be treated as a FT employee for purposes of the Employer Mandate for the two overlapping stability periods, *i.e.*, the initial stability period (April 1, 2016 - March 31, 2017) and the stability period associated with Smith's first standard measurement period (January 1, 2017- December 31, 2017).

Changes in Employment Status and Termination/Rehire Situations

Changes in Employment

If a new variable or seasonal employee has a change in employment status during the initial measurement period so that after the change the employee is in a job that, had he or she been in that job at the start of the employee's employment, the employee would have reasonably been expected to work on average at least 30 hours of service per week and classified as a FT employee, then such employee's FT employee status will change. An employee who has such a change in employment status will be treated as a FT employee for purposes of the Employer Mandate as of the first day of the fourth full calendar month following the change in employment status or, if earlier and the employee averages more than 30 hours of services per week during the initial measurement period, the first day of the first

month after the end of the initial measurement period and, as applicable, any administrative period associated with the initial measurement period. If an employee has such a change in employment, and the employee is otherwise eligible for an offer of coverage during such prior period and is actually offered coverage by the first day following such period (provided, for purposes of the unaffordable coverage/no minimum value penalty, the coverage provides minimum value), if the employee is then employed, then no Employer Mandate penalty will apply for such prior period.

This change in employment status rule applies only for new variable hour and seasonal employees and **not** to changes in employment status for ongoing employees. Thus, if an ongoing employee is determined to be a FT employee during a standard measurement period, such employee will continue to be a FT employee during the related stability period, if still employed during the stability period, even if the employee has a change in employment status during the stability period (*e.g.*, a reduction in hours of service to less than 30 hours of service per week) that would otherwise cause the employee to no longer be a FT employee.

Termination/Rehire

In the case of an employee who has a period for which no hours of service are credited (*e.g.*, due to a termination of employment or period of unpaid leave of absence) (a "no-service period"), if such period is at least 13 consecutive weeks (26 consecutive weeks in the case of employees of educational organizations), the employer may treat the employee who has an hour of service after a no-service period as having terminated employment and then been rehired as a new employee when applying the measurement period rules upon the employee's rehire. If the no-service period is less than 13 (or, as applicable, 26) consecutive weeks, an employer may apply a rule of parity whereby an employee may be treated as having terminated employment and rehired as a new employee if the no-service period is at least four consecutive weeks long and exceeds the employee's period of employment immediately preceding the no-service period. For example, if an employee works five weeks, terminates employment and then is rehired eight weeks later, because the no-service period (*i.e.*, eight weeks) is at least four weeks long and exceeds the prior period of employment, the employer may treat the rehired employee as a new employee for purposes of determining his or her FT employee status under the applicable measurement period rules.[12]

The Final Regulations provide a method for crediting hours of service for periods that include "special unpaid leave" in the case of an employee who is treated as a continuing employee (and not as a terminated/new employee) upon the employee's return to employment. Special unpaid leave means a period of unpaid leave under the Family and Medical Leave Act or the Uniform Services Employment and Reemployment Rights Act, or on account of jury duty. Special rules also apply under the Final Regulations with respect to employment break periods for employees of an educational organization and the FT employee determination applicable to employees of temporary staffing agencies.[13]

[12] If an employee who had a no-service period later returns to service and is not treated as a new employee for Employer Mandate purposes, then upon the resumption of services the employee will pick up the status (*e.g.*, FT employee) he or she had with respect to an applicable stability period (*i.e.*, if the employee returns during a stability period for which the employee is treated as a FT employee, the employee would retain that status for the balance of that stability period).

[13] In the case of an employment break period (*i.e.*, a period of at least four consecutive weeks, but disregarding any special unpaid leave periods) during the non-working period under an educational organization's academic calendar when the employee has no hours of service, the educational organization must either (i) determine an employee's average hours of service per week during the measurement period by excluding the employment break period and any special unpaid leave and apply such average for the entire measurement period or (ii) treat the employee as credited with hours of service for the employment break period and any special unpaid leave at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not part of the employment break period or special unpaid leave. The educational organization is not required to exclude or credit (as the case may be) an employee in any calendar year with more than 501 hours of service for any employment break period in a calendar year (disregarding for this 501-hour limit, hours of service excluded or credited for

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The Final Regulations also provide rules governing how a switch from an employment position for which the look-back measurement method applies to a position for which the monthly measurement method applies (or vice versa), which rules generally are intended to protect an employee's FT employee status during the period of transitioning between positions.

F. TRANSITION RELIEF

The transition relief described below is available for 2015 (and, as applicable, for the portion of the 2015 fiscal plan year that falls in 2016). As noted, 2015 is the first year for which the Employer Mandate applies.

1. Transition Relief For Employers With Fewer Than 100 FT Employees (Including FTE Employees)

The IRS recognizes that the implementation of the Employer Mandate for certain smaller employers that would otherwise be subject to the new requirements may involve significant health plan changes. To assist these employers, the Final Regulations provide the following transition relief so that if the applicable conditions are met no Employer Mandate penalty will apply to eligible employers for any calendar month in 2015 or any calendar month during the portion of a non-calendar year plan year that begins in 2015 (a "2015 plan year") but which falls in 2016.

An employer is eligible for this new transition relief only if it meets the following conditions:

- The employer employs an average of at least 50 FT employees (including FTE employees) but less than 100 FT employees (including FTE employees) during 2014. The calculation as to whether the 100 FT employees threshold is met is made in accordance with the regular rules, exceptions and other transition relief applicable to the determination of an employer's status as an applicable large employer for purposes of the Employer Mandate.

- During the period beginning on February 9, 2014 and ending on December 31, 2014, the employer does not reduce its workforce or the overall hours of service of its employees in order to fall under the 100 FT employees threshold, unless such reductions are for bona fide business reasons (*e.g.*, workforce reductions due to disposition of a business unit or economic changes in the employer's business market).

- During the period, for employers with a calendar year plan, beginning on February 9, 2014 and ending on December 31, 2015 (and for employers with a non-calendar year plan, the period beginning on February 9, 2014 and ending on the last day of the plan year that begins in 2015) (referred to as the "coverage maintenance period"), the employer does not eliminate or materially reduce the health coverage, if any, it offered as of February 9, 2014. An employer will not be treated as eliminating or materially reducing health coverage if:

  (i) it continues to offer each employee who is eligible for coverage during the coverage

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special unpaid leave). Further, these educational organization employment break period rules apply only to an employee treated as a continuing employee upon his or her return to service, and not to an employee otherwise treated as terminated and then rehired as a new employee.

maintenance period an employer contribution toward the cost of employee-only coverage that is either (A) at least 95% of the dollar amount of the contribution toward such coverage that the employer offered on February 9, 2014, or (B) the same (or a higher) percentage of the cost of coverage that the employer was offering to contribute on February 9, 2014;

(ii) in the event there is a change in benefits under the employee-only coverage offered, such coverage provides minimum value after the change; and

(iii) the employer does not change the terms of its health plan to narrow or reduce the class (or classes) of employees (or the employees' dependents) to whom coverage was offered on February 9, 2014.

- The employer certifies, on an information reporting form to be prescribed, that it satisfies the above eligibility requirements.

In the case of an employer that was not in existence during 2014 but that would otherwise be an applicable large employer for purposes of the Employer Mandate in 2015 (*i.e.*, an employer newly established in 2015 that is reasonably expected to employ an average of at least 50 FT employees (including FTE employees) during 2015), the transition relief described in this section will be available if (i) the employer reasonably expects to employ and actually employs fewer than 100 FT employees (including FTE employees) during 2015, (ii) the employer reasonably expects to meet and actually meets the workforce and coverage maintenance standards, described above, from the date the employer comes into existence, and (iii) the employer certifies its compliance with such eligibility requirements.

2. Shorter Testing Period for Determining Applicable Large Employer Status for 2015

Generally, an employer's status as an applicable large employer for a calendar year (and thus as an employer subject to the Employer Mandate for such year) is based on the number of FT employees (including FTE employees) employed during the full preceding calendar year. To facilitate an employer's determination whether it is an applicable large employer for 2015, an employer may use a period of at least six consecutive calendar months, as selected by the employer, during 2014 (in lieu of applying the entire 2014 calendar year). Thus, for example, an employer may determine whether it is an applicable large employer for 2015 (*i.e.*, employs an average of at least 50 (or, per the transition relief described in section 1 above, 100) FT employees (including FTE employees)) based on the six consecutive calendar month period beginning on April 1, 2014 and ending on September 30, 2014.

3. Shorter Look-Back Measurement Period for Stability Period Beginning in 2015

As discussed in our earlier Alert (and as discussed above), employers are allowed to determine which employees are FT employees (as defined in the Final Regulations) based on a look-back measurement period that precedes the stability period to which the FT employee determinations are applied. While generally the look-back measurement period will need to be 12 consecutive months if the related stability period is to be 12 months, a transition rule permits employers to adopt a transition measurement period that is less than 12 consecutive months (but not less than 6 consecutive months) and that begins no later than July 1, 2014 and ends no earlier than 90 days before the first day of the plan year beginning in 2015.

Thus, for example, an employer with a calendar year plan may use a look-back measurement period, for purposes of

determining which employees are FT employees for a stability period consisting of calendar year 2015, that runs from May 1, 2014 through October 31, 2014 (followed by an administrative period (used to provide timely notice and plan enrollment for those determined to be FT employees) that runs from November 1, 2014 through December 31, 2014). This transition guidance applies to a stability period beginning in 2015 (and thus would continue into 2016 in the case of the portion of a 2015 stability period that carries over into 2016) and only to individuals who are employees as of the first day of the transition measurement period. For those employees hired after such initial date of the transition measurement period, such employee's FT employee status will be determined under the provisions of the Final Regulations governing generally look-back measurement period calculations.

4. Coverage Offers for January 2015

In applying the Employer Mandate penalties, the Final Regulations provide generally that if an employer fails to offer coverage to a FT employee for any day in a calendar month such employee will be treated as not offered coverage for that month. Under this new transition relief, solely for purposes of January 2015, if an employer offers coverage to a FT employee no later than the first day of the first payroll period that begins in January 2015, the employee will be treated as having been offered coverage for January 2015.

5. Coverage of Dependents

To avoid a potential Employer Mandate penalty, an employer is required to offer minimum essential coverage to its FT employees and the FT employees' dependents. Under this transition relief, if an employer takes steps during the 2014 and 2015 plan years toward offering coverage to its FT employees' dependents, it will not be subject to an Employer Mandate penalty solely on account of a failure to offer dependent coverage for the 2015 plan year, provided that, with respect to the plan, any of the following conditions is met: (i) dependent coverage is not offered, (ii) dependent coverage is offered with respect to coverage that is not minimum essential coverage, or (iii) dependent coverage is offered for some, but not all, dependents. However, this transition relief is not available with respect to dependents who were offered coverage in either the 2013 or 2014 plan year (or both) (*i.e.*, the relief is available only with respect to dependents who were without an offer of coverage in the 2013 and 2014 plan years).

6. 2015 Employer Mandate Penalty Relief

a. Failure to Offer Coverage Relief

As discussed above, an Employer Mandate penalty may apply where the employer fails to offer a sufficient number of its FT employees (and their dependents) minimum essential health coverage for any calendar month (referred to as the "failure to offer coverage" penalty). In determining whether a sufficient number of an employer's FT employees (and their dependents) are offered coverage, the Final Regulations require that coverage be offered to at least 95% of the employer's FT employees (or, if it results in a greater number of excluded FT employees, up to five FT employees can be excluded).

Under this new transition relief, for each calendar month during 2015 (and any calendar months during the 2015 plan year that fall in 2016), an employer that offers minimum essential coverage to at least 70% (instead of 95%) of its FT employees (and, as applicable, their dependents) will not be subject to the failure to offer coverage penalty.

b. Calculation of Failure to Offer Coverage Penalty Relief

In calculating the failure to offer coverage penalty for each calendar month under the Employer Mandate, the penalty will be equal to one-twelfth of the applicable payment amount ($2,000, adjusted for inflation) multiplied by the number of FT employees (excluding 30 FT employees), provided at least one FT employee receives a premium cost subsidy for exchange-based individual health coverage. If the employer is part of a controlled group, the 30 FT employees exclusion is allocated ratably among the controlled group members based on the number of FT employees employed by each member during the calendar month.

Under this new transition relief, for 2015 and any calendar months during the 2015 plan year that fall within 2016, if an applicable large employer, determined on a controlled group and affiliated service group basis and reflecting the transition relief-based requirement of having an average of 100 or more FT employees (including FTE employees) during 2014, is potentially subject to a failure to offer coverage penalty for 2015 (and any applicable portion of the 2015 plan year that falls in 2016), such penalty will be calculated by reducing the employer's number of FT employees by 80, instead of 30 (or, if part of an aggregated employer group, its ratable share thereof).

7. Non-Calendar Year Plans

The Final Regulations offer three forms of transition relief for employer health plans maintained on the basis of a non-calendar year plan year.

a. Pre-2015 Plan Year Eligibility Relief

If an applicable large employer maintained a non-calendar year plan as of December 27, 2012 and the plan year was not changed after such date to begin at a later date (*e.g.*, changing the plan year beginning date from July 1 to October 1), then no Employer Mandate penalty will apply with respect to any FT employee for the period during 2015 that is prior to the beginning of the 2015 plan year if:

- the employee would be eligible for coverage under the plan on the first day of the plan year beginning in 2015 pursuant to the plan's eligibility terms in effect on February 9, 2014 and such employee is not otherwise eligible for coverage under a plan maintained by the employer as of February 9, 2014 that has a calendar year plan year; and

- the coverage offered the employee as of the first day of the 2015 plan year is "affordable" and provides "minimum value."

b. Significant Percentage (All Employees) Transition Relief

If an applicable large employer maintained a non-calendar year health plan as of December 27, 2012 and the plan year of the plan was not changed after such date to begin at a later date, then no Employer Mandate penalty will apply for any calendar month prior to the beginning of the 2015 plan year with respect to employees who are offered affordable coverage that provides minimum value by the first day of the 2015 plan year and who would not have been eligible for coverage under any employer plan maintained as of February 9, 2014 that has a calendar year plan year, provided, with respect to ***all employees*** of the employer, the non-calendar year plan:

- had, as of any date in the 12-month period ending on February 9, 2014, at least 25% of all of its employees covered by the plan, or

- offered coverage under such plan to at least one-third of all of its employees during the open enrollment period that ended most recently before February 9, 2014.

c. Significant Percentage (FT Employees) Transition Relief

If an applicable large employer maintained, as of December 27, 2012, a non-calendar year health plan and the plan year of such plan was not changed after such date to begin at a later date, then no Employer Mandate penalty will apply for any calendar month prior to the start of the 2015 plan year with respect to FT employees who are offered affordable coverage that provides minimum value by the first day of the 2015 plan year and who would not have been eligible for coverage under any employer plan maintained as of February 9, 2014 that has a calendar year plan year, provided, with respect to the employer's ***FT employees***, that:

- as of any date within the 12-month period ending on February 9, 2014 at least one-third of the employer's **FT employees** were covered under the non-calendar year plan, or

- the employer offered coverage under the non-calendar year plan to at least 50% of its **FT employees** during the open enrollment period that ended most recently before February 9, 2014.

Notwithstanding the foregoing transition relief for employers that maintain non-calendar year plans, if the employer does not offer minimum essential health coverage to all but 5% (or, if greater, five) of its FT employees (and their dependents) (or, if the transition relief described above applies, does not offer coverage to all but 30% of its FT employees (and their dependents)) as of the first day of the 2015 plan year, an Employer Mandate penalty (calculated under the "failure to offer coverage" penalty rules) may apply for any calendar month in 2015, determined without regard to the non-calendar year plan transition relief. In addition, employers subject to certain annual information reporting regarding the health plan coverage offered to its employees for 2015 will need to provide such reporting information for the entire 2015 calendar year even though the employer is eligible for the transition relief for its non-calendar year plan for 2015.

G. ASSESSMENT OF EMPLOYER MANDATE PENALTIES

Employer Mandate Penalty Assessments

Employer Mandate penalties will be imposed on an individual employer basis. Thus, under the Final Regulations, if an employer is part of a controlled group, such employer will be liable only for its own Employer Mandate penalties and will not be liable for the penalties assessed against the other members of its controlled group. Employers are not required to include the penalty on any employer tax return and the penalty amount is not deductible by the employer. The IRS and Treasury Department will be issuing additional guidance concerning the determination and assessment of liability on employers for Employer Mandate penalties.

Employers should be developing procedures to determine which of its employees are FT employees (as described above) and whether affordable/minimum value employer health coverage is offered to those FT employees, and maintaining adequate records to support such determinations. In addition, the provision of substantial and accurate communications to an employer's FT employees will be essential to minimize the likelihood that employees will

inappropriately be determined to be eligible for Exchange-based subsidies and the employer incorrectly assessed Employer Mandate penalties. The correct determination of the eligibility of FT employees for Exchange-based subsidies is not only in the employer's financial interests, but also in their employees' interest because any improperly paid subsidies will need to be reconciled and repaid to the government by the affected employee.

H. EMPLOYER CONSIDERATIONS/ACTION STEPS

The Employer Mandate rules will soon become effective and employers are encouraged to take action now to understand how the rules work and how they may impact their decision whether to continue offering health plan coverage, and what, if any, changes may be needed to their plans in order to avoid tax penalties from being imposed. In light of the Employer Mandate requirements, the Final Regulations, and the January 1, 2015 implementation date, all employers should consider the following questions and administrative issues:

Questions Regarding Continuance of Employer Health Plan Coverage and Possible Plan or Workforce Changes

- Should the employer continue offering qualifying health plan coverage to its FT employees and their dependents or cease providing coverage and pay the applicable failure to offer coverage penalties?

- If the employer continues to offer health plan coverage, does such coverage meet the affordability and minimum value requirements under the Employer Mandate rules? If not, what changes are needed to the employer's health plan to meet such requirements (*e.g.*, revise the employee's share of the premium for the lowest cost self-only coverage option to incorporate one of the "affordability" safe harbor formulas)?

- Does the employer need to modify its plan's eligibility requirements to conform to the FT employee definition under the Final Regulations?

- Should the employer consider restructuring its workforce to reduce the number of FT employees it has by lowering their employees' hours worked per week?

- If the employer ceases offering health plan coverage to any employees, does the employer wish to increase employee pay to help subsidize the employees' cost of obtaining coverage through the Exchanges? Related IRS guidance addresses the impact of certain new health care law reforms on alternative employer funding arrangements.

- Does the employer qualify for any of the special transition relief rules, and if so, are such rules helpful in implementing the Employer Mandate for 2015?

Compliance Steps

- If the look-back measurement/stability period method is to be used, establish standard and initial measurement periods and related stability and, as applicable, administrative periods for determining FT employee status.

- Develop internal recordkeeping systems to calculate hours of service. For salaried employees, will

hours of service be credited using an equivalency method? If so, will it be the days-worked or weeks-worked equivalency formula?

- Make appropriate determinations of FT (and, as applicable, FTE) employee status.
- Review and apply, if beneficial, any applicable transition relief available for 2015.
- Is the employer part of a controlled group or an affiliated service group? If so, consider the impact on (i) the determination of applicable large employer status for each group member, (ii) the allocation of the 30 (or, per the special 2015 transition relief, 80) FT employee exclusion in calculating the failure to offer coverage penalty, and (iii) the crediting of hours of service to employees working within the group.
- For new hires, document the initial determination as to whether the new employees are reasonably expected to work on average at least 30 hours of service per week.
- Develop procedures for tracking employees who perform no hours of service (*i.e.*, due to a termination of employment or unpaid leave of absence) and then return to service so as to properly determine the impact on their FT employee status when they return.
- Consider establishing a procedure to review, and, if desired, to proactively address, any improper determination of employee eligibility for Exchange-based subsidies. Maintain documentation showing the employer health coverage, if any, offered to FT employees.
- Develop procedures to obtain the health plan coverage information necessary to file and furnish applicable information returns with the IRS and written statements to FT employees, and coordinate with outside vendors (*e.g.*, health insurers) with respect to the required information filings.

These are just some of the issues employers may wish to consider in deciding how to proceed with respect to the Employer Mandate. However, all employers should take action as promptly as practicable to develop a strategy to address the Employer Mandate rules and the potential employer tax penalties thereunder. Contact any of the attorneys listed below if you would like assistance with respect to the impact of these new tax rules.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

David M. Glaser	**212-336-2624**	**dmglaser@pbwt.com**
Bernard F. O'Hare	**212-336-2613**	**bfohare@pbwt.com**
Bruce L. Wolff	**212-336-2959**	**blwolff@pbwt.com**
Jessica S. Carter	**212-336-2885**	**jcarter@pbwt.com**
Meridith Bogart Krell	**212-336-2361**	**mkrell@pbwt.com**