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Client Alert:

IRS Issues Final Affordable Care Act Employer Mandate Regulations

February 18, 2014

Final Regulations issued on February 10, 2014 include transition relief for 2015 for employers with fewer than 100 "full-time" employees but leave Section 6056 reporting requirements in effect as of January 1, 2015.

On February 10, 2014, Treasury and the IRS issued final regulations (T.D. 9655 (Feb. 10, 2014); 79 Fed. Reg. 8,544 (Feb. 12, 2014)) on shared responsibility for employers regarding health coverage under the Patient Protection and Affordable Care Act, as amended ("PPACA") (Pub. L. 111-148, 124 Stat. 119 (2010)). In 2013, the IRS provided transition relief for 2014 from the employer shared responsibility provisions under Internal Revenue code section ("Section") 4980H [1] and the information reporting requirements under Sections 6055 and 6056. The preamble to the final regulations ("Preamble") provides additional transition relief from compliance with Section 4980H for the 2015 calendar year, and for employers that maintain a plan with a non-calendar year, the portion of 2016 that falls within the 2015 plan year.

This transition relief applies to employers with more than 50 but fewer than 100 full-time employees, including full-time equivalent employees ("FTEs") on business days during 2014. The Preamble provides additional relief for employers that exceeds 100 full-time

1 An ALE is an employer deemed to employ 50 or more full-time employees, including FTEs, during the prior calendar year. FTEs are calculated generally by aggregating the hours of service of non-full-time employees for a given month and dividing that number by 120.

2 A full-time employee is an employee under the common law standard who performed on average 30 or more hours of service per week, but the final regulations provide specific methods for calculating hours of service.

Action Items

- **Employers are advised to adopt a system of tracking employee service hours for a shorter measurement period during 2014, which must be at least 6 calendar months in duration, meaning that such tracking must be made possible at the latest by July 1, 2014 to comply with information reporting rules under Section 6056**

- **Employers that expect to reach the 100 full-time employee and FTE threshold for 2015 must establish an eligible employer-sponsored plan for 2015, and if they wish to use transition relief under the look-back measurement method for calculating employees in 2015 under Section 4980H assessable payment provisions, must select a transition measurement period beginning not later than July 1, 2014**

- **Employers should confirm that any independent contractors are not common law employees to avoid potential reclassification by the IRS and any subsequent penalties for failure to comply with applicable PPACA provisions due to any resulting full-time employee or FTE miscalculations**

employees, including FTEs with respect to assessment of penalties under Section 4980H. But the Preamble generally does not extend existing transition relief from Section 6056 reporting obligations scheduled to become effective in 2016 and rely initially on employer status in 2015.

This Client Alert summarizes the 2015 transition relief from PPACA for smaller employers and from Section 4980H penalties for larger employers, and illustrates how these transition rules may assist both types of employers with compliance with the information reporting requirements, which they are advised to begin in 2014. The Client Alert concludes by highlighting the significant role of employee classification in complying with PPACA under the available transition relief and beyond 2015.

Rules for Determining ALE Status and Related 2015 Transition Relief

Full-time employees generally are individuals who are "common-law" employees and who are employed on average at least 30 hours per week, or 130 hours of service per calendar month. FTEs are all common-law employees other than full-time employees. The number of FTEs for each calendar month in the preceding calendar year may be determined by calculating the aggregate number of hours of service of the FTEs for that calendar month not exceeding 120 hours of service per each FTE, and dividing the sum by 120.

In general, hours of service mean hours for which an employee is paid, or entitled to payment, for the performance of duties for the employer, and hours for which the employee is entitled to payment even if no services are performed, such as during vacation or leave. Certain equivalency rules apply to determine number of hours of service of non-hourly employees. An employer that employed an average of at least 50 full-time employees, including FTEs on business days during the preceding calendar year is deemed an applicable large employer ("ALE") for the current calendar year.

Accordingly, an ALE with more than 50 but fewer than 100 full-time employees, including FTEs, generally would not be subject to any Section 4980H assessable payments with respect to a non-calendar year plan until the end of the plan year in 2016. If such an ALE never adopted a plan or has a calendar year plan, in the event of noncompliance assessable payments would begin to apply on January 1, 2016.

Assessable Payment Rules Under Section 4980H and Related 2015 Transition Relief

Generally, payments of $1/12^{th}$ of $2,000 per full-time employee per month would be assessed under Section 4980H(a) beginning in 2015 if the ALE failed to offer minimum essential coverage to at least 70 percent, or 95 percent beginning in 2016, of its full-time employees and their dependents (children). Section 4980H(a) penalties apply for a given month only if at least one full-time employee enrolled in a "qualified health plan" and was eligible for a premium tax credit or cost-sharing reduction. In order for an employee to qualify for a premium tax credit under Section 36B, minimum essential coverage offered by the ALE has to fail to be "affordable" or to provide "minimum value" with respect to the full-time employee.

Also, an ALE generally would be subject to an assessable payment of $1/12^{th}$ of

$3,000 per full-time employee per month under Section 4980H(b) if the ALE offered minimum essential coverage but it was not affordable or failed to provide minimum value with respect to one or more such employees. It is possible an ALE may fail to comply with both Sections 4980H(a) and (b). However, the assessable payment under Section 4980H(b) may not exceed the penalty imposed under Section 4980H(a).

The total number of employees of an ALE is reduced by its allocable share of 30 for purposes of calculating assessable payments under Section 4980H(a), and by its allocable share of 80 to conform to the transition relief provided to employers with fewer than 100 full-time employees, including FTEs for the 2015 calendar or non-calendar plan year. Thus, if in each calendar month in 2015, an employer is deemed to employ 100 full-time employees and fails to offer health coverage to any of them, Section 4980H(a) penalties in the amount of $40,000 would be assessed for 2015 with respect to only 20 full-time employees, provided at least one full-time employee was eligible for a Section 36B premium tax credit during each of the months.

The same reduction rule and related transition relief also apply in calculating the maximum amount of penalties as set forth in Section 4980H(b)(2). Thus, if, under the same facts, 50 full-time employees received Section 36B premium assistance during each calendar month, the ALE would be assessed $40,000 instead of $150,000 under Section 4980H(b) for the entire 2015, the maximum amount assessable under Section 4980H(a).

Section 6056 Information Reporting Rules and Related 2015 Transition Relief

Section 6056 was intended to assist the IRS with the administration of the premium tax credit under Section 36B and the requirements to offer coverage under Section 4980H. Under Section 6056, an ALE must file a return and a transmittal form not later than March 31 if filed electronically containing, among other information, a certification whether the ALE offered minimum essential coverage under an eligible employer-sponsored plan to its full-time employees during the preceding calendar year. If coverage was offered, the return has to specify the length of a waiting period for such coverage; the months during which coverage was available in the prior year; and, the monthly premium for the lowest cost option in each category under the plan.

The Section 6056 return also has to provide the number of full-time employees for each calendar month during the previous calendar year, identifying information for each full-time employee and any months during which each such employee and any dependents were covered under any eligible employer-sponsored plan of the ALE. In addition to the return, the ALE has to furnish before January 31 to each individual who was a full-time employee for one or more months during the preceding calendar year a written statement containing employer information and the information required to be shown on the Section 6056 return with respect to that full-time employee.

The final Section 4980H regulations do not contain additional transition relief for ALEs to begin compliance with the information reporting requirements under Section 6056. Thus, penalties under Sections 6721 (for failure to file correct information returns) or 6722 (for failure to furnish correct payee statements) would apply in the event of failure to file Section 6056 reports and furnish applicable employee statements in 2016 for the 2015 calendar year.

As with Section 4980H, knowing whether compliance with Section 6056 is mandatory requires the threshold determination of whether an employer is an ALE, which in turn necessitates calculating the number of full-time employees, including FTEs. Under Section 4980H, full-time employees may be determined by one of two methods. Employers may use the monthly measurement method, by counting hours of service of employee for each calendar month. Alternatively, they may use the look-back measurement method by "looking back" at a selected standard measurement period generally of at least three but not more than 12 months and then treating the individual as a full-time employee during a subsequent stability period.

Section 4980H allows the use of the monthly measurement method to calculate the number of full-time employees for purposes of either the ALE status inquiry or the amount of assessable payments. On the other hand, the look-back measurement method applies only for determining full-time employees for purposes of calculating penalties under I.R.C. section 4980H. However, employers may use either method to determine full-time employees for Section 6056 information reporting purposes.

Final regulations provide transition relief for measuring the number of full-time employees for 2015 under either method. With respect to non-calendar-year plans, ALEs may use actual service data or the look-back measurement period to

determine full-time employees for Section 6056 reporting for the portion of the 2014 non-calendar plan year falling in 2015 after the end of that plan year. Furthermore, the Preamble sets forth two rules allowing shorter measurement periods solely under the look-back method and generally for ALE status for 2015.

Shorter 2014 Measurement Period Under the Look-Back Measurement Method. As a general rule, for ongoing, full-time employees (generally, those employed an average of 30 or more hours of service per week), the stability period must be at least 6 consecutive months and not shorter than the standard measurement period. In addition, for ongoing employees determined not to be employed for an average of at least 30 hours per week, the stability period may *not be longer than* the standard measurement period. Conversely, the measurement period in this case may not be shorter than the stability period.

The Preamble permits *shorter* measurement periods for stability periods that begin in 2015 ("transition measurement period"). The transition measurement period may not begin later than July 1, 2014. Also, it may not end more than 90 days before the beginning of the 2015 plan year (corresponding to a maximum 90-day administrative period that could separate the measurement and the stability period). The transition measurement period may be shorter than 12 months but may not be fewer than 6 consecutive months.

ALEs with fewer than 100 full-time employees may defer offer of coverage until 2016 but should begin certain compliance in 2014.

Shorter Period for Determining ALE Status for 2015. As a general rule, ALE status for a calendar year is determined by the sum of the total number of full-time employees (determined under either method for Section 6056 purposes and by the monthly measurement method for Section 4980H ALE status purposes) and FTEs for each calendar month in the preceding calendar year, divided by 12. The second useful exception in the Preamble is the allowance of a shorter measurement period in 2014 to determine ALE status for the 2015 calendar year. The employer may chose a measurement period of at least 6 consecutive months during the 2014 calendar year. Thus, ALE status would be determined by reference only to 6 months instead of the entire 2014 calendar year.

Identifying and Counting Full-Time Employees and FTEs Beginning in 2014

Employers are advised to consult with their counsel to begin implementing procedures for determining the number of full-time employees for the 2015 ALE status by selecting a measurement period in 2014, which may be as brief as 6 consecutive months. The same measurement period may be used in determining the number of FTEs for that period. This determination will inform the employer both whether it is subject to PPACA and if so, whether the additional transition relief with respect to Section 4980H would apply for 2015 with respect to ALEs that have fewer than 100 full-time employees.

If an employer expects to reach the 100-employee threshold, implementing the transition measurement period beginning not later than July 1, 2014 will provide additional flexibility in identifying full-time employees for a stability period in 2015 under the look-back measurement method for purposes Section 4980H. An employer with fewer than 100 full-time employees not subject to Section 4980H for 2015 alternatively may use the transition measurement period to determine ALE status for 2015 under the Section 6056 information reporting rules.

If an employer would be deemed an ALE for 2015 but had fewer than 100 full-time employees, including FTEs in 2014, it should calculate the number of full-time employees and FTEs in 2015 for purposes of (i) determining if it is an ALE for 2016, when Section 6056 information reporting rules take effect; (ii) reevaluating the ALE status for purposes of compliance with other PPACA provisions, including Section 4980H, which would apply to smaller ALEs beginning with the 2016 plan or calendar year; and, (iii) if an ALE for 2016, using 2015 as a measurement period under the look-back measurement method for identifying full-time employees for calculating any assessable payments incurred in 2016 under Section 4980H.

Employee Status Reclassification Issues

The Preamble addressed briefly concerns of some commenters that the IRS during an audit might seek to reclassify certain service providers as employees, which may lead to violation of various PPACA provisions if ALE status was determined incorrectly. Such errors would affect calculation of full-time employees and FTEs for initially determining ALE status, and for any required information reporting or any applicable assessable payments. Accordingly, employers are advised to revisit classification of their service providers and confirm with the assistance

of counsel that any independent contractor is not a common law employee.

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[1] All references to "Sections" in this Client Alert are references to sections of the Internal Revenue Code of 1986, as amended, 26 U.S.C. 1 et.seq.

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