Pay or Play Guide

A Guide to the Affordable Care Act's “Employer Shared Responsibility” Rules Under Code Section 4980H

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Overview

The health care reform law from 2010 (the Patient Protection and Affordable Care Act, now called the "ACA" by regulators)[1] requires certain large employers to provide health plan coverage or pay a penalty tax to the federal government. There are several requirements that must be satisfied in order to ensure that the penalty tax is avoided. We sometimes refer to this requirement as the "Pay or Play Rule", although it is sometimes called the "Employer Shared Responsibility" rule (or is referred to by its Internal Revenue Code section, Section 4980H).

This Guide outlines which entities are subject to the penalty tax, how the tax is calculated and how the tax can be avoided. For ease of understanding, the Guide sometimes discusses how hypothetical companies could avoid (or be subject to) the Pay or Play Rule and the related tax penalty. The Guide makes the Pay or Play Rule easier to understand by using a step-by-step explanation.[2]

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[1] The ACA has been modified several times in its brief history, including by the Health Care and Education Reconciliation Act of 2010, Public Law 111-152 (124 Stat. 1029 (2010)), as amended by the Medicare and Medicaid Extenders Act of 2010, Public Law 111-309 (124 Stat. 3285 (2010)), the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, Public Law 112-9 (125 Stat. 36 (2011)), the Department of Defense and Full-Year Continuing Appropriations Act, 2011, Public Law 112-10 (125 Stat. 38 (2011)), and the 3% Withholding Repeal and Job Creation Act, Public Law 112-56 (125 Stat. 711 (2011)).

[2] John Barlament would like to thank Sarah Fowles and Alyssa Dowse for their contributions to the Guide.

Step 1

Step 1: Understand General Pay or Play Rule

The Pay or Play Rule applies to an employer with at least 50 full-time (and/or full-time equivalent ("FTE")) employees. The penalty under the Pay or Play Rule depends on whether an employer offers "minimum essential coverage" to all full-time employees and dependents (with a few exceptions). If an employer does not offer minimum essential coverage to all full-time employees (and their dependents)[3] the employer must pay an annual tax of $2,000 for each full-time employee (less the first 30), if at least one full-time employee obtains federally-subsidized coverage through an "Exchange."[4] We call this the "Subsection A Penalty."

If an employer does offer minimum essential coverage to all full-time employees (and their dependents) but at least one full-time employee obtains federally-subsidized coverage through an Exchange, the employer must pay an annual tax of the lesser of: (1) $3,000 per subsidized full-time employee; or (2) $2,000 for each full-time employee (less the first 30 full-time employees). We call this the "Subsection B Penalty".[5] These rules are illustrated in a flowchart in Exhibit A, at the end of this Guide.

Note that the Pay or Play Rule includes an "inflation adjustment" for the $2,000 and $3,000 penalty amounts. This adjustment is calculated by multiplying the applicable dollar amount (i.e., $2,000 or $3,000) by a "premium adjustment percentage" that HHS will set each year.[6] This means that, beginning in calendar years after 2014, these dollar amounts (and an employer's potential liability) will increase from year to year. The premium adjustment percentage for 2015 is 4.213431463%,[7] resulting in increased penalties of $2,080 (instead of $2,000) and $3,120 (instead of $3,000) for 2015.[8] For ease of explanation and examples, this Guide will use the $2,000 and $3,000 dollar amounts when explaining the Pay or Play Rule.

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[3] A "dependent" means a "child" (as defined in Internal Revenue Code ("Code") Section 152(f)(1)) of an employee who has not attained age 26. 26 CFR 54.4980H-1(a)(12). A "dependent" does not include a stepchild or eligible foster child (as defined in Code Section 152(f)(1)(C)), or any individual who is excluded from the definition of dependent under Code Section 152 by operation of Code Section 152(b)(3) (certain citizens or nationals of other countries). A "dependent" also does not include a spouse or, presumably, a domestic partner. An employer can rely on an employee's representation about that employee's children and their ages, unless the employer has knowledge to the contrary. 26 CFR 54.4980H-1(a)(12).

[4] According to the federal agencies that enforce the ACA, Exchanges "will provide competitive marketplaces for individuals and small employers to directly compare available private health insurance options on the basis of price, quality, and other factors" and will "enhance competition in the health insurance market, improve choice of affordable health insurance, and give small businesses the same purchasing clout as large businesses." U.S. Department of Health and Human Services ("HHS"), Proposed Regulations, Establishment of Exchanges and Qualified Health Plans (July 2011).

[5] The terms "Subsection A Penalty" and "Subsection B Penalty" are our terms, not Internal Revenue Service ("IRS") terms. The IRS refers to the former as "4980H(a) liability" and the latter as "4980H(b) liability". IRS Notice 2011-36, I. Note that a few other exceptions exist to some of these penalty calculations, such as New, Full-Time Employees who have not yet completed about three months of service. In addition, the IRS has provided transition relief for some of these penalty calculations, such as the ability to subtract the first 80 employees (instead of the first 30 employees) for an employer's 2015 plan year. See Step 1(a) with respect to transition relief.

[6] Code Section 4980H(c)(5). The "premium adjustment percentage" will be set by the HHS no later than October 1 of the preceding calendar year and will be "the percentage (if any) by which the average per capita premium for health insurance coverage in the United States for the preceding calendar year exceeds such average per capita premium for 2013." ACA Section 1302(c)(4). HHS will publish the premium adjustment percentage each year in its annual "notice of benefits and payment parameters." 45 CFR 156.130(e).

[7] On March 11, 2014, HHS released a final rule stating that it will base the premium adjustment percentage on the per enrollee employer-sponsored health insurance premiums from the National Health Expenditure Accounts data (calculated by the Centers for Medicare and Medicaid's Office of the Actuary). Based on that data, HHS has stated that the premium adjustment percentage for 2015 will be 4.213431463%. HHS Final Rule, Notice of Benefit and Payment Parameters for 2015, 79 Fed. Reg. 13744, 13802 (March 11, 2014).

[8] The amount of any annual increase is rounded down to the next lowest multiple of $10. Code Section 4980H(c)(5)(B).

In addition, note that both penalties are determined on a month-by-month basis. So, an employer may owe a lesser amount if a penalty applies for only a portion of a year (e.g., the penalty would be one-half of the above amounts if the employer failed the Pay or Play Rule for only six months, not twelve months). The tax generally is not deductible.[9]

These general rules are subject to several exceptions as further described in this Guide.

Step 1(a): When is the Pay or Play Rule Effective?

The Pay or Play Rule was originally to be effective for calendar months beginning January 2014.[10] However, in July 2013, the Obama administration announced that the Pay or Play Rule will be delayed for one year.[11] With the delay, the Pay or Play Rule will generally now be effective in 2015. The IRS issued final regulations regarding the Pay or Play Rule on February 12, 2014.[12]

Note that the delay of the Pay or Play Rule does not affect most other ACA requirements that come into effect in 2014, such as the new limits on waiting periods.

The Pay or Play Rule final regulation contained a delayed effective date for some non-calendar year health plans (e.g., those that operate on a basis other than January 1 - December 31)[13] and for certain other purposes, such as when a dependent must be offered coverage. The final regulation also included various transition rules for calculating the Subsection A Penalty and the Subsection B Penalty. These transition rules are summarized in the following chart. Note that certain other transitional relief which was relevant prior to 2015 is not summarized below.[14]

Type of Transition Relief	Description of Relief	Comments	Example
Subsection A Penalty Relief: 70% of Full-Time Employees (and Dependents) Must be Offered Coverage	The final regulations require that large employers offer coverage to at least 95% of their full-time employees (and dependents) to avoid a Subsection A Penalty under the Pay or Play Rule. The IRS reduced this requirement to 70% for 2015 and any calendar months during the 2015	This transition rule applies to an employer with a non-calendar year plan year only if the employer did not modify the plan year of its plan after February 9, 2014 to begin on a later calendar date. Beginning in 2016, an employer subject to the Pay or Play Rules must offer coverage to at least	

[9] Code Section 4980H(c)(7).
[10] See, e.g., 78 Fed. Reg. 218, 239 (stating that "Section 4980H is effective for months after December 31, 2013.").
[11] The White House and the Treasury Department originally announced the delay of the Pay or Play Rule in separate blog posts on July 2, 2013. The IRS officially delayed the Pay or Play Rule on July 9, 2013 when it issued Notice 2013-45.
[12] IRS Final Regulations, Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. 8544 (February 12, 2014).
[13] A calendar year plan year is "a period of twelve consecutive months beginning on January 1 and ending on December 31 of the same calendar year." 26 CFR 54.4980H-1(a)(35).
[14] For an explanation of this prior relief, see our January 28, 2013 and August 1, 2013 versions of this Guide.

Type of Transition Relief	Description of Relief	Comments	Example
	plan year that fall in 2016. Accordingly, an employer will not be subject to the Subsection A Penalty for the 2015 plan year if the employer offers coverage to at least 70% of its full-time employees (and dependents, unless the transition relief for dependent coverage applies as discussed below).[15]	95% of its full-time employees (and dependents) to avoid the Subsection A Penalty. This transition relief does not provide relief from the Subsection B Penalty.[16]	
Subsection A Penalty Relief: Reduction of 80 Full-Time Employees Used in Calculation	For the 2015 plan year, the Subsection A Penalty will be equal to $2,000 for each full-time employee (less the first ***<u>80</u>*** full-time employees). This transition relief applies only to employers with 100 or more full-time or full-time equivalent employees on business days during 2014 (or applicable large employer members that are part of such large employer).[17]	This transition rule applies to an employer with a non-calendar year plan year only if the employer did not modify the plan year of its plan after February 9, 2014 to begin on a later calendar date. Beginning in 2016, employers will calculate the Subsection A Penalty with a 30 full-time employee reduction (instead of 80). This transition relief may indirectly reduce an employer's 2015 Subsection B Penalty, which is capped at the amount of the Subsection A Penalty.[18]	
Pay or Play Rule Delayed until 2016 for Certain	The final regulations provide that certain mid-size employers (those with	This transition relief does not apply to employers with 100 or more full-time	As of February 9, 2014, Employer A sponsors a calendar year plan under

[15] 79 Fed. Reg. at 8575.
[16] 79 Fed. Reg. at 8575-76.
[17] 79 Fed. Reg. at 8575-76.
[18] 79 Fed. Reg. at 8575-76.

Type of Transition Relief	Description of Relief	Comments	Example
Mid-Size Employers	between 50 and 99 full-time and full-time equivalent employees during 2014) will not be subject to the Pay or Play Rule during 2015 and, for employers with non-calendar plan years, during the portion of the 2015 plan year that falls in 2016. This transition relief applies to a mid-size employer who certifies on an IRS form that the employer (1) employs on average between 50 and 99 full-time and full-time equivalent employees on business days during 2014, (2) does not reduce the size of its workforce or overall hours of workforce between February 9, 2014 and December 31, 2014 in order to meet the 50-99 employee requirement, and (3) during the "coverage maintenance period," does not eliminate or materially reduce the health coverage, if any, it offered as of February 9, 2014. The "coverage maintenance period" is the period from February 9, 2014 to December 31, 2015 for an employer with a calendar year plan, and is the period from	employees. Such employers must comply with the Pay or Play Rule beginning in 2015. Employers who are eligible for this transition relief must comply with the Pay or Play Rule beginning in 2016. An employer that first comes into existence in 2015 may take advantage of this transition relief if it expects to employ fewer than 100 full-time and full-time equivalent employees during 2015 and meets similar workforce, maintenance and certification requirements. It appears that mid-size employers who qualify for this transition relief must still comply with certain related reporting requirements under the Affordable Care Act. It appears that employers qualifying for this transition relief will make the required certification as part of those reporting requirements. The transition relief is not available to an employer that changes its plan year after February 9, 2014 to begin on a later date.[20]	which 40 of its full-time employees are offered coverage with an employer contribution of $300 per month for employee-only coverage. The coverage is affordable with respect to some, but not all, full-time employees. In 2014, 2 of Employer A's employees voluntarily terminate employment and Employer A terminates 3 employees due to nonrenewal of a customer contract but does not otherwise reduce the size of its workforce or reduce any employee's hours of service. Had those 5 employees continued employment throughout 2014, Employer A would have had an average of 100 full-time employees (including FTEs) on business days in 2014. As a result of the terminations, it had an average of 97 full-time employees (including FTEs) for business days in 2014. From February 9, 2014, through December 31, 2015, Employer A does not change the eligibility requirements for the plan (including existing dependent

[20] 79 Fed. Reg. at 8574-75.

Type of Transition Relief	Description of Relief	Comments	Example
	February 9, 2014 to the last day of the 2015 plan year for an employer with a non-calendar year plan. An employer may reduce its workforce or the overall hours of service due to a business activity (e.g., sale of division) if the change is unrelated to this transition relief. In addition, the IRS will not treat an employer as eliminating or materially reducing health coverage if the employer meets certain requirements in the final regulations.[19]		health coverage) and continues to make a contribution of $300 per month toward the cost of employee-only coverage that provides minimum value. Employer A certifies in a timely manner as to its eligibility for the transition relief. In this case, no Pay or Play penalty would be due for 2015.[21]
Non-calendar year plans: "Eligibility Transition Guidance"	The first transition rule for non-calendar year plans provides that if an employer maintained a non-calendar year plan as of December 27, 2012, and did not modify the plan year after December 27, 2012 to begin at a later calendar date, no Pay or Play penalty will apply to employees who would be eligible for coverage beginning on the first day of the 2015 plan year under the eligibility terms of the plan as in effect on February 9, 2014. All transition rules for non-	If an employer maintains a calendar year plan as of February 9, 2014 in addition to the non-calendar year plan, this relief does not apply to those employees who are eligible for the calendar year plan. If an employee terminates employment before the beginning of the 2015 plan year but would otherwise be eligible for coverage beginning on the first day of the 2015 plan year under the eligibility terms of the plan as in effect on February 9, 2014, this	Employer Z has 600 employees, all of whom are full-time employees within the meaning of the final regulations, and Employer Z maintained a plan with an April 1 plan year as of December 27, 2012 (and did not later change the plan year). All of Employer Z's employees are eligible for coverage under the plan under the eligibility terms as in effect on February 9, 2014, but the coverage is not affordable. All of Employer Z's employees are offered affordable

[19] 79 Fed. Reg. at 8574-75.
[21] 79 Fed. Reg. at 8575.

Type of Transition Relief	Description of Relief	Comments	Example
	calendar year plans require that the plan year was not modified after December 27, 2012 to begin at a later calendar date. This could limit the transition relief available to employers that changed their plan year during 2013 to take advantage of "early renewal" opportunities or who changed their plan year during 2013 to delay implementation of certain aspects of health care reform.[22]	relief will still apply to that employee.[23]	coverage that provides minimum value no later than April 1, 2015. In this case, no Pay or Play penalty will be due for any employee of Employer Z before April 1, 2015.[24]
Non-calendar year plans: "Significant Percentage Guidance (All Employees)"	The second transitional rule for non-calendar year plans seems to be designed to allow a non-calendar year plan additional time to expand its eligibility provisions and offer coverage to those who were not previously eligible for coverage. Like the first transitional rule for non-calendar year plans, this rule only applies to an employer that maintained a non-calendar year plan as of December 27, 2012, and did not modify the plan year after December 27, 2012 to begin at a later calendar date.	This relief applies only if the employer offers minimum essential coverage to a sufficient percentage of its full-time employees (95% or, if the relief below applies, 70%) as of the first day of the 2015 plan year. If an employer maintains a calendar year plan as of February 9, 2014 in addition to the non-calendar year plan, this relief does not apply to those employees who are eligible for the calendar year plan. If an employer maintains two or more non-calendar year plans, this transitional	Employer Y has 1,100 employees. 1,000 of Employer Y's employees are full-time employees and 100 of Employer Y's employees are not full-time employees. Employer Y maintained a plan with a July 1 plan year as of December 27, 2012 (and did not later change the plan year). Employer Y chooses December 1, 2013 to measure the number of employees it covered. On December 1, 2013, Employer Y covered 23% of its employees under the plan and so does not meet the 1/4 rule. During the open

[22] 79 Fed. Reg. at 8570.
[23] 79 Fed. Reg. at 8570.
[24] 79 Fed. Reg. at 8570-71.

Type of Transition Relief	Description of Relief	Comments	Example
	The second transitional rule will apply if the plan either (1) had, as of any date between February 10, 2013 and February 9, 2014, at least 1/4 of its employees[25] covered under the non-calendar year plan, or (2) offered coverage under the non-calendar year plan to 1/3 or more of its employees during the open enrollment period that ended most recently before February 9, 2014. If one of these rules is met, no Pay or Play penalty will apply for any month prior to the first day of the 2015 plan year with respect to employees who are offered affordable coverage that provides minimum value no later than the first day of the 2015 plan year.[26]	rule only applies to that employer if all non-calendar year plans had the same plan year as of December 27, 2012.[27]	enrollment period that ended most recently before February 9, 2014, Employer Y offered coverage under the plan to 45% of its employees and so meets the 1/3 rule. Employer Y offers affordable coverage that provides minimum value to all full-time employees as of the first day of the 2015 plan year. Employer Y will not be subject to any Pay or Play penalty for the period before July 1, 2015.[28]
Non-calendar year plans: "Significant Percentage Guidance (Full-Time Employees)"	The third transitional rule for non-calendar year plans is designed for employers that cannot satisfy the second transition rule for non-calendar year plans due to large numbers of seasonal or part-time employees. Like the first transitional	This relief applies only if the employer offers minimum essential coverage to a sufficient percentage of its full-time employees (95% or, if the relief below applies, 70%) as of the first day of the 2015 plan year. If an employer maintains a	Employer W has 2,000 employees, of whom 500 are full-time employees and 1,500 are not full-time employees. Employer W maintained a plan with a July 1 plan year as of December 27, 2012 (and did not later change the plan year).

[25] It is not completely clear if the term "employees" refers to all employees of an employer or if certain groups of employees (e.g., foreign employees) could be excluded.
[26] 79 Fed. Reg. at 8571.
[27] 79 Fed. Reg. at 8571.
[28] 79 Fed. Reg. at 8571.

Type of Transition Relief	Description of Relief	Comments	Example
	rule for non-calendar year plans, this rule only applies to an employer that maintained a non-calendar year plan as of December 27, 2012, and did not modify the plan year after December 27, 2012 to begin at a later calendar date. The third transitional rule will apply if the plan either (1) had, as of any date between February 10, 2013 and February 9, 2014, at least 1/3 of its full-time employees covered under the non-calendar year plan, or (2) offered coverage under the non-calendar year plan to 1/2 or more of its full-time employees during the open enrollment period that ended most recently before February 9, 2014. If one of these rules is met, no Pay or Play penalty will apply for any month prior to the first day of the 2015 plan year with respect to employees who are offered affordable coverage that provides minimum value no later than the first day of the 2015 plan year.[29]	calendar year plan as of February 9, 2014 in addition to the non-calendar year plan, this relief does not apply to those employees who are eligible for the calendar year plan. If an employer maintains two or more non-calendar year plans, this transitional rule only applies to that employer if all non-calendar year plans had the same plan year as of December 27, 2012.[30] The term "full-time employee" for purposes of the 1/3 and 1/2 rules under this transitional rule means an employee who is employed on average at least 30 hours of service per week under Code Section 4980H. The final regulations do not state whether an employer could count an employee's hours using the Look-Back Measurement Method (which would "look back" to hours in 2012). The more conservative approach is likely to determine whether an employee is full time based on whether the employee works at least 30 hours per week (130	Employer W chooses December 1, 2013 to measure the number of employees it covered. On December 1, 2013, Employer W covered 20% of its full-time employees under the plan and so does not meet the 1/3 rule. During the open enrollment period that ended most recently before February 9, 2014, Employer W offered coverage under the plan to 60% of its full-time employees and so meets the 1/2 rule. Employer W offers affordable coverage that provides minimum value to all full-time employees as of the first day of the 2015 plan year. Employer W will not be subject to any Pay or Play penalty for the period before July 1, 2015.[31]

[29] 79 Fed. Reg. at 8571.
[30] 79 Fed. Reg. at 8571-72.
[31] 79 Fed. Reg. at 8572.

Type of Transition Relief	Description of Relief	Comments	Example
		hours per month) as of the applicable dates used for this transitional rule.	
Offers of Coverage for January 2015	This transition rule is designed for employers who will offer coverage to full-time employees on a day other than the first day of January 1, 2015. This transition rule provides that if an employer offers coverage to a full-time employee no later than the first payroll period that begins in January 2015, the employee will be treated as having been offered coverage for January 2015.[32]	This transition rule applies only for January 2015.[33]	Employer V has never offered health plan coverage to employees. Employer V will begin offering coverage to its full-time employees effective the first payroll period of January 1, 2015, which begins January 12, 2015. Those full-time employees offered coverage beginning January 12, 2015 will be treated as having been offered coverage for the entire month of January 2015.
Short Measurement Period, Long Stability Period	The final regulations recognize that employers who wish to adopt a 12-month measurement period and a 12-month stability period under the look-back measurement method will have time constraints due to the final regulation being published in February 2014. The transition rule allows an employer to adopt a shorter measurement period (such as six months) but keep the longer stability period (such as 12 months). To rely on this transition rule,	The effect of this rule is surprisingly difficult to succinctly summarize due to the varying length of the administrative period an employer could select (0 - 90 days) and the varying length of the measurement period the employer could select (apparently, 6 months to 11 months, although 11 months is reduced in some situations). An employer with a plan year beginning on July 1 must use a measurement period that is longer than	An employer with a calendar year plan may use a transition measurement period from April 15, 2014 through October 14, 2014 (six months), followed by an administrative period ending on December 31, 2014. In addition, an employer with a July 1, 2014 plan year may use a 10-month transition measurement period from June 15, 2014 through April 14, 2015, followed by an

[32] 79 Fed. Reg. at 8573.
[33] 79 Fed. Reg. at 8573.

Type of Transition Relief	Description of Relief	Comments	Example
	the transition measurement period must be at least six months long, must begin no later than July 1, 2014 and must end no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2015. If an employer hires an employee during or after the transition measurement period described above, the general Pay or Play Rules for new employees under the look-back measurement method would apply.[34]	6 months to comply with the requirement that the measurement period begin no later than July 1, 2014 and end no earlier than 90 days before the stability period. Measurement periods beginning after July 1, 2014 cannot rely on this transitional relief and must follow the typical rule that the measurement period is equal in length to the stability period. In addition, mid-size employers who are not subject to the Pay or Play Rules in 2015 (as described above) cannot rely on this transition rule in 2016. Accordingly, such mid-size employers must adopt a 12-month measurement period in 2015 if they would like to adopt a 12-month stability period that begins in 2016.	administrative period from April 15, 2015 through June 30, 2015.[35]
Determination of Large Employer Status	Some employers will be close to 50 full-time (and full-time equivalent) employees. These employers may need extra time to determine if they are subject to the Pay or Play Rule. A transition rule allows an employer the option to determine its "large employer" status	This rule will be helpful for such employers who otherwise would have needed to verify their size as of December 31, 2014 (and then offered, or not offered, coverage as of January 1, 2015 -- an administratively difficult task). However, whether an	Employer U, which does not use seasonal workers, counts its full-time and full-time equivalent employees from January 1, 2014 through June 30, 2014. Employer U employs an average of 48 full-time and full-time equivalent employees during those

[34] 79 Fed. Reg. at 8572.
[35] 79 Fed. Reg. at 8572.

Type of Transition Relief	Description of Relief	Comments	Example
	with respect to a period of at least six consecutive calendar months in the 2014 calendar year (rather than the entire 2014 calendar year). This transition rule can be used for purposes of the new transitional rule for employers with 50-99 full-time (and full-time equivalent) employees described above.[36]	employer meets the requirements of the seasonal worker exception for purposes of determining large employer status for 2015 is based on the entire 2014 calendar year.[37]	six consecutive months. Employer U is not a large employer for 2015 and is not subject to the Pay or Play Rule for 2015. Employer U must re-determine during 2015 whether it is a large employer for 2016, and will have to make that determination based on the entire 2015 calendar year.
"Dependents" who Must be Offered Coverage	In order to avoid a Pay or Play Rule penalty, an employer must offer coverage to full-time employees and their "dependents." The Pay or Play final regulation requires that coverage be offered to an employee's children (but not the employee's stepchildren or foster children) who have not yet attained age 26. "Dependent" does not include a spouse or, presumably, a domestic partner. Under a special transitional rule, an employer does not need to offer dependent coverage in 2015, as long as it "takes steps" in 2014 or 2015 (or both) to provide such coverage.[38]	This relief applies to employers for the 2015 plan year with respect to plans under which (1) dependent coverage is not offered, (2) dependent coverage that does not constitute minimum essential coverage is offered, or (3) dependent coverage is offered for some, but not all, dependents. This relief is not available to the extent the employer offered dependent coverage during the 2013 or 2014 plan years. If coverage was offered to some, but not all, dependents during the 2013 or 2014 plan year, the relief applies only with respect to dependents who were not offered	Employer T offers no coverage to employees' dependents during the 2013 or 2014 plan years. However, during the 2014 and 2015 plan years, Employer T takes steps to extend coverage to employees' dependents, such as working with its TPA or insurer to obtain cost estimates and to select plan designs for dependent coverage. Assuming these are sufficient steps, it appears Employer T is not required to offer dependent coverage during 2015 to comply with the Pay or Play Rule (though of course it must comply with other requirements of the Pay

[36] 79 Fed. Reg. at 8573.
[37] 79 Fed. Reg. at 8573.
[38] 79 Fed. Reg. at 8573-74.

Type of Transition Relief	Description of Relief	Comments	Example
		coverage at any time during the 2013 or 2014 plan year.[39]	or Play Rule).
Multiemployer Plan Coverage	An applicable large employer member is not subject to a Pay or Play Rule penalty with respect to a full-time employee who satisfies the eligibility requirements of a multiemployer plan if: (1) the employer is required to contribute to a multiemployer plan pursuant to a collective bargaining agreement or an appropriate related participation agreement; (2) coverage under the multiemployer plan is offered to the full-time employee (and the employee's dependents); and (3) the coverage offered to the full-time employee is affordable and provides minimum value.[40]	Employers can rely on this transition rule until the IRS issues additional guidance regarding multiemployer plan arrangements under the Pay or Play Rule. Any future guidance would apply prospectively. Note that, if a Pay or Play Rule penalty is due with respect to an employee (e.g., if the coverage is not affordable or does not provide minimum value), then the applicable large employer member is responsible for the penalty.[41] Employers who contribute to a multiemployer plan should likely contact the plan and obtain satisfactory proof that all three of the requirements from the column to the left are, in fact, satisfied. Note that some items (such as whether the coverage is affordable) seem ambiguous.	

[39] 79 Fed. Reg. at 8573.
[40] 79 Fed. Reg. at 8576. The IRS intended for this transition rule to be a continuation of the multiemployer plan guidance originally set forth in the proposed regulations. See IRS Proposed Regulations, Shared Responsibility for Employers Regarding Health Coverage, 78 Fed. Reg. 218, 238 (January 2, 2013); see also IRS Correction to Proposed Regulations, Shared Responsibility for Employers Regarding Health Coverage, 78 Fed. Reg. 16445 (March 15, 2013).
[41] 79 Fed. Reg. at 8576.

Step 2: Determine if You are a "Large Employer"

The Pay or Play Rule applies to an "applicable large employer."[42] An "employer" is the entity that is the employer of an "employee" as determined under a common-law test.[43]

An "employer" includes all types of common law employers, including private employers, public employers, churches and non-profit employers.[44]

A "large" employer is an employer who employed an average of at least 50 full-time employees (including full-time equivalent employees) on business days during the preceding calendar year.[45] If an employer does not have at least 50 full-time employees, it still can be subject to the Pay or Play Rule if:

* The employer is part of a "controlled group"[46] and the total full-time employees (including full-time equivalent ("FTE")) employees)[47] of the controlled group at least equals 50 (see Step 2(a) in Appendix I). As discussed further in Step 2(a), each employer in a controlled group is generally called an "applicable large employer member."[48] The Pay or Play Rule penalty generally applies separately with respect to each applicable large employer member;[49]
* The employer is a new employer and it expects to employ an average of at least 50 full-time employees in the current calendar year (see Step 2(b) in Appendix I);
* The employer is deemed to be "large" due to a predecessor employer (see Step 2(c) in Appendix I) [50]; or
* The employer has enough FTE employees to cause the employer to be treated as a large employer (see Step 2(d) in Appendix I).

Many employers will know (prior to examining Steps 2(a)-2(d)) that they are a "large" employer. <u>If you know that you are a "large" employer subject to the Pay or Play Rule, you can proceed to Step 3 below. If you are not certain, proceed to Appendix I for the remainder of Step 2 (i.e., Steps 2(a)-2(d)).</u>

[42] Code Section 4980H.
[43] 26 CFR 54.4980H-1(a)(16). For additional information on the common-law standard see 26 CFR 31.3121(d)-1(c).
[44] 78 Fed. Reg. at 221. It also includes an employer that is an organization described in Code Section 501(c) which is exempt from federal income tax pursuant to Code Section 501(a).
[45] Code Section 4980H(c)(2). See also 26 CFR 4980H-1(a)(4. Remember that, under the transitional relief described in Step 1(a), certain mid-size employers (i.e., employers with between 50 and 99 full-time and full-time equivalent employees during 2014) will not be subject to the Pay or Play Rule during 2015. An employer should use the rules in this Step 2 to determine if it would be an "applicable large employer" under the Pay or Play Rule and, if so, if the transitional relief for mid-size employers applies. If the transitional relief applies, the employer should keep records proving that it is eligible for the relief in 2015.
[46] 26 CFR 54.4980H-1(a)(16).
[47] The term "full-time equivalent employee" or "FTE" is defined at 26 CFR 54.4980H-1(a)(22).
[48] 26 CFR 54.4980H-1(a)(5).
[49] This seems to be fairly clear with respect to the Subsection A Penalty, based on 26 CFR 54.4980H-4(d), and the Subsection B Penalty, based on 26 CFR 54.4980H-5(d). See the further discussion of this rule in Step 2(a).
[50] The IRS has not yet defined the term "predecessor employer." See 26 CFR 54.4980H-1(a)(36).

Step 3: Will Any of Your Employees Receive Federally Subsidized Exchange Coverage?

Generally, beginning in 2014, individuals will be able to obtain health insurance through an "Exchange." Exchanges were expected to be state-created marketplaces where insurance products can be easily compared. If a state does not create an Exchange the federal government can establish and operate an Exchange in that state.[51] Only 16 states and the District of Columbia will create Exchanges. In the states that have not created an Exchange, the federal government will establish and operate an Exchange in that state, or will operate the Exchange in partnership with the state.[52]

Some individuals who obtain Exchange coverage will be eligible for federal subsidies to help pay for health insurance premiums, or to help reduce certain health plan costs.[53] For purposes of the Pay or Play Rule, beginning in 2015, an employer can face a penalty if an employee obtains either federal Exchange subsidy: the premium assistance subsidy or the cost-reduction subsidy.[54] We refer to both of these subsidies as "federal Exchange subsidies" throughout this Guide. An employer should receive notice from the U.S. Department of Health and Human Services that an employee has received such an Exchange subsidy.[55] The subsidies will be available in an Exchange established by a state and most likely will be available in a Federally-run exchange.[56]

If the subsidies are not available in a Federally-run exchange, this would be significant. If no subsidy is available in a particular state, a large employer in that state could not face a penalty under the Pay or Play Rule. As will be explained below in more detail (and as is illustrated in Exhibit A), an employer can face a Pay or Play Rule penalty only if an employee receives subsidized Exchange coverage.[57]

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[51] ACA Section 1321(c).

[52] See Kaiser Family Foundation, "State Decisions for Creating Health Insurance Exchanges, 2014" (available at http://kff.org/health-reform/state-indicator/health-insurance-exchanges/ (as visited February 24, 2014).

[53] The subsidies for premiums are found in Code Section 36B, as added by ACA Section 1401. The cost-sharing provisions are found in ACA Section 1402.

[54] Code Sections 4980H(a)(2), 4980H(b)(1)(B).

[55] See 78 Fed. Reg. at 231 (discussing general concepts of notifying employers and introducing the concept of a "Section 1411 certification", which is the notice an employer will receive if a full-time employee receives an Exchange subsidy which potentially triggers a Pay or Play Rule penalty). See also 26 CFR 54.4980H-1(a)(35) (defining "Section 1411 certification").

[56] Final regulations interpreting the premium subsidies under Code Section 36B contain a definition of "Exchange" that includes federally-operated Exchanges, indicating that the premium tax credit is available through both types of Exchanges (state-operated and federally-operated). 26 CFR 1.36B-1(k). Federal court cases have been brought in the District of Columbia, Indiana, Oklahoma, and Virginia challenging the legality of these final regulations. See *Halbig v. Sebelius*, Case No. 13-0623 (D.C.); *State of Indiana v. Internal Revenue Service*, Case No. 1:13-cv-1612 (S.D. Ind.); *Pruitt v. Sebelius et. al.*, Case No. 6:11-cv-00030 (E.D. Okla.); and *King v. Sebelius*, Case No. 3:13-cv-630 (E.D. Va.). As of February 24, 2014, the D.C. and Virginia cases were dismissed and the dismissals appealed by the plaintiffs. The Oklahoma and Indiana cases are pending. Thus, this remains an open question.

[57] Under the statute, both the Subsection A Penalty and the Subsection B Penalty are triggered when an "employee" (rather than a dependent) has been certified as receiving subsidized exchange coverage. Code Sections 4980H(a)(2), 4980H(b)(1)(B). However, a prior portion of the same statute seems to require an offer of coverage to both employees and dependents. See Code Sections 4980H(a)(1) (Subsection A Penalty) and 4980H(b)(1)(A) (Subsection B Penalty). It is unclear whether a violation of this prior portion would trigger the Pay or Play Rule penalty. It is possible that an employer violating this prior portion (i.e., not offering coverage to dependents) would not face any penalty. Some groups have made this argument to the federal government. See, e.g., The ERISA Industry Committee letter to Jeanne M. Lambrew, Deputy Assistant to the President for Health Policy (August 27, 2012) (available at http://www.eric.org/uploads/doc/health/ERIC_Letter_SharedResponsibilityDependentCoverage_082712.PDF) (as visited August 29, 2012). In the final Pay or Play Rule regulation the IRS indicates that an employer must cover "dependents" in order to avoid all Pay or Play Rule penalties. 79 Fed. Reg. at 8567, 8573. However, the regulation does not seem to address how a Pay or Play Rule penalty could be triggered if an employee (but not a dependent) is offered affordable, minimum value coverage which constitutes minimum essential coverage under an eligible employer - sponsored plan -- as noted above, the statute does not seem to support a penalty.

Unfortunately, it may be very difficult for an employer to know, in advance, whether an employee is eligible for subsidized Exchange coverage. This is because an employer usually would not know the employee's income or eligibility for other coverage (e.g., Medicaid).[58]

Avoid Pay or Play Rule Penalty Through Plan Design

Steps 4 through 6 will discuss when an employer could be subject to the Pay or Play Rule penalty. As will be discussed, <u>it is possible for an employer to design its health plan so that it never pays a Pay or Play Rule penalty</u>. However, this may require that an employer modify its current health plan design. Also, in some situations it may be financially better (i.e., cheaper) for the employer to pay the penalty, rather than provide the coverage.

What must an employer do to ensure it never pays a Pay or Play Rule penalty? In general, an employer must:

* Offer "Minimum Essential Coverage" under an "eligible employer-sponsored plan" to nearly all its "full-time" employees (and, dependents of those employees) who are eligible for federal Exchange subsidies (which will often be individuals with household income between 100% and 400% of the federal poverty level, although this range can vary from state-to-state);[59]
* Ensure that the employer's plan provides "Minimum Value"; and
* Ensure that the employee's share of the premium for self-only coverage for the employer's lowest-cost, Minimum Value coverage is "Affordable".

Employers who wish to avoid all possible Pay or Play Rule penalties must ensure they satisfy these three requirements. Steps 4 through 6 discuss each of these requirements.

[58] A prior version of this Guide illustrated how Medicaid expansion could affect an employer's Pay or Play rule risk. For more details on Medicaid expansion, see *"Current Status of State Medicaid Expansion Decisions, 2014," Kaiser Family Foundation* (http://kff.org/health-reform/slide/current-status-of-the-medicaid-expansion-decision/) (last visited February 27, 2014). The prior version of the Guide is available upon request.

[59] Theoretically, an employer could avoid the Pay or Play Rule penalty by offering coverage <u>only</u> to those employees eligible for a federal Exchange subsidy (or by offering coverage to those employees as a separate coverage category under its health plan). This option seems impractical because of the complexities involved in calculating household income and determining applicable Medicaid coverage, as discussed previously in Sections 3(a) and 3(b).

Step 4: Verify Whether You Offer Minimum Essential Coverage Under an Employer Plan

Most employers with major medical coverage will "offer" "minimum essential coverage" under an "eligible employer-sponsored plan", as explained in Steps 4(a) and 4(b). An employer will "offer" health plan coverage if it provides an "effective opportunity" to (a) elect to enroll at least once during the plan year, and (b) elect to decline to enroll if the coverage does not provide minimum value or requires an employee contribution for any month of more than 9.5% of 1/12 of the federal poverty level for a single individual.[60] Whether there is an "effective opportunity" is a facts-and-circumstances test.[61] Note that the coverage which is offered generally must apply to every day of every month. That is, if an employee is not offered coverage for even a single day in a month, the employer generally is treated as not "offering" coverage for that month.[62]

There are certain situations where an employer may "offer" coverage on behalf of another employer, but there remain some unresolved questions raised by the definition of "offer." Consider the following scenarios.

Employers Within a Controlled Group. Holding Company Inc. has two subsidiaries, Subsidiary A and Subsidiary B. All three companies are applicable large employer members. Subsidiary A offers minimum essential coverage to its full-time employees. Subsidiary A's offer of coverage to its employees is treated as an offer of coverage by Holding Company and Subsidiary B.[63]

Multiemployer and Multiple Employer Plans. A unionized employer contributes to a multiemployer plan. An offer of coverage under the multiemployer plan made to an employee on behalf of the employer generally is treated as being made by the employer.[64] This rule also applies to single employer Taft-Hartley plans and multiple employer welfare arrangements (MEWAs).[65]

Staffing Firms. Packaging Inc. utilizes the services of temporary employees acquired through Staffing Firm. Staffing Firm is not the common law employer of the temporary employees.[66] Staffing Firm makes an offer of coverage under a plan that Staffing Firm has established and maintains. Staffing Firm's offer of coverage will be treated as being made by Packaging Inc. *only if* Packaging Inc. pays Staffing Firm additional fees with respect to employees actually enrolled in Staffing Firm's coverage.[67]

Employee Negotiates Higher Wages. Hospital Inc. hires Nancy, a nurse, on February 1, 2015. Nancy will be a full-time employee. Nancy has health plan coverage through her husband. Nancy asks Hospital Inc. to pay her higher wages in lieu of health plan benefits. Nancy and Hospital Inc. intend for the arrangement to last the entire period of Nancy's employment (it is not just for a single year). Will Hospital Inc. face a Pay or Play Rule penalty because it has failed to "offer" Nancy coverage? If the answer is "no" because there was a "waiver" by Nancy, must Nancy "waive" the offer of health plan

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[60] 26 CFR 54.4980H-4(b)(1).
[61] 26 CFR 54.4980H-4(b)(1).
[62] 26 CFR 54.4980H-4(c). Note that there are some exceptions to this rule, as discussed in Step 7.
[63] 26 CFR 54.4980H-4(b)(2).
[64] 26 CFR 54.4980H-4(b)(2). See Step 1 for a further discussion of this rule, along with important restrictions.
[65] 26 CFR 54.4980H-4(b)(2).
[66] Note that some employers using temporary workers assume that staffing firms or professional employer organizations (PEOs) are the common law employer of the temporary workers. However, in the preamble to the final regulation, the IRS indicates that in a "typical case," a PEO or staffing firm is <u>not</u> the common law employer of the worker. 79 Fed. Reg. 8566.
[67] 26 CFR 54.4980H-4(b)(2). Note that this "additional fees" requirement may cause issues if the current arrangement is not structured this way.

coverage every year?

The arrangement seems risky in light of the IRS regulation. As noted above, the regulation generally requires that an employee have an opportunity to enroll (or decline to enroll if the coverage does not meet minimum value and cost standards) at least once each plan year.[68] Hospital Inc. should reconsider the arrangement in light of the IRS regulation.

No "Offer" Per Collective Bargaining Agreement. An employer has a workforce which is partially unionized. The union employees are full-time. The employer and the union representatives had -- prior to 2015 -- agreed that the employer would not offer health plan coverage to the union employees. Instead, the union negotiated higher wages and other benefits. Will the employer have a Pay or Play Rule risk because it does not, as of January 1, 2015, offer health plan coverage to these employees?

Likely yes. In the preamble to the final regulation, the IRS addressed this question. The IRS stated that the bargaining-away of the coverage would <u>not</u> be viewed as an offer of coverage.[69]

Step 4(a): Verify You Provide Minimum Essential Coverage

"Minimum essential coverage" means coverage under any of the following:

- (i) Certain government programs (such as Medicare Part A or Medicaid);
- (ii) Coverage under an employer-sponsored plan;
- (iii) Plans in the individual market within a State;
- (iv) Grandfathered health plan coverage; or
- (v) Other coverage recognized by HHS.[70]

Minimum essential coverage does not include coverage under certain excepted benefits.[71] Thus, if the only coverage offered by an employer consists of these excepted benefits, the employer could face a Subsection A Penalty under the Pay or Play Rule. These excepted benefits include:

- (i) Coverage only for accident, or disability income insurance, or any combination thereof;
- (ii) Coverage issued as a supplement to liability insurance;
- (iii) Liability insurance, including general liability insurance and automobile liability insurance;
- (iv) Workers' compensation or similar insurance;
- (v) Automobile medical payment insurance;
- (vi) Credit-only insurance;
- (vii) Coverage for on-site medical clinics; and
- (viii) Other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits.

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[68] 26 CFR 54.4980H-4(b)(1).
[69] 79 Fed. Reg at 8566.
[70] Code Section 5000A(f)(1).
[71] Code Sections 4980H(a)(1), (b)(1) and 5000A(f)(3).

In addition, an employer does not provide minimum essential coverage if the only coverage offered by the employer consists of one or more of these benefits, where the benefits are provided under a separate policy, certificate or contract of insurance:

(i) Limited scope dental or vision benefits;
(ii) Benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof;
(iii) Such other similar, limited benefits as are specified in regulations;
(iv) Medicare supplemental health insurance (as defined under section 1882(g)(1) of the Social Security Act);
(v) Coverage supplemental to the coverage provided under chapter 55 of title 10, United States Code; and
(vi) Similar supplemental coverage provided to coverage under a group health plan.[72]

The following benefits also are not minimum essential coverage, but apparently only if they are offered as independent, noncoordinated benefits:[73]

(A) Coverage only for a specified disease or illness; and
(B) Hospital indemnity or other fixed indemnity insurance.

The above list includes many types of health plans which are not traditional, major medical plan coverage. For example, a typical, fully-insured dental or vision plan (which is separate from a major medical plan) is an "excepted benefit" and will not constitute "minimum essential coverage." So, if an employer provides only a typical, fully-insured dental or vision plan (without providing any major medical plan) the employer is not offering minimum essential coverage and could face a penalty under the Pay or Play Rule. However, as noted in the following text box, the list seems to fail to include some plans which might be surprising.

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[72] Code Section 5000A(f)(3)(A), (B). Note that there is some slight confusion caused by the statute's language. Code Section 5000A(f)(3)(B) refers to a "separate policy, certificate, or contract of insurance" and also refers to PHSA Sections 2791(c)(2) and (4). However, PHSA Section 2791(c)(3) refers to benefits "offered separately", without mentioning a policy, certificate or contract of insurance. It is unclear if Congress was attempting to distinguish between insured and self-funded benefits in its reference to PHSA Section 2791(c)(2). In addition, PHSA Section 2791(c)(4) only refers to a "separate insurance policy", without listing a "certificate" or "contract of insurance". It is unclear if Congress was attempting to distinguish among different types of insurance policies or contracts in its reference to PHSA Section 2791(c)(4). Further complicating the statute, IRS regulations appear to incorporate the descriptions of excepted benefits under PHSA Sections 2791(c)(2) and (4), without requiring that such excepted benefits be offered under a separate policy, certificate or contract of insurance. 26 CFR 1.5000A-2(g).

[73] Code Section 5000A(f)(3)(B). See IRS Proposed Regulations, Shared Responsibility Payment for Not Maintaining Minimum Essential Coverage, 78 Fed. Reg. 7314, 7317 (Feb. 1, 2013). Note that Code Section 5000A(f)(3) references PHSA Section 2791(c)(3) and provides that benefits described in that section are not "minimum essential coverage" if they are provided under a separate policy, certificate or contract of insurance. However, PHSA Section 2791(c)(3) also requires that these benefits be offered as "independent, noncoordinated benefits." Although the statute does not clearly incorporate these additional requirements of PHSA Section 2791(c)(3), the preamble to certain IRS proposed regulations provides that the benefits referenced in PHSA Section 2791(c)(3) are excepted benefit s "only if offered under a policy, certificate, or contract of insurance ***separate from, and not coordinated with***, any group or individual health plan maintained for the same plan sponsor." (emphasis added.) Accordingly, it appears that these benefits must meet the additional requirements in PHSA Section 2791(c)(3) in order to constitute excepted benefits under Code Section 5000A(f)(3).

Can Our Self-Insured Dental or Vision Plan Constitute "Minimum Essential Coverage"? Perhaps, but this seems unlikely. The above definition of "minimum essential coverage" excludes many typical, fully-insured dental or vision plans. These plans are usually provided under a "separate policy, certificate or contract of insurance" and satisfy this requirement of the exception. However, a self-insured dental or vision plan is not provided under a "separate policy, certificate or contract of insurance". It appears that a self-insured dental or vision plan could be an "eligible employer-sponsored plan" (as discussed in Step 4(b), below). Thus, it appears that a self-insured dental or vision plan could be "minimum essential coverage." This suggests that an employer could avoid the Pay or Play Rule penalty simply by providing a self-insured dental or vision plan. Note, though, that a self-insured dental or vision plan which is not an "excepted benefit" may need to comply with the full scope of the ACA, such as no dollar limits on essential health benefits and free preventive care. Also, it is somewhat doubtful whether such a plan would provide "Minimum Value" (as discussed in Step 5). Further IRS guidance would be helpful.

Step 4(b): Verify You Provide Such Coverage Under an Eligible Employer-Sponsored Plan

An "eligible employer-sponsored plan" includes:

* A governmental plan;
* Any other plan or coverage offered in the small or large group market within a State;
* A grandfathered health plan offered in a group market; or
* A self-insured group health plan under which covered is offered by, or on behalf of, and employer to the employee.[74]

The term "group health plan" means an employee welfare benefit plan as defined under the Employee Retirement Income Security Act ("ERISA") to the extent that the plan provides medical care to employees or their dependents.[75] Most health benefits offered by employers meet the requirements necessary to be considered employee welfare benefit plans under ERISA.

Bottom Line: The definitions described in Steps 4(a) and 4(b) are likely to be satisfied by most employers who provide major medical health plans to employees. Thus, we expect that most employers offering major medical health benefits to employees will be providing an "eligible employer-sponsored plan" and that these employers will satisfy Step 4.

[74] Code Section 5000A(f)(2); 26 CFR 1.5000A-2(c)(1).
[75] 26 CFR 1.5000A-1(d)(7); PHSA Section 2791(b)(2).

Step 5: Ensure That Your Plan Provides "Minimum Value"

An employee could potentially receive an Exchange subsidy if the employer's health plan does not provide "minimum value."[76] The statute states that a plan does not provide "minimum value" if the "plan's share of the total allowed cost of benefits provided under the plan is less than 60 percent of such costs."[77]

Note that most employer-sponsored plans are expected to satisfy the minimum value requirement. A report issued by HHS found that approximately 98% of individuals covered by employer-sponsored plans are enrolled in plans that have an actuarial value of at least 60% using methods and assumptions similar to those the agencies have provided for determining minimum value.[78]

The IRS has issued proposed regulations that provide four options for determining whether an employer's plan provides minimum value. Note that the proposed regulations seem to require that all small, fully-insured plans be tested in the same manner, regardless of whether they are grandfathered or not.[79]

The proposed options are summarized in the table below.

Method	Overview	Comments
Minimum Value Calculator	The federal government has posted an online "calculator" in which terms of the health plan can be described. The website then determines whether the plan provides minimum value.[80]	This option is probably the easiest method for an employer to use. However, some plans with non-standard features cannot use the calculator and would need to select a different option.

[76] Code Section 36B(c)(2)(C)(ii).
[77] Code Section 36B(c)(2)(C)(ii). Note that, unlike the rules for determining the "actuarial value" of a plan, the 60% standard for minimum value does not include a de minimis variation of 2 percentage points. See IRS Notice 2012-31, IV; HHS Final Regulations, Standards Related to Essential Health Benefits, Actuarial Value, and Accreditation, 78 Fed. Reg. 12834, 12852 (Feb. 25, 2013) ("whereas the statute allows for de minimis range with actuarial value there is no similar provision in section 36B of the Code with regard to [minimum value]").
[78] See IRS Notice 2012-31, II.
[79] See IRS Proposed Regulations, Minimum Value of Eligible Employer-Sponsored Plans and Other Rules Regarding the Health Insurance Premium Tax Credit, 78 Fed. Reg. 25909, 25910 (May 3, 2013), stating that a plan can use the following method to determine if the plan provides minimum value: "For plans in the small group market, conformance with the requirements for a level of metal coverage defined at 45 CFR 156.140(b) (bronze, silver, gold, or platinum."); see also IRS Notice 2012-31, V ("For employer-sponsored plans in the small group market, minimum value must be determined using a method that is consistent with actuarial value rules under Section 1302(d) of the Affordable Care Act and HHS guidance provided under that provision."). However, somewhat confusingly, other guidance could be read as stating that only non-grandfathered, small, fully-insured plans are subject to this test (while grandfathered plans are subject to some other test, apparently). See Center for Medicare and Medicaid Services ("CMS"), Actuarial Value and Cost-Sharing Reductions Bulletin, I (Feb. 2012) available at http://www.cms.gov/CCIIO/Resources/Files/Downloads/Av-csr-bulletin.pdf.
[80] See 26 CFR 1.36B-6(d)(1). The minimum value calculator can be found at http://cciio.cms.gov/resources/regulations/index.html#hmr.

Method	Overview	Comments
Small, Fully-Insured Plan	Certain small, fully-insured health plans will satisfy a metal coverage tier (such as a bronze silver, gold or platinum) and will automatically be deemed to provide minimum value.[81]	Presumably an employer would rely on an insurer's statement that the plan satisfies a particular coverage tier.
Actuarial Certification	An employer (or perhaps an insurer on behalf of an employer) can hire an actuary to certify that the plan provides minimum value if the plan has nonstandard features that are not compatible with the minimum value calculator described above.[82]	Will probably be the last resort for employers (if employer must hire the actuary) due to extra cost.
Safe Harbor Plan Design	The proposed regulations describes certain plan designs, which are likely to automatically provide minimum value.[83]	The proposed safe harbor plan designs are not final and could change. We expect more guidance on this option. Current proposed safe harbor offers three options: 1. A plan with a \$3,500 integrated medical and drug deductible, 80% plan cost-sharing and a \$6,000 maximum out-of-pocket limit for employee cost-sharing. 2. A plan with a \$4,500 integrated medical and drug deductible, 70% plan cost-sharing, a \$6,400 maximum out-of-pocket limit and a \$500 employer contribution to a HSA. 3. A plan with a \$3,500 medical deductible, \$0 drug deductible, 60% plan medical expense cost-sharing, 75% plan drug cost-sharing, a \$6,400 maximum out-of-pocket limit and drug

[81] See 26 CFR 1.36B-6(d)(4).
[82] 26 CFR 1.36B-6(d)((3).
[83] See 26 CFR 1.36B-6(d)(2); 78 Fed. Reg. at 25912.

Method	Overview	Comments
		co-pays of $10 / $20 / $50 for the first, second and third prescription drug tiers, with 75% coinsurance for specialty drugs.

Wellness Plan Rewards and Minimum Value.

The proposed regulations also address the minimum value calculation for an employer that offers its employees a reward-based wellness plan where the reward is a reduction in the deductible or out-of-pocket maximum. In such a case, the employer can take into account the wellness plan reward only to the extent it relates to tobacco use.[84] As noted in the three examples below, this can sometimes be easy to apply, and other times difficult and unclear.

Wellness Program Example #1 (simple). Sample Co. offers a self-funded health plan. The plan has a $2,000 deductible but, if an employee participates in the wellness program, the deductible is decreased by $300 (to $1,700). The wellness program focuses only on tobacco use. Sam, the Benefits Director for Sample Co., wants to know if the plan provides minimum value. Sam logs into the website, which contains the minimum value calculator. The calculator asks Sam to include the plan's deductible. Sam is uncertain on how to answer the question: Is it $2,000 (the general deductible) or $1,700 (the deductible for individuals who do not use tobacco or who complete a tobacco cessation course)?

It appears that, under the proposed regulations, Sam would list the deductible as $1,700. This is true because the wellness program provides a discount which is based on not using tobacco. Note that Sam will list $1,700 even if some (or many) employees do not qualify for the discount and are subject to the full $2,000 deductible. Sample Co. is pleased to list the deductible as $1,700 (rather than $2,000) because it makes the plan look more valuable and results in the plan being more likely to provide minimum value.

Note that there would be a different result if the $300 deductible decrease related to a health factor other than tobacco use (such as acceptable blood glucose or cholesterol levels). In that case, the possible $300 discount is ignored, and Sam would list $2,000 (not $1,700) as the plan's deductible for minimum value purposes.

Wellness Program Example #2 (moderate difficulty). What if tobacco use is just one factor that can help an employee earn the $300 reward? For example, suppose Sample Co.'s wellness plan gives the $300 deductible discount to any employee who earns 100 wellness points. There are four ways to earn the 100 points (acceptable glucose levels are worth 25 points; acceptable cholesterol levels are worth 25 points; physical activity is worth 25 points; and not using tobacco is worth 25 points). Thus, everyone who earns the wellness reward will not use tobacco. Could the company apply 25% of the $300 (i.e.,

[84] 26 CFR 1.36B-6(c)(2). Note that the preamble to the proposed regulations provides transition relief from the Pay or Play Rule for plan years beginning before January 1, 2015 with respect to reward-based wellness plans. 78 Fed. Reg. at 25911. Several requirements must be satisfied to qualify for the transition relief, including that the applicable wellness program must have been in effect on May 3, 2013.

$75) reward when it inputs information on minimum value?

Perhaps -- it seems to be supported by the proposed regulation. The regulation states that the wellness program incentive is earned "to the extent" the incentive relates to tobacco use.[85] This seems to mean that to the extent the wellness discount is not tobacco-related, it is ignored. If so, here $225 (that is, $300 - $75 = $225) would be ignored as the "non-tobacco discount," and $75 could apparently be "counted" as the "tobacco discount." While this seems logical, no examples or other language in the regulation supports the conclusion. So, this remains a bit unclear.

Wellness Program Example #3 (difficult). Suppose Sample Co. offers a wellness plan in which an employee earns a $300 deductible discount by earning five points. Sample Co. offers seven ways (similar to the ways noted in the prior example — for example, no tobacco use, exercise and cholesterol levels) to earn the five points. Each of the seven ways is worth one point. So, some employees who earn the $300 deductible discount will qualify, in part, because of not using tobacco. But, other employees will earn the $300 deductible discount even though they do use tobacco. Sample Co. does not know in advance (and may not know at all, because Sample Co.'s wellness vendor may not share the information with Sample Co.) how many employees qualified for the discount because of not using tobacco. When Sample Co. lists its deductible in the minimum value calculator, can Sample Co. include some portion of the $300 deductible discount?

This is very unclear. Unless Sample Co. has some data to support the amount it lists, it would seem to be risky to list any discount. Unfortunately, we will probably not know the answer to this question until the IRS issues further guidance.

HRAs, HSAs and Minimum Value.

An employer's contributions to a health reimbursement arrangement ("HRA") or health savings account ("HSA") can help the employer to demonstrate that its plan provides minimum value. For an HRA, an employer considers amounts which are newly made available with respect to an HRA that is integrated with the employer's health plan, if the new amounts may be used only to reduce cost-sharing for covered medical expenses.[86] For an HSA, the full amount an employer contributes is considered. However, for both amounts, it appears that the most that can be taken into account is the amount of expected spending for health care costs in a benefit year.[87] It is not clear how an employer would determine this amount.

HRA Example. As noted in the prior examples, Sample Co. has a health plan. Sample Co. also offers an HRA and contributes $1,200 to the HRA for each individual who participates in the health plan. The HRA can only be used to reduce cost-sharing for covered medical expenses. Sam, the benefits director for Sample Co., sees that the minimum value calculator requests that Sam input the HRA Employer Contribution. Sam would like to include the full $1,200 HRA contribution, because it would make the health plan more likely to provide minimum value. Can Sam include the full $1,200 contribution?

It appears that Sam can include the entire $1,200. The HRA (presumably its plan document and summary plan description) limit eligible expenses to reducing cost-sharing for covered medical expenses. This is good — that is the first hurdle Sam must clear under the new regulations. Next, Sam would need to confirm that the HRA is integrated with the health plan. This is likely true here, assuming

[85] 26 CFR 1.36B-2(c)(3)(v)(A)(4).
[86] 45 CFR 156.145(d); 26 CFR 1.36B-6(c)(4).
[87] 26 CFR 1.36B-6(c)(3).

that all employees who receive an HRA contribution also are in the health plan (and that all employees in the health plan also receive an HRA contribution).

Finally, the regulations state that the amount of the HRA contribution that is taken into account is the amount of expected spending for health care costs in a benefit year.[88] Suppose Sample Co. knows that, on average, HRA participants spend 70% of Sample Co.'s contribution each year (the remaining 30% rolls over to the following year). Would Sam put into the minimum value calculator 70% of $1,200 (i.e., $840)? Or does the calculator expect Sam to include the full $1,200 — and then the calculator will adjust this amount downward? The regulations are not clear on this point. However, other minimum value calculator guidance seems to indicate that Sam would include the full $1,200 amount.[89]

[88] 26 CFR 1.36B-6(c)(5).
[89] See Department of Health and Human Services, "Minimum Value Calculator Methodology," (stating that an employer will include, in the case of HSAs, an annual amount contributed by the employer or, in the case of HRAs, the amount first made available) (available at http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/mv-calculator-methodology.pdf) (last visited March 3, 2014).

Step 6

Step 6: Verify the Coverage is Affordable for Employee

Generally, an employee will be able to receive an Exchange subsidy only if the plan does not provide "minimum value" (as discussed in Step 5) or if the employee's required health plan premium contribution under an employer's plan is not "affordable" -- that is, the contribution exceeds 9.5% of the employee's household income.[90] Hidden within this general rule, however, are some subtle nuances, such as how "household income" is calculated, what level of coverage is used in the calculation (e.g., the lowest cost plan offered by the employer versus the highest-cost plan offered by the employer) and what type of coverage is used in the calculation (e.g., employee-only versus family coverage). We discuss these nuances in this Step 6. Note that some items remain unaddressed by the IRS. For example, it is not clear in all instances if the 9.5% is based on the maximum an employee could pay or what the employee actually does pay (this amount could be lower due to the avoidance of a spousal surcharge).

Step 6(a): What is "Household Income"?

In general, "household income" is the modified adjusted gross income of the employee and any members of the employee's family (including any spouse and dependents) who are required to file an income tax return.[91] "Modified adjusted gross income" means adjusted gross income (within the meaning of Code Section 62) increased by amounts excluded from gross income under Code Section 911, by the amount of any tax-exempt interest a taxpayer receives or accrues during the taxable year, and by the portion of the taxpayer's social security benefits not included in the taxpayer's gross income (under Code Section 86) for the taxable year.[92]

This definition of "household income" poses a problem for employers. Employers may know the income (or much of the income) of employees. However, employers usually do not know the income of an employee's spouse and dependents. Thus, an employer would have "practical difficulties" (in the words of the IRS) determining whether a health plan is "affordable" to an employee.[93]

Step 6(b): Applying Household Income to Cost of Plan

Because of this practical difficulty, the IRS allows an employer to determine that its health plan coverage is "affordable" by using one of three safe harbors, as noted in the following chart. Note that all the safe harbors focus on the cost of self-only coverage, not some other level of coverage (e.g., family coverage). This means an employer could charge more than 9.5% (e.g., 10% or 15%) for self-plus-one or family coverage yet still avoid Pay or Play Rule penalty.[94]

Note that, if an employer's health plan coverage is affordable for the employee based on the cost of self-only coverage, the employee's family members generally will not be eligible to receive an Exchange subsidy.[95] This is the case even if the employee's cost of self-plus-one or

[90] Code Section 36B(c)(2)(C)(i)(II).
[91] IRS Notice 2011-73, II, citing Code Section 36B(d)(2)(A).
[92] Code Section 36B(d)(2)(B).
[93] IRS Notice 2011-73, II.
[94] See 26 CFR 1.36B-2(c)(3)(v)(A)(2) ("an eligible employer-sponsored plan is affordable for a related individual if the portion of the annual premium the employee must pay for self-only coverage does not exceed [9.5%]").
[95] 26 CFR 1.36-2(c)(3)(v)(A)(2).

family coverage under the employer's health plan is prohibitively expensive. Employers should keep in mind that, by charging high premiums for self-plus-one or family coverage, an employer might inadvertently cause its employee to be unable to afford family coverage under its health plan ***and*** cause the employee's spouse and dependents to be unable to obtain subsidized coverage through an Exchange.

Name of Safe Harbor	Description	Comments
Rate of Pay Safe Harbor	Coverage will be affordable for a calendar month if employee's required contribution for month for lowest cost, self-only coverage that provides minimum value does not exceed 9.5% of a Rate of Pay Safe Harbor Amount. This Rate of Pay Safe Harbor Amount equals 130 hours multiplied by employee's hourly rate of pay as of the first day of the coverage period (generally first day of plan year) or the employee's lowest hourly rate of pay during the calendar month.[96] For salaried employees, monthly salary is used instead of hourly rate of pay. Employer can use any reasonable method to convert payroll periods to monthly salary.[97] The IRS notes that as a "practical matter," the Rate of Pay Safe Harbor cannot be used for tipped employees or for employees who are compensated solely on the basis of commissions.[98] The IRS notes that employers can use the two other affordability safe harbors for employees whose compensation is not based on a rate of pay.[99]	Rate of Pay Safe Harbor available only to extent employer does not reduce monthly wages of salaried employees during calendar year (including transfers of employment to another applicable large employer member).[100] The Rate of Pay Safe Harbor is available if an employer reduces the hourly rate of pay of an hourly employee, provided that the rate of pay is applied separately to each calendar month, rather than to the entire year and the employee's required contribution may be treated as affordable if it is affordable based on the lowest rate of pay for the calendar month multiplied by 130 hours.[101] For example, assume Employer W employs Employee D from January 1, 2015 - December 31, 2015. Employee D's contribution for self-only coverage is $85 per month. D is paid at a rate of $7.25 per hour. W can assume D earns $942.50 per calendar month (130 x $7.25). The maximum "affordable" premium is 9.5% of $942.50 = $89.53. Because D is only charged $85 (less than $89.53), D's coverage is affordable.[102]

[96] 26 CFR 54.4980H-5(e)(2)(iii).
[97] 26 CFR 54.4980H-5(e)(2)(iii).
[98] 79 FR at 8564.
[99] 79 FR at 8564-65.
[100] 26 CFR 54.4980H-5(e)(2)(iii).
[101] 26 CFR 54.4980H-5(e)(2)(iii).
[102] This example comes from 26 CFR 54.4980H-5(e)(v), Ex. 4.

Name of Safe Harbor	Description	Comments
Federal Poverty Line Safe Harbor	Coverage will be affordable for a calendar month if employee's required contribution for lowest-cost self-only coverage that provides minimum value under the plan does not exceed 9.5% of a Federal Poverty Line Safe Harbor. The Federal Poverty Line Safe Harbor is determined by calculating Federal poverty line for single individual (where individual is employed) for applicable calendar year, divided by 12.[103] The Federal poverty line is the federal poverty line that is in effect within six months before the first day of the plan year for the state in which the employee is employed.[104]	For example, the general federal poverty line for 2014 for a single person is $11,670, and 9.5% of $11,670 is $1,108.65. One-twelfth of $1,108.65 is approximately $92.39. Coverage would be affordable if employee's monthly contribution amount for self-only premium of the employer's lowest cost coverage that provides minimum value is equal to or less than $92.39. This is true even if employee's wages vary somewhat in a particular month (e.g., because of low hours in a month, an hourly employee may end up paying a larger "percentage" of wages in a particular month).[105]
Form W-2 Safe Harbor	Verify whether employee's required contribution for the calendar year for the employer's lowest cost self-only coverage that provides minimum value during the entire calendar year does not exceed 9.5% of that employee's Form W-2 wages from the employer for the calendar year.[106] The cost of COBRA or other continuation coverage is ignored if the employee terminates employment. This is good for an employer because COBRA is usually expensive for the employee, since an employer usually does not subsidize its cost. Thus, if the cost was considered in the test, the former employee's coverage would likely be unaffordable. Note that the opposite rule applies for an employee who reduces hours and elects COBRA. The cost of COBRA (again, usually unsubsidized) does count for purposes of the W-2 Safe Harbor.[107]	W-2 wages are used, which provides some level of employer control. However, employers may not always precisely know wages in the middle of the year due to bonuses or other variable compensation.

[103] 26 CFR 54.4980H-5(e)(2)(iv).
[104] 26 CFR 54.4980H-5(e)(2)(iv).
[105] This example is from 26 CFR 54.4980H-5(e)(v), Ex. 6.
[106] 26 CFR 54.4980H-5(e)(2)(ii)(A).
[107] 26 CFR 54.4980H-5(e)(2)(ii)(A).

Additional Detail on Form W-2 Safe Harbor. The Form W-2 Safe Harbor has a few additional details to note. First, the IRS expects that the affordability determination under the Form W-2 Safe Harbor will be made after the end of the calendar year.[108] For example, an employer would determine whether it met this affordability test for 2015 for an employee by looking at that employee's W-2 wages for 2015 and comparing 9.5% of that amount to the employee's 2015 employee contribution.[109] An employer is not permitted to, under the W-2 Safe Harbor, make discretionary adjustments to the employee's required contribution in order to satisfy the W-2 Safe Harbor.[110] Rather, the employee's required contribution must remain a "consistent amount or percentage" of all Form W-2 wages for the year.[111]

The IRS regulation also provides an adjustment if an employee did not work the entire year. In essence, an employee's Form W-2 wages are adjusted downward, by a proportionate amount, for an employee who did not work an entire year.[112]

Employee Exchange Subsidy Uses Alternative Test. It appears that these "safe harbors" for employers would not apply to an employee's eligibility for an Exchange subsidy. In other words, some individuals will be deemed to have "affordable" employer coverage for purposes of the employer penalty under the Pay or Play Rule yet have "not affordable" coverage for Exchange subsidy purposes. For these employees, the employer will not owe the penalty tax. However, those same employees may still qualify for an Exchange subsidy.[113]

Wellness Plan Rewards and Affordability. As discussed above, the affordability test is based on whether the plan charges more than 9.5% of an employee's wages for self-only coverage. Proposed IRS regulations provide that affordability for these purposes will, like minimum value (as described in Step 6(b) above), consider only tobacco-related wellness program discounts.[114] However, the final Pay or Play regulations do not adopt this guidance and appear to limit this guidance to plan years beginning prior to January 1, 2015.[115] Thus, the more cautious approach is to ignore tobacco-related wellness program discounts when calculating affordability. In any event, discounts for other wellness program activities (such as exercise or having acceptable blood sugar or cholesterol levels) will be ignored for affordability purposes.

HRAs and Affordability. Under earlier guidance, it appeared that amounts an employer newly makes available for the current plan year under an integrated HRA would be considered — and could assist the employer — for affordability purposes under the Pay or Play Rule. According to

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[108] 26 CFR 54.4980H-5(e)(2)(ii)(A).
[109] IRS Notice 2011-73, II.
[110] 26 CFR 54-4980H-5(e)(2)(ii)(A).
[111] 26 CFR 54.4980H-5(e)(2)(ii)(A).
[112] 26 CFR 54.4980H-5(e)(2)(ii)(B).
[113] IRS Notice 2011-73, II. This concept was adopted in the IRS final regulation. 26 CFR 54.4980H-5(e)(2). For example, an employee's household income may be less than W-2 wages due to adjustments to gross income for alimony paid or losses due to self-employment. Such an employee may qualify for subsidized Exchange coverage. The IRS safe harbor would not penalize the employer in this situation.
[114] See 78 Fed. Reg. at 25911. As noted in footnote 84 above, the preamble to the proposed regulations provides transition relief from the Pay or Play Rule for plan years beginning before January 1, 2015 with respect to reward-based wellness plans. Several requirements must be satisfied to qualify for the transition relief, including that the applicable wellness program must have been in effect on May 3, 2013. Based on the delayed effective date of the Pay or Play Rule, this transition rule will likely only benefit employers with non-calendar year plans.
[115] 79 Fed. Reg. at 8570, providing that the preamble to the proposed minimum value regulations provide "transition guidance" under section 4980H for determining affordability and MV as related to wellness programs for plan years of an employer's group health plan "beginning before January 1, 2015."

the IRS, this rule would apply only if the employee may use the amounts only for premiums or may choose to use the amounts for either premiums or cost-sharing.[116] However, the final Pay or Play Rule regulations do not adopt this guidance. Thus, it appears that the more cautious approach is to disregard amounts available under an HRA when calculating affordability.

[116] See 78 Fed. Reg. at 25911.

Step 7

Step 7: Determine Who is a "Full-Time" Employee and How Penalty is Calculated

As illustrated in Exhibit A and discussed in Step 1, two penalties are possible:

- Subsection A Penalty: If an employer does not offer minimum essential coverage to at least 95% of all full-time employees (and dependents) the employer must pay an annual tax of $2,000 for each full-time employee (less the first 30 full-time employees), if at least one full-time employee obtains federally-subsidized coverage through an Exchange.

- Subsection B Penalty: If an employer does offer minimum essential coverage to at least 95% of all full-time employees (and dependents) but at least one full-time employee obtains federally-subsidized coverage through an Exchange, the employer must pay an annual tax of the lesser of: (1) $3,000 per subsidized full-time employee;[117] or (2) $2,000 for each full-time employees (less the first 30 full-time employees).

Note that the penalty is sometimes applied based on all (or nearly all) of an employer's full-time employees and other times based on the number of full-time employees who receive an Exchange subsidy. In nearly all situations, an employer which must pay a penalty would prefer the latter (based on full-time employees who receive an Exchange subsidy) rather than the former (based on all full-time employees). The latter will nearly always be a lesser amount. Of course, many employers will not want to pay any Pay or Play Rule penalty and will structure their plans to ensure that they do not pay any such penalty.

No Penalty if Employee is in Limited Non-Assessment Period. The final regulation clarifies that an employer generally will not incur a Subsection A or, sometimes, a Subsection B penalty if a full-time employee is in a "limited non-assessment period."[118] This rule was needed because, as will be discussed in this Step 7, there are some "exceptions" to who is a "full-time" employee. For example, an employee may be a New, Full-Time Employee but the employer may not have to offer coverage to the employee for about three months. Even though the employee is "full-time", the employer usually would not owe a Pay or Play Rule penalty for the first few months because during those first few months the employee is in a "limited non-assessment period."

Step 7(a): Determine Who is an "Employee"

The ACA does not define "employee" for Pay or Play Rule purposes. However, IRS guidance provides that an employee is an individual who is an employee "under the common-law standard."[119] The common law standard generally focuses on whether a company has the right to control what an individual will do and how it will be done.[120] An "employee" does not

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[117] An employer can exclude from its count of "full-time" employees for purposes of the $3,000 penalty: (a) those who are New, Full-Time Employees during their first three months of employment; (b) those who are New Variable Hour or New Seasonal Employees during the months of those employee's Initial Measurement Period (and associated Administrative Period); and (c) those who were offered the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan that satisfied minimum value and was affordable. 26 CFR 54.4980H-5(a).
[118] 26 CFR 54.4980H-1(a)(26).
[119] 26 CFR 54.4980H-1(a)(15). See 26 CFR 31.3401(c)-1(b) for additional guidance on this standard.
[120] IRS Publication 15 (2012), p. 9. Note that IRS Publication 15-A contains more details on this test. See IRS Publication 15-A (2012), pp. 7-8.

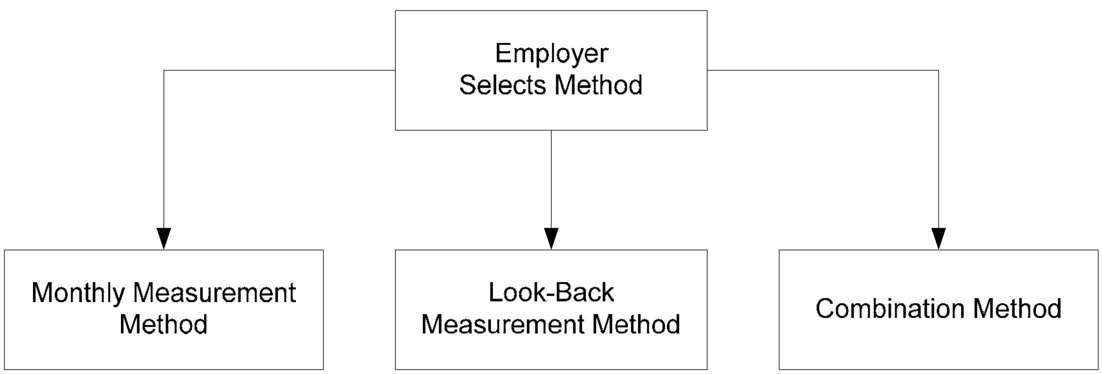
include a “leased employee” (as defined in Code Section 414(n)(2)), a sole proprietor, a partner in a partnership or a 2-percent S corporation shareholder.[121]

Step 7(b): Determine Who is a “Full-Time” Employee for Penalty Purposes

In Step 2(d)(i) (covered in Appendix I) we discuss who is a “full-time” or “full-time equivalent” employee for purposes of determining whether an employer is subject to the Pay or Play Rule. Those rules generally apply for Pay or Play Rule penalty purposes, although some of the rules (such as the “seasonal worker” rule) are not used for Pay or Play Rule penalty purposes.

The current IRS guidance on who is a “full-time” employee for penalty purposes is discussed in this Step 7. In general, the guidance provides clear rules for employers. However, the guidance is still incomplete. For example, the IRS has stated that additional guidance may be required in some situations. For example, suppose an employee transfers from one position to another (e.g., he moves from California to Illinois). If the change in position also results in different measurement periods applying, the current regulation seems to be inadequate – the IRS notes that future guidance may address this situation.[122]

Employers generally have three choices in determining who is a “full-time” employee: (1) a “Monthly Measurement Method”; (2) a “Look-Back Measurement Method”; or (3) a combination of the two (what we call the “Combination Method”).[123] The Combination Method can be used for only certain categories of employees.[124] It appears that a large employer must use one of these methods (i.e., they are required and are not optional).[125]



[121] 26 CFR 54.4980H-1(a)(15).
[122] 79 Fed. Reg. at 8563.
[123] 26 CFR 54.4980H-3(a).
[124] 26 CFR 54.4980H-3(a), referring to categories of employees noted in 26 CFR 54.4980H-3(d)(1)(v), -3(d)(3)(v).
[125] We use the word “required” although it is not exactly clear if the methods described herein are required. Prior guidance stated that the methods were an optional “safe harbor” that employers were “not required” to use. IRS Notice 2012-58, IV. However, an employer that did not use this “optional” safe harbor would apparently have no IRS-approved basis for determining who is a “full-time” employee and therefore would be at significant risk of a Pay or Play Rule penalty. In addition, the final regulations do not refer to these methods as being “optional.” Therefore, we expect most employers will treat these methods as a requirement, rather than as an option.

These three methods are summarized below.

Method	Overview	Advantages	Disadvantages
1. Monthly Measurement Method	Employee first must be otherwise eligible, then must complete a waiting period. Then employer determines full-time employee status by looking at current month's hours of service	Likely the "easiest" method (least complex)	Not very useful for avoiding Pay or Play Rule penalty because it is difficult to use month-by-month method to determine health plan eligibility
2. Look-Back Measurement Method	Employer measures hours of employees who are not full-time. If employee averages 30 hours per week (130 hours per month) employee is "locked in" as full-time employee	Provides most certainty for employers about which employees are "full-time". Only method which can guarantee employer does not have Pay or Play Rule Penalty	Somewhat complex. May require significant amount of recordkeeping and hours tracking
3. Combination Method	Employer can elect to use Monthly Measurement Method for one group of employees (e.g., hourly employees) and Look-Back Measurement Method for another group of employees (e.g., salaried employees)	Perhaps could be useful in some situations	May be the most complex method

An employer may not know, from the above chart, which method it will select. Employers likely should review the remainder of this Step 7 to understand all the requirements of each option, then determine which method to use. The methods are discussed in more detail in the following subsections. Note that the method selected by the employer may be relevant for a related legal requirement -- the "applicable large employer" ("ALE") report. A discussion of the ALE reporting rule and how it interacts with the Pay or Play Rule will be in Appendix II, Applicable Large Employer Reporting (this will be covered in a future update).

Step 7(c): Details of the Monthly Measurement Method

The basic concept under the Monthly Measurement Method is simple: an employer examines an employee's hours each month to determine if the employee had 130 hours of service. If so, the employee is full-time for that month. If not, the employee is not full-time. The Monthly Measurement Method apparently applies to all types of employees -- seasonal, part-time, full-time, temporary or otherwise. There are important details and ambiguities, however, as discussed in this Step 7(c).

Step 7(c)(i): Will the Method Help Avoid a Penalty?

If an employer's employees have hours which go up and down -- above and below 30 hours per week -- an employer should be cautious before deciding to use the Monthly Measurement Method.[126] This is because an employee's status as "full-time" is made on a retroactive basis. But, the Pay or Play Rule penalty applies on a current-month basis (i.e., was health plan coverage offered for that month). This is illustrated below.

> **Difficulty With Monthly Measurement Method.** Up and Down Inc. has 2,000 full-time employees. It manufactures widgets. Demand fluctuates frequently for widgets. As a result, its manufacturing employees (1,800 of the 2,000 employees) some months work long hours (greater than 130 hours per month) and other months short hours (less than 130 hours per month). Up and Down changed its health plan eligibility provision to adopt the Monthly Measurement Method. So, an employee who has 130 hours of service in a month (e.g., January) will be eligible for coverage the next month (e.g., February). An employee who has less than 130 hours of service in a month (e.g., February) will not be eligible for coverage the next month (e.g., March). Will this protect Up and Down from a Pay or Play Rule penalty?
>
> Most likely no. The examples which illustrate the use of the Monthly Measurement Method make it clear that the Method determines full-time status for a particular -- current -- month.[127] So, Up and Down could be exposed to a Pay or Play Rule penalty for the months when an employee was full-time but for which the employee did not receive an offer of coverage. Thus, the Monthly Measurement Method will be of limited value to an employer with employees whose hours fluctuate above and below 130 hours per month.

The Monthly Measurement Method would also be difficult to use, if it was used to determine health plan eligibility. This is because it could result in an employee's eligibility changing monthly: one month eligible; the next month ineligible; the following month eligible, etc. While theoretically possible, it would be administratively burdensome on both the employer and employee to continually have eligibility changes such as this.

> **So, When Would an Employer Use the Monthly Measurement Method?** The Monthly Measurement Method will be useful in some situations. Perhaps the most likely employer to use it would be an employer that has employees who are all clearly defined, with hours well above 30 hours per week or well below 30 hours per week. The Monthly Measurement Method may be a good choice for that employer because it may be easier to establish and track than the Look-Back Measurement Method or the Combination Method. For such an employer, the "simplicity" of the Monthly Measurement Method may be appealing. And, such an employer presumably would not be very concerned about the Pay or Play Rule penalty, as it probably offers coverage to all its full-time employees and probably does not offer coverage to part-time employees.
>
> It may also be helpful to an employer which: (1) has employees who work very high hours for a few

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[126] An employer should consider all other relevant factors, including the Code Section 6055 / 6056 reporting rules, when making a decision about which method to use.

[127] See, e.g., 26 CFR 54-4980H-3(c)(5), Ex. 3 and 79 Fed. Reg. 8554, noting that "determinations are based on hours of service during that particular calendar month".

months, then a smaller number the rest of the year; and (2) the employer does not offer any health plan coverage. For example, suppose that the City of Big Falls employs a number of hourly employees who are very busy in four or five months (e.g., during the spring and summer months, when they manage a golf course, operate a public pool, cut grass, etc.). During those months the employees typically work well over 40 hours per week. During the remainder of the year the employees remain employed but work very few hours. None of these hourly employees receive an offer of health pan coverage.

Assume that if the City uses a 12-month Look-Back Measurement Method all the hourly employees would qualify as “full-time” employees for the entire twelve months (due to their high hours for the four or five months). This means the employer would have a possible Pay or Play Rule penalty for all twelve months of the year. In contrast, if the City uses the Monthly Measurement Method the hourly employees will be full-time for only the four or five busy months. Thus, the City would have a possible Pay or Play Rule penalty for only those four or five months. Adopting the Monthly Measurement Method could save the City a significant amount of Pay or Play Rule penalties.

Note that although we refer to full calendar months in this Step 7(c), an employer could tweak this slightly by generally using the first day of the week that includes the first day of the calendar month.[128]

Step 7(c)(ii): Using the Monthly Measurement Method

Assuming the employer is comfortable using the Monthly Measurement Method, the employer then needs to determine how it actually “works”, which is what we discuss in this Step 7(c)(ii).

The general rule under the Monthly Measurement Method is that an employer will start facing a possible Pay or Play Rule penalty once an employee first becomes "full-time".[129] Once that happens, the “clock starts ticking” and the employer generally must offer coverage to that employee within three months. If the coverage is offered by then the employer avoids the Subsection A Penalty for that three-month period.[130] If the coverage which is offered provides minimum value and is affordable, the employer will also avoid the Subsection B Penalty for that three-month period.[131] Note that the employee, during that three-month period, must be "otherwise eligible" for coverage.[132]

Wait -- the Coverage Only Has to Provide Minimum Value, Regardless of Whether it is Affordable?
The regulation's reference to minimum value in the paragraph, above -- without reference to whether the coverage is also affordable -- is, at first glance, odd. As noted at the beginning of Step 7, the Subsection B Penalty can be triggered if the employer's offer of coverage is either unaffordable or fails to provide minimum value. Here, though, the penalty with respect to the initial three months is triggered only if the coverage does not provide minimum value. The IRS is not clear on why it structured

[128] 26 CFR 54.4980H-3(c)(3).
[129] 26 CFR 54.4980H-3(c)(1).
[130] 26 CFR 54.4980H-3(c)(2). Note that the example and statements here assume an employee becomes eligible on the first of the month. If the employee becomes eligible on a day other than the first day of the month, slightly different rules would apply (e.g., an employer should carefully examine how the 90-day Waiting Period Rules apply).
[131] 26 CFR 54.4980H-3(c)(2).
[132] 26 CFR 54.4980H-3(c)(1). The phrase "otherwise eligible", according to the preamble, means that the employee meets all conditions to be offered coverage under the plan other than the completion of a waiting period. 79 Fed. Reg. 8554. It is unclear why the final regulation refers to, and incorporates, a waiting period. (The proposed regulation did not.) Employers, insurers and third party administrators may have to carefully draft their plans' (or policies') definition of "waiting period" to ensure it "syncs up" with the regulation's use of the term.

the regulation this way. Perhaps it is because an employer simply would lack time or information needed in order to ensure that the coverage is affordable (because employee wages can vary). However, an employer could always ensure that its plan provides minimum value, so perhaps that is why the IRS only focuses on that feature. In any event, it is a favorable standard for employers.

Note that this special three-month rule cannot apply more than once per "period of employment" for each employee.[133] In other words, for an employee who is continuously employed, the special relief, above, for the three-month period can only apply once per employee. If an employee terminates employment and is "rehired" so that the employee is treated as a new employee, the employer can again claim the three-month relief noted above.[134] See Step 7(c)(iii) for a discussion of the "rehire" rules. Also note that special rules apply if an employee transfers to an international position at the same applicable large employer.[135]

The following illustration shows how the rule applies with respect to Ed and Julie, employees at Bigco (a large employer which has adopted the Monthly Measurement Method). Both are hired on February 1, 2015. Neither have before worked at Bigco and neither terminate employment in the time periods below.[136] The Bigco health plan provides that employees will first become eligible after they have worked 130 or more hours in a month. Months which are shaded in blue, below, are months where Bigco has risk of a Pay or Play Rule penalty if coverage is not offered.

2015	Ed's Hours of Service	Comments About Ed	Julie's Hours of Service	Comments About Julie
January	Not employed		Not employed	
February	140	Per three - month rule, Bigco will not be liable for February 2015 if it offers Ed minimum value coverage for month of May 2015.	100	No exposure for Bigco because: (1) three - month rule not yet "used" for Julie; and (2) 130+ hours of service not reached.
March	140	Per three - month rule, Bigco will not be liable for March 2015 if it offers Ed minimum value coverage for month of May 2015.	100	No exposure for Bigco because: (1) three - month rule not yet "used" for Julie; and (2) 130+ hours of service not reached.

[133] 26 CFR 54.4980H-3(c)(2).
[134] 26 CFR 54.4980H-3(c)(2), citing to 26 CFR 54.4980H-3(c)(4) to determine whether an employee has been rehired. The averaging method for periods of special unpaid leave and employment break periods do not apply under the Monthly Measurement Method. 26 CFR 54.4980H-3(c)(4)(iii).
[135] 26 CFR 54.4980H-3(c)(4)(vi).
[136] If an employee terminates employment before reaching the fourth month after having 130 or more hours, it appears an employer can fail to offer coverage for the first three months, yet still not face a Pay or Play Rule penalty. 26 CFR 54.4980H-3(c)(2).

2015	Ed's Hours of Service	Comments About Ed	Julie's Hours of Service	Comments About Julie
April	100	Per three-month rule, Bigco will not be liable for April 2015 if it offers Ed minimum value coverage for month of May 2015. Although somewhat unclear, it appears that Bigco also will not be liable for April because Ed did not work 130+ hours in that month.[137]	100	No exposure for Bigco because: (1) three - month rule not yet "used" for Julie; and (2) 130+ hours of service not reached.
May	100	Per three-month rule, Bigco will not be liable for February, March or April 2015 if it offers Ed minimum value coverage for month of May 2015. Even though Ed did not work 130+ hours in May, Bigco likely will offer minimum value coverage in May in order to satisfy three - month rule requirements.	140	Per three - month rule, Bigco will not be liable for May 2015 if it offers Julie minimum value coverage for month of August 2015.
June	140	Three - month rule cannot apply for June 2015 because Bigco has already "used it" for Ed. So, Bigco has exposure if affordable, minimum value coverage is not offered.	100	Per three-month rule, Bigco will not be liable for June 2015 if it offers Julie minimum value coverage for month of August 2015.
July	100	Three - month rule already used. However, no exposure for Bigco because 130+ hours not reached.	100	Per three-month rule, Bigco will not be liable for July 2015 if it offers Julie minimum value coverage for month of August 2015.
August	100	Three - month rule already used. However, no exposure for Bigco because 130+ hours not reached.	100	Even though Julie did not work 130+ hours, Bigco likely will offer minimum value coverage in August 2015 in order to satisfy three - month rule requirements.
September	100	Three - month rule already used. However, no exposure because 130+ hours not reached.	140	Three-month rule already "used" for Julie. So, Bigco has exposure for September 2014 if no coverage is offered.

[137] The reason for this uncertainty is that the regulation states that no penalty will be owed for the three-month period after an employee (here, Ed) is first eligible if the employee is "otherwise eligible" for the coverage. The meaning of this phrase is not clear.

Step 7(c)(iii): Rehire Rules Under the Monthly Measurement Method

In the above example, Ed and Julie are continuously employed. That is, they never terminate employment, wait some period of time, then become rehired by Bigco. But, this could happen. If this happens, the employer determines whether the rehired employee is a "new" employee or a "continuing" employee. If the employee is "new", the employer can -- without incurring a Pay or Play Rule risk -- not offer coverage until the employee has again worked 130 or more hours of service in a month.[138]

In contrast, if the employee is a "continuing" employee, the employer must treat the continuing employee in "the same way" as it does other employees who have not experienced a period of no hours of service.[139] This seems to mean that the employer does not have the "luxury" of the 3-month rule discussed above. Instead, if a continuing employee has 130 hours of service in the month he or she returns, the employer must (in order to avoid a Pay or Play Rule penalty) offer coverage by the first day of the calendar month after resuming services.[140] In contrast, if the continuing employee does not reach 130 hours of service, the employer apparently does not need to offer health plan coverage.[141]

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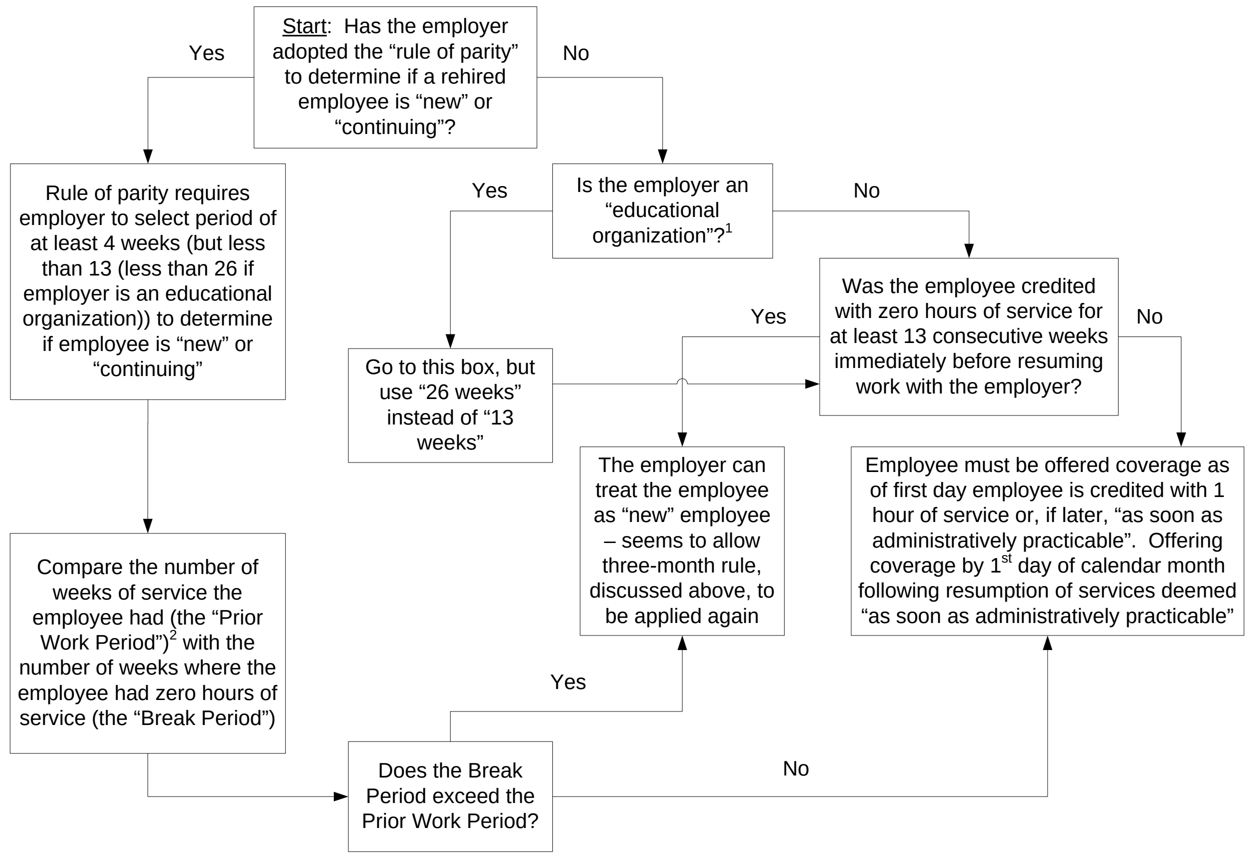
[138] 26 CFR 54.4980H-3(c)(4)(i).
[139] 26 CFR 54.4980H-3(c)(4)(iv).
[140] 26 CFR 54.4980H-3(c)(4)(iv).
[141] See 26 CFR 54.4980H-3(c)(4)(iv).

So, when can an employer treat a rehired employee as "new"? When will the employee be "continuing"? It depends on how long the break was; whether the employer has adopted a "rule of parity" which controls in this situation; and whether the employer is an educational organization.[142] These rules are illustrated in the following.



1. See 26 CFR 54.4980H-3(a)(13) for the definition of "educational organization."
2. In determining an employee's Prior Work Period, the "averaging method" for special unpaid leave and employment break periods do not apply, regardless of whether the employer is (or is not) an educational organization. 26 CFR 54.4980H-3(c)(4)(iii).

Step 7(d): Details of Look-Back Measurement Method

This Step 7(d) explores an alternative to the Monthly Measurement Method -- the Look-Back Measurement Method. The Monthly Measurement Method focuses on "current" information to determine which employees are "full-time." In contrast, the Look-Back Measurement Method looks at historical information -- for example, in the past 12 months, did the employee average 30 hours per week? If so, the employee's status as "full-time" may be "locked in" for a subsequent "block" of time.

[142] 26 CFR 54.4980H-3(c)(4). In addition, special rules are provided for international transfers under 26 CFR 54.4980H-3(c)(4)(vi).

One of the tricky items in using the Look-Back Measurement Method is that different rules apply depending on an employee's “category.” These “categories” are required by the IRS for each employer that uses the Look-Back Measurement Method. An employer apparently cannot create “different” categories.

An employer that uses the Look-Back Measurement Method will “sort” its employees into the following “categories”. <u>All</u> employees must be placed into these categories.

Employee Category	Definition of Term	Summary / Comments
Ongoing Employee	Employee who has been employed by employer for at least one complete “Standard Measurement Period.” An Ongoing Employee can be full-time (working at least 30 hours per week) or part-time.	A “Standard Measurement Period” is the 3-12 month period selected by the employer where the employer determines the individual's “full-time” status. An Ongoing Employee's status as “full-time” or “part-time” is generally “locked in” during the Stability Period. For example, a reduction in that employee's hours usually would not affect that employee's status as “full-time.” There is one exception, however. An employer can change to a Monthly Measurement Method for certain employees who “bump down” to part-time status, if certain requirements are satisfied (e.g., minimum value coverage has been continuously offered)
New Employee	Employee who has been employed by an applicable large employer member for less than one complete Standard Measurement Period.	If former employee is rehired after a certain break in service, employee can be treated as a New Employee (i.e., prior hours can be ignored). If break is not long enough, employee treated as a “continuing” employee and prior hours cannot be ignored.
New, Full-Time Employee	Employee is reasonably expected as of his or her start date to work full-time (30 hours or more per week).	Appears to be a “snapshot” test which focuses on the first day of employment. Unlike proposed regulations, final regulations essentially impose “Monthly Measurement Method” with respect to employee until employee becomes an Ongoing Employee. If uncertainty over whether employee will be Full-Time, employer considers various factors. Factors include, but are not limited to, whether the employee is replacing an employee who was a full-time employee or a variable hour employee; the extent to which the hours of service of employees in the same or comparable positions have actually varied above and below

Employee Category	Definition of Term	Summary / Comments
		an average of 30 hours of service per week during recent measurement periods; and whether the job was advertised, or otherwise communicated to the new employee or otherwise documented (for example, through a contract or job description) as requiring hours of service that would average at least 30 hours of service per week, less than 30 hours of service per week, or may vary above and below an average of 30 hours of service per week.
New, Variable Hour Employee	Employer cannot, as of employee's start date, determine whether employee is reasonably expected to work on average at least 30 hours per week during the Initial Measurement Period because the employee's hours are variable or otherwise uncertain.	Determination is made based on all "facts and circumstances." Various factors are considered. A change in employment status (e.g., becoming a full-time employee) during an Initial Measurement Period is considered and results in the employee becoming eligible for coverage within a certain time. From 2015 on, the employer must assume the employee will not terminate employment before the end of the Initial Measurement Period.[143]
New, Seasonal Employee	An employee who is hired into a position for which the customary annual employment is six months or less.[144] One IRS example approves of a ski instructor as a Seasonal Employee.[145]	Also note that exceeding six months by a short period (e.g., a few weeks) should be acceptable.[146]
New Part-Time Employee	New employee reasonably expected to be employed on average less than 30 hours per week during the Initial Measurement Period. Determination based on all "facts and circumstances." Generally tested for full-time status using same rules as for New, Variable Hour Employee. For example, employer can use a 3-12 month Initial Measurement Period and related	Factors in "facts and circumstances" test include those listed for New, Variable Hour Employees, above.[148]

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[143] 26 CFR 54.4980H-1(a)(49)(ii)(B); see also 78 Fed. Reg. at 238, 239.
[144] 26 CFR 54.4980H-1(a)(38).
[145] See 79 Fed. Reg. 8558.
[146] 79 Fed. Reg. 8558 (discussing a ski instructor working an additional month because of heavy snow).

Employee Category	Definition of Term	Summary / Comments
	Administrative Period and Stability Period.[147]	

The rules for determining the possible Pay or Play Rule penalty for each category of employee vary. Each category of employee is discussed in Steps 7(d)(i) - (iv). A New Employee is not specifically discussed, as the "New" label is a modifier which is applied to other categories.

Sometimes it may not be clear how to categorize a particular employee. Consider the following example.

Pick a Category, Any Category…. Helpful Non-Profit receives much of its funding through two types of grants: those which terminate each year but are regularly renewed and "special" grants which are almost never renewed. In 2016 Helpful receives two $50,000 grants, enabling Helpful to hire two new employees, Amy and Brian. Each $50,000 grant will enable Amy and Brian to work for six months. Amy's grant is very likely to be renewed -- but it's not guaranteed. Helpful is so certain of renewal that it is already planning on Amy working for at least one year. In contrast, Brian's grant is very unlikely to be renewed -- but it's theoretically possible. So, Helpful is not planning on Brian working longer than six months -- even though it could, perhaps, occur. Both Amy and Brian are expected to work 40 hours per week. Helpful has a 12-month Initial Measurement Period for Part-Time Employees.

How should Helpful classify Amy? How should Helpful classify Brian? Does it matter that Amy's grant is very likely to be renewed? Does it matter that Brian's grant almost certainly will not? It is not completely clear. For purposes of determining if Amy and Brian are Variable Hour Employees, Helpful "may not take into account the likelihood" that they will terminate before the end of the Initial Measurement Period.[149] That rule certainly makes sense for Amy's position, where the six-month grant is nearly always renewed for another six months. That makes Amy look like a New, Full-Time Employee.

But the rule makes less sense for Brian's position. His grant almost certainly will not be renewed. If Helpful could consider this fact, it would make Brian look like a Part-Time Employee (because Brian is likely to average only 20 hours per week in his Initial Measurement Period -- i.e., 40 hours per week for 6 months, then 0 hours per week for 6 months). Unfortunately, Helpful may need to "ignore" this fact because of the rule noted above (where it cannot consider the likelihood of termination of employment). If Helpful must ignore it - even if it's a near-certainty - it makes Brian look like a New, Full-Time Employee (not a Part-Time Employee). Further IRS clarification (or an example) would be helpful.

Step 7(d)(i): Ongoing Employees

An employer can use a Standard Measurement Period / Stability Period "safe harbor" for determining whether an Ongoing Employee is a full-time employee for purposes of the Pay or Play Rule penalty.[150] To do so, an employer first establishes its Standard Measurement Period. The Standard Measurement Period is a period of three to twelve months. An applicable large

[148] 26 CFR 54.4980H-1(a)(321).
[147] 26 CFR 54.4980H-3(d)(3)(i).
[149] 26 CFR 54.4980H-1(a)(49)(ii)(A).
[150] 26 CFR 54.4980H-3(d)(1).

employer member can determine when the Standard Measurement Period starts and ends, although the period must be made on a uniform basis for all employees in a particular category.[151] It can start in the middle of the month, the first of the month or some other date. The employer can also coordinate the Standard Measurement Period with its payroll periods.[152]

The purpose of creating and using a Standard Measurement Period is to examine whether an employee averaged at least 30 hours per week during the Standard Measurement Period.[153] If so, the employer must treat the employee as a "full-time" employee during the employee's subsequent "Stability Period."[154] A Stability Period begins after the Standard Measurement Period.[155] If the employee is full-time, the Stability Period must be at least 6 consecutive calendar months and must be at least as long as the Standard Measurement Period.[156] If the employee is not full-time, the Stability Period need not be 6 months long - it could be shorter (e.g., 3 months).[157] The Stability Period for that Part-Time Employee cannot be longer than the Standard Measurement Period.[158]

There is an exception, however. The beginning of the Stability Period could be delayed for a brief period of time during an "Administrative Period." The Administrative Period is a period of a few weeks or months in which an employer calculates an employee's hours, answers questions from employees, collects materials from employees and enrolls employees who elect coverage.[159] The Administrative Period, if one is selected, begins immediately following the end of a Measurement Period and ends immediately before the start of an associated Stability Period.[160] For Ongoing Employees, the Administrative Period can last up to 90 days.[161] Ongoing Employees who are covered because of their status as full-time employees (based upon a prior Measurement Period) continue to receive coverage during the Administrative Period.[162]

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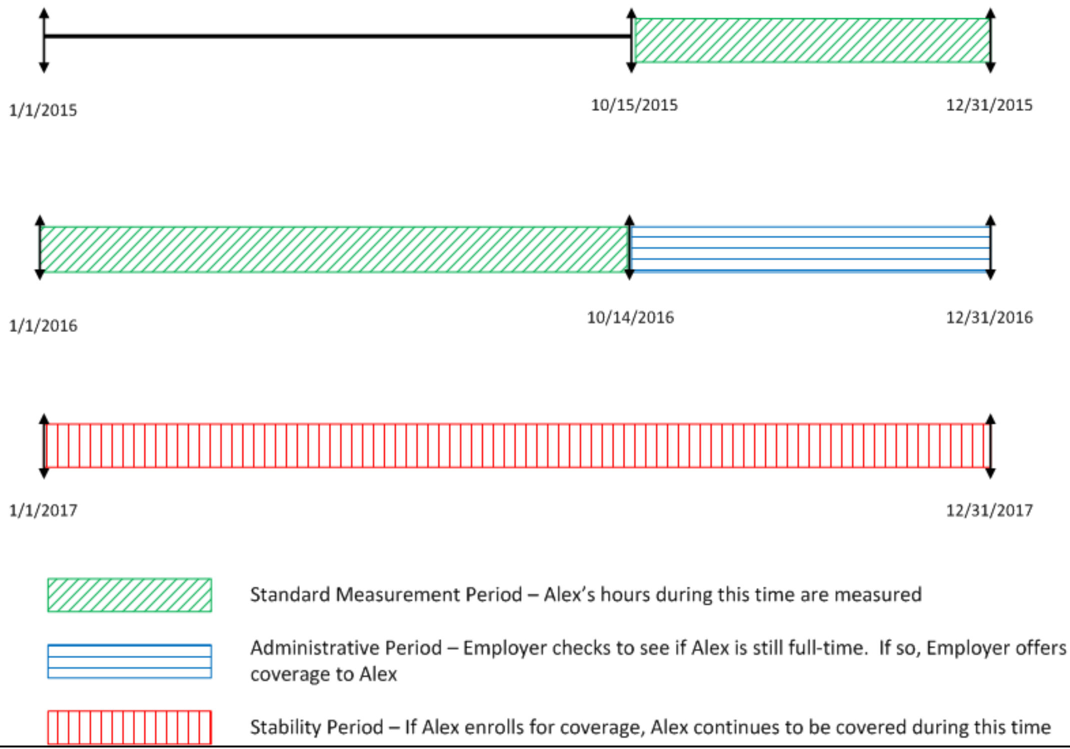
[151] 26 CFR 54.4980H-3(d)(1)(i).
[152] 26 CFR 54.4980H-3(d)(1)(ii).
[153] 26 CFR 54.4980H-1(d)(1)(i)
[154] 26 CFR 54.4980H-1(a)(1)(i).
[155] 26 CFR 54.4980H-1(a)(45).
[156] 26 CFR 54.4980H-3(d)(1)(iii).
[157] 26 CFR 54.4980H-3(d)(iv).
[158] 26 CFR 54.4980H-3(d)(1)(iv).
[159] See 26 CFR 54.4980H-1(a)(1).
[160] 26 CFR 54.4980H-1(a)(2).
[161] 26 CFR 54.4980H-3(d)(1)(vi). As is discussed below, the Administrative Period may need to be shorter for Variable Hour and Seasonal Employees.
[162] IRS Notice 2012-58, III.B; 26 CFR 54.4980H-3(c)(1)(vi).

These new concepts can be difficult to apply in the abstract. To assist, they are illustrated immediately below.

Illustration of Full-Time Employee Time Periods

In this example, assume Employer uses a 12-Month, October 15-based Standard Measurement Period. Employer also uses a 12-Month Stability Period and 2½ month Administrative Period. Assume Employer hired Alex the Employee as a full-time employee in 2007 and Alex has worked continuously since then as a full-time employee of Employer.



An employer can use a Measurement Period, Stability Period and Administrative Period which vary in length or starting and ending dates for these classes of employees:

- Collectively bargained employees and non-collectively bargained employees;
- Different groups of collectively bargained employees;
- Salaried employees and hourly employees;
- Employees located in different states.[163]

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[163] 26 CFR 54.4980H-3(d)(1)(i), (d)(1)(vi). Note that the start and end dates for the Standard Measurement Period and the Initial Measurement Period must be made on a "uniform and consistent basis" for all employees in the same category. 26 CFR 54.4980H-3(d)(3)(i).

Although these options are available, we expect that many employers usually will not adopt separate Measurement Periods and Stability Periods for these various classes of employees. While it is possible, it would increase the administrative complexity for employers.

Step 7(d)(ii): New, Full-Time Employees

For a "New" employee (not an Ongoing Employee), an employer first considers whether, as of the employee's "start date", the employee is "reasonably expected" to work full-time.[164] Factors to consider are noted in the table in Step 7(d).

With respect to such a New Employee, an employer will not face a Pay or Play Rule penalty if the employer offers minimum value health plan coverage by the first day of the fourth full calendar month of employment (if the employee is still employed then).[165] Also, the employee must have been "otherwise eligible" for the coverage during those first three months.[166]

Separately, other IRS guidance provides that an employer generally cannot impose longer than a 90-day waiting period (the "90-Day Rule").[167] This 90-Day Rule will be counted on a day-by-day basis (including weekends and holidays), and will not be equivalent to "three months" or "three calendar months."[168]

Step 7(d)(iii): New, Variable Hour; New, Seasonal; or New, Part-Time Employees

When an employer hires a Variable Hour Employee, the employer is not certain whether the employee will be a "full-time" employee. IRS guidance generally allows employers slightly more than 13 months to determine whether a Variable Hour Employee is a "full-time" employee who must receive health plan coverage. This Step 7(d)(iii) describes how employers make this determination. The IRS guidance generally treats Variable Hour, Seasonal and Part-Time Employees in the same manner.[169] Thus, we do the same. In the discussion and examples that follow, a Seasonal Employee and a Part-Time Employee would generally be treated the same as a Variable Hour Employee.

The full-time status of Variable Hour Employees is based upon a Measurement Period -- although this Measurement Period is called an "Initial" Measurement Period rather than a "Standard" Measurement Period.[170] The Initial Measurement Period will be a period of between 3 and 12 months.[171] However, as shown below in an example, an employer often will not select 12 months, as this will give the employer little time to enroll an employee. Some employers may be more likely to select a lesser number of months, such as 11 months, for the Initial Measurement Period.

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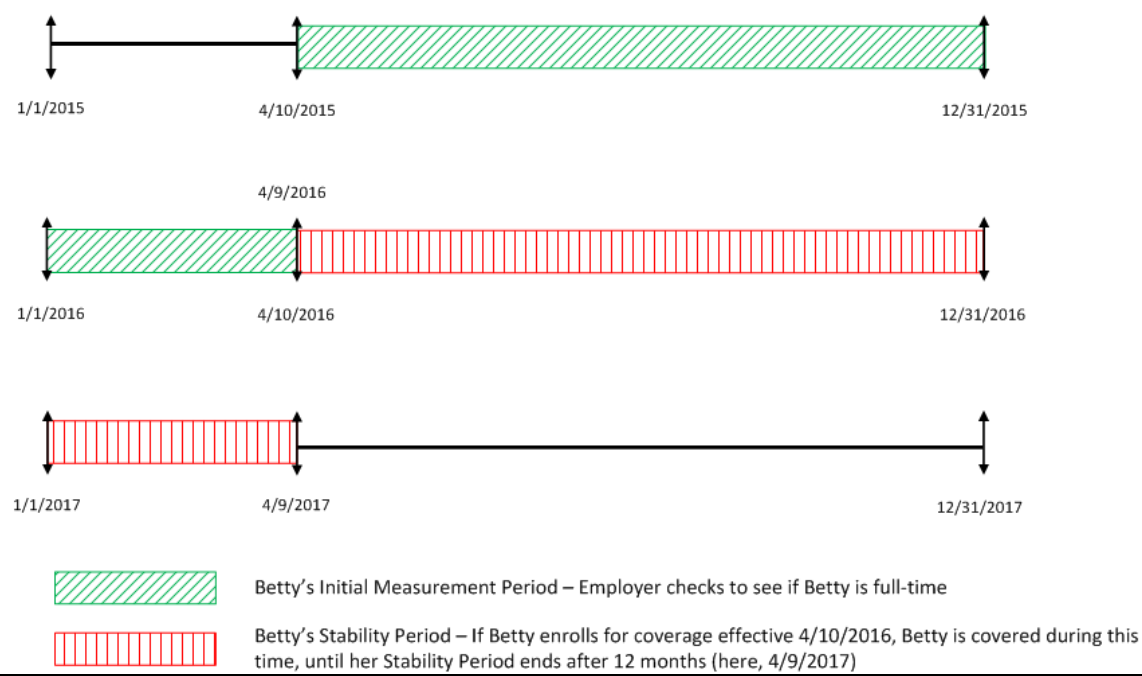
[164] 26 CFR 54.4980H-3(d)(2)(i).
[165] 26 CFR 54.4980H-3(d)(2)(iii). The coverage which the employee did not receive also might have to be minimum value coverage in order to rely on this exception.
[166] 26 CFR 54.4980H-3(d)(2)(iii).
[167] 29 CFR 2590.715-2708(a). Final and proposed waiting period regulations were issued in February 2014. A future version of this Guide will discuss these regulations, and how they interact with the Pay or Play Rule, in more detail.
[168] 29 CFR 2590.715-2708(d).
[169] 26 CFR 54.4980H-3(d)(3)(i).
[170] 26 CFR 54.4980H-3(d)(3)(i).
[171] 26 CFR 54.4980H-3(d)(3)(i).

An employer will measure a Variable Hour Employee's hours during the Initial Measurement Period to determine whether the employee earned an average of at least 30 hours of service per week during that period.[172] If so, the Variable Hour Employee must be treated as a full-time employee for a Stability Period. The Stability Period for Variable Hour Employees must be the same length as the Stability Period for Ongoing Employees.[173] For a Variable Hour Employee who is treated as a full-time employee, the Stability Period must be a period of at least six consecutive calendar months that is no shorter in duration than the Initial Measurement Period and that begins after the Initial Measurement Period (and any associated Administrative Period).[174] This is illustrated below. In addition, to avoid a Pay or Play Rule penalty, the employee must be offered minimum value coverage by the first day of the Stability Period.[175] Although the illustration and discussion use calendar months, an employer can also use payroll periods.[176]

Illustration of New, Variable Hour Employee (No Administrative Period)

For New Employees, the Employer uses an initial Measurement Period which begins on the first day of employment and ends 12 months later. Employer also uses a 12-Month Stability Period and no Administrative Period. Assume Employer hired Betty the Employee as a Variable Hour Employee on April 10, 2015.



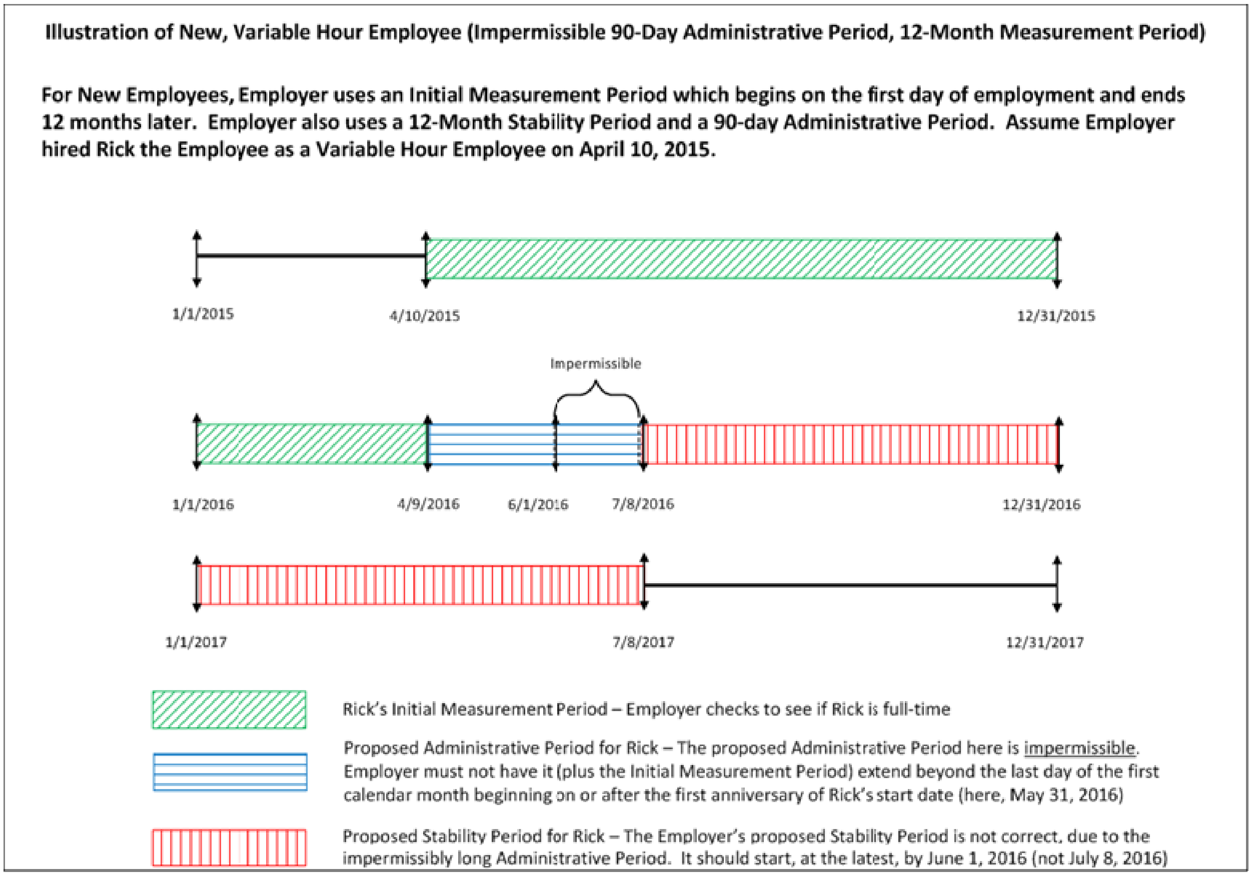
[172] 26 CFR 54.4980H-3(d)(3)(i).
[173] 26 CFR 54.4980H-3(d)(3)(i).
[174] 26 CFR 54.4980H-3(d)(3)(iii).
[175] 26 CFR 54.4980H-3(d)(3)(iii).
[176] 26 CFR 54.4980H-3(d)(3)(ii).

In the above example, the employer did not have any Administrative Period. This is certainly possible but few employers will choose such an option. Having no Administrative Period means that Betty, in the above example, apparently must be allowed to enter Employer's health plan on April 10, 2016, which is only one day after her Initial Measurement Period ends (April 9, 2016). This does not give Employer much time to enroll Betty, answer questions, gather paperwork or take other administrative actions. Thus, we think few employers will choose to have no Administrative Period.

Split Administrative Period. For a Variable Hour Employee, an employer can "split" the Administrative Period into two sections.[177] The first section often would be used by an employer to delay the beginning of the Initial Measurement Period to a future date (such as the first of the next month after the employee's start date). The second section would then often be used by an employer after the Initial Measurement Period ends (usually to make coverage be effective as of the first of a month after the employee's Initial Measurement Period has ended).[178] In addition to starting on the first of the month, an employer generally can start the Initial Measurement Period as of the first payroll period that starts after the employee's start date.[179]

[177] 26 CFR 54.4980H-1(a)(1).
[178] 26 CFR 54.4980H-3(d)(3)(vi)(B).
[179] 26 CFR 54.4980H-3(d)(3)(ii).

While such a "split" can work and may be helpful for an employer, there is a complicating rule. The combined Initial Measurement Period and the Administrative Period for a New Variable Hour or New Seasonal Employee 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 (totaling, at most, 13 months and a fraction of a month).[180] The effect of this rule is that an employer will not be able to use a full 12-month Initial Measurement Period and a full 90-day Administrative Period for Variable Hour Employees. This is illustrated below.[181]

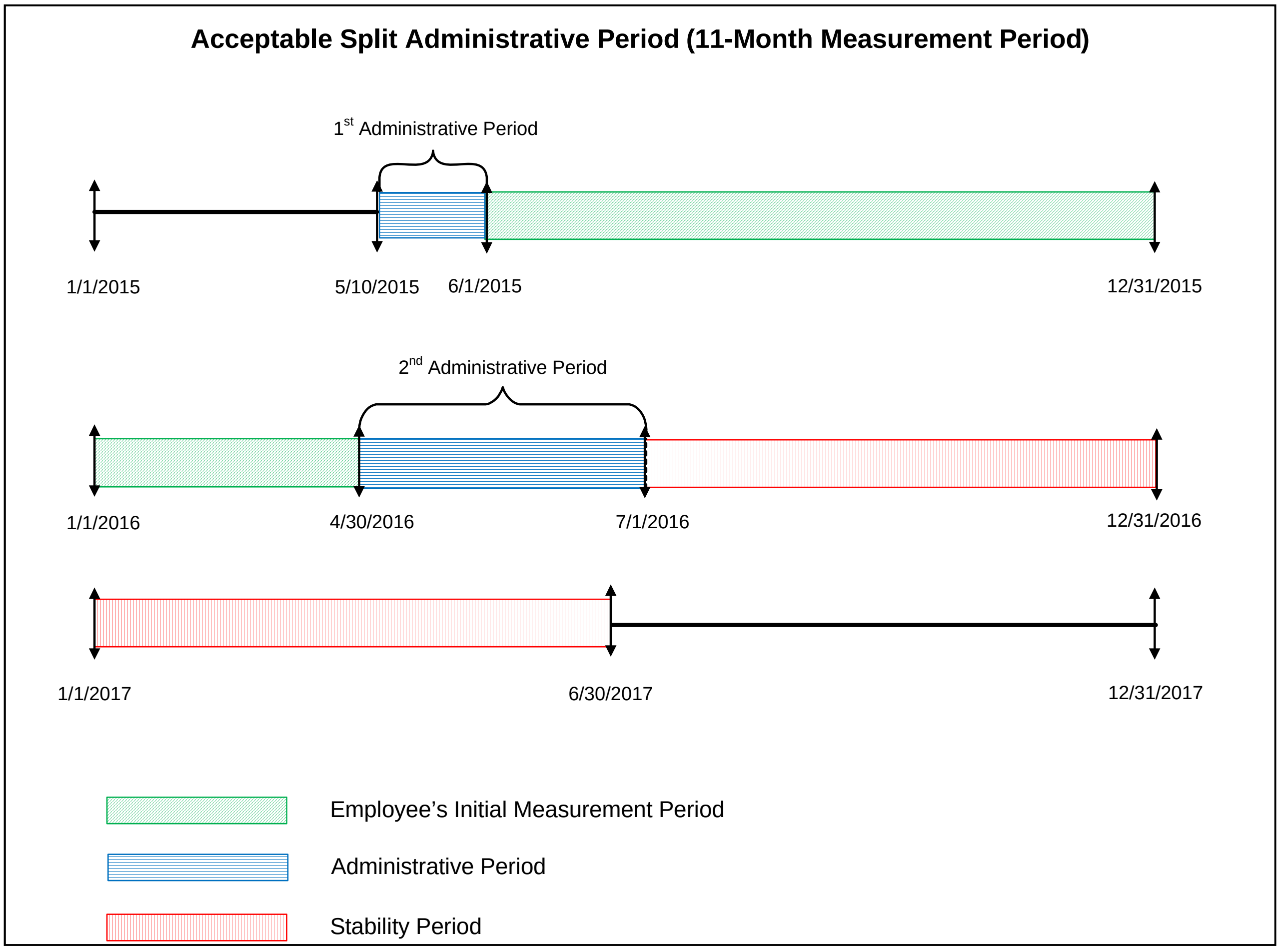


An example of an acceptable "split" Administrative Period is the following.

Example of Acceptable Split Administrative Period. Big Box Store uses an 11-month Initial Measurement Period that begins on the first day of the first calendar month beginning after the start date of a new Variable Hour Employee. The first section of Big Box's Administrative Period therefore is used at the beginning of the Variable Hour Employee's start date. The second section of Big Box's Administrative Period runs from the end of the Initial Measurement Period through the end of the second calendar month beginning on or after the end of the Initial Measurement Period.

[180] 26 CFR 54.4980H-3(d)(3)(vi)(B).
[181] A similar result is found at 26 CFR 54.4980H-3(d)(5), Ex. 4.

Big Box hires Employee on May 10, 2015. Employee will be a Variable Hour Employee. Employee's Initial Measurement Period does not start on Employee's start date. Rather, Big Box starts the Initial Measurement Period on the first of the next month (here, June 1, 2015). Thus, Big Box uses 22 days (May 10, 2015 - May 30, 2015) immediately as an Administrative Period. Employee's Initial Measurement Period will end April 30, 2016 (remember, Big Box is using an 11-month Initial Measurement Period, not a 12-month Initial Measurement Period). If Employee works an average of 30 hours per week during this Initial Measurement Period, Big Box will not offer coverage right away, on May 1, 2016. Rather, Big Box will use the 31 days in May 2016 and 30 days in June 2016 as the second section of its Administrative Period. Big Box will therefore offer coverage starting on July 1, 2016, running through June 30, 2017 (which is Big Box's Stability Period). A visualization of this split Administrative Period is as follows:[182]



[182] A similar example is found at 26 CFR 54.4980H-3(d)(5), Ex. 3.

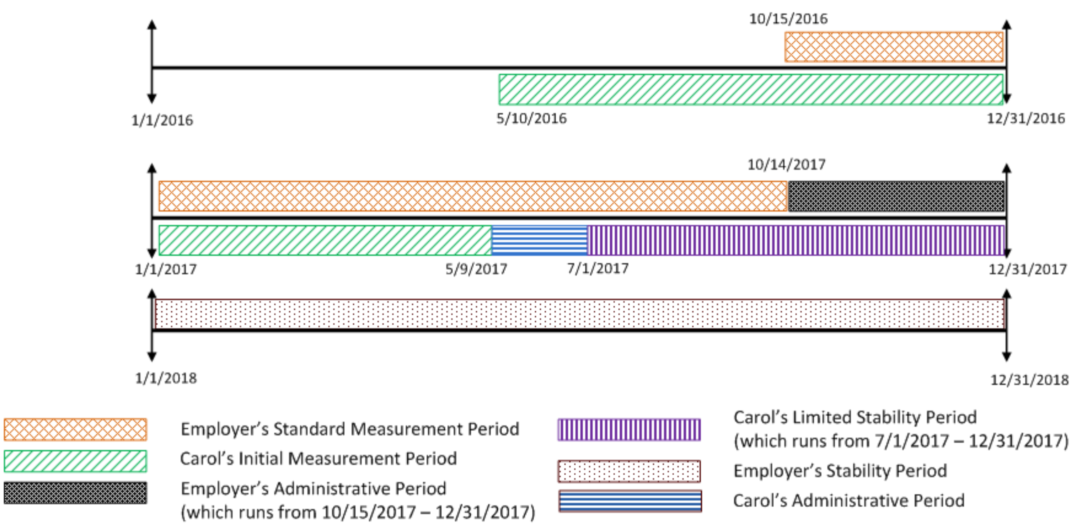
Example of Split Administrative Period, Continued. Big Box's split Administrative Period is acceptable under the Pay or Play Rule. Big Box uses: (a) an Initial Measurement Period that does not exceed 12 months; (b) an Administrative Period totaling not more than 90 days; and (c) a combined Initial Measurement Period and Administrative Period that does not last beyond the final day of the first calendar month beginning on or after the one-year anniversary of Employee's start date. With respect to Employee, Big Box: (x) will not be subject to a Subsection A or Subsection B Penalty with respect to May 2015 because the employee's start date is on a date other than the first day of the calendar month; (y) will not be subject to a Subsection B penalty for any calendar month from June 2015 through June 2016 if the coverage Big Box offers is minimum value; and (z) will not be subject to a Subsection A Penalty if Employee was "otherwise eligible" for the offer of coverage.[183]

[183] A similar example is found at 26 CFR 54.4980H-3(d)(5), Exs. 1 and 2.

The rules change slightly if the Variable Hour Employee is not treated as a full-time employee during the Initial Measurement Period. In that situation, the employer is permitted to treat the employee as not being a full-time employee during a special, "Limited" Stability Period that follows the Initial Measurement Period.[184] The Limited Stability Period must not be more than one month longer than the Initial Measurement Period and must not exceed the remainder of the Standard Measurement Period (plus any associated Administrative Period) for which the employee has been employed.[185] This appears to be designed to quickly allow an employee another opportunity to qualify again as a full-time employee. This is illustrated below.

Illustration of New, Variable Hour Employee (Limited Stability Period)

In this example, assume Employer uses a 12-Month, October 15-based Standard Measurement Period for Ongoing Employees. For New Employees, the Initial Measurement Period begins on the first day of employment and ends 12 months later. An Administrative Period is used for these New, Variable Hour Employees, where the Period runs until the end of the month after the Initial Measurement Period ends. For Ongoing Employees, Employer uses a 12-Month Stability Period which begins on January 1 and a 2½ - month Administrative Period. Assume Employer hired Carol the Employee as a Variable Hour Employee on May 10, 2016. Assume Carol only averages 28 hours during the Initial Measurement Period of May 10, 2016 – May 9, 2017, but 30.0 hours during the 10/15/2016 – 10/14/2017 Standard Measurement Period.



Thus, the net effect is that:

- Carol is not offered coverage from the start date (May 10, 2016) through all of 2017
- Because Carol was not deemed full-time during her unique Initial Measurement Period, Carol receives another chance to qualify for full-time status. Employer must count the hours Carol worked from October 15, 2016 – October 14, 2017 (the Standard Measurement Period which applies to Ongoing Employees – even though Carol is not an Ongoing Employee as of the start of that Standard Measurement Period).
- Although Employer may want to "lock in" Carol as a Part-Time Employee who is not eligible for plan coverage from July 1, 2017 – June 30, 2018 (the typical 12 months) Employer cannot do this. Carol's average of 30 hours during the overlapping Standard Measurement Period of October 15, 2016 – October 14, 2017 "controls." Carol becomes a Full-Time Employee on January 1, 2018 and receives plan coverage.

A Note About Seasonal Employees. It appears that an employer's Pay or Play Rule risk with respect to Seasonal Employees mainly depends on the length of the employer's Initial Measurement Period. Employers with a long Initial Measurement Period (such as 11 or 12 months) apparently will have little Pay or Play Rule risk with respect to such Seasonal Employees. The Seasonal Employees simply will not be employed long enough to ever become "full-time" employees for Pay or Play Rule purposes unless they are rehired, as we discuss below. In contrast, an employer with a short Initial Measurement Period (and a short, or

[184] The phrase "Limited" Stability Period is our term, not an IRS term.
[185] 26 CFR 54.4980H-3(d)(3)(iv).

nonexistent Administrative Period) will face some Pay or Play Rule risk with respect to Seasonal Employees. Consider the following two examples.

Seasonal Employees (Low Pay or Play Rule Risk). Big Ski Hill Inc. operates a seasonal business and hires Seasonal Employees, including Stacie. Stacie's start date is November 15, 2015 and the ski season is expected to run through March 15, 2016, at which time all employees will terminate employment. Big Ski Hill uses a 12-month Initial Measurement Period that begins on a Seasonal Employee's start date. Big Ski Hill uses an Administrative Period from the end of the Initial Measurement Period through the end of the first calendar month beginning after the end of the Initial Measurement Period. Thus, Stacie's Initial Measurement Period runs from November 15, 2015 through November 14, 2016.

Stacie works 60 hours per week from November 15, 2015 through March 15, 2016. However, Stacie is not reasonably expected to average 30 hours per week for the 12-month Initial Measurement Period. Thus, Big Ski Hill does not need to treat Stacie as a full-time employee (she will be a Seasonal Employee) and does not need to offer Stacie health plan coverage in order to avoid a Pay or Play Rule penalty.[186]

Seasonal Employees (High Pay or Play Rule Risk). Little Ski Hill Inc., like Big Ski Hill, operates on a seasonal basis. Little Ski Hill hires Ted as a Seasonal Employee. Little Ski Hill uses a 3-month Initial Measurement Period and an Administrative Period that lasts until the first of the month following the end of the Initial Measurement Period.

Like Stacie from the prior example, Ted works 60 hours per week from November 15, 2015 through March 15, 2016. Ted is not reasonably expected to average 30 hours per week over the entire year. At what point (if ever) does Ted become a "full-time" employee for Pay or Play Rule purposes?

Probably March 1, 2016. Ted's Initial Measurement Period ends on February 14, 2016. The Administrative Period allows Little Ski Hill to delay treating Ted as a full-time employee through February 28, 2016. However, Ted apparently becomes a full-time employee as of March 1, 2016. This is before Ted's employment ends on March 15, 2016. Thus, if Little Ski Hill does not offer Ted health plan coverage as of March 1, 2016, Little Ski Hill could face a Pay or Play Rule penalty.

Step 7(d)(iv): Re-Hired Employees or Employees Resuming Services After a Break. What happens when a former employee is rehired or returns after a break in service? Will an employer be able to ignore the prior hours of service performed by such employee? Must the hours be "counted"? The regulation provides two key ways in which a re-hired employee's prior hours can be ignored. The effect of ignoring prior hours of service is that a re-hired employee can be treated as a "New" employee. This can be very helpful for an employer. For example, it would allow an employer to subject a rehired Seasonal Employee, Variable Hour Employee or Part-Time Employee to a brand-new Initial Measurement Period (which would delay the employee becoming a "full-time" employee). The two IRS rules are as follows:

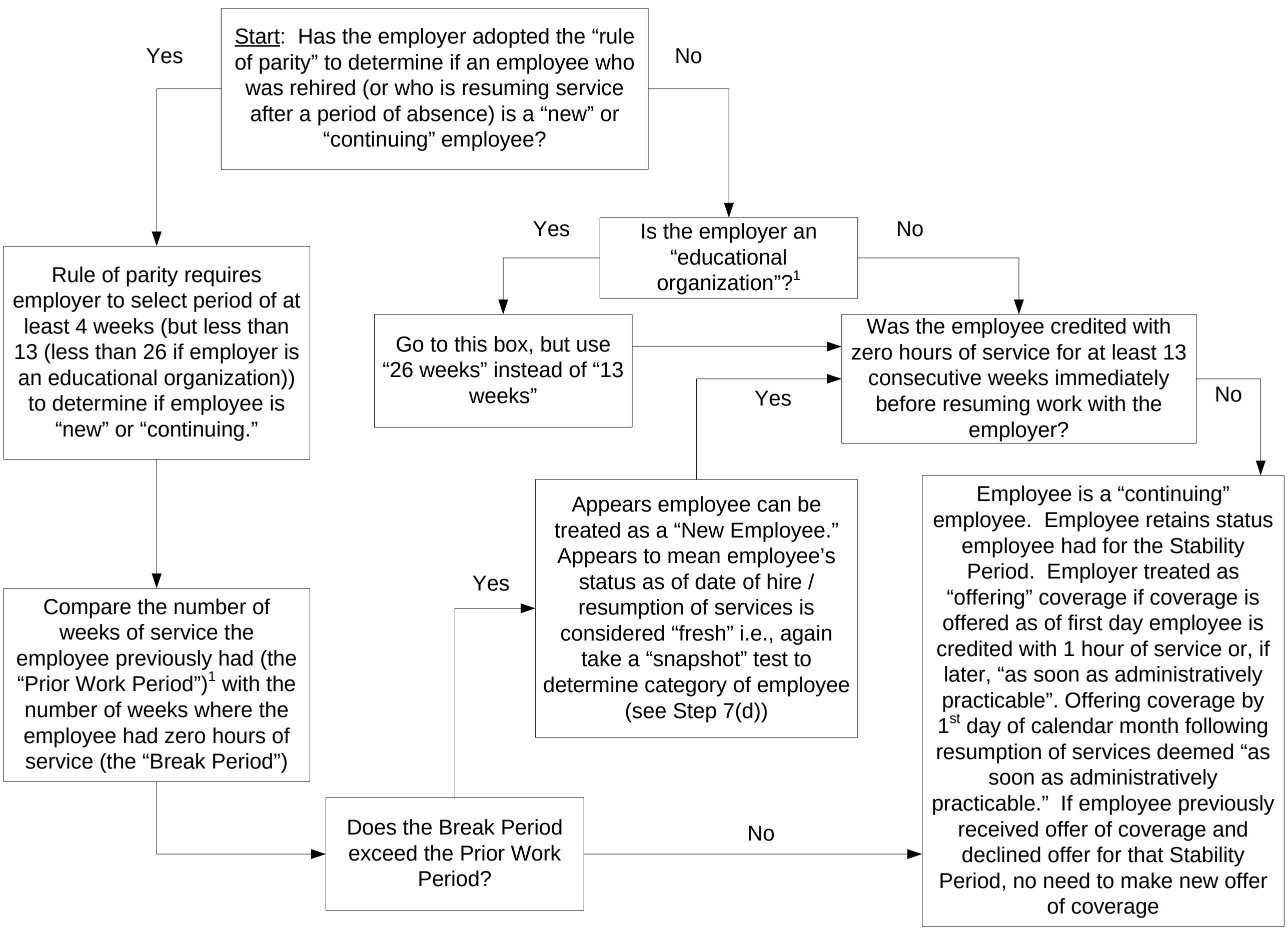
* The employer can treat the rehired employee as a "new" employee if the person had no hours of service for at least 13 consecutive weeks (26 if the employer is an educational organization).

[186] A similar example is found at 26 CFR 54.4980H-3(d)(5), Ex. 11.

* The employer may apply a “rule of parity” for a break which is less than 13 weeks. Under this rule of parity, an employee may be treated as a new employee if the employee's period of time with no credited hours of service is at least four weeks long and is longer than the employee's immediately preceding period of employment.[187]

For example, suppose Employee B works for Client Co. for three weeks, then terminates employment. B is rehired 10 weeks later. Client Co. can treat B as a new employee because the 10-week period with no credited hours of service: (1) is at least four weeks long; and (2) is longer than the immediately preceding three-week period of employment. If a rehired employee cannot be treated as a “new” employee, the employee must be offered health plan coverage as soon as administratively practicable.[188]

These rules are illustrated in the following flowchart. This is similar -- but not identical to -- the flowchart in Step 7(c) (which applies if the employer is using the Monthly Measurement Method).



1. In calculating the Prior Work Period, the employer applies the special rules for employment break periods and special unpaid leave. 26 C.F.R. 54.4980H-3(d)(6(iv).

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187 26 CFR 54.4980H-3(d)(6)(C)(iv). Special rules also apply for certain international transfers. See 26 CFR 54.4980H-3(d)(6)(c)(v).
188 26 CFR 54.4980H-3(d)(6)(C)(iv).

Step 7(e): Combination Method

In addition to the Monthly Measurement Method and the Look-Back Measurement Method, an employer could choose a combination of the two (what we call the "Combination Method"). As noted below, an employer may be required to use this method for some New, Full-Time Employees. Different applicable large employer members of the same applicable large employer may use different methods for determining who is a full-time employee.[189] Also, a single applicable large employer member could use the Monthly Measurement Method for some categories of employees and the Look-Back Measurement Method for other categories of employees.[190] The categories of employees which can be so divided are:

* Collectively bargained employees and non-collectively bargained employees;
* Each group of collectively-bargained employees covered by a separate collective bargaining agreement;
* Salaried employees and hourly employees; and
* Employees whose primary places of employment are in different States.[191]

The final regulation clarifies how a New, Full-Time Employee is treated in the time before she becomes an Ongoing Employee. Remember, an employee becomes an Ongoing Employee only after she has completed an entire Standard Measurement Period - which could take about a year. Until the employee becomes an Ongoing Employee, it appears that her "full-time" status is determined under the Monthly Measurement Method, or at least something similar to it.[192] Nearly all employers who adopt the Look-Back Measurement Method will have some New, Full-Time Employees. If so, nearly all employers will use the Combination Method, at least to some extent.

Example of Change for New, Full-Time Employee. Giantco hires Kate on February 16, 2016. As of Kate's start date, both Kate and Giantco expect Kate to work at least 30 hours per week for the indefinite future. Thus, Giantco classifies Kate as a New, Full-Time Employee. Giantco has a 12-month Standard Measurement Period. Giantco offers Kate coverage by the fourth month. Then, two months later, Kate has a personal need to start working reduced hours (15 hours per week). Must Giantco continue to treat Kate as a "full-time" employee for Pay or Play Rule purposes?

Probably not. Kate has not yet been employed for one complete Standard Measurement Period. Thus, Kate has not yet become an Ongoing Employee.[193] Kate's status as "full-time" seems to be based on her

[189] 26 CFR 54.4980H-3(e).
[190] 26 CFR 54.4980H-3(e).
[191] 26 CFR 54.4980H-3(e), referencing 26 CFR 54.4980H-3(d)(1)(v), (d)(3)(v).
[192] 26 CFR 54.4980H-3(d)(2)(i). The regulation does not use the term "Monthly Measurement Method." However, the regulation provides that the employee's status as a "full-time" employee is "based on the employee's hours of service for each calendar month" - which seems similar to the Monthly Measurement Method. However, the regulation's failure to explicitly cross-reference the Monthly Measurement Method creates some ambiguities. For example, the "averaging method" for special unpaid leave and employment break periods does not apply under the Monthly Measurement Method. 26 CFR 54.4980H-3(c)(4)(ii). However, it does apply under the Look-Back Measurement Method. 26 CFR 54.4980H-3(d)(6). It is not clear which rule applies in a situation involving a New, Full-Time Employee who reduces his or her hours prior to the becoming an Ongoing Employee (such as Kate in this example).
[193] 26 CFR 54.4980H-1(a)(31).

current monthly hours - here, only about 60 hours per month (15 hours per week x about 4 weeks per month).[194] Thus, Giantco does not need to treat her as full-time employee (assuming she continues to work 60 hours per month).

Step 7(f): Employee Moving Between Methods

If an employer uses both the Monthly Measurement Method and the Look-Back Measurement Method, it is possible that an employee could transfer positions. If so, the new position may use a measurement method which is different than the one which previously applied to the employee. The Pay or Play regulation provides the following guidance if this happens.

Step 7(f)(i): Change From Look-Back Measurement Method to Monthly Measurement Method

If an employee transfers from a position under which the Look-Back Measurement Method is used to one in which the Monthly Measurement Method is used, the following rules apply:

* If the employee is in a Stability Period at the time of the change and the employee is a full-time employee at that time, the employer must continue to treat the employee as full-time;
* If the employee is in a Stability Period at the time of the change and the employee is not a full-time employee at that time, the employer can continue to treat the employee as "not full-time" for the remainder of the Stability Period. Alternatively, the employer can apply the Monthly Measurement Method through the end of the Stability Period beginning with any calendar month including the calendar month in which the change in employment status occurs or any subsequent calendar month;
* For the Stability Period "associated with" the Measurement Period during which the change in employment status occurs, the employer must treat the employee as a full-time employee for any calendar month during which the employee either would be treated as a full-time employee under the Stability Period that would have applied based on the Measurement Period in which the change in employment status occurred or would be treated as a full-time employee under the Monthly Measurement Method; and
* For any calendar month subsequent to the Stability Period thereafter, the Monthly Measurement Method applies.[195]

The third rule, above, in essence provides the employee with the "best of both worlds." The employee's hours would be measured under both the Monthly Measurement Method and the Look-Back Measurement Method. If the employee qualifies as full-time under one method, but not-full-time under the other, the employee receives the advantage of being full-time.

[194] 26 CFR 54.4980H-3(d)(2)(i).
[195] 26 CFR 54.4980H-3(f)(1)(i).

Note that this rule is somewhat confusing in the abstract. A future version of this Guide will illustrate this concept through examples.

Step 7(f)(ii): Change from Monthly Measurement Method to Look-Back Measurement Method

If the employee transfers from a position under which the Monthly Measurement Method is used to a position which uses the Look-Back Measurement Method, the following rules apply:

* For the remainder of the Stability Period during which the change occurs, the employer must continue to use the Monthly Measurement Method to determine the employee's "full-time" status unless the employee's hours of service prior to the change in employment status would have resulted in the employee being treated as a full-time employee during the Stability Period in which the change occurs, in which case the employer must treat the employee as a full-time employee for that Stability Period;
* For the applicable Stability Period following the Measurement Period during which the change occurs, the employer must treat the employee as a full-time employee under the Monthly Measurement Method; and
* For any calendar month subsequent to the Stability Period after that Stability Period, the Look-Back Measurement Method applies in determining the employee's full-time status.[196]

Again, a future version of this Guide will illustrate this through an example.

Step 7(g): Transition From New Employee to Ongoing Employee

Can a New, Variable Hour Employee, a New, Seasonal Employee or a New, Part-Time Employee ever switch to a different category -- such as becoming an Ongoing Employee? Yes. The regulation provides two ways for a change to occur. First, if a New, Variable Hour Employee or New, Seasonal Employee has a "change in employment status" before the end of the Initial Measurement Period, the employee apparently can become a New, Full-Time Employee.[197] The change must involve a situation where the employee is now reasonably expected to be employed on average at least 30 hours of service per week. The employee must be offered (in order to avoid a Pay or Play Rule penalty) minimum value coverage by the earlier of:

* The first day of the fourth month following that change in employment status; or
* If the employee averages more than 30 hours of service per week during the Initial Measurement Period, the first day of the first month following the end of the Initial Measurement Period (including any related Administrative Period).[198]

Once a New Employee has been employed for an entire Standard Measurement Period the New Employee changes to an Ongoing Employee.[199] The employer then must test the employee

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[196] 26 CFR 54.4980H-3(f)(1)(ii).
[197] 26 CFR 54.4980H-3(d)(3)(vii)(A).
[198] 26 CFR 54.4980H-3(d)(3)(vii).
[199] 26 CFR 54.4980H-3(d)(4)(i).

for full-time status at the same time and under the same conditions as other Ongoing Employees.[200]

Note that there usually will be an "overlap" between the Initial Measurement Period and the Standard Measurement Period. In other words, an employee's work for some period of time will likely be included in both Periods, as this example demonstrates.

Conversion from New Employee to Ongoing Employee (12-Month Periods). Clientco hires Chuck on February 12, 2015. Clientco uses a calendar year Standard Measurement Period and a one-year Initial Measurement Period. Chuck's future hours are uncertain and Clientco classifies Chuck as a Variable Hour Employee.

Chuck's Initial Measurement Period will run from February 12, 2015 through February 11, 2016. As of February 11, 2016 Chuck has been employed for an entire Standard Measurement Period. Thus, Chuck's status changes from Variable Hour Employee to Ongoing Employee. Clientco should determine if Chuck is a full-time employee, in which case Chuck would be offered coverage. If Chuck is not a full-time employee, Clientco would test Chuck's hours based on Clientco's Standard Measurement Period of January 1, 2015 - December 31, 2015 (not the Initial Measurement Period dates of February 12, 2015 - February 11, 2016 which initially applied to Chuck).[201] Thus, Chuck's hours from February 12, 2015 - December 31, 2015 will "count" for purposes of both the Initial Measurement Period and the Standard Measurement Period.

The above example seems clear when 12-month Initial Measurement Periods and Standard Measurement Periods are used. It becomes a little more complicated when a different period (e.g., 6 months) is used, as is illustrated in this example, but the same general rule applies.

Conversion from New Employee to Ongoing Employee (6-Month Periods). Employer C uses a 6-month Initial Measurement Period for New, Variable Hour Employees. The Initial Measurement Period begins on the employee's start date. C also uses an Administrative Period that runs from the end of the Initial Measurement Period through the end of the first full calendar month beginning after the end of the Initial Measurement Period. For Ongoing Employees, C uses a 6-month Standard Measurement Period, starting each May 1 and November 1 and a 6-month Stability Period, starting July 1 and January 1, respectively.

C hires Employee Z, a Variable Hour Employee, on May 10, 2015. Z's Initial Measurement Period runs from May 10, 2015 through November 9, 2015. During this time Z averages 30 hours of service per week. Thus, Employer C offers Employee Z health plan coverage for the Stability Period running from January 1, 2016 - June 30, 2016. This arrangement works well and is "straightforward."[202]

However, when must Employer C re-test Employee Z's hours to confirm that Z is still full-time? The regulation states that Employer C must re-test Employee Z "at the same time and under the same conditions as apply to other ongoing employees."[203] The eligibility status for Ongoing Employees of Employer C for the period of July 1, 2016 - December 31, 2016 will be based on those Ongoing Employees' hours during the November 1, 2015 - April 30, 2016 Standard Measurement Period. Thus,

[200] 26 CFR 54.4980H-3(d)(4)(i).
[201] 26 CFR 54.4980H-3(d)(4)(i).
[202] A similar example is found at 26 CFR 54.4980H-3(d)(5), Ex. 9.
[203] 26 CFR 54.4980H-3(d)(4)(ii).

Employer C would use Employee Z's hours from this same time period to determine Z's full-time status for the period of July 1, 2016 - December 31, 2016.[204]

Once an employee is determined to be a full-time employee during an Initial Measurement Period or a Standard Measurement Period the employee will be treated as a full-time employee for the entire associated Stability Period.[205] In some senses, the employee is "protected" or "vested" in his or her status as a full-time employee for the associated Stability Period. A subsequent decrease in hours will not immediately cause the employee to lose his or her full-time employee status.

Similarly, an employee may be determined to not be a full-time employee during the Initial Measurement Period, but be a full-time employee during the overlapping or immediately following Standard Measurement Period. If so, the employee is treated as a full-time employee for the entire Stability Period that corresponds to that Standard Measurement Period.[206]

Change in Status for Ongoing Employee. Can an Ongoing Employee who was full-time lose full-time status in the future? If so, how is that measured and when does the "loss" occur? The following example illustrates that this can happen.

Loss of Full-Time Employee Status. Clientco hired Stan in 2007 as a full-time employee. Stan has worked continuously since then. However, Stan's hours declined in 2015 and 2016 and Clientco wishes to verify whether Stan is a full-time employee. Clientco uses a 12-month Standard Measurement Period starting October 15 and a 12-month Stability Period starting January 1.

Clientco determines that Stan worked an average of 28 hours a week from October 15, 2015 through October 14, 2016. Clientco continues to offer coverage to Stan through December 31, 2016 (the end of the Stability Period relating to the October 15, 2014 - October 14, 2015 Standard Measurement Period). Clientco does not offer coverage to Stan as of January 1, 2017. Will Clientco face a Pay or Play Rule penalty?

No. Clientco does not need to offer coverage to Stan as of January 1, 2017 , because this date is after the expiration of the Stability Period in which Stan was deemed a full-time employee.[207]

Change in Employment Status. If an Ongoing Employee experiences a "change in employment status" before the end of the Stability Period, the employee's status -- full-time or not-full-time -- generally does not change.[208] So, for example, suppose the employee was not a full-time employee (she averaged only 25 hours per week in the most recent Standard Measurement Period). A few months into her Stability Period, she receives a promotion and will be working 40 hours per week. The employer can continue to treat her as a "not-full-time" employee for the remaining portion of the Stability Period.[209]

[204] 26 CFR 54.4980H-3(d)(5), Ex. 9.
[205] 26 CFR 54.4980H-3(d)(4)(ii).
[206] 26 CFR 54.4980H-3(d)(4)(iii).
[207] For a similar conclusion, see IRS Notice 2012-58, III.E.1., Ex. 6 and 26 CFR 54.4980H-3(d)(5), Ex. 6.
[208] 26 CFR 54.4980H-3(d)(1)(vii).
[209] 26 CFR 54.4980H-3(d)(1)(vii).

The final regulations contain one exception for such an Ongoing Employee, which we call the "Continuous Minimum Value Exception". This rule notes that an employee may experience a change in employment status (e.g., a decrease in hours) which could allow the Ongoing Employee to lose "full-time" status before the end of the Stability Period.

To rely on this Continuous Minimum Value Exception, the employer should verify if the change is one that, if the employee had begun employment in the new position or status, the employee would have reasonably been expected not to be employed on average at least 30 hours of service per week. If so, the employer can stop measuring the employee's hours under the Look-Back Measurement Method. Instead, the employer can start using the Monthly Measurement Method following the employee's initial three full calendar months of employment. The employer can continue to apply the Monthly Measurement Method through the end of the first full Measurement Period (and associated Administrative Period) that would have applied had the employee remained under the applicable Look-Back Measurement Method.[210]

While employers may appreciate this flexibility, it comes with a few "strings" attached. First, it may be difficult to track, apply and communicate to employees. Second, the applicable large employer member must have offered minimum value coverage by the first day of the calendar month following the employee's initial three full calendar months of employment, through the calendar month in which the change in employment status occurs. Finally, the employee must actually average less than 30 hours of service per week for each of the three full calendar months following the change in employment status.[211]

Caution About Using This Exception. The "strings" noted in the prior paragraph make this exception difficult for many employers to use. It contains several ambiguities. For example, the employee must have been offered "minimum value" coverage starting in the employee's fourth month of employment. But, what if the employee's start of employment was years ago (e.g., in the year 2000) -- well before the concept of "minimum value" was even introduced? Such an employer would seem to have great difficulty in making this determination (e.g., the employer probably would not have kept records going back more than a few years). Also, the fact that the employee must actually average less than 30 hours per week during the first three months after the change in the employment status means that the employer cannot know for certain, at the time of the employment status change, whether the exception will be available. The employer may <u>think</u> the employee will average less than 30 hours per week, but will the employer <u>know</u> this with a certainty? Given these issues, this exception will be useful only in certain circumstances.

[210] 26 CFR 54.4980H-3(f)(2).
[211] 26 CFR 54.4980H-3(f)(2)(i).

Step 7(h): Determine Which Employees Can be Excluded Based on Waiting Period

The ACA generally requires that a health plan cannot impose a waiting period that exceeds 90 days (the "90-Day Rule").[212] However, this rule will not require an employer to offer coverage to all employees after the employee has worked 90 days. For example, an employer may exclude part-time employees under the plan. This 90-Day Rule would not require the employer to cover part-time employees (whether or not the employees have worked for 90 days).[213]

What about a condition for eligibility which is based on some factor other than days which have passed in a waiting period, such as an employee completing a certain number of hours of work, obtaining a license or other factors? The IRS regulation is somewhat vague and provides that such conditions are permissible unless they are "designed to avoid compliance with the 90-day waiting period limitation."[214] The proposed regulations state that a cumulative hours of service requirement cannot exceed 1,200 hours.[215] Apparently other health plan eligibility requirements (such as obtaining a license) will be subject to a fact-specific interpretation.

The 90-Day Rule is effective for plan years beginning on or after January 1, 2014. The delay of the Pay or Play Rule did not delay the effective date of the 90-Day Rule.

Step 7(i): Determine Which Employees Can be Excluded Due to Nonpayment or Late Payment

Sometimes an employee will be "full-time" but will not pay the premium she owes. Suppose an employer terminates her health plan coverage. The employee then goes to an Exchange and applies for an Exchange subsidy. Will the employer face a Pay or Play Rule risk due to not providing health plan coverage?

Probably not, but the employer must be careful to follow the IRS regulation on "nonpayment" or "late payment" of required premiums. Under this regulation, an employer must follow COBRA's rules regarding late payment or nonpayment of premiums.[216] Those rules can be somewhat complicated (e.g., coverage which is "mostly" paid is generally sufficient, unless the employer pursues full payment).[217] Employers likely will want to ensure that these new rules are incorporated into the relevant documents and procedures.

It is unclear whether the Pay or Play Rule would accommodate other reasons why employers sometimes terminate (and thereafter fail to offer) health plan coverage, such as fraud against the plan. Employers should be careful if they experience such a situation.

Step 7(j): Consider Nondiscrimination and Coverage Rules

Note that this Step 7 does not address an important point: nondiscrimination and coverage rules. Self-funded health plans are subject to Code Section 105(h). Code Section 105(h) limits an employer's ability to discriminate in favor of "highly compensated individuals."

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[212] PHSA Section 2708, as added by ACA Section 1201. See also Step 7(b)(ii) regarding counting days under the 90-Day Rule.
[213] 26 CFR 54.9815-2708(c)(1).
[214] 26 CFR 54.9815-2708(c)(3)(ii).
[215] 26 CFR 54.9815-2708(c)(3)(ii).
[216] 26 CFR 54.4980H-3(g).
[217] 26 CFR 54.4980B-8, Q&A 5(d).

Similarly, the ACA prohibits discrimination for non-grandfathered, fully-insured health plans.[218] This nondiscrimination rule was originally set to become effective for plan years beginning on or after September 23, 2010 (i.e., January 1, 2011 for a calendar year plan). However, the IRS delayed the effective date until the IRS or other agencies have issued guidance.[219]

Excluding groups of individuals can sometimes cause a self-funded plan to fail the Code Section 105(h) test. Presumably the same will be true for fully-insured health plans. A discussion of the full requirements of these rules is beyond the scope of this Pay or Play Guide.

Step 7(k): Examples of Common Scenarios

Now that you have a good understanding of the rules, a few examples will help apply the rules to "real-world" situations.

<u>**Example 1: Seasonal Employees**</u>

City has 1,000 year-round, full-time employees. During its busy summer months, City hires 200 seasonal, full-time employees and 100 seasonal, part-time employees. City offers a good health plan (one that provides "minimum value", constitutes "minimum essential coverage" and is "affordable") to its year-round employees immediately upon hire. However, City does not offer any health plan coverage to its seasonal employees (whether full-time or part-time). Will City face a Pay or Play Rule penalty?

Probably not, although more information is needed to be definitive. There will not be any penalty for the year-round, full-time employees because City has structured its plan to ensure that no penalty is possible. Also, there will not be any penalty for the seasonal, part-time employees, since no Pay or Play Rule penalty is possible for part-time employees.

The main risk for City lies with its seasonal, full-time employees. As discussed in the "Little Ski Hill" example in Step 7(d)(iii), these employees may be considered "full-time" in a few months. Thus, we need to know the length of City's Initial Measurement Period and Administrative Period (if any). We also need to know how long these employees will actually work. City likely could be "safe" from a Pay or Play Rule perspective if it establishes a longer Initial Measurement Period (e.g., 11 months) rather than a shorter Initial Measurement Period (e.g., 3 months). City should consider creating such a longer Initial Measurement Period. However, as noted in Steps 7(c)(iv) and 7(d)(iv), City must be somewhat careful if it will re-hire these Seasonal Employees next year. If a Seasonal Employee is re-hired, her prior hours "count" unless she can be treated as a "new" employee.

<u>**Example 2: Short Duration Employees**</u>

Call Center Inc. has 2,000 full-time employees: 200 management and 1,800 call center operators. All the employees are full-time (40 hours per week) and are expected to work indefinitely (they are not Variable Hour Employees). Call Center Inc. offers a good health plan (one that provides "minimum value," is "affordable" and constitutes "minimum essential coverage" and is offered to eligible employees upon hire). However, the health plan is only offered to management employees, not call center operators. The turnover rate among call center operators is high -- the typical length of

[218] PHSA Section 2716.
[219] IRS Notice 2011-1.

employment is four months. Will Call Center Inc. face a risk of incurring a Pay or Play Rule penalty?

Yes, there is some risk. Call Center Inc. has structured its plan so it will not face a penalty for its management employees. What about call center operators? First, we need to identify what "type" of employee each newly-hired operator is -- Seasonal; Variable Hour; Part-Time; or New, Full-Time. There is no clear indication from the facts we are given that the call center operators are Seasonal, especially since they seem to be continuously hired throughout the year. Perhaps, though, some of the operators are hired during a busy season (e.g., the holiday shopping season). This may make some of them Seasonal, but it is doubtful that all of them are Seasonal.

Will all the operators be Variable Hour? Probably not. We are told that Call Center Inc. hires them to be full-time employees, so it appears that Call Center Inc. expects them to be working full-time hours (and that Call Center Inc. is not uncertain about whether or not they will average 30 hours per week). Even though the employee group as a whole has a high turnover rate of four months, the IRS transition relief for Variable Hour Employees (discussed in Step 1(a)) provides that Call Center Inc. cannot assume that all operators will leave within a few months.[220] Thus, while a few of the operators may be Variable Hour Employees, not all of them can be so classified.

Could the operators be Part-Time Employees? Perhaps, but this seems aggressive. Call Center Inc. expects the operators to work full-time hours (40 hours per week). The only way for Call Center Inc. to meet the definition of a Part-Time Employee here is if Call Center Inc. can take into account the likelihood that an operator will terminate employment early (e.g., four months into a 12-month Initial Measurement Period). Can Call Center Inc., take into account this likelihood? It's not entirely clear. The rules note that Call Center Inc.'s classification of the employees is a "facts and circumstances" test.[221] Also, the rules note that, for Variable Hour Employees (as discussed above), Call Center Inc. cannot take into account the likelihood that the employees will terminate. Somewhat curiously, that "cannot take into account" rule is "missing" from the definition of "Part-Time Employee."[222] This suggests that Call Center Inc. could take into account this likelihood. On the other hand, the preamble to the final regulations states that the "same rules that apply to new variable hour employees… apply to new part-time employees."[223] This suggests that Call Center Inc. cannot take into account the likelihood of an operator's early termination. In addition, the preamble also notes that the IRS considered whether to create a special rule for "high turnover" employees --- but rejected doing so.[224] Again, this makes it risky for Call Center Inc. to take such a position here.

Thus, Call Center Inc. probably will classify the operators (or at least many of them) as New, Full-Time Employees. As noted in Step 7(d)(ii), a New, Full-Time Employee must be offered coverage within about 3 months. Here, that is before many of the operators typically terminate employment. Thus, Call Center Inc. does have a Pay or Play Rule risk -- it will likely have full-time employees who should receive an offer of coverage, but who will not receive that offer.

Call Center Inc. likely should re-design its plan or do other workforce restructuring (e.g., in the future hire part-time, not full-time, operators) to reduce its Pay or Play Rule risk.[225] Note that Call Center Inc.'s discriminatory health plan coverage (i.e., covering management but not the employees) also raises nondiscrimination issues (see Step 7(j)).

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[220] 26 CFR 54.4980H-1(a)(49)(ii)(A).
[221] 26 CFR 54.4980H-1(a)(32).
[222] Compare 26 CFR 54.4980H-3(a)(32) ("Part-Time Employee") with 26 CFR 54.4980H-1(a)(49) ("Variable hour employee").
[223] 79 Fed. Reg. 8559.
[224] 79 Fed. Reg. 8562.
[225] Call Center Inc. should consider all applicable laws before conducting any workforce restructuring.

<u>Example 3: Pay AND Play</u>

In 2017, Generous Co. has 1,000 full-time employees. Generous Co. offers excellent health plan coverage to 940 of these employees. However, it has minor operations in five remote states far from its headquarters (and the other 940 employees). Generous Co. had difficulty covering the 60 employees in these remote locations. So, employees in these locations receive additional compensation in lieu of health plan coverage. All employees are full-time and are expected to work indefinitely. Could Generous Co. face a penalty? If so, how much?

Yes, a penalty is possible. Generous Co. offers health plan coverage to 94% of its employees. This is risky because the "de minimis" rule for the Subsection A Penalty is capped at 5%.[226] However, employees who are in a "limited non-assessment period" are ignored when determining if coverage was offered to 95% or more of all full-time employees.[227] If some of Generous Co.'s 60 "remote" employees are in a limited non-assessment period, this could result in Generous Co. being deemed to offer coverage to at least 95% of its full-time employees. For example, if 20 of the 60 "remote" employees are new and are in a limited non-assessment period -- and none of the other 940 are -- Generous Co. would be offering coverage to 940 / 980 employees, or 95.9% -- a "safe" number.

If this is not true and one or more of the 60 full-time employees obtains subsidized Exchange coverage, Generous Co.'s annual penalty would be:

((1,000 - 30) = 970) x $2,000 = $1,940,000

Generous Co. is facing a large non-deductible penalty considering that it provides a rich health plan to over 90% of its employees. In essence, Generous Co. is facing the worst of all worlds -- providing expensive health coverage for the vast majority of employees, yet still paying the Pay or Play Rule penalty! Generous Co. should strongly consider restructuring how it treats the 60 employees (e.g., offering them coverage) in order to ensure that Generous Co. could not face a Pay or Play Rule penalty.

[226] 26 CFR 54.4980H-4(a).
[227] 26 CFR 54.4980H-4(a).

Step 8: Review Strategic Considerations

Even with the delayed effective date for the Pay or Play Rule (now generally 2015), employers will likely need to consider potential strategies and plan design revisions in their 2014 renewals, especially if the plan is collectively-bargained (and therefore more difficult to change).

Employers who paused their preparation following announcement of the delayed effective date will likely want to re-engage in active preparation since it may include amending health plans to reflect choices involving Measurement Periods, Stability Periods and Administrative Periods. Some employers had been actively engaged in "managing" employee hours downward (e.g., reducing 35-hour-per-week employees to 25-hour-per-week employees). That strategy has some risk associated with it, and this risk may increase in 2014 and beyond.

When preparing for the Pay or Play Rule, employers will need to consider a variety of "soft" factors (e.g., non-monetary factors like employee morale) and "hard" factors (e.g., Pay or Play Rule monetary penalties). While the hard factors will be easier to quantify than the soft factors, we recommend conducting a thorough evaluation of both.

Some of the hard factors for employers are as follows:

* Estimate Potential Penalties – Review the $2,000/$3,000 penalties and determine if you want to restructure the workforce to move more individuals from full-time to part-time status or modify plan design to ensure it provides minimum essential coverage and is affordable. Consider whether such changes raise legal concerns.
* Conduct an Analysis on Current Employee Population – Estimate how many employees would likely qualify for the federal Exchange subsidy and potentially adjust contributions and/or hours worked.
* Evaluate the Tax Impact – Employers currently receive significant tax savings under the employer-provided health plan system -- would an employer's tax liability increase if it no longer sponsored a health plan?
* Approximate Additional Compensation Scenarios – Would an employer need to increase an employee's compensation if it no longer provided health plan benefits?

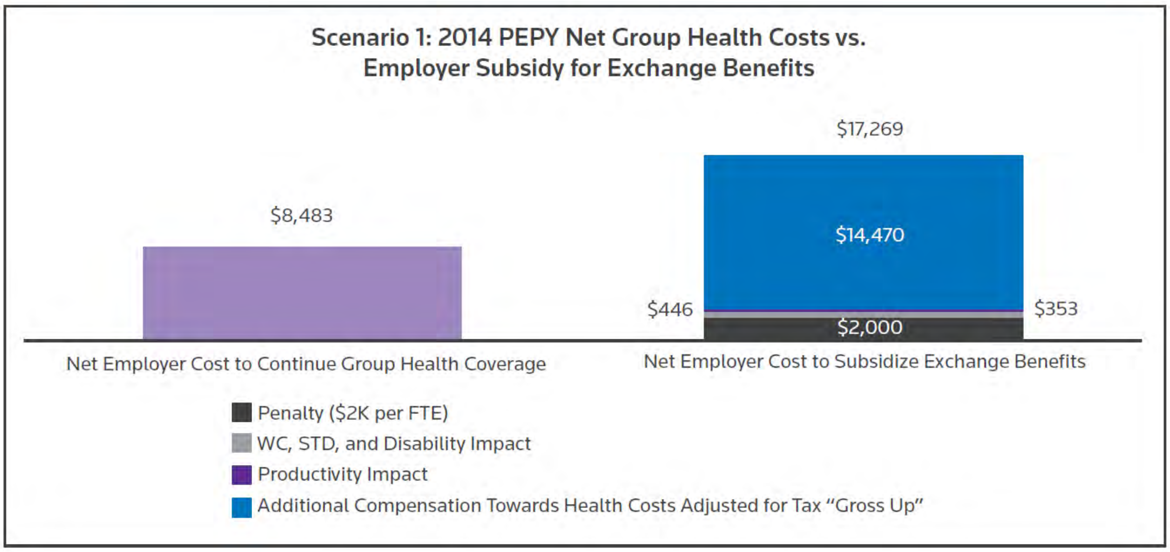
Softer factors include a potential loss of control over employee health, productivity, and behavior. These could be a deterrent to employers considering eliminating health plan coverage. Other soft factors that employers should consider are reduced employee morale and retention since it could be difficult to attract and retain qualified employees due to the lack of health plan coverage.

Of course, "soft factors" also carry a dollar amount. Some estimates of these costs are available. For example, in July 2012 Truven Health Analytics published a white paper, “Modeling the Impact of “Pay or Play” Strategies on Employer Health Costs,”[228] which used data from 33 large employers with 933,000 employees in various industries. Truven estimated that an employer which moved its workforce to the Exchange and away from its own health plan would face a $446 productivity impact (i.e., cost to the employer) and a $353 workers' compensation, short term disability and disability impact (for a total annual impact of $799).[229]

In the Truven White Paper, four scenarios were considered in which an employer moved its employees to an Exchange. The “variable” was what the employer did (if anything) to assist employees with the cost of Exchange coverage. These scenarios were, from most favorable to the employee, to least favorable to the employee, the following.

(1) Employees Made Whole -- Employer moves employees to Exchange and makes employees whole by paying employees additional compensation.

FIGURE 1B

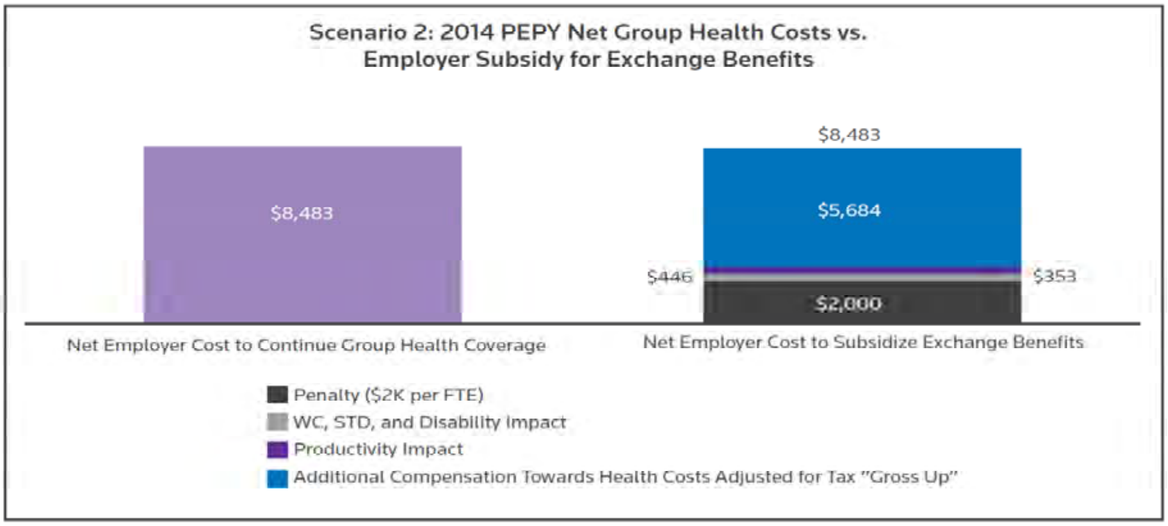


As is illustrated above, this is a costly option for employers. Employers would spend $14,470 in additional compensation to help offset the increased Exchange coverage.

[228] We thank Truven Health Analytics for their permission to discuss the White Paper and reproduce some of its graphics. We note that we have not analyzed the underlying data or calculations from Truven Health Analytics and make no representations regarding their accuracy or whether all relevant factors were considered.
[229] See Truven White Paper, p. 6.

(2) Cost-Neutral Impact on Employer -- Employer moves employees to Exchange and provides additional compensation to employees, so that net impact on employer is equal to what employer would experience if it had maintained its current health plan.

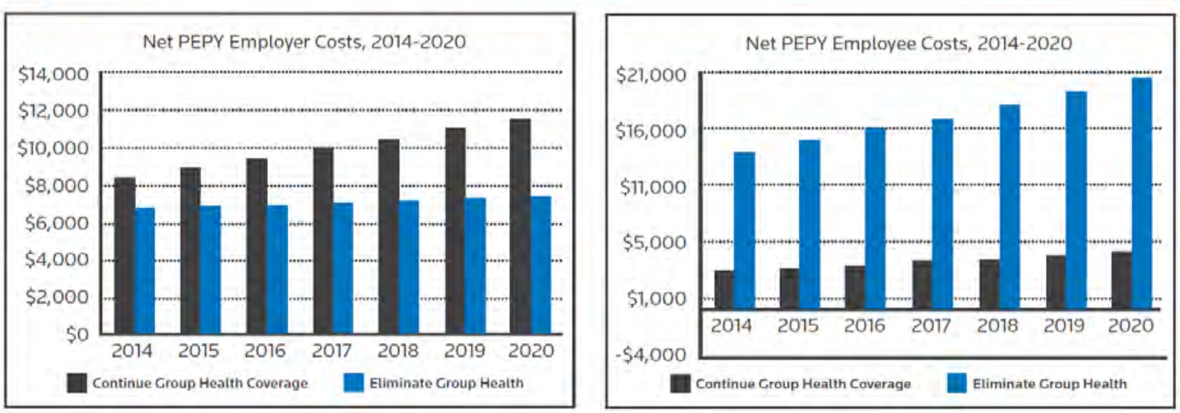
FIGURE 2B



In this Scenario, Truven projects that employers will provide an additional $5,684 (or 67% of current health plan costs) in salary to compensate for eliminating group health plan coverage in 2014.[230] However, employees would bear over $10,000 in new costs, so the employer subsidy may not be sufficient to cover the new costs.[231]

(3) Cost to Employer Decreased by 20% -- Employer subsidizes employees, but in a lesser amount, so that employer receives a 20% cost savings compared to cost if employer had maintained its current plan.

FIGURE 3A

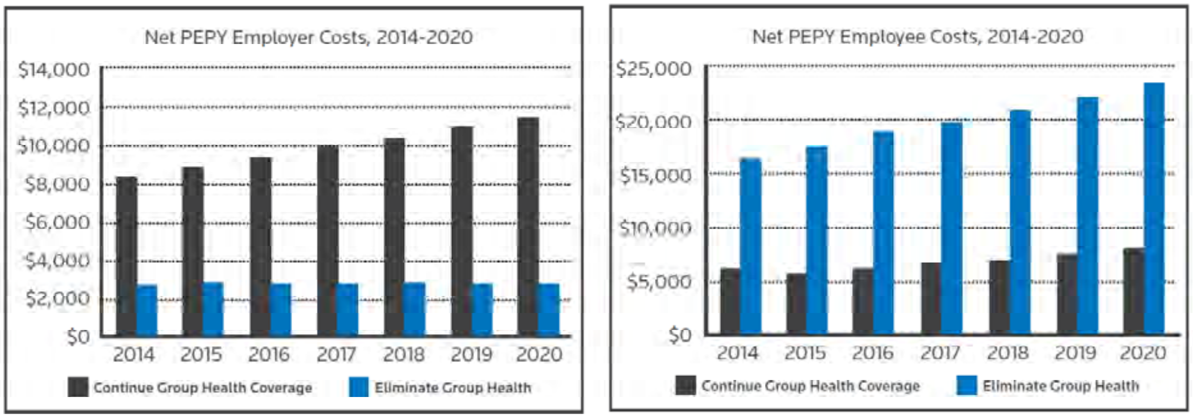


230 Truven White Paper, p. 6. Note that Truven completed its White Paper prior to the delay of the Pay or Play Rule.
231 Truven White Paper, p. 6.

As Truven notes, the 20% savings would be helpful to employers but could cause “employee relationship” issues, as employees will bear significant additional costs.

(4) No Subsidy to Employees -- Employer does not provide any subsidy to employees.

FIGURE 4A



In this scenario, the employer saves significantly in comparison to the cost of offering health plan coverage. However, employees end up paying significantly more.

Summary

These “Pay or Play” decisions will involve sensitive human resources, benefits consulting and legal issues. We expect many employers will work closely with their benefit consultants and legal team to identify and implement a strategy. For Quarles & Brady LLP clients, we encourage you to contact your Quarles & Brady LLP attorney to review questions or discuss possible strategies.

* * *

ADDENDUM

Exhibit A

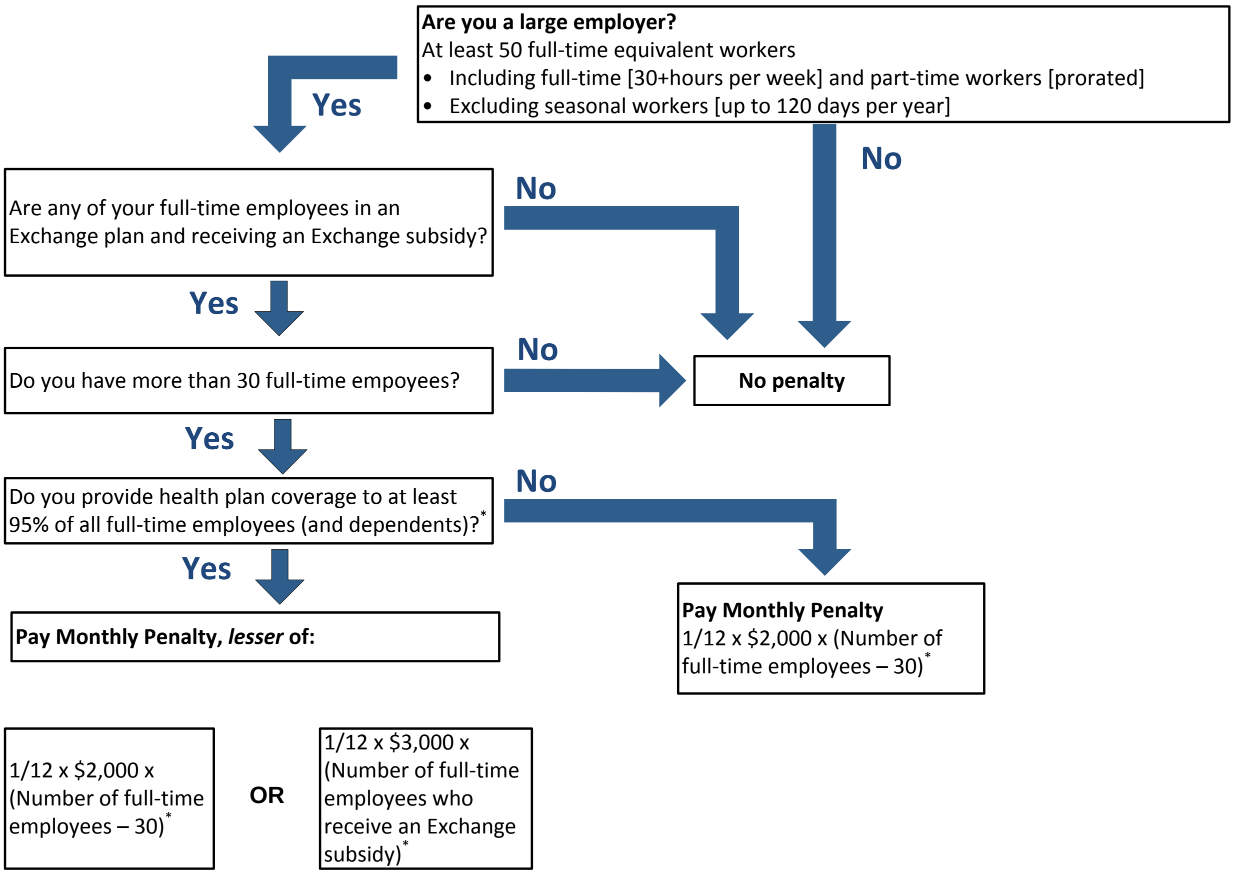
Appendix I (Additional Detail for Step 2)

Appendix II (Large Employer Reporting)

Exhibit A

Will the Employer Pay A Penalty?

Note: This Exhibit A has not been updated to reflect the transition relief described in Step 1.



*Employees who are in a “limited non-assessment period” generally are excluded from this calculation. 26 CFR 54.4980H-4(a); 26 CFR 54.4980H-5(a).

Appendix I Additional Detail for Step 2

Step 2(a): Include Employees in Controlled Group

All employees of a controlled group under Code Sections 414(b) or 414(c) are considered when determining whether an employer is a "large" employer.[232] These are the "controlled group" rules which often apply in the retirement plan context (e.g., for some retirement plan nondiscrimination tests).

In addition, entities that are part of an affiliated service group under Code Section 414(m) are also included in determining whether an employer is a "large" employer.[233] An affiliated service group generally exists when multiple employers are linked together through joint activity or a combination of common ownership and joint activity.[234]

Controlled Group Rules and the Small Employer Exception. Edna the Entrepreneur has 100% ownership of Edna Inc., a company which had 200 full-time employees in 2013. Edna is very concerned about the Pay or Play Rule, as Edna Inc. does not offer health insurance. Edna proposes dividing Edna Inc. into five separate companies of 40 employees in 2014. Edna would maintain 100% ownership of all five companies. Edna believes this strategy will ensure that none of the companies will be subject to the Pay or Play Rule. Is Edna correct?

Probably not. Because Edna has 100% ownership of all five companies, there is a "controlled group" of companies. The number of full-time employees would be aggregated. If, together, all five companies had 200 full-time employees in 2014, each of the companies would be a "large" employer. This is true even though each of them, by themselves, only had 40 employees.

In contrast to the above rule, the Pay or Play Rule penalty does not apply on a controlled group basis. Instead, the penalty applies to each "applicable large employer member"[235] separately.[236] An employer's status as an "applicable large employer member" is determined on a month-by-month basis.[237] The 30-employee reduction (discussed in Step 7) is allocated among an applicable large employer's members, based on the number of full-time employees employed by each employer.[238] It is not clear if one employer in a controlled group (e.g., a parent) would be liable for another employer's (e.g., a subsidiary's) Pay or Play Rule penalty.[239]

[232] Code Section 4980H(c)(2)(C)(i).
[233] Code Section 4980H(c)(2)(C)(i).
[234] The full definition of "affiliated service group" is complex and beyond the scope of this Guide. See Code Section 414(m)(2).
[235] 26 CFR 54.4980H-1(a)(5) (definition of "applicable large employer member").
[236] 26 CFR 54.4980H-4(d); 26 CFR 54.4980H-5(d). Employers generally will be pleased with this clarification from the IRS. The clarification is somewhat surprising, as Code Section 4980H(c)(2)(C)(i) requires that all related employers are treated as one employer.
[237] 26 CFR 54.4980H-1(a)(5) provides that an employer that is treated as a single employer with other employers will be an applicable large employer member for a calendar month if it is an applicable large employer member on any day of that calendar month. In addition, the final regulations provide rules for determining which applicable large employer member is responsible for a Pay or Play Rule penalty in the situation where an employee is a full-time employee of more than one applicable large employer member during a given month. 26 CFR 54.4980H-4(d); 26 CFR 54.4980H-5(d).
[238] Code Section 4980H(c)(2)(D); 26 CFR 54.4980H-4(e); 26 CFR 54.4980H-4(d); 26 CFR 54.4980H-5(d). See also the transitional relief described in Step 1(a). Note that if an applicable large employer is allocated a fraction, it is rounded up to the next highest whole number (so the total number of excluded employees may exceed thirty). 26 CFR 54.4980H-4(e).
[239] Code Section 4980H(d)(1) notes that the penalty is enforced in the same manner as an assessable payment under Subchapter B of Chapter 68 of the Code (26 USC 6671 et.seq.). Those rules are not clear on how the Pay or Play Rule penalty would be enforced.

Controlled Groups and Penalty. Private Equity Co. owns eight separate corporations that are part of a single controlled group. Each separate corporation sets its own health plan design and eligibility.

Private Equity Co. is concerned that the health plan of one of its corporations will not satisfy the Pay or Play Rule requirements. Private Equity Co. is concerned that this could cause the seven other corporations to face a Pay or Play Rule penalty. Is Private Equity Co. correct in being concerned about this?

Probably not, based on the IRS regulation. The statue seems to provide that all entities treated as a single employer for purposes of the Code's controlled group rules are treated as a single employer for Pay or Play Rule purposes.[240] This would suggest that Private Equity Co. could have liability if only a single one of its applicable large employer members incurred a Pay or Play Rule penalty. However, as noted above, the IRS has (thankfully) taken the opposite position.

Step 2(b): For New Employer, Determine Expected Number of Employees

As noted above, the employer's size is generally determined based on the number of full-time employees in the prior calendar year. What if the employer did not exist for the entire prior year? The Pay or Play Rule provides that such an employer can still be a "large" employer that is subject to the Pay or Play Rule if the employer "reasonably expects" to employ an average of at least 50 full-time employees (taking into account FTEs) on business days during the current calendar year. It appears that this "reasonable expectation" is determined at the time the business comes into existence, even if an employer's reasonable expectation changes over time.[241]

It is unclear how an employer would determine if it "reasonably expects" to employ an average of at least 50 full-time employees. The regulation provides an example of an employer which, as of January 1, 2016, had three employees. However, the Company had purchased a factory intended to open within two months of incorporation and to employ 100 full-time employees. By March 15, 2016 the company had more than 75 full-time employees. The IRS concluded the employer was a large employer.[242]

Note that an employer may take into account whether it will hire "seasonal workers." If an employer reasonably expects that the sum of its full-time employees and FTEs for the current calendar year will exceed 50, but only for 120 days or fewer during the current calendar year, and that the employees in excess of 50 who will be employed during that period of no more than 120 days will be seasonal workers, the employer is not a large employer for the current calendar year. [243]

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[240] Code Section 4980H(c)(2)(C)(i). It is possible that this aggregation rule would only apply for purposes of determining whether an employer is a "large" employer that is subject to the Pay or Play Rule. This is suggested by the heading to Code Section 4980H(c)(2)(C) (which is titled "Rules for Determining Employer Size"), which focuses on employer "size" rather than penalties. However, a later section (Code Section 4980H(c)(2)(D)) applies the aggregation rule for purposes of applying the 30-employee reduction used in the Pay or Play Rule penalty.

[241] 79 Fed. Reg. at 8547 ("[U]nder the final regulations, the determination of whether a new employer is an applicable large employer during its first calendar year is based on the employer's reasonable expectations at the time the business comes into existence, even if subsequent events cause the actual number of full-time employees (including FTEs) to exceed that reasonable expectation.")

[242] 26 CFR 54.4980H-2(d), Ex. 5.

[243] 26 CFR 54.4980H-2(b)(2).

Step 2(c): Consider Predecessor Employer

When determining whether an employer is subject to the Pay or Play Rule, the employer must also consider a "predecessor" employer.[244] No IRS guidance clarifies what this term means. The IRS regulation specifically reserves the definition for future guidance.[245] The preamble to the final regulation notes that the IRS is continuing to consider development of rules for identifying predecessor (and successor) employers. Until further guidance is issued, employers must use a reasonable, good faith interpretation of the provisions for predecessor (and successor) employers.[246] Further IRS guidance is likely.

Step 2(d): Include FTE Employees

The Pay or Play Rule requires that FTE employees be considered when determining if an employer is a "large" employer.[247] Many employers will employ at least 50 full-time employees during the prior calendar year. These employers need not consider FTE employees.

Some employers will employ fewer than 50 full-time employees but have some part-time employees. These employers must engage in a mathematical determination of their "large" employer status. This FTE calculation states that an employer generally will be "large" if, with respect to the prior calendar year:[248]

$$[\text{Average number of full-time employees}] + [\text{Average number of FTE employees}] \geq 50$$

Each calculation is explained below.

Step 2(d)(i): Determine Average Number of Full-Time Employees

For purposes of determining whether an employer is subject to the Pay or Play Rule, a "full-time" employee is determined on a monthly basis.[249] Thus, an employee whose hours fluctuate over the year may be a "full-time employee" for some months (e.g., perhaps during a "busy season" such as October, November and December), but not be a "full-time employee" in other months (e.g., January through September). If the employee is not a "full-time employee" during some months, the individual still will count as an FTE employee during those months. Thus, an employer would need to "count" such an employee under Step 2(d)(iv), below.[250]

The term "full-time employee" means a person who is "employed on average at least 30 hours of service per week."[251] The IRS seems to believe that determining a "30 hours per week"

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[244] Code Section 4980H(c)(2)(C)(iii).
[245] 26 CFR 54.4980H-1(a)(31).
[246] 79 Fed. Reg. at 8548. The preamble provides that it would be reasonable for this purpose to use the rules developed in the employment tax context for determining when wages paid by a predecessor employer may be considered as having been paid by the successor employer. See also 26 CFR 31.3121(a)(1)-1(b).
[247] 26 CFR 54.4980H-2(b)(1).
[248] Code Section 4980H(c)(2)(A), (E); 26 CFR 54.4980H-2(b)(1). Remember that, as noted in Step 1(a), a special transition rule applies in 2014. Under this rule, an employer need only examine 6 months of data to determine its large employer status in 2015.
[249] 26 CFR 54.4980H-2(b)(1).
[250] IRS Notice 2011-36, IV.B. (noting that "An employee who is not a full-time employee under this standard (including a seasonal employee) for a given month is taken into account in the FTE calculation.").
[251] Code Section 4980H(c)(4)(A); 26 CFR 54.4980H-1(a)(21) (definition of "full-time employee").

standard may be difficult for employers. The final regulation provides that this determination be based on 130 hours of service in a calendar month.[252]

Step 2(d)(ii): Determine Hours of Service

"Hours" of service are generally determined based on hours for which an individual is entitled to payment. This can include hours actually worked, along with other paid hours (e.g., vacation). The IRS standard is:

> (1) each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer; and
>
> (2) each hour for which an employee is paid, or entitled to payment by the employer for a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.[253]

The final regulation provides specific exclusions from this standard. Under these exclusions, an hour of service for purposes of the Pay or Play Rule does not include hours of service performed as a bona fide volunteer,[254] hours of service for service performed as part of a Federal Work-Study Program (or a substantially similar program),[255] or hours of service for certain services performed outside the United States.[256]

The IRS has recognized that it may be difficult for employers to determine the hours of service for certain categories of employees (such as adjunct faculty, commissioned salespeople, and airline employees) and certain categories of hours worked by employees (such as layover hours and on-call hours).[257] The preamble to the final regulation provides that, until the IRS issues additional guidance regarding these categories of employees and hours, employers must use a reasonable method of crediting hours of service for these categories of employees and hours that is consistent with the Pay or Play Rule.[258] In general, it would not be reasonable for an employer to take into account only a portion of an employee's hours if the effect would be to treat an employee in a position that traditionally involves at least 30 hours of service per week

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[252] 26 CFR 54.4980H-1(a)(21)(ii). Note that the "full-time employee" definition also allows an employer to use a "weekly rule" for purposes of calculating a Pay or Play Rule penalty if the employer is using the monthly measurement method to calculate hours of service (see Step 7 above). 26 CFR 54.4980H-1(a)(21)(iii). Under this optional weekly rule, an employee's full-time status for some months is based on hours of service over four weekly periods, and for other calendar months is based on hours of service over 5 weekly periods. When using the weekly rule, an employee with at least 120 hours of service during a month with four weekly periods is a full-time employee, and an employee with at least 150 hours of service during a month with five weekly periods is a full-time employee. 26 CFR 54.4980H-1(a)(21)(iii). An employer cannot use the weekly rule for purposes of determining if it is a large applicable employer. 26 CFR 54.4980H-3(c)(1).

[253] 26 CFR 54.4980H-1(a)(24)(i). The regulation clarifies that "leave of absence" is defined in 29 CFR 2530.200b-2(a). A prior IRS notice stated that no more than 160 hours of service would be counted for an employee on account of any single continuous period during which the employee was paid or entitled to payment but performed no duties. IRS Notice 2011-36, III.C. This 160-hour rule was removed in the proposed regulation. 78 Fed. Reg. at 223.

[254] 26 CFR 54.4980H-1(a)(24)(ii)(A). A "bona fide volunteer" is defined at 26 CFR 54.4980H-1(a)(7).

[255] 26 CFR 54.4980H-1(a)(24)(ii)(B). A "Federal Work-Study Program" is defined at 34 CFR 675.

[256] 26 CFR 54.4980H-1(a)(24)(ii)(C). The final regulation provides that an hour of service for purposes of the Pay or Play Rule does not include any hour of service to the extent the compensation for the service is income from sources without the United States (within the meaning of Code Sections 861-863 and the corresponding regulations).

[257] 79 Fed. Reg. at 8551.

[258] 79 Fed. Reg. at 8551. Although the final regulation does not actually provide additional rules or exclusions for these categories of employees and hours, the final regulation anticipates that the IRS will issue additional guidance in the future regarding these issues. 26 CFR 54.4980H-3(h).

as a non-full-time employee.[259] The IRS has provided the following examples of reasonable and unreasonable methods of crediting hours of service for certain employees and hours:

* Commissioned Traveling Salespersons - It would not be reasonable for an employer to fail to take into account travel time for a commissioned travelling salesperson; [260]

* Adjunct Faculty - It would be reasonable for an employer to credit an adjunct faculty member with 2 and 1/4 hours of service per week for each hour of teaching or classroom time and, separately, an hour of service per week for each additional hour the adjunct faculty member is required to spend performing duties outside the classroom (e.g., required office hours or faculty meetings);[261]

* Layover Hours - It would not be reasonable for an employer to fail to credit a layover hour as an hour of service if the employee is paid for that hour beyond any pay that the employee would have otherwise received, or if the employer counts the layover hour towards required hours of service for the employee's regular pay. For layover hours for which the employee does not receive additional pay or that are not counted towards the employee's required hours of service, it would be reasonable for the employer to credit an airline employee with 8 hours of service for each day that the employee is required to stay away from home overnight for business provided this credit does not substantially understate the employee's actual hours of service for the day.[262]

* On-Call Hours - It would not be reasonable for an employer to fail to credit an employee with hours of service for on-call hours if (1) payment is made or due for the on-call hours, (2) the employee is required to remain on the employer's premises during the on-call hours, or (3) the employee's activities while on call are subject to substantial restrictions that prevent the employee from using the on-call hours for the employee's own purposes.[263]

An employer generally will use its records of hours worked and hours for which payment is made or due in determining hours of service.[264] This should be relatively easy for employees paid on an hourly basis. But what about non-hourly (e.g., salaried) employees? For these employees an employer calculates hours of service by using one of these methods:

* Actual hours of service from records of hours worked and hours for which payment is due or made. Note that an employer may not have any such records with respect to salaried employees;

[259] 79 Fed. Reg. at 8551.
[260] 79 Fed. Reg. at 8551.
[261] 79 Fed. Reg. at 8552.
[262] 79 Fed. Reg. at 8552.
[263] 79 Fed. Reg. at 8552.
[264] 26 CFR 54.4980H-3(b)(2).

* Using a days-worked equivalency whereby the employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service;[265] or
* Using a weeks-worked equivalency whereby the employee is credited with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service.[266]

An employer is not required to use the same method for all non-hourly employees. An employer may apply different methods for different categories of non-hourly employees, provided the categories are "reasonable and consistently applied."[267] Each applicable large employer member may select its own method regardless of what another applicable large employer member has selected.[268] However, it appears that an employer may only change its chosen method of calculating hours of service for non-hourly employees (or a category of non-hourly employees) once each calendar year.[269]

The final regulation also includes an "anti-abuse" rule with respect to how hours of service are calculated. The above-described days-worked or weeks-worked equivalencies for non-hourly employees "must reflect generally the hours actually worked and the hours for which payment is made or due."[270] An example of this rule is as follows.

Improper Use of Equivalent Hours. Friendly Hospital has a group of surgeons who, due to patient needs, will regularly work long hours (12+ hours per day) three days per week, when surgery is scheduled. Other days (when no surgery is scheduled) the doctors usually work no hours. All the surgeons are salaried (i.e., non-hourly) employees. For Pay or Play Rule purposes, Friendly Hospital wishes to provide each surgeon with 24 hours of service per week (i.e., 3 days of work x 8 hours per day) -- with the result that the surgeons would not be "full-time" employees. May Friendly do so?

Probably not. Friendly likely knows that surgeons, on days when they work, work long hours, in excess of 8 hours per day. In fact, they typically work 36 or more hours per week. Friendly's proposed method would appear to substantially understate the number of hours surgeons actually work. Friendly likely should change how it calculates hours.

Note that the preamble to the final Pay or Play Rule regulations clarifies that this understatement concern (and anti-abuse rule) applies for all Pay or Play Rule purposes, including for purposes of determining if Friendly Hospital is an applicable large employer. If Friendly Hospital is right on the edge

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[265] The regulation notes this rule and then adds a somewhat-confusing reference to how the rule applies if an employee would be required to be credited with at least one hour of service "in accordance with paragraph (b)(2) of this section." Paragraph (b)(2), by its terms, only applies to hourly employees, not non-hourly employees. Paragraph (b)(2) also requires an employer to determine an hour of service from "records of hours worked and hours for which payment is made or due". 26 CFR 54.4980H-3(b)(3)(i)(B), (b)(2). However, an employer may not have a "record of hours worked" for a salaried employee. Thus, the reference is somewhat confusing. Perhaps the regulation is best interpreted to mean that a salaried employee who works for at least one hour per day (however this is measured and tracked) must be credited with 8 hours of service for that day. It is unclear whether salaried employee would receive any credited hours of service if the employee worked for a period of less than one hour (e.g., 30 minutes) in a day.

[266] As in the prior footnote, the IRS regulation contains a reference to "paragraph (b)(2)", which only applies to hourly employees. Thus, as discussed in the prior footnote, there is some confusion on how to apply this rule to salaried employees.

[267] 26 CFR 54.4980H-3(b)(2)(ii).

[268] 26 CFR 54.4980H-3(b)(2)(ii).

[269] 26 CFR 54.4980H-3(b)(2)(ii).

[270] 26 CFR 54.4980H-3(b)(2)(iii).

of having 50 full-time employees, the anti-abuse rule may push Friendly Hospital over the 50 full-time employee mark and into applicable large employer status.[271]

Under prior guidance, it appeared that an employer also needed to take into account special rules for crediting or ignoring an employee's unpaid leave of absence and for educational organizations.[272] The final Pay or Play Rule regulations clarified that these special rules do not apply for purposes of determining if an employer is an applicable large employer.[273]

Step 2(d)(iii): Determine Average Number of Employees Worked

The IRS has also indicated that the 50-full-time-employee standard is an "average" number, determined over the course of the year. This calculation is illustrated below.

Illustration of Month-to-Month Determination. Client Co. had 49 full-time employees in 2014 and one employee, B, whose hours fluctuated significantly in 2014. The first four months B worked 100 hours per month. The next four months he worked 130 hours per month. The final four months he worked 160 hours per month. For how many months in 2014 was B a "full-time" employee? Will Client Co. be subject to the Pay or Play Rule in 2015?

B was a "full-time" employee for eight months: the four months when he worked 130 hours per month and the four months he worked 160 hours per month. Thus, Client Co. had 50 full-time employees for eight months in 2014. Client Co. also had 49 full-time employees and a FTE employee (again, B) for four months. As discussed below in Step 2(d)(iv), the FTE calculation reveals that B is treated as an .833 FTE for each of the four months when he worked 100 hours. Client Co.'s average number of full-time employees equals:

Month	Full-time Employees + FTEs for Month
January	49.833
February	49.833
March	49.833
April	49.833
May	50
June	50
July	50
August	50
September	50
October	50
November	50
December	50
Yearly Total	**599.332**
Average Per Month (Yearly Total / 12)	49.94

[271] See 26 CFR 54.4980H-3(b)(2)(iii) (discussing how an employer may not use a days-worked equivalency for an employee who generally works three 10-hour days per week, because the equivalency would credit the employee with 24 hours of service, rather than the 30 hours of service the employee actually completed). In addition, an employer may not use a days-worked equivalency or weeks-worked equivalency if the result is to understate the hours of service of a substantial number of employees, even if no particular employee's hours of service are substantially understated and even if the understatement would not cause the employee to be treated as a full-time employee. 26 CFR 54.4980H-3(b)(2)(iii); see also 79 Fed. Reg. at 8550.

[272] See proposed regulation 26 CFR 54.4980H-3(e)(3), (4).

[273] 26 CFR 54.4980H-3(c)(1); 26 CFR 54.4980H-3(c)(4)(iii).

The IRS guidance states that fractions (i.e., the ".94" here) are ignored and the number is rounded down for purposes of determining whether the Pay or Play Rule applies.[274] Thus, Client Co. has 49 total full-time plus FTE employees. Client Co. will not be subject to the Pay or Play Rule in 2015.

Note that Client Co. does not, under the month-to-month determination method, examine B's average hours over the year. If Client Co. did so, B would likely be a full-time employee for the entire year. This is because B's average hours for the year were 130 hours ((100 x 4) + (130 x 4) + (160 x 4) / 12 = 130 hours average per month). Under this calculation, B would count as a full-time employee and Client Co. would have 50 full-time (and FTE) employees. Client Co. therefore would be subject to the Pay or Play Rule -- if this calculation rule had been adopted by the IRS (which did not happen).

Step 2(d)(iv): Determine Average Number of FTE Employees

If an employer has less than 50 full-time employees, as determined above, the employer must calculate the number of FTE employees it had during the prior calendar year. Any employee (including but not limited to seasonal workers) who was not a full-time employee for any month in the preceding calendar year is included in calculating the employer's FTEs for a month.[275] Thus, for each month an employee must be classified as either a full-time employee or an FTE -- there is no other classification.

To determine an employer's number of FTEs (as well as the total number of FTEs and full-time employees) for each calendar month in the preceding calendar year the employer must:

(1) Calculate the aggregate number of hours of service (but not more than 120 hours of service for any employee) for all employees who were not full-time employees for that month;

(2) Divide the total hours of service from Step 1 by 120. The result is the number of FTEs for the calendar month. Do not drop any fractional amounts (may round to the nearest one hundredth);

(3) For each month add the total number of full-time and FTE employees;

(4) Add the numbers for each month to reach a yearly total; and

(5) Divide the yearly total by 12, then disregard any fractions. The result is the number of full-time and FTE employees. If the result is 50 or more, the employer is subject to the Pay or Play Rule.

[274] 26 CFR 54.4980H-2(b)(1).
[275] 26 CFR 54.4980H-2(b)(1); 26 CFR 54.4980H-2(c)(1).

Illustration of Calculating Number of FTE Employees. Farmer Inc. has 40 full-time employees from January through December 2014. Farmer Inc. also has 30 additional employees who assist during the busiest time of the year, a five-month period from May through September. Ten of the 30 employees work 100 hours per month during those five months, while twenty of the 30 employees work 125 hours per month. How many FTEs does Farmer Inc. have? Is Farmer Inc. subject to the Pay or Play Rule?

Farmer Inc. would calculate its FTEs as follows:

(1) Aggregate Hours. The aggregate hours for each of the five months will equal: [(10 employees x 100) + (20 employees x 120)] = 1,000 + 2,400 = 3,400 aggregate hours per month. Note that the maximum number of hours considered is 120, even though twenty of the employees actually worked more (here, 125 hours). The extra five hours (125 - 120) are ignored.

(2) Divide by 120. Divide the aggregate hours (3,400) by 120. The result is 28.33, which is the FTE number for each month.

(3) Add Full-Time Employees. Now add to the FTE number (28.33) the number of full-time employees for that month (here, 40). For May through September, Farmer Inc. has 68.33 employees who are counted (full-time plus FTE).

(4) Add Each Month. Now add up the numbers for each month.

Month	Total Counted Employees (Full-Time + FTE)
January	40
February	40
March	40
April	40
May	68.33
June	68.33
July	68.33
August	68.33
September	68.33
October	40
November	40
December	40
Total for Year	**621.65**

(5) Divide by 12. Now divide the yearly total by 12. 621.65 / 12 = 51.80. The fraction (.80) is disregarded. Farmer Inc. has 51 counted employees (full-time plus FTE). Farmer Inc. is subject to the Pay or Play Rule because it has at least 50 counted employees.[276]

There is one additional exception that could exempt an employer, if the employer employs "seasonal workers".[277] If an employer's workforce exceeds 50 full-time and FTE employees, but

[276] Note that the final Pay or Play regulation includes a special "transition rule" for an employer's first year as an applicable large employer. 26 CFR 54.4980H-2(b)(5). Under this rule, with respect to an employee who was not offered coverage in the prior calendar year, an employer will not be subject to a Pay or Play Rule penalty for January through March of that year if the employer offers coverage that provides minimum value to the employee on or before April 1 of the first calendar year for which the employer is an applicable large employer. This rule can apply only once for each applicable large employer.

[277] 26 CFR 54.4980H-2(b)(2). The term "seasonal worker" is defined in the Pay or Play regulation (see 26 CFR 54.4980H-1(a)(39)). This definition generally focuses on whether the employee "performs labor or services on a seasonal basis." It includes (but is not limited to) employees described in 29 CFR Section 500.20(s)(1). Employers can apply this Department of Labor definition of "seasonal worker" and apply it by analogy to other types of employees. It includes certain retail workers employed during a busy holiday shopping period. 26 CFR 54.4980H-1(a)(39).

only for 120 days or fewer during the preceding calendar year, and the employees in excess of 50 who were employed during that period of no more than 120 days were seasonal workers, the employer is not a large employer for the current calendar year.[278] For these purposes, "120 days" will be treated as the equivalent of four calendar months.[279] The four calendar months and 120 calendar days need not be consecutive.[280] The following example illustrates this exception.

Illustration of Calculating Number of FTE Employees. Farmer Inc.'s neighbor is Neighbor Farmer Inc. Neighbor Farmer Inc. has 40 full-time employees from January through December 2014. Neighbor Farmer Inc. has 50 (not 30, as Farmer Inc. does) additional employees who assist during the busiest time of the year, a four-month period from May through August. Twenty of the 50 employees work 100 hours per month during those four months, while thirty of the 50 employees work 125 hours per month. All the workers are "seasonal" workers. How many FTEs does Neighbor Farmer Inc. have? Is Neighbor Farmer Inc. subject to the Pay or Play Rule?

Neighbor Farmer Inc. would calculate its FTEs as follows:

(1) Aggregate Hours. The aggregate hours for each of the four months will equal: [(20 employees x 100) + (30 employees x 120)] = 2,000 + 3,600 = 5,600 aggregate hours per month. Note that the maximum number of hours considered is 120, even though thirty of the employees actually worked more (here, 125 hours). The extra five hours (125 - 120) are ignored.

(2) Divide by 120. Divide the aggregate hours (5,600) by 120. The result is 46.66.

(3) Add Full-Time Employees. Now add to the FTE number (46.66) the number of full-time employees for that month (here, 40). For May through August, Neighbor Farmer Inc. has 86.66 employees who are counted (full-time plus FTE).

(4) Add Each Month. Now add up the numbers for each month.

Month	Total Counted Employees (Full-Time + FTE)
January	40
February	40
March	40
April	40
May	86.66
June	86.66
July	86.66
August	86.66
September	40
October	40
November	40
December	40
Total for Year	**666.64**

[278] Code Section 4980H(c)(2)(B); 26 CFR 54.4980H-2(b)(2).
[279] 26 CFR 54.4980H-2(b)(2).
[280] 26 CFR 54.4980H-2(b)(2).

(5) Divide by 12. Now divide the yearly total by 12. 666.64 / 12 = 55.55. The fraction (.55) is disregarded. Neighbor Farmer Inc. has 55 counted employees (full-time plus FTE). This is above the typical 50-employee limit. However, we need to add an additional step -- Step 6, below -- to determine if Neighbor Farmer Inc. satisfies the seasonal employee exception noted above.

(6) Examine Seasonal Employee Exception. The seasonal employee exception is limited to employees who were employed for a maximum of a 120-day period. Here, the time period (May - August) technically exceeds 120 days (it equals 122 days). IRS guidance, however, provides that the extra two days are ignored, since there are only four calendar months involved.[281] Thus, the "120-day" standard is satisfied.

Here, all the employees in excess of 50 are seasonal employees. (Remember, Neighbor Farmer, Inc. only has 40 year-round, full-time employees.) Thus, all the criteria for the seasonal employee exception are satisfied. Neighbor Farmer Inc. is not subject to the Pay or Play Rule in 2015, even though it has 55 counted employees (full-time plus FTE) in 2014.[282]

[281] This is illustrated in an example at 26 CFR 54.4980H-2(d), Ex. 3.
[282] For a similar example with seasonal workers and other FTEs, see 26 CFR 54.4980H-2(d), Ex. 4.

Appendix II Large Employer Reporting [Reserved for Future Update]

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