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Putting the Shared Responsibility Penalty Puzzle Together

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Background

If an employer's health plan provides minimum value,[1] is affordable and is offered to all full-time employees (FTEs), the employer may not be assessed a shared responsibility penalty if the employer can demonstrate how it meets all of these requirements.

This report considers how an employee is determined by the employer to be a FTE—who may trigger the shared-responsibility tax if the employee obtains coverage on an exchange and receives cost-sharing reductions or premium tax credits, and the employer doesn't offer affordable coverage or provide minimum value. This report is solely for purposes of comparing and contrasting the guidance for determining which employees are treated as FTEs for the shared responsibility tax and not for any other purposes under health reform. The flow charts are to assist in analyzing different aspects of the employer shared responsibility penalties.

For employers in states not electing the Medicaid expansion, employers may be required to pay a shared-responsibility penalty for individual employees who obtain coverage on an exchange and can qualify for premium tax credits (individuals who earn between $11,490 to $15,282 in 2014), and for employees with families of four who obtain coverage on an exchange and can qualify for premium tax credits (employees with a family of four who earn between $23,550 to $31,322 in 2014).

If the state has instead elected the Medicaid expansion, these employees would be covered by the Medicaid expansion and the employer won't be subject to the shared-responsibility penalty for them. For employers in states electing the Medicaid expansion Medicaid will cover any employee earning up to $15,282 with individual coverage and employee earning up to $31,322 with a family of four.[2]

The shared-responsibility penalty can be triggered either by:

- an applicable large employer (ALE) not offering coverage in a plan that offers minimum essential coverage (tax code Section Section 4980H(a) penalty), *or*
- an ALE that offered coverage that was either not affordable to an employee, or didn't provide minimum value, and the employee (and 30 others) went to an exchange and purchased coverage and received cost reductions or a premium credit (Section 4980H(b) penalty).

4980H Overview

In order to encourage applicable large employers (ALEs) to continue to offer health coverage to employees, the Patient Protection and Affordable Care Act (the ACA) included a penalty structure that it called the shared responsibility penalty. An ALE is measured on a controlled-group basis considering all of the FTEs in all of the controlled U.S. entities and all the full-time equivalent employees (FTEEs) in the controlled group

[1] 45 C.F.R. § 156.145(a)(1)-(3).

[2] *See* http://www.obamacarefacts.com/federal-poverty-level-.php.

in U.S. entities.[3] An ALE is an employer with 50 or more FTEs or FTEEs. Services performed outside of the U.S. aren't counted for determining full-time status.[4] If an employer is a member of a controlled group under Section 414(b) or (c) of an ALE on any day in the month, the employers is a member of that ALE for that month (an ALE Member).[5]

An employer determines whether it is potentially an ALE and subject to the penalty tax by determining how many FTEs it has working on an average of 30 or more hours per week, and then adding up all of the hours of all other employees for the month (other than hours performed outside of the U.S., hours of bona fide volunteers and hours worked in a work study program[6]) and dividing them by (120) to determine how many FTEEs the employer has in that month. The number of FTEs is added to the number of FTEEs to determine if the employer has 50 or more FTEEs and if it does, then it is an ALE.[7] This is calculated on a month by month basis.

For 2015, an employer may determine its ALE status based on its FTEs or FTEEs for a period of at least six consecutive months chosen by the employer (instead of on business days in the preceding calendar year). During the 2014 calendar year, six consecutive months may be used to determine the number of FTEs and FTEEs instead of the full 2014 calendar year, but the determination of the number of FTEs excludes seasonal workers during the full 2014 calendar year; however, even if the six-month period is used to determine ALE status, seasonal workers status is determined based on the full 2014 calendar year, and not the six months designated period for ALE status.[8] Employees counted for the ALE determination and the assessment of the penalty tax include all "common law" employees of the employer and the employer considers all employers in the controlled group under Section 414(b), (c), (m) or (o).[9]

Overview of Two Alternative Penalties

Some refer to the shared-responsibility penalty as the "pay or play" penalty because there are two separate penalties that apply in two separate instances. The (a) penalty applies if the ALE Member doesn't offer coverage to its FTEs, although there is a safe harbor from this penalty if the ALE offers coverage to at least 95 percent of all FTEs of the ALE Member (or, if greater, five FTEs if that would be greater than 5 percent).[10] For employers with 50 to 99 FTEs, the (a) penalty will not apply in 2015.[11]

The (b) penalty applies if the ALE offers health coverage to its FTEs, but a FTE goes to the insurance marketplace and obtains a premium tax credit or a cost-sharing reduction from the insurance marketplace and the employer's coverage is either not affordable to the FTE or it doesn't provide minimum value.[12]

Practice Tip: The regulations clarify that an employer isn't subject to both of the penalties in the same month.[13]

The Section 4980H penalty is calculated on a month by month basis and by each individual FTE and not by FTEEs. FTEs are individuals who on the average work 30 or more hours per week and others who are determined to be FTEs,[14] and how full-time status is determined for employees who work either variable hours, work as a seasonal employee or who work intermittently or with breaks in employment (such as teachers) are determined to be or not be FTEs is discussed below.

Note that seasonal employees are different from seasonal workers. Seasonal workers are persons who provide migrant agricultural work or who are retail workers employed exclusively during the holiday season.[15] Seasonal employees are persons hired into a position for which the customary employment is six months or less.[16] Seasonal workers are included in the FTE count used to determine if the employer is an ALE subject to the shared-responsibility penalty,[17] and there is a special exception to the calculation related to seasonal workers employed fewer than 120 days that permits exclusion of such seasonal workers from the determination of whether the employer is an ALE, but there is nothing that excludes seasonal workers or seasoned employees totally from the penalty if the employer is an ALE.[18]

Employer Offers Coverage

An ALE will be subject to the (b) penalty if the ALE decides to play and offer coverage to its FTEs, but some of its FTEs (and their dependents) go to the exchange to obtain coverage and are entitled to either a premium tax credit (tax code Section 36B) or cost-sharing reduction (ACA Section 1402), or an advance payment of such credits or cost-sharing reduction under ACA Section 1412, due to the level of their household income and the unaffordability of the employer-offered coverage (it doesn't provide minimum value or exceeds 9.5 percent of the employee's household income).

The penalty is imposed on a month by month basis for each month in which an employee obtains the subsidized coverage on the exchange. The assessable penalty that is imposed for a month is 1⁄12 times $3,000 per FTE or dependent who obtains the subsidized coverage. However this penalty for any month can't be more than 1⁄12

[3] Treas. Reg. § 54.4980H-1(a)(4) and (5) and § 54.4980H-2.
[4] Treas. Reg. § 54.4980H-1(a)(24)(ii)(C).
[5] Treas. Reg. § 54.4980H-1(a)(5).
[6] Treas. Reg. § 54.4980H-1(a)(24)(ii).
[7] I.R.C. § 4980H(a) and (c)(2)(E); Treas. Reg. § 54.4980H-1(a)(4), (5), and (24) and § 54.4980H-2.
[8] 79 Fed. Reg. 8544, 8573 § XV.D.3. (Feb. 12, 2014.)
[9] Treas. Reg. § 54.4980H-1(a)(15) and (16).
[10] Treas. Reg. § 54.4980H-4(a).
[11] 79 Fed. Reg. 8544, 8574, § XV.D.6. (Feb. 12, 2014).
[12] I.R.C. § 4980H(b).
[13] Treas. Reg. § 54.4980H-5(d).
[14] I.R.C. § 4980H(c)(4).
[15] Treas. Reg. § 54.4980H-1(a)(39) and 29 C.F.R. § 500.20(s)(1).
[16] Treas. Reg. § 54.4980H-1(a)(38).
[17] Treas. Reg. § 54.4980H-2(b)(1).
[18] Treas. Reg. § 54.4980H-2(b)(2).

times $2,000 times the number of FTEs employed during such month (less the 30 freebies).[19] The calculation of this penalty is explained below.

In no event can this penalty exceed the amount that would have been assessed on the ALE Member under the penalty for not offering coverage for any month ($2,000 x 1⁄12 x (the number of FTEs less 30 or the ALE Member's share of 30)).

Employer Decides to Not Offer Affordable Coverage or Provides Minimum Value and Employee Gets Health Care Tax Credit or Cost-Sharing Reduction on a Marketplace

If the ALE Member instead decides to not offer health coverage to its FTEs (and their dependents), then it faces the "pay" part of the pay or play penalty provisions. In this case the ALE Member must pay the (a) penalty for each month in which it doesn't offer its FTEs and their dependents the opportunity to enroll in minimum essential coverage and at least one FTE goes to an exchange to purchase coverage and is certified as eligible for a premium tax credit and such amount is allowed or paid for such employee. Then the ALE must pay an assessable penalty equal to 1⁄12 times $2,000 times the number of FTEs during the month less the 30 freebies under Section 4980H(c)(2)(D)(i)(II) (the 30 free FTEs are allocated among the ALE Members pro-rata based upon the number of FTEs of each entity).

The 30 freebies are allowed once per ALE and when a controlled group of employers is involved, the 30 freebies are allocated among the entities in the controlled group ratably on the basis of the number of FTEs.[20] If an ALE Member allocation isn't a whole number, it is rounded to the next highest whole number.[21] Here the penalty is only imposed with respect to those persons determined to be FTEs who work on the average 30 or more hours per week and who go to the exchange and obtain a premium tax credit (collectively "subsidized coverage").

For both penalties, the offer of affordable coverage providing minimum value must be offered at least one time per plan year to avoid the penalty for failing to offer coverage.[22]

Practice Tip: An annual offer of affordable coverage providing minimum value to employees during open enrollment is sufficient.

If an annual offer to switch from PRN status (employees who choose to work a shift periodically as needed and aren't regularly scheduled) to a position with benefits is made at open enrollment, the PRN employees would be treated as having been offered coverage for the plan year so the failure to offer coverage penalty wouldn't apply. This may apply to other workers who only work in a status where they only work as needed provided they are annually offered affordable coverage with minimum value.

Minimum essential coverage is defined in tax code Section 5000A(f)(2) as an eligible employer-sponsored plan that may or may not be grandfathered, but that doesn't include excepted benefits, such as stand-alone vision or dental, health flexible spending accounts or benefits described in Section 2791(c)(1) of the PHSA.[23] Any plan offered on the marketplace to the small or large employers in the state constitutes minimum essential coverage and must provide at least Minimum Value, which is different from minimum essential coverage.

The IRS and the Department of Health and Human Services both issued guidance regarding what constitutes minimum value.[24] Coverage of Minimum Value considers what percentage of projected costs of Essential Health Benefits will be covered, and to provide Minimum Value coverage must cover at least 60 percent of such projected costs. An employer-sponsored plan, even if it is grandfathered and has only some of the ACA provisions applicable, qualifies as minimum essential coverage.[25] An individual is not eligible to obtain a premium tax credit under Section 36B if the individual has employer coverage available that is affordable and provides minimum value.

Coverage is affordable if the premium cost to the employee is less than 9.5 percent of the individual's household income and the coverage also provides minimum value that is the lowest cost bronze plan standard (60 percent of the projected costs).[26] If an ALE Member offers coverage that is affordable to all of its FTEs and dependents and such coverage meets the minimum value requirements,[27] the ALE Member's FTEs shouldn't be eligible for the premium tax credit and thus shouldn't be able to trigger the shared-responsibility penalty for purchasing coverage on the marketplace with a premium tax credit. For this purpose the term dependents includes a child as defined in tax code Section 152(f)(1), but doesn't include stepchildren or an eligible foster child. A child who qualifies as a dependent remains a dependent to age 26. A spouse is not a dependent.[28] This means a health plan may exclude coverage for spouses, stepchildren and foster children without incurring a tax penalty for violation of the shared-responsibility employer tax. However, there may be consequences outside of the tax law for such exclusions.

"Bronze-Plated" Plans. Some vendors are recommending employers offer an even lower value plan to low-income employees—sometimes referred to as "bronze-plated plan." Because these are new benefit packages and plan designs, for the most part these

[19] I.R.C. § 4980H(c)(2)(D)((i)(II).
[20] Treas. Reg. § 54.4980H-4(e).
[21] Treas. Reg. § 54.4980H-4(e).
[22] Treas. Reg. 26 C.F.R. § 54.4980H-4(b)(1).
[23] *See* IRS Notice 2013-54 regarding whether certain accounts are "excepted benefits" or not.
[24] 45 CFR § 156.145(a)(1)-(3).
[25] I.R.C. § 5000A(f).
[26] I.R.C. § 36B(c)(2)(C).
[27] 45 CFR § 156.145(a)(1)-(3).
[28] Treas. Reg. § 54.4980H-1(a)(12).

aren't grandfathered plans and still must comply with all of the applicable ACA requirements.

A "bronze-plated plan" considers the benefits it must offer to meet the ACA-mandated benefit requirements—including the out-of-pocket maximum limitation, the preventive care mandates, clinical trial coverage, dependent coverage to age 26, the prohibition on annual dollar limits and lifetime dollar limits—but covers so few other benefits that it cannot meet the 60 percent of costs standard to be deemed to provide minimum value. The plan considers the cost of such mandates in the total benefits costs and considers other limits, but then severely limits the other benefits it covers so that it provides enough coverage to constitute minimum essential coverage for the individual to avoid the individual mandate penalty and yet is low enough in cost for low wage employees to purchase so that they don't go to an exchange for subsidized coverage and thus trigger the shared-responsibility penalty on the employer. However, if a low-wage employee suffers a catastrophe claim and goes to the exchange to purchase more complete coverage, such individual will be able to trigger the employer penalty because offering "bronze-plated coverage" doesn't constitute offering minimum value coverage.

The fact that the type of coverage provided by bronze-plated plans doesn't meet minimum value standards must be disclosed in a new category of disclosures on the summary of benefits and coverage beginning in 2014.[29]

Caution: While these bronze-plated plans may work for a self-insured plan if the actuaries can make them work and they are carefully drafted, there are a number of issues to consider prior to implementing such a plan design, mainly that the employer isn't protected from the shared-responsibility penalty by offering such bronze-plated plan coverage because it doesn't provide minimum value. Thus, cost savings in the plan may be offset by an increased penalty tax liability.

Other Uses of the Full-Time Employee Status Definition in the Shared Responsibility Final Regulations Penalty Administrative Scheme

The definitions that determine employees' status and the related reporting will impact many persons.

The final shared-responsibility penalty tax regulation is just one piece of the puzzle, but it is a key piece for employers because it establishes the meaning of some of the defined terms that are used in the reporting requirements related to health plan coverage offered under the employer's plan to FTEs and dependents.[30] Thus, the regulation provides the definition of the testing parameters and the records an employer must maintain to defend against the assessment of the shared-responsibility penalty.

Employers must know who is a FTE and the dependents of such employee to know on whom they must report to the IRS regarding to whom coverage was offered and provided.[31] Some of the reporting requirements only apply to those employees who are FTEs as defined for the shared-responsibility penalty.[32] The penalties for failing to file complete reports or reporting inaccurately on these reporting requirements are $100 per form up to $1,500,000 per year (there is a report sent to the IRS and a form for each FTE).[33]

There are also reporting requirements for a plan sponsor providing coverage that requires reporting to the primary insured and also requires a plan sponsor to report the taxpayer identification number of each primary insured and each individual covered under the policy. However, there is no reporting required for those who don't enroll.[34]

Thus, on one portion of the report (Form 1095-C) the employer may show the FTE and her dependent children who were offered coverage and on another report for the same employee show the FTE, her spouse and her dependent children and stepchildren and the months each had coverage along with each of their federal tax identification numbers.

Caution: The reporting requirements may result in an employer reporting on coverage of individuals for whom they aren't subject to the shared-responsibility tax if the employer offers coverage to persons who don't meet the final regulation's determination of being a "full-time employee" or a dependent that isn't defined to cover many persons frequently covered by group health plans as dependents, such as spouses. If an employer reports coverage under tax code Section 6056 for persons in excess of the FTEs, the employer may be subject to penalties for filing Form 1095-C and including incorrect information.[35]

The reporting will be used by the IRS to determine for which employees, spouses or dependents the IRS will assess a penalty on the employer and over-reporting will cause the IRS to investigate additional employees that are not FTEs.[36] This reporting is also used by the IRS to determine which individuals might be entitled to a health care tax credit claimed by that individual on their income tax return or at the marketplace. The IRS provided some relief to facilitate employers who elect to over-report on all employees, their spouses and their dependents.[37]

The definition and determination of who is a FTE in these regulations will have implications for

- an employer's record capture and retention to enable an employer to defend against pay or play penalty assessments, and
- the employer's ability to comply with the reporting requirements and avoid penalties for incomplete or inaccurate reporting.[38]

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[29] U.S. Department of Labor, ACA FAQs XIV, Q&A 1-3.

[30] Treas. Reg. § 54.4980H-4(a).

[31] Treas. Reg. § 301.6056-1 and I.R.C. § 1.6055-1.

[32] Treas. Reg. § 301.6056-1(b)(6), (d) and (g) requiring reporting by ALE on FTEs as defined in I.R.C. § 4980H.

[33] I.R.C. § 6721.

[34] Treas. Reg. § 1.6055-1.

[35] I.R.C. § 6721(a)(2)(B).

[36] I.R.C. §§ 6055, 6056 and 6721.

[37] See the 98 percent Alternative on Reporting below.

[38] Treas. Reg. § 301.6056-1(b)(6).

Practice Tip: The employer must know which employees are FTEs (as defined by these regulations) and the name and tax identification number of each dependent covered by the FTEs' election of coverage for each month of the year beginning in 2014 for measurement periods starting in 2014, or for December 2014 if the employer uses the monthly facts and circumstances test.[39]

This is important in order for the employer to know on whom it must report to the IRS regarding whether affordable coverage was offered for any particular month in a calendar year to such FTE, how much such coverage cost and potentially also the dependents and spouses names and social security numbers.[40] The determination of full-time status must be made for all employees including members of collective bargaining units that mandate coverage of all members, because this is for penalty calculation and there is no exception to the penalty or to the reporting requirements for collective bargaining unit members even if all have coverage contractually.

Effective Date Delayed

The penalty was originally set to be effective as of Jan. 1, 2014, with transition rules for fiscal year plans. IRS Notice 2013-45 provided transition relief for employers from application of the penalty under Section 4980H and from the employer's information reporting requirement under Section 6056 until 2015. Notice 2013-45 clearly stated both Sections 4980H and 6056 will be fully effective for 2015.

Such transition relief doesn't impact an employee's access to the premium tax credit and it doesn't delay an employer's obligation to comply with the coverage or insurance reform mandates or for any other portion of the ACA. Notice 2013-45 didn't address how this will impact the transition rules for fiscal year plans contained in Part IX of the preamble to the proposed Section 4980H. The individual mandate penalty was delayed to not be effective until 2015. ALEs with 50 to 99 FTEs or FTEEs aren't subject to the tax until 2016.[41]

Determination of Whether an Entity Is Subject to the Pay or Play Penalty

The penalty regulations do clarify a number of items. First, the penalty applies only to "applicable large employers" (ALEs).[42] Determining if an entity is an ALE requires counting the FTEs[43] and FTEEs of an employer and considering all such employees of the commonly-controlled entities as members of the controlled group and as one employer of all of the respective entities' employees in the prior calendar year.[44] Thus, employers must identify all entities that are members of the controlled group to determine which FTEs must be included to see if the number of FTEs and FTEEs exceeds 50. All common law employees must be considered, so the employer needs to review independent contractors to determine the status of such persons and who is the employer with respect to each.[45]

Caution: Employers using staffing agencies will continue to live in ambiguity under these regulations regarding whether staff or leasing company employees working for the employer are the employer's employees or if the coverage provided by the staff leasing company satisfies the employer's responsibility to offer coverage.

Leased employees under tax code Section 414(n), sole proprietors, partners in partnership, 2 percent S-corporation shareholders and certain real estate agents and direct sellers under Section 3508 are not employees and are not included in the count of FTEs.[46]

Practice Tip: If an employer uses the monthly measurement method to determine an employee's full-time status, it must maintain documentation of each of these monthly determinations for each employee to defend against the assessable penalty.

Transition Rule on ALE Status

If the potential ALE's sum of its FTEs and FTEEs exceeds 50 for 120 days or less in the prior calendar year and if the employees in excess of the 50 who were employed during the period were employed for no more than 120 days are seasonal workers, the employer isn't considered to employ more than 50 FTEs and the employer isn't an ALE.[47] In the case of an employer that wasn't in existence on any business day during the preceding calendar year, if the employer reasonably expects that the number of its FTE and FTEEs for the current calendar year will exceed 50 for 120 days or less and the employees in excess of 50 will be employed no more than 120 days and will be seasonal workers, the employer isn't an ALE.[48]

This may present challenges in identifying who is full-time where an employee's services are allocated among more than one entity in a controlled group and may require employers to identify such shared employees as a separate group, consolidate payroll records for such shared persons and test those shared employees considering services to all entities combined to determine if they are FTEs of the controlled group if the controlled group is close on determining if it is an ALE. The number of FTEs then must be added with the number of FTEEs, and compared to the 50-employee threshold.

Practice Tip: An entity may not use the lookback measurement/stability period to determine which employees are

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[39] Treas. Reg. § 54.4980H-3(c); Treas. Reg. § 301.6056-1(f).
[40] I.R.C. §§ 6055 and 6056.
[41] 79 Fed. Reg. 8544, 8576 § XV.D.6. (Feb. 12, 2014).
[42] Treas. Reg. § 54.4980H-1(a)(4) and § 54.4980H-2.
[43] Employees who are employed on the average at least 30 hours per week, using the controlled group or ALE definition of the employer and not just the common law employing entity, and who are not seasonal workers (Treas. Reg. § 54.4980H-2(b)(2)).
[44] Treas. Reg. § 54.4980H-1(a)(4) and § 54.4980H-2.
[45] Treas. Reg. § § 54.4980H-1(a)(15).
[46] *Id.*
[47] Treas. Reg. § 54.4980H-2(b)(2).
[48] Treas. Reg. § 54.4980H-2(b)(2).

FTEs for purposes of determining whether the employer or its controlled group are an ALE.[49]

Calculating Hours Worked for ALE Determination and for Full-Time Status Determination

Full-time equivalent employees (FTEEs) are determined by considering how many hours the other employees who aren't regularly scheduled to work 30 hours per week actually work in total in a month (disregarding hours in excess of 120 hours in a month by any individual) and dividing that total number of hours by 120 hours per month to determine how many worked more than 30 hours per week on average in the particular month.[50]

Hours worked include hours paid, or for which the employee is entitled to payment for services or entitled to payment for periods in which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. There is no clarification regarding whether the hours an employee isn't working but is receiving payment due to one of the above specified reasons, with the payment coming from a third party (e.g., payments for a union member during layoff from the union, or payment of disability benefits from an insurance company from whom the disability insurance was purchased by the employer or with a combination of employee and employer contributions) are included in the hours for which the employee is entitled to payment for a period in which no services were performed or if those don't count because the payment is not from the employer.[51] There is also no clarification as to whether hours that an individual is off due to a layoff or furlough during which the employee may receive payment from the union are counted since there is no payment from the employer.[52]

Payments from third parties for hours not worked would present additional challenges for employers because they may not have timely or any records of such payments when the hours must be used to make the full-time status determination. There are specified equivalencies that can be used to attribute hours to employees for which there are no hours-worked records to determine full-time status as long as the equivalencies do not understate the hours worked.[53]

Hours worked as a bona fide volunteer don't count and hours worked by students on certain work-study programs don't count. Hours worked outside the United States don't count if the compensation constitutes income from sources outside of the U.S. Hours worked by an individual whose work is done under a vow of poverty don't count toward treating the member[54] of the order as a FTE (e.g., sisters or nuns working under a vow of poverty at a hospital or school).

[49] Treas. Reg. § 54.4980H-1(a)(21)(i).
[50] Treas. Reg. § 54.4980H-2(c)(2).
[51] Treas. Reg. § 54.4980H-1(a)(24).
[52] 79 Fed. Reg. 8544, 8568 § XIII, XIV and XV (Feb. 12, 2014).
[53] Treas. Reg. § 54.4980H-1(a)(21).
[54] Treas. Reg. § 54.4980H-1(a)(24)(ii).

The Treasury Department is still considering difficult groups such as commissioned sales people and airline employees with layover hours and on-call hours and adjunct faculty. Until guidance is issued on these categories, employers may use a reasonable method of crediting hours.[55] The final regulations include methods for imputing hours when an employee is on certain unpaid leaves (FMLA, USERRA and jury duty) and for bridging breaks in service with rules regarding whether or not prior service must be counted.[56]

Once an employee is determined to be a FTE and the employer is determined to be an ALE based on employment in the prior calendar year, the effective date of the pay or play penalty is determined for the ALE. The next step is for the members of the ALE to determine which employees are FTEs (under the rules for the pay or play penalty) and on which individuals the penalty might be assessable. *These are not eligibility rules.* These are rules regarding to whom a penalty may apply if either coverage isn't offered or if the coverage offered isn't affordable or doesn't provide minimum value and the individual obtains a premium tax credit in the marketplace. The full-time status determines which employees the employer must report under Section 6056, but another reporting requirement applies for all employees actually covered and their covered family members. The employer must be able to prove why the penalty doesn't apply to each FTE and why each person is not an FTE, if the safe harbors don't preclude application of the penalty. The employer must retain records reflecting how they determined each individual is not subject to the penalty.

Practice Tip: The key is that the shared-responsibility penalty regulation is *not* a determination of eligibility, it is a determination of for whom the ALE must maintain records that can be used to defend the employer against the assessment of a shared responsibility penalty and the first step in for whom the employer will have reporting obligations to the IRS and for whom there may be penalties for such reporting.

Determination of Who Is a Full-Time Employee for Whom an Employer May Need to Pay the Shared Responsibility Penalty

Choice of Testing Method Determines Records to Maintain and for Whom Records Are Maintained

An employer may determine if an employee is a FTE using either the monthly review of hours worked in the prior month or the lookback measurement/stability period method.[57] The monthly method can be used for both determining if the employer is an ALE and for determining the employer's liability for a tax assessed under the shared responsibility tax (except it doesn't apply with respect to the weekly rule). The measurement/stability period method may only be used to de-

[55] 79 Fed. Reg. 8544, 8551, VI.B. and C. (Feb. 12, 2014).
[56] Treas. Reg. § 54.4980H-3(c)(4).
[57] Treas. Reg. § 54.4980H-1(a)(21)(i) and § 54.4980H-3(a).

termine the employer's liability for a tax assessed under the shared-responsibility tax, and it may not be used to determine how many FTEs exist for determining if the employer is an ALE.[58]

The method of measuring full-time status of employees determines whether the employer tests all employees and makes a determination each month, or whether the employer starts by carving out those employees who are in positions expected to work 30 or more hours per week and who aren't seasonal employees, variable hour employees or part-time employees (the "SEVPTE"). The employer could then test the SEVPTE using the lookback measurement/stability period to determine which employees may be in full-time status. Employers with workforces that have a group of employees who are in positions that are scheduled to regularly work 30 or more hours per week and who aren't SEVPTEs can carve this group of FTEs out as automatically full-time and only test the SEVPTE. The method used to determine FTE status may vary by the member entities within the ALE and may also vary within a particular entity by certain categories of employees.[59]

Nonhourly employees that have their hours calculated under either the monthly measurement or the lookback measurement method must use one of the following methods:

- actual hours worked (if there are records),
- using a days worked equivalency, or
- using a weeks worked equivalency.[60]

Practice Tip: Different methods can be applied for different categories of nonhourly workers.

An employer may determine if an employee is a FTE using either the monthly review of hours worked in the prior month or the measurement/stability period method.[61]

If nonhourly employees change between positions using different methods, there are transition rules related to the change in the method of determining FTE status.[62]

Overview of Monthly Measurement Method

Under the monthly measurement period there is no initial split between full-time vs. not full-time employees as there is under the lookback measurement/stability period method. Instead, the calculation is a monthly determination of hours worked and a related monthly offer of coverage.[63] Every employee's status is tested each month to determine full-time status.

Practice Tip: If an employer uses the monthly measurement method it must maintain documentation of each of these monthly determinations for each employee to defend against the assessable penalty.

While the monthly measurement period sounds simple, because life is not simple or uniform and it takes time to gather and analyze data and implement changes in status, this simple rule has many nuances.

The monthly method can result in an individual moving in and out of needing to receive an offer of coverage on a monthly basis. For each move in and out of eligibility for the employer-offered coverage that is lost due to a reduction in hours worked in the prior month, the loss of that coverage would trigger an eligibility for COBRA continuation coverage.[64]

To permit time to assess eligibility for enrollment, the monthly measurement period provides that an employer isn't subject to being assessed a penalty (the Section 4980H(a) penalty) for failing to offer coverage for each calendar month during the period of three full calendar months beginning with the first full calendar month in which the employee is otherwise eligible to be offered coverage under the group health plan, provided the employee is offered coverage no later than the first day of the first calendar month immediately following such three full-calendar-month period if the employee is still employed on such date and the coverage the individual is eligible for provides minimum value.[65] This permits the employer to still comply with the ACA limitation of waiting periods to 90 days, which is only counted after the individual is eligible.[66] If an employer meets the first day of the month following the three calendar month requirement, and the coverage offered provides minimum value, then the employer is also exempt from the Section 4980H(b) penalty for offering coverage that wasn't taken or because it was either not affordable or didn't provide minimum value.[67]

Practice Tip: An employer isn't subject to an assessable penalty under Section 4980H(a) or (b) during the first three consecutive full calendar months after the employee is determined to be eligible for an offer of coverage if the employee is offered coverage that is effective no later than the first day of the first calendar month following the three consecutive full calendar months if the employee is still employed on such last day. The employer is only protected from the (b) penalty if the coverage provided on such date provides minimum value.[68]

A special rule addresses calculations using weekly instead of monthly periods.

Rehire Rules for the Monthly Method

The above special rules for the initial determination of eligibility and offer of coverage may only be used once per "period of employment." A period of employment ends when an employee's employment terminates, but if an employee terminates and then returns in a way the regulations determines constitutes a rehire, then the monthly method determination may apply again to the rehire to determine again if the individual is a FTE.[69]

[58] Treas. Reg. § 54.4980H-3(a).
[59] Treas. Reg. § 54.4980H-3(b)(3)(ii).
[60] Treas. Reg. § 54.4980H-3(b).
[61] Treas. Reg. 54.4980H-1(a)(21)(i) and § 54.4980H-3(a).
[62] Treas. Reg. § 54.4980H-3(b)(3)(ii).
[63] Treas. Reg. § 54.4980H-3(a) and (c)(1).
[64] I.R.C. § 480B(f)(2)(B)(i)(I); Treas. Reg. § 54.4980B-4, Q&A 1(b).
[65] Treas. Reg. § 54.4980H-3(c)(2).
[66] Treas. Reg. § 54.9815-2708(a), (b) and (c).
[67] Treas. Reg. § 54.4980H-3(c)(2).
[68] Treas. Reg. § 54.4980H-3(c)(2).
[69] Treas. Reg. § 54.4980H-3(c)(2).

An employee who terminates employment and has no hours of service with the ALE for at least 13 consecutive weeks immediately before he resumes service and then resumes employment (other than a teacher working for an education organization),[70] is treated as being a new employee when he is rehired.[71] Since such employee is treated as a new employee and not a continuing employee, he must satisfy the test to be a FTE again.

If an individual is employed by an education organization, the employee must not provide any services to the education organization for 26 consecutive weeks before he is rehired to be treated as a new hire and not a continuing employee.[72] Even if an employee is a continuing employee, he still must be a continuing FTE in order for the tax to be potentially applicable to him. If an employee is absent from work due to an unpaid FMLA leave, USERRA leave or jury duty, the averaging method, which imputes hours during such unpaid leaves, doesn't apply if an employer uses the monthly measurement period.[73]

The fact that a returning employee is treated as a continuing employee and not as a new employee means the employee is tested as if he was first eligible under the monthly measurement method and as if he hadn't suffered a period during which he had no hours of service worked. A continuing employee is treated as being offered coverage upon resumption of services, if such continuing employee is offered coverage as of the first day that employee is credited with an hour of service, or as soon as administratively practicable.[74]

Rule of Parity for Rehires

A special "rule of parity" was provided for employers who wanted to disregard earlier service, but wanted to do so earlier than after 13 weeks with no service. The rule permits the employer to select a period of four to 12 weeks during which no services are provided as the threshold from when the employee is treated as a new hire. If an employer elects this method, and if the employee's number of weeks before the period without service is less than the duration of the period without any hours of service, then the employee is a new hire. If the period before the break is 13 weeks or longer for non-education organization employees or 26 weeks or longer for education organization employees, then the employee is treated as a continuing employee.[75]

Expatriates

For purposes of calculating the Section 4980H penalty, if an employee is transferred to another member of the ALE or within the ALE to a position that is anticipated to continue for at least 12 months or expected to be indefinite and substantially all of the employee's compensation in such position will be income from sources outside of the U.S., then the ALE may treat that expatriate's employment as terminated when calculating the Section 4980H penalty. This means such expatriates will need to be coded as not employed or not subject to Section 4980H as an expatriate outside the U.S. if they are employed by an entity subject to Section 4980H and their employment isn't transferred to a non-U.S. entity.[76]

Impatriates

For an individual who formerly was an expatriate as explained above who transfers to a position with an ALE that is within the U.S. and with respect to which the income will be from U.S. sources, the ALE may treat this inbound individual as a new hire "to the extent consistent with the rules related to rehired individuals."[77]

Lookback Measurement/Stability Period Method

The *second* option for testing for full-time status is to use the lookback measurement/stability period method of testing. This method determines a person's full-time status by looking back at their hours worked during a lookback measurement period chosen by the employer. This is followed by the administrative period during which the employer determines if the individual met the requirements for full-time status during the lookback period and then offers coverage to be effective at the beginning of the stability period. The stability period is the period during which the individual is deemed to stay in the status determined for them by the administrative period, and if such status was full-time, the individual must be offered coverage by the full stability period, unless they terminate employment.

Under the lookback measurement/stability period, there is an initial split between those hired in a position expected to work at least 30 hours per week and those who are seasonal employees, variable hour employees and part-time employees.[78] Any employee who is hired into a position in which the individual is expected to work 30 or more hours per week, and who isn't a seasonal employee, variable hour employee or part-time employee (a "SEVPTE"), is automatically counted as an FTE unless they are excluded for another reason, such as being an expatriate.[79]

Practice Tip: The FTEs are not subject to further testing as long as their position doesn't change. The full-time status is decided based on the facts and circumstances at the time the individual is hired. The lookback measurement/stability period testing then applies to the SEVPTEs.[80] This is an important clarification because it makes it clear that even a SEVPTE who may work 30 or more hours per week for a limited period is still subject to being tested to determine if the individual is an FTE. When one is determined

[70] Treas. Reg. § 54.4980H-1(a)(13).
[71] Treas. Reg. § 54.4980H-3(c)(4).
[72] Treas. Reg. § 54.4980H-3(c)(4)(ii).
[73] Treas. Reg. § 54.4980H-3(c)(4)(iii).
[74] Treas. Reg. § 54.4980H-3(c)(4)(iv).
[75] Treas. Reg. § 54.4980H-3(c)(4)(v).
[76] Treas. Reg. § 54.4980H-3(c)(4)(vi).
[77] Treas. Reg. § 54.4980H-3(c)(4)(vi).
[78] Treas. Reg. § 54.4980H-3(d)(2).
[79] *Id.*
[80] Treas. Reg. § 54.4980H-3(d)(2).

to be a FTE, this status interacts with the ACA requirement that waiting periods not exceed 90 days.[81]

The final regulations on the 90-day waiting period were released Feb. 21, 2014.[82]

For the SEVPTEs, those individuals aren't outside of the testing to determine if the individual is a FTE, but instead they are tested using the lookback measurement/stability period testing.[83] A seasonal employee is someone hired into a position for which the customary annual employment is six months or less, e.g., lifeguards working at outdoor pools or beaches in Michigan.[84] The SEVPTEs and their dependents aren't automatically required to be offered health coverage, but it is for the SEVPTEs that an employer must maintain records as to when they meet the full-time status definition during the initial lookback period or during subsequent lookback periods and could subject the employer to a shared-responsibility penalty.

Hours Worked

For both of the testing options for determining FTE status, the hours worked are calculated using the hours for which payment is made or due for hourly employees as explained above. For employees paid on a non-hourly basis, a day's worked equivalency can be used with eight hours per each day worked credited or a weeks-worked method crediting 40 hours for each week in which any work was performed.[85]

The equivalencies can be used as long as the equivalency doesn't result in crediting the individual with fewer hours than those actually worked. An employer can use different equivalency methods for different categories of non-hourly employees as long as the categories are reasonable and consistently applied (and provided the employer's IT department can program the classification codes for the categories and different equivalency rules). The regulations didn't include any special rule with respect to certain industries in which the hours worked are regulated by federal safety laws or regulations.[86]

Initial Measurement/Stability Period for New Employees

The lookback measurement/stability period new employee analysis begins by determining whether a new employee is a SEVPTE or is a FTE for whom the employer may potentially be subject to a penalty. Any person hired into a position to work 30 or more hours per week is a FTE (but not a SEVPTE) that must be offered coverage that will be effective no later than the first day of the fourth full calendar month after his date of hire to avoid a penalty and avoid violating the 90-day limit on waiting periods.[87] A new employee is determined to be a FTE or SEVPTE based upon the facts and circumstances at the time of hire.

SEVPTEs are initially segregated for additional testing under the lookback measurement/stability period testing. When an education organization makes the determination of which employees are seasonal employees, part-time or variable hour employees, it cannot take into account the employment break period (summer) in determining expected hours.[88] Once a new employee who isn't a SEVPTE is determined to be in full-time status during the initial lookback measurement period, he becomes an ongoing employee and is subject to the ongoing employee retesting of full-time status with the frequency of such testing determined by the employer's selection of the lookback measurement and stability periods.[89]

For testing the SEVPTEs, the employer designates a period over which the individual will be measured from initial employment for the related initial eligibility. Then there is a related period during which the determination made based on hours worked in the measurement period, there is an administrative period, and then the determination of the full-time status is applied and must remain in effect, during the stability period. The initial measurement period must be at least three months and not more than 12 months. The stability period for an individual following their initial measurement period must be at least as long as the stability period would be for ongoing employees and it also must be at least six months and no more than 12 months;[90] however if the SEVPTE isn't determined to be a FTE after the initial measurement period, such individual's stability period must not be more than one month longer than their initial measurement period and cannot extend beyond the first standard measurement period and any related administrative period.[91] The stability period is required to immediately follow the measurement and any administrative period. Different administrative periods may also be used for different categories of employees. Employers can track the lookback measurement and stability period using the payroll periods provided certain requirements are met.[92]

New SEVPTE—Initial Lookback Measurement Stability Period

Employers may designate the lookback measurement and stability periods for new hires that aren't FTEs as long as the initial lookback period is at least three months and no more than 12 months and the related stability period is at least six months and no more than 12 months.[93] However, there are limits on the duration of the combined lookback and administrative period that may apply to new SEVPTEs and such combined periods cannot last longer than the last day of the first

[81] *See* Treas. Reg. § 54.9815-2708.
[82] 79 Fed. Reg. 10296 (Feb. 24, 2014).
[83] Treas. Reg. § 54.4980H-3(d)(2) and (3).
[84] Treas. Reg. § 54.4980H-1(a)(38).
[85] Treas. Reg. § 54.4980H-3(b)(3) and § 54.4980H-1(a)(21) and (24).
[86] Treas. Reg. § 54.4980H-3(b).
[87] Treas. Reg. § 54.4980H-3(d)(2); Treas. Reg. § 54.9815-2708.
[88] Treas. Reg. § 54.4980H-3(d)(2)(ii).
[89] Treas. Reg. § 54.4980H-3(d)(2)(i) and § 54.4980H-3(d)(6)(iii).
[90] Treas. Reg. § 54.4980H-3(d)(2)(iii).
[91] *Id.*
[92] Treas. Reg. § 54.4980H-3(d)(3)(ii).
[93] Treas. Reg. § 54.4980H-3(d)(3)(i), (iii) and (v).

calendar month beginning on or after the first anniversary of the employee's start date.

Example: If a new SEVPTE starts on Jan. 15, 2014, and his lookback period begins on the first day of the next month and the employer uses a 12-month lookback period, the lookback period ends on Jan. 31, 2015. But the combined lookback and administrative period cannot extend beyond the last day of the first calendar month beginning on or after the first anniversary of the employee's start date. The first anniversary of this employee's start date is Jan. 15, 2015, and the combined period cannot extend beyond Feb. 28, 2015, the last day of the first month following the anniversary of the employee's start date.[94]

If the lookback period is shorter than 12 months, then the administrative period may be longer but it cannot exceed 90 days. For a new hire, the administrative period includes all periods between the start date of a new SEVPTE and the date the employee is first offered coverage.[95]

The Initial Lookback Measurement/Stability Period

If a new employee isn't determined to be a FTE in the initial lookback measurement period, then the employer may generally treat the new employee as not being a FTE for the full initial stability period except that the initial stability period cannot be more than one month longer than the initial measurement period and it must not exceed the remainder of the first entire standard measurement period (including any administrative period).[96] However, if a new SEVPTE has a change in his employment status before the end of the initial measurement period in such a way that the SEVPTE's position would have been reasonably considered to be a full-time position, the employer won't be subject to an assessable penalty under either of the alternative penalty provisions for the period before the first day of the fourth calendar month following the change in employment status. So, if an employee has a change in employment status to full-time during the initial the measurement period, that change in his employment status from variable hour to full-time status terminates looking at the full measurement period and moves the employee to full-time status for the penalty calculation for the fourth month following the date of his change to a full-time employment status. This change in status would apply possibly even before the stability period would have applied if he had completed the initial measurement period.[97]

If a SEVPTE averages more than 30 hours per week during the initial measurement period and the employee is offered coverage by the first day of the first month following the end of the initial measurement period, then the employer won't be subject to an assessable penalty for such employee provided the employee is offered coverage that is affordable and provides minimum value during such time period.[98]

An employer may vary the initial measurement period and stability period within the parameters explained elsewhere in the regulations and this report for the following categories of employees:

- collectively bargained v. non-collectively bargained,
- each separate collectively bargained group under a separate collective bargaining agreement,
- salaried v. hourly employees, and
- employees whose primary places of employment are in different states.[99]

With respect to new SEVPTEs by an ALE Member and for the certain categories of employees, once an employee is determined to be a FTE in an initial measurement period, that status remains in effect for the full related stability period.[100]

Transitioning from Initial Lookback/Stability Period to Ongoing

When a SEVPTE has been employed for a full standard measurement period, the individual must be tested based on such standard measurement period in the same manner and under the same conditions as the employer tests other ongoing employers. Thereafter, the employee's status is determined in the same way as other ongoing employees.[101]

Ongoing Employees

There is also a measurement and stability period for ongoing employees for whom records must be kept and there are rules related to transitioning from the initial measurement/stability period to ongoing measurement/stability periods. If the measurement/stability period method is chosen, the employer must maintain records of hours worked for each employee's initial measurement period and for each ongoing measurement period for ongoing SEVPTEs and SEVPTEs that qualify as FTEs for one measurement/stability period.

Practice Tip: The employer may use different measurement periods for different categories of employees as long as the records can be procured for each employee's respective initial and ongoing measurement period (and IT is willing).

Ongoing Employer Measurement/Stability Period

The administrative period is the period during which an employer must determine that the employee is or isn't a FTE, and prepare to offer the FTE coverage.

The individual's status and health plan coverage applies after the administrative period following the measurement period during the related stability period. There are limits on how long the administrative period may extend depending upon the duration of the lookback measurement period. While an employer isn't required to use an administrative period, as a practical matter

[94] Treas. Reg. § 54.4980H-3(d)(3)(vi).
[95] Treas. Reg. § 54.4980H-3(d)(3)(v) and (vi).
[96] Treas. Reg. § 54.4980H-3(d)(3)(vi).
[97] Treas. Reg. § 54.4980H-3(d)(3)(vii).
[98] *Id.*
[99] Treas. Reg. § 54.4980H-3(d)(1)(v) and § 54.4980H-3(d)(3)(v).
[100] § 54.4980H-3(d)(4)(ii).
[101] Treas. Reg. § 54.4980H-3(d)(4).

most employers will need time to make the determination and offer coverage to the FTE in a manner compliant with all applicable requirements and disclosures. The administrative period may not increase or decrease the length of the measurement or stability periods and any waiting period cannot exceed 90 days.[102] Special rules apply when longer lookback measurement periods are used to provide a combined limitation on the initial measurement period when combined with the administrative period as discussed above. Health plan coverage must be maintained for the duration of each stability period with respect to a measurement period during which the individual was determined to be a FTE.

The stability period for an ongoing employee must be at least six months and it cannot exceed 12 months. The stability period may not be shorter than the lookback measurement period. The lookback measurement period for ongoing employees must be at least three months and no longer than 12 months. There are also rules regarding the lookback measurement and stability period and how they must relate to each other. The four classifications of employees by which the measurement/stability period may vary are: (1) salaried v. hourly, (2) collective bargaining unit member, (3) member of different collective bargaining units, and (4) employees whose primary place of employment is in different states. However, there are additional limits and rules that apply in designating the lookback measurement and stability period and the employer needs to be sure that all of those are addressed.

Practice Tip: The lookback stability periods determinations must be made on a uniform and consistent basis across all employees in the same category.[103]

For the 2015 plan year, an employer may adopt a transition lookback measurement period as long as it is at least six months long and no longer than 12 months, it begins before July 1, 2014, and it ends no earlier than the first day of the 2015 plan year.

Example: A transition period from April 15, 2014 to Oct. 14, 2014, would be permissible for a Jan. 1, 2015 plan year, with an administrative period from Oct. 15, 2014 to Dec. 31, 2014.[104]

This applies to a stability period beginning in 2015 through the end of that stability period, including any portion of the stability period extending into 2016.

There are special rules for determining FTE status for employees who are rehired or who return after an absence. If an individual performs no hours for at least 13 weeks, the employer may calculate his full-time status as if he were a new hire, provided the employer is not an educational organization. Some of these special rules are explained below.

Special Situations and FTE Determination

Educational organizations have special rules due to the school year employment. Rules for churches are to be provided at a later date.

Expatriates

If an employee transfers to a position outside of the U.S. that is expected to continue for at least 12 months and if substantially all of the compensation for such position will constitute compensation from sources outside of the U.S., that employee is not considered to be a FTE. An individual transferred into employment of the U.S. entity for at least 12 months and whose compensation will constitute U.S. source income is counted as an FTE for whom the pay or play penalty could be assessed. This is slightly different than other tax rules related to inpats and expats, so employers need to be careful in counting these individuals. There are also special rules for certain inpats and expats when they move into the U.S. to permit treating them as new hires for purposes of the pay or play penalty.[105]

Employee Terminations and Rehires and Other Absences

Under the lookback measurement/stability period, for employers other than education organizations, an employee who is absent and doesn't work any hours for 13 or more weeks is treated as having terminated employment and rehired when the individual resumes working. Since the individual is treated as a rehire, the individual is a new employee and subject to the initial lookback measurement period and stability period.[106] If the employee weren't treated as a rehire, he would be a continuing employee and subject to the lookback measurement/stability periods then in effect with the possibility of imputed hours during his absence.

Practice Tip: This rule applies solely to determine if the individual is treated as a new hire or a continuing employee when the individual returns to work and doesn't address whether the individual is a FTE.

Non-Educational Organization Employees

If an employee is on unpaid leave for FMLA, USERRA or jury duty, and she is treated as a continuing employee rather than a new hire because her employment break without any hours of service is shorter than the 13 weeks above or the period for which her status is bridged under the rule of parity if the employer elected to use the rule of parity, then the individual is a continuing employee and for purposes of calculating her service during the measurement period in which the absence occurs the employer may elect to average her hours and impute such hours to her credit for her absence.[107]

The average of new hours worked can be based on just the period during which she wasn't on leave, and, then the average is imputed to the full period of absence for such leaves in the lookback measurement period.

[102] 79 Fed. Reg. 10296 (Feb. 24, 2014); Treas. Reg. § 54.9815-2708.
[103] Treas. Reg. § 54.4980H-3(d)(1) and § 54.4980H-3(e).
[104] 79 Fed. Reg. 8544, 8572 XV.D.2. (Feb. 12, 2014).
[105] Treas. Reg. § 54.4980H-3(d)(6)(v).
[106] Treas. Reg. § 54.4980H-3(d)(6).
[107] Treas. Reg. § 54.4980H-3(d)(6)(i)(B).

Educational Organization Employers and Special Unpaid Leaves for FMLA, USERRA or Jury Duty

An employee of an education organization who doesn't have any hours of service credited for a period of at least 26 consecutive weeks immediately before he resumed working for the education organization will be treated as having terminated employment and as having been rehired with a new initial lookback measurement period and will not be treated as a continuing employee.[108] This is solely for purposes of determining if the individual is included as a new hire or a continuing employee, not for determining if the individual is employed in a full-time status.

If the employee returning from the leave was absent with no hours of service for fewer than 26 consecutive weeks from the education organization, then the individual is treated as a continuing employee and is not subject to a new initial measurement period, instead he reenters the measurement/stability periods then in effect for the individual. The education organization may determine the employee's full-time status for a measurement period including such unpaid leave by either averaging the hours in the measurement period, excluding the period of the unpaid leave or break and using that average for the full period, or the employer may choose to credit the employee for hours of service for the period of the special unpaid leave at a rate equal to the individual's average weekly rate during the weeks within the measurement period that aren't part of the special unpaid leave period. An educational organization isn't required to credit more than 501 hours for a break in service.[109]

An employer computing the employee's average weekly rate may use any reasonable rate and if it is computed for a measure period of less than six months, the six-month period ending with the close of the measurement period is used to compute the average hours of service.[110]

Continuing Employees—Offer of Coverage Requirements

An employee who is treated as a continuing employee upon going back to work resumes the full-time or not status he had with respect to the stability period then in effect for him. A continuing employee who is full-time is treated as offered coverage if the employee is offered coverage as of the first day he works an hour of service when he returns, or as soon as administratively feasible (The term "as soon as administratively feasible" applies if the coverage is offered no later than the first day of the calendar month following the first day the employee works an hour of service).[111]

Practice Tip: The rules regarding continuing employee treatment apply to all continuing employees regardless of the type of employer.

Rule of Parity

Employers may also choose to use a version of the rule of parity for dealing with whether breaks in service constitute a termination and a rehire. The rule of parity was discussed above. A similar rule of parity provision exists in Treas. Reg. § 54.4980H-3(d)(6)(iv) under the monthly measurement method.

Expatriates/Impatriates

Expatriates under the measurement stability period method are also not counted as FTEs, provided they are out of the U.S. for at least 12 months and they have no income from U.S. sources. Similarly inbound individuals are counted subject to the shared-responsibility penalty if they are in the U.S. at least 12 months and have U.S. source income.[112]

Change from Lookback Measurement/Stability Period to Monthly Measurement Period

If the individual was determined to be full-time using the lookback measurement stability method before they transferred to a monthly measurement method position and was in a stability period, the individual must be treated as full-time through the end of the stability period to which the full-time status determination related. If the employee had been determined to not be full-time in the last measurement period and is in the stability period, the employee may continue to use the last determination for the full stability period or the employer can apply the monthly measurement period through the end of the stability period. Once the stability period is over the monthly method applies.[113] The regulations don't address what happens if an employee transfers to a position measured using a different method during the administrative period before the stability period starts.

Change from Use of Monthly Method Position to Lookback/Measurement Stability Method

When an employee transfers from a position for which full-time status is measured under the monthly method to a position using the lookback stability method, different rules apply. If an employer used the monthly measurement method for that employee for determining the employee's full-time status for the duration of the applicable status period in effect when the transfer of employment position occurred, then unless the employee's hours prior to the transfer would have made the employee full-time during the stability period in which the change occurred, the employee must continue to be a FTE for the duration of the related stability period.[114]

If such a change from monthly measurement to the lookback stability period method occurs, then for the stability period following the measurement period during which the employee changed to a position using the lookback measurement/stability period method, the employer must treat the individual as a FTE for any cal-

[108] Treas. Reg. § 54.4980H-3(d)(6)(ii).
[109] Treas. Reg. § 54.4980H-3(d)(6)(ii)(B).
[110] Treas. Reg. § 54.4980H-3(d).
[111] Treas. Reg. § 54.4980H-3(d)(6)(iii).

[112] Treas. Reg. § 54.4980H-3(d)(6)(iv).
[113] Treas. Reg. 26 C.F.R. § 54.4980H-3(f).
[114] Treas. Reg. § 54.4980H-3(f)(1)(ii).

endar month during which either the employee would be treated as a FTE based on the measurement period in which the change in employment status occurred, or would be treated as a FTE under the monthly measurement period.

Query: Does this mean that for an employee transferring from a position using the monthly measurement period to a position using the lookback/stability measurement method the employer must continue to apply the monthly measurement period for the initial lookback/stability period and continue to use the monthly measurement period until the employee completes an initial measurement period in the position using the lookback/stability measurement period method specificed for such position? For any calendar month subsequent to the above stability period, the lookback measurement period applies to determine the employee's full-time status.[115]

Examples: In each example below, the employer is an ALE with 200 full-time employees. For each example, the employer uses the monthly measurement method for determining whether a salaried employee is a FTE, and the look-back measurement method for determining whether an hourly employee is a FTE with a measurement period from October 15 through October 14 of the following calendar year, and a stability period from January 1 through December 31. In each case, the relevant employee has been employed continuously for several years.

Example 1 (Monthly measurement method to look-back measurement method): Employee B is a salaried employee of Employer Y. On July 1, 2017, Employee B transfers to an hourly employee position. Based on Employee B's hours of service from Oct. 15, 2015, through Oct. 14, 2016, Employee B would have been treated as a FTE for the stability period from Jan. 1, 2017, through Dec. 31, 2017, had the look-back measurement method applicable to hourly employees applied to Employee B for the entire stability period. For the calendar months January 2017 through June 2017 (prior to Employee B's change to hourly employee status), Employee B's status as a FTE is determined using the monthly measurement method. For the calendar months July 2017 through December 2017, Employer Y must treat Employee B as a FTE because Employee B would have been treated as a FTE during that portion of the stability period had the look- back measurement method applied to Employee B for that entire stability period. Employee B is employed for hours of service from Oct. 15, 2016, through Oct. 14, 2017, such that under the applicable look-back measurement method Employee B would be treated as a FTE for the period Jan. 1, 2018, through Dec. 31, 2018. Accordingly, Employee B must be treated as a FTE for the calendar year 2018. For calendar year 2019, the determination of whether Employee B is a FTE is made under the applicable look-back measurement method.

[115] Treas. Reg. § 54.4980H-3(f)(1)(ii).

Example 2 (Monthly measurement method to look-back measurement method): Same facts as Example 1, except that based on Employee B's hours of service from Oct. 15, 2015, through Oct. 14, 2016, Employee B would not have been treated as a full-time employee from Jan. 1, 2017, through Dec. 31, 2017. For the calendar months of 2017, Employer Y applies the monthly measurement method to determine Employee B's status as a FTE. Employee B is employed for hours of service from Oct. 15, 2016, through Oct. 14, 2017, such that under the applicable look-back measurement method Employee B would be treated as a FTE for the period Jan. 1, 2018, through Dec. 31, 2018. Accordingly, Employee B must be treated as a FTE for the calendar year 2018. For calendar year 2019, the determination of whether Employee B is a FTE is made under the applicable look-back measurement method.

Example 3 (Monthly measurement method to look-back measurement method): Same facts as Example 1, except that Employee B is employed for hours of service from Oct. 15, 2016, through Oct. 14, 2017, such that under the applicable look-back measurement method Employee B would not be treated as a FTE for the period of Jan. 1, 2018, through Dec. 31, 2018. For the calendar year 2018, Employer Y must treat Employee B as a FTE only for calendar months during which Employee B would be a FTE under the monthly measurement method.[116]

However, if an employee moved from a position measured by the lookback method to a position measured by the monthly method at the ALE, the employer can apply the monthly measurement method to such employee beginning with the last day of the fourth calendar month following the month of the change in status (instead of waiting until the end of the stability period) provided the employee wouldn't have been expected to work 30 or more hours per week. This only applies if the ALE Member had offered the employee coverage with minimum value by the first day of the fourth calendar month after the employee changed employment status, and only if the employee actually averaged less than 30 hours per week for each of the initial three full calendar months following the change to the position measured on a monthly basis.[117] The monthly method can be applied to such persons even if such method isn't applied to other employees in that category.

Examples: For example consider the following situations—in each of the three examples below, the employer is an ALE with 200 FTEs. For each example, the employer uses the monthly measurement method for determining whether a salaried employee is a FTE, and the look-back measurement method for determining whether an hourly employee is a FTE with a measurement period from October 15 through October 14 of the following calendar year, and a stability period from January 1 through December 31. In each case, the rel-

[116] Treas. Reg. § 54.4980H-3(f)(1)(iii).

[117] Treas. Reg. § 54.4980H-3(f)(2)

evant employee has been employed continuously for several years.

Example 1 (Look-back measurement method to monthly measurement method): Employee A is an hourly employee. Based on Employee A's hours of service from Oct. 15, 2015, through Oct. 14, 2016, Employee A is treated as a FTE from Jan. 1, 2017, through Dec. 31, 2017. On July 1, 2017, Employee A transfers from a position as an hourly employee to a position as a salaried employee. For the months July 2017 through December 2017, Employee A must be treated as a FTE. Employee A is employed for hours of service from Oct. 15, 2016, through Oct. 14, 2017, such that under the applicable look-back measurement method Employee A would be treated as a FTE for the period of Jan. 1, 2018, through Dec. 31, 2018. Accordingly, Employee A must be treated as a FTE for the calendar year 2018. For calendar year 2019, the determination of whether Employee A is a FTE is made under the monthly measurement method.

Example 2 (Look-back measurement method to monthly measurement method): Same facts as Example 1, except that based on Employee A's hours of service from Oct. 15, 2015, through Oct. 14, 2016, Employee A is not treated as a full-time employee from Jan. 1, 2017, through Dec. 31, 2017. For the months July 2017 through December 2017, Employer Z may either treat Employee A as not a FTE or apply the monthly measurement method to determine Employee A's status as a FTE. Employee A is employed for hours of service from Oct. 15, 2016, through Oct. 14, 2017, such that under the applicable look-back measurement method Employee A would be treated as a FTE for the period of Jan. 1, 2018, through Dec. 31, 2018. Employee A must be treated as a FTE for the calendar year 2018. For calendar year 2019, the determination of whether Employee A is a FTE is made under the monthly measurement method.

Example 3 (Look-back measurement method to monthly measurement method): Same facts as Example 1, except that Employee A is employed for hours of service from Oct. 15, 2016, through Oct. 14, 2017, such that under the applicable look-back measurement method Employee A would not be treated as a FTE for the period of Jan. 1, 2018, through Dec. 31, 2018. For the calendar year 2018, Employer Z must treat Employee A as a FTE only for calendar months during which Employee A would be a FTE under the monthly measurement method. For calendar year 2019, the determination of whether Employee A is a FTE is made under the monthly measurement method.[118]

Nonpayment or Late Payment of Premiums

If an employee fails to pay the premium due to cover himself or his dependents and the coverage is terminated during the period solely for failure to pay the premium, the employee isn't treated as failing to offer a FTE coverage for such period when coverage was terminated. However, the employer is only treated as not failing to offer the employee and his dependents coverage through the end of the coverage period (typically the plan year) if the plan complies with COBRA's premium payment rules in Treas. Reg. § 54.4980B-8, Q&A 5, which requires: 30-day grace period rule, disclosure to healthcare providers and others pending premium payment regarding covered status, the "not significantly less" rule and payments are treated as made on the date sent to the plan.[119]

Effective Date

The regulations in Treas. Reg. § 54.4980H-1, -2 and -3 relate to determination of full-time status, ALE status and the applicable definitions are effective on and after Jan. 1, 2014.

Shared Employees, Multiemployer Plans, Employees of Staffing Firms and the Section 4980H(a) Penalty

For ALEs who may share employees and allocate their services among a number of the members of the ALE (e.g., an ALE who allocates one member of its legal department staff to be the general counsel to two of its separate subsidiaries), the fact that one entity that is a member of the ALE's controlled group offers health coverage to the shared attorney satisfies the requirement that all of the ALE Members may have to offer coverage to such employee.[120] Similarly for an employer that participates in a multiemployer plan under a collective bargaining agreement with the sponsor of the multiemployer plan, the offer of coverage to the collective bargaining unit member by the collective bargaining unit sponsoring the multiemployer plan, Taft-Hartley plan or multiple employer welfare arrangement is treated as an offer of coverage made by the employer for that month.[121] If a FTE works for more than one ALE Member during a month, the Section 4980H penalty is the obligation of the ALE Member for whom the employee has the greatest number of hours of service during the calendar month in question.[122]

Staffing Firms. If an employer contracts with a staffing firm to handle the employment of some or all of its employees and the employees aren't common law employees of the staffing firm and the staffing firm offers the employees leased to the employer health coverage under a plan maintained by the staffing firm, such offer of coverage by the staffing firm is treated as made by the client employer who contracted with the staffing firm for purposes of the Section 4980H penalties only if the fee the employer pays to the staffing firm for the employee enrolled in the staffing firm's health plan is higher than the fee the employer would pay to the staffing firm for a similar employee if that employee didn't enroll in the staffing firm's health plan.[123]

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[118] Treas. Reg. § 54.4980H-3(f)(1)(iii).

[119] Treas. Reg. § 54.4980H-3(g).

[120] Treas. Reg. § 54.4980H-4(b)(2).

[121] *Id.*

[122] Treas. Reg. § 54.4980H-4(d).

[123] *Id.*

When Has an Employer Offered Coverage?

In order for an employer to satisfy the requirement that it offered coverage to its FTEs to avoid the Section 4980H(a) penalty, it must provide its FTEs with an effective opportunity to elect to enroll in coverage at least once with respect to each plan year.[124]

Practice Tip: An opportunity to enroll during open enrollment annually suffices and employers aren't required to have a continuous open enrollment period during the plan year; however, it is important to remember that the special enrollment periods for addition of a dependent due to marriage, birth, adoption or placement for adoption or for loss of other coverage under HIPAA still apply[125] and that the cafeteria plan regulations governing when an election can be changed in the middle of a plan year also still apply to determine whether the change is a permitted pretax mid-year change in election of benefits.[126]

One advantage of using the lookback measurement stability period is it can be set to somewhat closely approximate a plan year entity date so eligibility is determined close to annual enrollment for entry following annual enrollment. However, using a single plan year entry forces open enrollment later in the plan year. If lookback measurement/stability periods are used for eligibility, they could result in needing to offer coverage more than once per year, which will present issues under cafeteria plan rules. To date the cafeteria plan regulations defining when a change in status has occurred haven't been changed to accommodate a change in an employee's status as full-time or ceasing to be full-time under Section 4980H.

In addition to the one-time-per-plan-year offer requirement, the opportunity to enroll must be for enrollment in coverage that provides minimum value and is affordable, which requires that the employee contribution required to obtain the coverage be less than 9.5 percent of a monthly amount for a single individual (calculated as the federal poverty level for the 48 contiguous states and Washington, D.C., for a single person for that year divided by 12).[127] Other safe harbor methods exist for calculating what is affordable as well.

If a plan provides for an evergreen election of coverage from one year to the next, with last year's election of coverage automatically renewing for the next year unless the employee makes a different affirmative election, that evergreen election still constitutes an effective annual offer of coverage for purposes of having offered coverage for avoidance of the failure to offer coverage penalty.[128]

Amount of Coverage to Avoid Section 4980H(a) Penalty

For an ALE Member to avoid the assessment of a Section 4980H penalty, the ALE Member must not fail to offer coverage to a FTE for any day in the calendar month in question.

Caution: An employer's failure to offer coverage for one day in a calendar month (regardless of the use of the payroll period or special weekly rules) results in the employer being required to treat that FTE as not being offered health coverage for that calendar month.[129]

There is an exception to this rule applicable in the month in which a FTE terminates employment provided the terminated employee would have been offered coverage for the full month if the employee had been employed for the full calendar month. In this situation, the ALE Member isn't subject to an assessable penalty for the FTE whose employment terminated during the month. A similar rule applies for the calendar month in which the employee starts working as a FTE if the employee starts employment on any date other than the first day of the calendar month to permit the ALE to treat the newly hired employee as covered for the entire calendar month.[130]

These special rules must be considered when determining how to report on each employee's coverage.

Determining if Your Coverage Is Affordable

An employer can use one of three safe harbors to determine if its coverage is affordable and less than 9.5 percent of an amount deemed to be the employee's household income.

The three safe harbors are to use:

- the employee's Form W-2 wages at the end of the year,
- the rate of pay safe harbor (which multiplies the employee's base pay rate by 130 hours), or
- the federal poverty level.

Only the "rate of pay" and "federal poverty level" safe harbors permit the employer to determine prior to the end of the calendar year if the coverage provided to employees meets the affordability requirement.[131]

W-2 Compensation Safe Harbor

If an employer uses Form W-2 compensation as a proxy for household income, then the employer won't be subject to a shared-responsibility penalty with respect to any of its FTEs if that employees' required contributions toward health insurance premiums for the year—for the lowest cost self-only coverage offered by the employer that provides minimum value—if the premiums are less than 9.5 percent of the employees' Form W-2 wages from the employer for that calendar year.

In order to be able to use this safe harbor, the employees' contribution toward their premiums must remain a constant amount or percentage of wages all year so that the ALE Member or ALE isn't permitted to make discretionary adjustments to the premium during the year.[132]

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[124] Treas. Reg. § 54.4980H-4(b).
[125] See I.R.C. § 9801(f) or ERISA § 701(f).
[126] Treas. Reg. § 1.125-4.
[127] Treas. Reg. § 54.4980H-4(b).
[128] Treas. Reg. § 54.4980H-4(b)(1).
[129] Treas. Reg. § 54.4980H-4(c).
[130] Treas. Reg. § 54.4980H-4(c).
[131] Treas. Reg. § 54.4980H-5(e).
[132] Treas. Reg. 54.4980H-5(e)(2)(ii).

Practice Tip: A consistent percentage of W-2 wages for the year that is subject to an absolute annual dollar cap on the total premium paid is permissible.

If coverage wasn't offered for the entire year, then the W-2 wages amount must be prorated for the period during which coverage was offered. For purposes of doing this proration, employment during one day in the month is treated as employment for the full month to determine the applicable fraction for proration of wages based upon the fraction obtained by dividing the number of calendar months during which coverage was offered by the number of calendar months in which the individual was employed during the calendar year.[133] For calculating whether one has minimum essential coverage, coverage for one day in a month counts as an entire month of coverage. This is different from other standards used for determining whether coverage was offered, where one day of coverage isn't treated as any coverage for a month and any day in a month for which one doesn't have coverage means they weren't offered coverage for that month.

Practice Tip: Due to the complexity of these rules and the related programming issues and reporting requirements, there appear to be reasons for employers to consider extending any coverage that might terminate mid-month automatically to the last day of the month so the month is counted in the same manner for all purposes related to the penalty assessment. Employers might also want to delay offering coverage until the beginning of a month following the month of hire to avoid potential months of compensation being compared to the cost of a full month of coverage and to fully utilize administrative periods and other mechanisms that treat months after initial hire as not subject to the penalty.

Rate of Pay Safe Harbor

The "rate of pay" safe harbor is one of two affordability safe harbors that can be used prospectively to plan to minimize any penalty.

The rate of pay safe harbor for an *hourly* employee is satisfied if the monthly premium the employee must pay for self-only coverage is less than 9.5 percent of the amount obtained by multiplying the employee's rate of pay per hour as of the first day of the coverage period times 130 hours per month, and the employer's coverage provides minimum value.

An ALE Member satisfies the rate of pay safe harbor with respect to a *salaried* employee if the employee's required monthly contribution toward self-only coverage is less than 9.5 percent of the employee's monthly salary calculated as of the first day of the coverage period. Any reasonable method can be used to convert payroll periods to monthly salary.

If coverage is offered on one day during the month under this safe harbor, the entire calendar month is counted both for purposes of determining the assumed income for the calendar month and for determining the employee's share of the premium for the calendar month.[134]

Practice Tip: The "rate of pay" safe harbor is one of the two safe harbors that can be used to determine on a prospective basis if coverage will be affordable for a particular employee, which may be helpful to employers trying to plan to avoid the shared-responsibility penalty. The income is imputed under this safe harbor regardless of the number of hours the individual actually works.

Federal Poverty Line Safe Harbor

The "federal poverty line" safe harbor applies to an employee if for a calendar month, the employee's required contribution is less than 9.5 percent of the monthly amount of the federal poverty line for a single individual for the applicable calendar year (i.e., federal poverty line for single individual divided by 12).[135]

If coverage is offered on one day during the month under this safe harbor, the entire calendar month is counted both for purposes of determining the assumed income for the calendar month and for determining the employee's share of the premium for the calendar month.

Practice Tip: The "federal poverty line" safe harbor is one of the two safe harbors that can be used to determine on a prospective basis if a coverage will be affordable for a particular employee, which may be helpful to employers trying to plan to avoid the shared-responsibility penalty.

Calculation of the Assessable Penalty under Section 4980H(a)—Failure to Offer Coverage

If an ALE isn't able to pass the test that it offered coverage to 95 percent or more of its FTEs or that it didn't offer coverage that provided minimum value and was affordable to fewer than five of its FTEs (or meet the related transitional rule) in any calendar month, then the ALE Members will each be subject to the assessable penalty of $2,000 times 1⁄12 times the number of FTEs employed for such month, less the ALE Member's allocable share of the 30 freebies.[136]

Each ALE Member is allocated a share of the 30 FTE reduction under Section 4980H(c)(2)(D)(i)(I) (the 30 freebies) to reduce its share of the Section 4980H(a) penalty tax. An ALE Member's allocated share of the 30 freebies is calculated by calculating the ALE Member's pro rata share of the 30 freebies based upon the number of FTEs that ALE Member employs as compared to the number of FTEs employed by all of the other ALE Members of the ALE for that month.[137]

Practice Tip: It is important that each ALE Member have a monthly count of the number of FTEs it employs for that month.

The calculation of the number of FTEs employed by an ALE Member considers the rules for allocating shared employees discussed herein. If the allocation of the 30

[133] *Id.*

[134] Treas. Reg. § 54.4980H-5(e)(2)(iii).

[135] Treas. Reg. § 54.4980H-5(e)(2)(iv).

[136] I.R.C. § 4980H(a) and Treas. Reg. § 54.4980H-4(d) and (e); *see* Transition Rule below for 2015 modification.

[137] Treas. Reg. § 54.4980H-4(e).

freebies results in an ALE Member being allocated a fractional freebie, then the fractional freebie is rounded to the next highest whole number—this rounding is done even if it means that the total number of freebies allocated to the ALE exceeds 30.[138]

If the employee has an equal number of hours for more than one ALE Member, then the ALE Members may determine which ALE Member is the employer of that employee for the month. If the ALE Members aren't able to agree and select which one will be the employer, then the IRS will select which ALE Member will be treated as the employer of the employee for purposes of the Section 4980H penalty assessment.[139] The regulation governing the penalty calculation under Section 4980H(a) is effective for periods after Dec. 31, 2014, because this tax is applicable in 2015.[140]

An employer isn't subject to an assessable penalty under Section 4980H(a) or (b) during the first three consecutive full calendar months after the employee is determined to be eligible for an offer of coverage if the employee is offered coverage that is effective no later than the first day of the first calendar month following the three consecutive full calendar months if the employee is still employed on such last day. The employer is only protected from the Section 4980H(b) penalty if the coverage provided on such date provides minimum value.[141] A special rule addresses calculations using weekly instead of monthly periods.

Calculation of the Assessable Penalty under Section 4980H(b)—Offered Coverage, but Employees Went to Marketplace and the Employer's Coverage Wasn't Affordable or Didn't Provide Minimum Value

If an ALE offers coverage to its FTEs and their dependents in any calendar month, and the ALE received a Section 1411 Certification with respect to one or more FTEs of the ALE or one of its ALE Members because the coverage either doesn't provide minimum value or isn't affordable, and the employee or dependents instead obtain coverage on the marketplace, then the ALE Member is subject to the assessable tax, which is equal to the product of the number of FTEs of the ALE Member for which it has received such a certification (that the employee received a tax credit or cost-sharing reduction on the marketplace) less the number of such employees who were offered coverage providing minimum value that met one of the affordability safe harbors, and less the number of the employees in a limited non-assessment period, times $3,000 times 1⁄12th.[142]

Once such amount is calculated, then it is compared to the penalty assessed under Section 4980H(a) and the lesser of the two amounts is the assessable penalty for that calendar month. This means the assessable penalty based on FTEs must be calculated under both methods for each month, unless the safe harbor for offering coverage to 95 percent is satisfied, in which case the penalty under Section 4980H(b) must be calculated after the safe harbor offer of coverage is documented. [143]

An offer of coverage for this purpose has the same meaning as an offer of coverage under Section 4980H(a) as discussed above.[144] In the same way that offering coverage for only a partial month in the Section 4980H(a) penalty calculation is treated as not offering coverage, failing to offer coverage for any day also is treated as not offering coverage for the month for the Section 4980H(b) penalty.[145] However, if an employee could have had a full month of coverage by paying the premium for continuing his coverage after his employment terminated, then his partial month of coverage is treated as a full month of coverage. No penalty is assessed on a FTE for the month in which he starts employment other than on the first day of the month for purposes of the Section 4980H(b) penalty.[146]

The Section 4980H(b) penalty is assessed on the ALE Member that employed the individual for the month in question, and if the employee was shared by two or more ALE Members, then the member with the most hours of service for that month is liable for the penalty for the FTE. If the FTE worked for an equal number of hours for two or more ALE Members, then the ALE Members may either agree which one will be treated as the employer, or if there is no agreement or if they take inconsistent positions (i.e., they fail to play well in the sandbox), then the IRS will determine which ALE Member should be liable.[147]

If the coverage was offered and provided minimum value to the FTEs, the next defense against assessment of a penalty is to show that the employee's share of the cost of coverage was "affordable" to the employee—that it cost less than 9.5 percent of one of the proxies for his household income.

As discussed above, three safe harbors can be used as a proxy for the FTE's household income. Two of the safe harbors permit a prospective calculation that can permit an employer to plan to avoid the penalty. The third safe harbor looks at wages after the end of the year as reported on Form W-2.

The safe harbors will apply even if they don't mean the coverage is affordable for any particular employee under the health care tax credit regulation provisions and that an applicable premium tax credit or cost-sharing reduction is allowed with respect to such employee. An employer can use one or more of the affordability safe harbors only if it offers its FTEs and their dependents the opportunity to enroll in health coverage that provides minimum value with respect to self-only coverage under an eligible employer-sponsored plan.

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[138] *Id.*
[139] Treas. Reg. § 54.4980H-4(d).
[140] Treas. Reg. § 54.4980H-4(g).
[141] Treas. Reg. § 54.4980H-3(c)(2).
[142] Treas. Reg. § 54.4980H-5(a).

[143] *Id.*
[144] Treas. Reg. § 54.4980H-5(b)
[145] Treas. Reg. § 54.4980H-5(c)
[146] *Id.*
[147] Treas. Reg. § 54.4980H-5(d)

Practice Tip: An employer may choose to apply the safe harbors to any group of employees or a reasonable category of employees that are applied in a uniform and consistent manner. Reasonable categories include specified job categories, nature of compensation (hourly or salary), geographic location and similar bona fide business criteria. Employees categorized by inclusion on a list of names isn't a reasonable category.[148]

Transition Rule for Pay or Play Penalty Tax Based on Number of FTEs and FTEEs

Transition relief provided in the preamble to the proposed regulations, as corrected, applies for 2014.[149] (See the chart at the end of this report for the transition relief for the penalty tax provided in the proposed regulations.) The final regulations provided broader transition relief than the proposed regulations. The IRS said in July 2013 that no assessable penalty will apply for 2014.[150] It is important to distinguish which transition relief provisions are being used and exactly what relief they provide.

Caution: The transition relief provisions under Section 4980H don't relieve employers from the reporting obligations under Sections 6055 and 6056 and vice-versa.

Employers who have 50 or more individuals who are treated as either FTEs or FTEEs and less than 100 FTEs won't have to pay the assessable penalty for any individual in 2014 or 2015 and the pay or play penalty won't apply to those ALEs until 2016.[151] This also applies for non-calendar year plans for employers of this size for the non-calendar year plan that begins in 2015 and extends to the part of that plan year that falls in 2016.[152] Employers with 100 or more employees who are either FTEs or FTEEs on more than 120 days in the prior calendar year will be required to comply in 2015 and pay the penalty in 2015 for anyone who doesn't meet the requirements.[153]

Calendar Year Plan Transition Relief

Transition Relief for Determining Full-time Employee Status

The determination of FTE status is based upon hours worked during the lookback measurement period prior to the stability period when the individual must be treated as being in that status for the duration of such stability period. For purposes of the stability period set to begin during 2015 an employer under this transition rule may adopt a lookback measurement period that is less than 12 consecutive months, but which is at least six months, and that begins on or before July 1, 2014, and ends no sooner than 90 days before the first day of the plan year beginning on or after Jan. 1, 2015 (90 days is the maximum permissible administrative period).

Example: An employer with a calendar year plan may use a measurement period from April 15, 2014, through Oct. 14, 2014, which is the six month minimum duration, which is followed by an administrative period that ends on Dec. 31, 2014 (less than the 90 day maximum administrative period) with coverage beginning Jan. 1, 2015. This guidance applies only to stability periods that begin in 2015 and won't apply in plan years after 2015. It also won't apply for any stability period that occurs after the initial transition stability period. This only applies to employees who are employed as of the first day of the transition measurement period and in this example, that means it only applies to the employees employed on April 15, 2014, and not to any hired after April 15, 2014. Any employee hired after the initial transition measurement period is subject to the new general rules.[154]

Transition Relief for Determining Applicable Large Employer Status for 2015

An ALE with respect to a particular calendar year is an employer that employed on the average at least 50 FTEs, including FTEEs, on business days during the preceding calendar year. For the 2015 calendar year, there is a transition rule that permits an employer to determine its status as an ALE by reference to a period that is at least six consecutive calendar months long and is chosen by the employer during the 2014 calendar year instead of using the full 2014 calendar year. This means that an employer in 2014 may designate six consecutive calendar months during which it will determine whether it is an ALE for 2015 by determining the average number of FTEs and FTEEs on business days during those six consecutive months in 2014.

Seasonal Workers: The determination of whether any seasonal workers are included in the group that may potentially be excluded from the count of FTEs and FTEEs in 2014 is based on the calendar year rather than on the calendar months chosen by the employer under the transition rule. This means that for the use of a seasonal worker exception an employer would need to be able to know the number of employees on each month during the calendar year in 2014 even though it may be making a determination of ALE status based on a six-month segment for 2014.

There is no special rule for educational organizations in this transition rule. The transition rule regarding counting during 2014 to determine ALE status in 2015 may also be used for purposes of the rule regarding the 2015 transition relief for ALEs with fewer than 100 FTEs, including FTEEs.[155]

Transition Rule Regarding Offering Coverage for January 2015

Many employers offer coverage that commences on the first day of a pay period rather than on the first day of a calendar month. The ACA regulations require that coverage be offered on every day of the month in order

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[148] Treas. Reg. § 54.4980H-5(e)(2).
[149] 79 Fed. Reg. 8544, 8569 XV.A. (Feb. 12, 2014).
[150] Notice 2013-45.
[151] 79 Fed. Reg. 8544, 8574 XV.D.6. (Feb. 12, 2014).
[152] I.R.C. § 4980H(a) or § 4980H(b).
[153] 79 Fed. Reg. 8544, 8574 XV.D.6. (Feb. 12, 2014), I.R.C. § 4980H.
[154] 79 Fed. Reg. 8544, 8572 XV.D.2. (Feb. 12, 2014).
[155] 79 Fed. Reg. 8544, 8572 XV.D.3. (Feb. 12, 2014).

for the employer to avoid the shared-responsibility penalty for that employee for that month.

In order to accommodate the fact that many employers base coverage commencement on the first day of the pay period in the new year, for January 2015 (and only January 2015) the transition rule treats such coverage as existing for the full month of January 2015 only if ALE Member offers coverage to a FTE no later than the first day of the first payroll period that begins in January 2015.[156]

Transition Rule for Coverage of Dependents

In order to avoid a potential assessable penalty under Section 4980H, an ALE Member must offer coverage to its FTEs and the FTEs' dependents. The preamble to the proposed regulations provided a transition rule for 2014. The final regulations extend relief to plans that hadn't previously offered dependent coverage for plan years beginning in 2015 if certain circumstances are met.

This relief applies to employers who for the 2015 plan year have plans that don't offer dependent coverage, or that offer dependent coverage that doesn't constitute minimum essential coverage, or dependent coverage is offered for some, but not all dependents. The relief as extended applies only with respect to dependents who were without an offer of coverage from the employer in both the 2013 and 2014 plan years. This relief is only available if the employer takes steps during the 2014 or 2015 plan year or both to extend coverage under the plan to the dependents not offered coverage during the 2013 or 2014 plan year.[157]

2015 Transition Relief for ALEs With Fewer Than 100 Full-Time Employees or Full-Time Equivalent Employees

A discussion of this transition relief for employers with fewer than 100 FTEs and FTEEs is contained in the report at "Effective Date Delayed." This transition rule is available to employers with fewer than 100 FTEs and FTEEs and applies for all of 2015 for calendar-year plans and for plan years beginning in 2015 for non-calendar year plans.

This rule precludes an employer being subject to the assessable penalties under Section 4980H(a) or (b). In order to be eligible for this transition relief, the number of FTEs and FTEEs must be at least 50 but less than 100 on business days during 2014. The number of FTEs is determined under the regulations. For the period beginning Feb. 9, 2014, and ending Dec. 31, 2014, the employer must not reduce the size of its workforce or the overall hours of service of its employees in order to fit within this special extension. Any workforce reduction or reduction in the overall service hours for bona fide business reasons won't be considered to have been made to satisfy the workforce size condition of this type of transition relief.

A coverage maintenance period is required to be complied with during which the employer must not eliminate or materially reduce the health coverage it offers to employees. The maintenance period begins on Feb. 9, 2014. The employer isn't considered as eliminating or materially reducing health coverage if it continues to offer each employee who is eligible for coverage during the coverage maintenance period an employer contribution towards the cost of employee-only coverage that either is at least 95 percent of the dollar amount of the contribution towards such coverage that the employer was offering on Feb. 9, 2014, or is the same, or a higher, percentage of the cost of coverage that the employer was offering to contribute for the employee as of Feb. 9, 2014.

In the event there was a change in benefits under the employee-only coverage offered, and the coverage will still provide minimum value after the change, and the employer doesn't alter the terms of the group health plan to narrow or reduce the classes of employees who are offered coverage as of Feb. 9, 2014, it qualifies. The coverage maintenance period runs from Feb. 9, 2014, and ends on Dec. 31, 2015 for calendar-year plans. Thus, the contribution toward the benefits must be maintained from the level of contribution on Feb. 9, 2014, through Dec. 31, 2015. Each employer must certify on the form prescribed by the IRS its compliance with the requirements with respect to the limited workforce size, its maintenance of previously offered healthcare coverage and the contributions towards such coverage and the maintenance of its workforce and aggregate hours of service during the transition period.[158]

This particular transition rule can apply to new employers if that new employer is reasonably expected to employ on average at least 50 FTEs, including any FTEEs on business days during the current calendar year and it actually employs an average of at least 50 FTEs, including FTEEs, on business days during the calendar year and thus becomes an ALE. For a new employer in 2015 to be subject to this rule it must certify that it reasonably expects to employ at least 50 and fewer than 100 FTEs and FTEEs on business days during 2015, that it will satisfy the maintenance standards with respect to maintaining the workforce and aggregate hours of service of its employees based at a level at least as of its initial date of operations and that it will maintain its health care coverage and contributions towards health care coverage at the same level that was in effect on the first day the coverage was offered.[159]

Multiple Transition Rules

If an employer desires to use more than one transition rule, there are provisions contained in the preamble to the final Section 4980H regulations that govern the use of multiple transition rules.[160]

[156] 79 Fed. Reg. 8544, 8573 XV.D.4. (Feb. 12, 2014).
[157] 79 Fed. Reg. 8544, 8573 XV.D.5. (Feb. 12, 2014).
[158] 79 Fed. Reg. 8544, 8574 XV.D.6. (Feb. 12, 2014).
[159] 79 Fed. Reg. 8544, 8574 XV.D.6.c. (Feb. 12, 2014).
[160] 79 Fed. Reg. 8544, 8575 XV.D.6. (Feb. 12, 2014).

2015 Transition Relief with Respect to Offers of Coverage

This transition rule applies only with respect to the Section 4980H(a) penalty assessed for failing to offer coverage. The safe harbor for offering FTEs coverage providing minimum value that is affordable to avoid the Section 4980H(a) penalty is that the ALE must offer coverage to its FTEs and their dependents so that it offers coverage to all but 5 percent of its employees, or if greater than 5 percent, all but five of its FTEs.[161] The offer of coverage must happen at least once per plan year.

Additional transition relief is provided in 2015 for calendar-year plans and during the 2015 plan-year months that fall in 2016 for non-calendar year plans. If the ALE that offers coverage offers it to at least 70 percent of its FTEs, or it fails to offer coverage to no more than 30 percent of its FTEs, then this transition rule, for 2015 only, treats the employer as having offered coverage and the penalty under Section 4980H(a) doesn't apply for 2015, provided the other conditions described below apply. The employer may still be subject to an assessable penalty under Section 4980H(b) with respect to any 2015 plan months that fall in 2016, but that penalty is calculated differently.

In calculating the Section 4980H(a) penalty, the ALE Member reduces its assessable penalty for its pro rata share of the 30 freebies; however, for 2015 the ALE Member reduces its assessable penalty by the ALE's pro rata share of 80 FTEs. This relief applies to all calendar months in 2015, plus calendar months of fiscal plan years that fall in 2016 and that are within the employer's 2015 plan year for those employers maintaining non-calendar year plans.

The transition relief applies in addition to other forms of transition relief with respect to non-calendar plan years, shorter measurement periods permitted for stability periods starting during 2015, shorter period permitted in 2014 for determining ALE status for 2015, offer of coverage for January 2015 and coverage for dependents.[162]

Multiemployer and Non-Calendar Year Plans

There is additional guidance on transition rules with respect to multiemployer plans and non-calendar year plans that isn't addressed in this report.

Transition Rules under Proposed Regulations in Effect in 2014

The Transition Rules from Prior Guidance Generally Apply for 2014.[163] The flow charts following this report provide only a general analytical framework for some aspects of the shared responsibility penalty.

Reliance

The final regulations on the shared responsibility penalty tax are effective for all ALEs on and after Jan. 1, 2016. Effective for ALEs with more than 99 FTEs on and after Jan. 1, 2015.

This is effective for certain ALEs with 50-99 FTEs in the previous calendar year on and after Jan. 1, 2016.[164]

Fiscal Year Plans – Penalty Assessment Transition Rule

Notice 2013-45 didn't address how the fiscal year plan transition rules would be impacted by the delay in the effective date of Section 4980H until Jan. 1, 2015. The fiscal year plan transition rules are also addressed in the final regulations. The following options are under the proposed regulations.

Option 1

The penalty won't be assessable for certain months in the calendar year prior to the beginning of the first plan year for a fiscal year plan beginning on or after Jan. 1, 2014, provided a number of requirements are satisfied by the employer and its group health plan. The penalty can be assessed against an employer (the entity within the controlled group providing the coverage) for either not offering any coverage or for failing to offer coverage that provides minimum value and that is affordable. This transition rule only applies if (for all of the numbered items below, the employer is the employing entity within the controlled group that is the ALE):

1. The employer must have had a group health plan with the same fiscal year on Dec. 27, 2012, as it has in 2014.
2. The eligibility terms of the group health plan on Dec. 27, 2012, must be the same at the commencement of calendar year 2014.
3. The group health plan for which the transition rule is sought must offer employees for the first plan year beginning in 2014 coverage *that both provides minimum value and is affordable*. The plan must be certain it has an option that using the minimum value calculator or via an actuarial certification it can prove it provides coverage for 60 percent of the expected medical costs for an individual for the plan to meet the minimum value requirement. Such coverage also must be affordable, which means it must not cost more than 9.5 percent of the lowest paid employee's household income (or one of the safe harbors available for calculating household income).
4. The coverage in item 3 must be affordable, provide minimum value and must be offered to employees of that employer on the first day of the first plan year beginning in 2014. For example, if all of the above criteria in 1 through 3 are satisfied, the affordable minimum value coverage must be offered on July 1, 2014.

The employer must still report for which of its FTEs it provides affordable minimum value coverage to the IRS and to the applicable exchange for every calendar month in 2014 regardless of the employer's plan year. The employer may determine which employees were FTEs for the reporting requirement for all of calendar

[161] Treas. Reg. § 54.4980H-4(a).
[162] 79 Fed. Reg. 8544, 8575 XV.D.7. (Feb. 12, 2014).
[163] 79 Fed. Reg. 8544, 8569 (Feb. 12, 2014).
[164] 78 Fed. Reg. 218, 239 X. (January 2, 2013).

year 2014 at the end of 2014 based upon the actual hours worked and it doesn't need to use the look-back rule for the reporting for the full 2014 calendar year, which will be due early in 2015. This is not a condition for the transition rule, but the employer must be prepared to do this reporting for 2014, or else, of course, there will be other penalties.[165]

Option 2

A second transition rule may apply where an employer is a member of a controlled group of employers and all of the employers don't have the same plan year for their group health plan and the employer wants to expand its plan's eligibility to additional employees for 2014. This transition rule applies if either (1) the employer had at least 25 percent of its employees eligible for coverage under one or more fiscal year plans that have the same plan year on Dec. 27, 2012, or (2) if the employer offered coverage to ⅓ or more of its employees during the most recent open enrollment period under the same fiscal year plan with an open enrollment period prior to Dec. 27, 2012, and the employer wants to extend the offer of coverage under these plans to other employees. If the requirements of this transition rule for expanding coverage applies, no shared responsibility penalty will be assessed with respect to the employees (a) who are offered coverage that is affordable and provides minimum value no later than the first day of the first plan year beginning on or after Jan. 1, 2014, and (b) who wouldn't have been eligible for any group health plan maintained by the entities in their employer's controlled group as of Dec. 27, 2012 that had a calendar year plan year. In order to calculate whether the 25 percent or ⅓ threshold are met for this transition rule to apply, the ALE (controlled group) may determine the percentage of its employees covered under fiscal year plan(s) as of the end of the most recent enrollment period or any date between Oct. 31, 2012, and Dec. 27, 2012.

As with the first transition rule, the employer must still report for which of its FTEs it provides affordable minimum value coverage to the IRS and to the applicable exchange for every calendar month in 2014 regardless of the employer's plan year. The employer may determine which employees were FTEs for the reporting requirement for all of calendar year 2014 at the end of 2014 based upon the actual hours worked and it doesn't need to use the look-back rule for the reporting for the full 2014 calendar year that will be due early in 2015. This is not a condition for the transition rule, but the employer must be prepared to do this reporting for 2014, or else, of course, there will be other penalties.[166]

Practice Tip: When considering the above two transition rule options on the penalty, one must also consider how the employees will be able to enroll under the cafeteria plan to avoid the individual mandate penalty for the early months in 2014 before the new plan year commences because the transition rule for the employers on the penalty does not mean that the employees don't have to comply with the individual mandate to maintain coverage.

Fixed-Year Cafeteria Plan Election Transition Rule

There is also transition relief from the cafeteria plan rules for election changes for a cafeteria plan that is a fiscal-year plan beginning in 2013 to permit the revocation, modification or commencement of salary reductions for accident and health coverage (i.e., medical plan coverage) offered through a cafeteria plan with a fiscal year to permit an employer to permit its employees to make certain elections. If the employer wants to permit such election changes, the employer must amend its cafeteria plan to permit such changes by Dec. 31, 2014, retroactively effective to the first day of the 2013 plan year.

Employers that take advantage of the fiscal-year plan transition rules need to know how to calculate FTEs and how the look-back/measurement period and stability period will need to be adjusted for the transition rule on the penalty and the calculation of which employees are full-time. The transition rule for implementing the determination of which employees are full-time for fiscal year plans is briefly described below. This is the transition rule for the determination of who is full-time working on the average 30 or more hours per week.[167]

Measurement and Stability Period Transition Rule

There is also a transition rule for the initial measurement and stability periods for stability periods beginning in 2014. This transition rule permits a transition measurement period that is shorter than 12 months and is no less than six months and that begins no later than July 1, 2013, and ends no earlier than 90 days before the first day for the plan year beginning on or after Jan. 1, 2014. However, an employer with a fiscal year beginning on July 1 must use a measurement period that is longer than six months in order to comply with the requirement that the measurement period begin no later than July 1, 2013, and end no earlier than 90 days before the stability period (the next following July 1) when coverage must commence.[168]

Related Reporting

Why Reporting?

In order for the IRS to be able to administer the health care tax credit under Section 36B and the employer shared-responsibility penalty under Section 4980H, the agency needs to have certain information regarding the coverage offered, its cost and who had such coverage. The reporting required under Section 6056 is designed to provide such information and uses many of the terms defined in Section 4980H and the regulations thereunder, which makes sense because Section 6056 requires reporting of the data needed for the IRS to assess the Section 4980H penalty and determine if an employee was offered coverage with minimum value that was

[165] 78 Fed Reg. 218, 236 IX. A. (January 2, 2013).
[166] 78 Fed. Reg. 218, 236 IX. (January 2, 2013).
[167] 78 Fed. Reg. 218, 236 IX.B. (January 2, 2013).
[168] 78 Fed. Reg. 218, 236 IX.C. (January 2, 2013).

affordable. The Section 6056 regulations, which focus on the reporting the IRS needs to assess the Section 4980 penalties, borrow the Section 4980H definitions for:

- Applicable Large Employer
- Applicable Large Employer Member
- Dependent
- Eligible Employer Sponsored Plan
- Full-Time Employee
- Governmental Unit and Agency or Instrumentality of a Governmental Unit
- Minimum Essential Coverage
- Minimum Value
- Person[169]

The filing requirement applies to an ALE Member in the same way that the shared-responsibility tax is calculated based upon each ALE Member's records.[170] ALE Members who don't have any employees aren't required to file under Section 6056.[171]

If the ALE Member is a disregarded entity (*i.e.*, a qualified subchapter S subsidiary under Section 1361(b)(3)(B) or an entity described in Treas. Reg. § 301.7701-2(c)(2)(i)), the disregarded entity is treated as a separate entity from its owner and the disregarded entity must report under Section 6056, not its owner. For example, when a qualified S corporation is owned by an ESOP, the qualified S corporation must report but the ESOP does not, or when an LLC taxed as a partnership that is a fund investing in a venture capital operating company that is organized as a partnership for tax purposes, the fund doesn't report but the LLC that is an ALE Member does report.[172]

Failure to comply with the Section 6056 reporting requirements is subject to the penalties under Section 6721 (failure to file correct returns). Failure to provide the correct information returns is subject to the penalty under Section 6722.[173] However, the penalties can be waived or abated if the failure to file or provide the information returns is due to reasonable causes.[174] For the Forms 1095-C required to be filed or furnished in 2016 for 2015 coverage, the IRS won't impose a penalty *if* the ALE Member made a good faith effort to comply with the Section 6056 information reporting requirements. However, no relief is available for an ALE Member who fails to file, only for incomplete filings.[175] Both the information under Section 6056 and 6055 are reported on the same Form 1095-C.

Requirements for Self-Insured Plan Reporting of Minimum Essential Coverage Provided

The reporting requirements under Section 6055 are intended to facilitate the IRS's administration of Section 5000A—the individual mandate—by reporting which individuals had minimum essential coverage (MEC) in each calendar month during a year and to help individuals file their federal income tax return regarding whether the individual maintained minimum essential coverage. Under Section 5000A, coverage of only one day in a calendar month counts as a full month of coverage. So when insurers and self-insured plans provide coverage, they must complete Form 1095-C or 1095-B to report when they provide MEC to the responsible individual (employee) and for the coverage for each covered dependent. The requirements include reporting the responsible individual's name (for an employer this is the employee), tax identification number, address and if a federal tax identification number isn't provided at the initial request, the employer must make a second request for the tax identification number, and for each covered dependent, their name, tax identification number or date of birth. For the dependent's tax identification number, the employer must make two requests each year.[176]

No penalty will be assessed as long as the TIN is requested at initial enrollment and a follow up request is made by December 31 of the year in which the relationship commenced. Each annual enrollment is treated as an initial solicitation, thus it appears there may be an annual pair of solicitations for a dependent's tax identification number. [177] Reporting a birth date for a dependent doesn't excuse an employer from making the initial and follow-up request for the dependent's tax identification number.[178]

The reporting requirement applies to all common-law employees but it doesn't apply to statutory employees.[179] Reporting is only required for responsible employees who enroll in coverage offered by the employer on Form 1095-C.

TINs reported can be truncated on the statements sent to individuals, but not on the Forms 1095-C sent to the government. Forms 1095-C can be mailed with the Form W-2 to employees.[180] The Form 1095-C must report the coverage months for each responsible person/employee and each covered dependent using one day of coverage in a calendar month qualifying as coverage for that full month in minimum essential coverage.[181]

While employers may report coverage provided in 2014, it isn't required to report coverage provided for 2014 under Section 6055. Beginning in calendar year 2015, each month of coverage provided in 2015 will be required to be reported in 2016.[182] If this was the only rule for reporting a month of coverage, the reporting would present challenges for pulling together the information

[169] 79 Fed. Reg. 13231, 13234 (March 10, 2014).
[170] *Id.*
[171] 79 Fed. Reg. 13231, 13235 (March 10, 2014).
[172] 79 Fed. Reg. 13231, 13235 (March 10, 2014).
[173] 79 Fed. Reg. 13231, 13246 XIII. (March 10, 2014).
[174] *Id.*; I.R.C. § 6724.
[175] 79 Fed. Reg. 13231, 13246 XIII. (March 10, 2014).
[176] 79 Fed. Reg. 13220, 13223 (March 10, 2014).
[177] 79 Fed. Reg. 13220, 13223 (March 10, 2014).
[178] 79 Fed. Reg. 13220, 13222 (March 10, 2014).
[179] 79 Fed. Reg. 13220, 13221 (March 10, 2014); Treas. Reg. § 1.6055-1(b)(11).
[180] 79 Fed. Reg. 13220, 13225 (March 10, 2014).
[181] 79 Fed. Reg. 13220, 13224 (March 10, 2014).
[182] 79 Fed. Reg. 13220, 13226 (March 10, 2014).

due to obtaining dependents' TINs and the conversion of one day of coverage into a month of coverage. But it is more challenging because the next reporting requirement only treats employees as offered coverage for a month if they are offered the coverage every day in the calendar month to be treated as covered. One day of coverage equals a month of coverage reported under Section 6055, but this contrasts with the reporting for Section 6056 on the same form, which treats one day of coverage missed during a calendar month as no offer of coverage for such month except in special circumstances such as termination of employment.[183]

Practice Tip: As employers plan for open enrollment for the 2015 plan year, they need to implement the steps to gather the tax identification numbers of each employee and dependent as part of the open enrollment and also to follow up with a second request to anyone who doesn't provide the information during the open or initial enrollment.

Reporting Related to Enforcement of the Employer Mandate and Offers of Coverage Providing Minimum Value on ALE Members

For each choice between one of the flexible alternatives provided under Section 4980H, 6055 or 6056, there are many restrictions that also apply and must be considered. There are also a number of conditions related to which rules apply. The documentation of who is an FTE will also determine for which employees the employer will be required to report based on the proposed regulations on reporting.

The reporting regulations on health care coverage under the ACA are critical because they require pulling information that is often housed in different systems. For example, information on to whom coverage is offered and the premiums at which coverage providing minimum value is offered for particular months may be contained in the HRIS system, while the hours worked may be contained in a payroll system for determining full-time status. Employers must also get the social security numbers of dependents and spouses, which is information that most employers don't have. Thus, reporting may require employers to solicit new information, pull information from separate computer systems and combine the new data with the data pulled from different systems into one report for the IRS and another statement sent to FTEs or responsible individuals.

The Section 4980H regulations also require employers to offer coverage to those FTEs qualifying as full-time by the first day of the fourth month after the end of the measurement period to avoid the Section 4980H penalty for the first three months after the measurement period ends.[184] If an employer fails to offer coverage to a FTE on any day during the month, that employee is treated as not offered coverage for the entire month and thus the employer is subject to the failure to offer coverage penalty for that employee for that month under the Section 6056 reporting that adopts the Section 4980H definitions. The Section 4980H definition of FTE is used as the definition of such term in Section 6056.[185]

This contrasts with the individual mandate penalty, which employers can avoid, if they have coverage for just one day in a calendar month. The employer must also report one day of coverage as a month of coverage under the Section 6055 regulations, even though the employer can't treat such same day of coverage as a month of coverage to defend itself against the assessment of the "pay or play" penalty with respect to offering coverage to the same individual—this may require some very good system programming.[186]

However for January 2015 only, if the employer offers the employee coverage by the first day of the first payroll period in January 2015, the employer will be treated as offering coverage for the entire month.

The fact that one day of non-coverage can expose the employer to the penalty for the entire month[187] may cause employers to rethink plan provisions regarding when coverage terminates for an employee or dependent and when coverage is added for the employee or dependent for a change in status or special enrollment period.

Caution: Employers need to consider how the cafeteria plan rules regarding the effective date of changes due to changes in status and special enrollment rights, and the date coverage is effective for such changes, mesh with the ACA rule that a day of missed coverage means no coverage for the month. Employers should consider the cost of extending coverage as compared to the penalty cost for not providing coverage for a month.

Before an employer decides to extend coverage from all coverage terminations occurring mid-month to the end of the month to be able to support simplifying the reporting so it shows that the employer offered coverage for the full month and provided coverage for the same full month, the employer should consider that for coverage lost due to termination of employment mid-month, where the coverage would have extended to the end of the month and the employee would have been offered coverage to the end of the month if employment had continued, is treated as coverage for the full month and thus no extension is necessary for such mid-month coverage terminations to report the offer and the coverage the same way for that month.[188] The employer may only need to consider extending coverage from a mid-month loss of coverage for a reason other than the employee's termination of employment to get those mid-month coverage terminations treated the same for reporting and for programming the system to generate the Form 1095-C. Extending coverage for employee's and dependents' mid-month coverage losses other than the employee's loss due to termination of employment, would lead to all employees and dependents mid-month

[183] Treas. Reg. § 1.6055(1)(e)(1)(iv) v. Treas. Reg. § 301.6056-1(d)(1)(iv) and (vi) and Treas. Reg. § 54.4980H-4(c)

[184] Treas. Reg. 26 C.F.R. § 54.4980H-3.

[185] Treas. Reg. § 301.6056-1(b)(6).

[186] Treas. Reg. § 1.6055-1(e) through (g).

[187] Treas. Reg. § 54.4980H-4(c).

[188] Treas. Reg. § 54.4980H-5(c).

coverage ending events not causing the employer to pay a shared responsibility penalty for such individual for such month.

Reporting Relief and Alternatives under Section 6056

In an effort to make the reporting under Sections 6055 and 6056 easier for ALE self-insured health plans, the IRS is permitting the information under both sections to be reported on Form 1095-C by completing different portions of such Form. The Form 1095-C must not only be filed with the IRS, but it also must be furnished to the FTEs. No transitional reporting methods or alternatives were included in the final regulations under Section 6055, only that Section 6055 reporting wasn't required for calendar year 2014 and no penalties would be imposed for such year.[189]

Section 6056 Reporting Alternatives

The reporting required under Section 6056 can be done under either the general or alternative method. The employer may use the general method for all employers and for any or all of its FTEs and may use the alternative method for those employees who qualify.[190] The information must be reported on and to each FTE of one of the ALE Members. If the alternative method isn't available for some group or groups of employees, the employer must use the general method for such groups of employees.

General Method

The information that must be reported under Section 6056 and the final regulations are:

- name, address and EIN of the reporting ALE Member and the calendar year for which the information is reported;
- name, address and telephone number of the contact for the ALE Member who can be an employee, agent or other party acting on behalf of the ALE Member;
- a certification as to whether the ALE Member offered its FTEs and their dependents the opportunity to enroll in coverage constituting minimum essential coverage by each calendar month;
- the number of FTEs for each calendar month during the year;
- for each FTE, the months during the calendar year for which minimum essential coverage under the plan was available;
- for each FTE, that employee's share of the lowest cost monthly premium for self-only coverage providing minimum value that was offered to such FTE under the plan; and
- the name, address and taxpayer identification number of each full-time employee during the calendar year and the months, if any, during which the employee was covered under an eligible employer-sponsored plan.[191]

Note the final regulation dropped the requirement that the TIN of the spouse and each dependent also be included for Section 6056 reporting, but retained the requirement for Section 6055 reporting.[192] In addition to the above seven types of information reported, additional information will be reported via the use of codes on the forms. The additional information that is reported via codes includes:

- whether the coverage offered to full-time employees and their dependents provides minimum value and whether the employee's spouse was offered coverage;
- the total number of employees for each calendar month;
- whether the employee's effective date of coverage was affected by a permissible waiting period by calendar month;
- whether the ALE Member had no employees or credited hours of service to any employee during the calendar month;
- whether the ALE Member is a member of a controlled group under Section 414(b), (c), (m) or (o) and if such a member, then the name and Employer Identification Number of each employer member of such ALE who was a member on any day of the calendar year being reported;
- if the ALE Member is a contributing member to a multiemployer plan, whether with respect to a full-time employee, the employer is not subject to an assessable penalty under Section 4980H due to the employer's contributions to a multiemployer plan;
- if an ALE appropriately designated person is reporting on behalf of an ALE Member that is a governmental unit or any agency or instrumentality thereof, the name, address and identification number of such appropriately designated person;[193] and
- if a third party reports for an ALE Member with respect to its full-time employees, the name, address and identification number of the third party (in addition to the same information on the ALE Member).[194]

Further, each calendar month of coverage reported for a full-time employee will carry with it codes for each month indicating whether coverage with minimum value was offered and to whom it was offered, or if coverage wasn't offered, why it wasn't offered, or if coverage was offered to a person who didn't qualify as a FTE, whether the employee was covered and if the coverage was affordable.[195]

Practice Tip: For the 2015 year, the Form 1095-C must be filed with the IRS by March 1, 2016 (March 31, 2016, if

[189] Treas. Reg. § 1.6055-1(j).
[190] *Id.*
[191] Treas. Reg. § 301.6056-1(d).
[192] 79 Fed. Reg. 13231, 13236 (March 10, 2014); Treas. Reg. § 301.6056-1(d) vs. Treas. Reg. § 1.6055-1(g).
[193] Treas. Reg. § 301.6056-1(k).
[194] 79 Fed. Reg. 13231, 13237 (March 10, 2014); Treas. Reg. § 301.6056-1(d) and (e).
[195] 79 Fed. Reg. 13231, 13238 (March 10, 2014).

electronically filed) and must be furnished to FTEs by Jan. 31, 2016.[196]

Alternative Methods

Reporting Based on Certification of Qualifying Offers

Simplified reporting is permissible for certain ALE Members if the qualifying ALE Member certifies that it offered certain coverage to one or more of its FTEs. With this simplified reporting also comes simplified statements to be provided to the FTEs who received an offer of coverage for each of the 12 calendar months. The ALE Member must certify that it offered coverage providing minimum value to all of its FTEs (as defined in Treas. Reg. § 4980H) and their spouses and dependents with the cost for employee-only coverage not in excess of 9.5 percent of the federal single poverty level for the 48 contiguous states and D.C.

However, this alternative method to comply with the Section 6056 reporting requirement doesn't apply if the transition relief related to offering dependents coverage in 2015 is used. See "Transition Rule for Coverage of Dependents" above; however, the cross-reference doesn't appear to relate to the correct provision in the final Section 4980H regulations.[197]

Using this alternative method for Section 6056 reporting requires the ALE Member to issue a statement to the employee that he and his dependents don't qualify for the premium tax credit, and it doesn't relieve the employer from complying with the Section 6055 reporting requirements.

Reporting Based on Qualifying Offers in 2015

For 2015, an ALE Member may use an alternative method similar to the general method above if it files with the IRS the Form 1095-C providing the employee's name, social security number and address and indicates using the indicator codes that the qualifying offer was made for all 12 months or the specified months for which it was made and provides a statement with such details to the employee. To use this alternative reporting method for Section 6056 reporting, the ALE Member must certify that it made the qualifying offer in X.A. of the preamble to full-time employees, spouses and their dependents and that in lieu of providing Form 1095-C to its employees, it satisfies the Section 6056 requirements with respect to FTEs by furnishing a statement to each FTE by January 31 of the year for which the statement is provided.[198] Use of this alternative method of reporting for Section 6056 doesn't relieve the ALE Member from its reporting obligation under Section 6055.

An Employer Can Report Without Separately Identifying Its Full-Time Employees if Certain Conditions Related to Offers of Coverage are Met (the 98 percent offers rule)

If an ALE Member satisfies this alternative reporting method's requirements, the ALE Member isn't required to report under the Section 6056 reporting either the number of FTEs it has or whether any particular employee was a FTE for any calendar month during the year.

The employer still must report on the employees, it just doesn't have to specify which were in full-time status. This works for an employer who offers minimum value coverage to all of its FTEs but may have missed a few employees as long as the ALE Member offered coverage providing minimum value that was affordable (employee-only under any applicable 4980H affordability safe harbor) and it can certify it offered such coverage to at least 98 percent of its employees (regardless of whether they are full-time employees) for whom it reports under Section 6056 for Treas. Reg. § 301.6056-1(j)(2). Penalties for failure to report under Section 6721, (failure to file a correct return) and 6722 (failure to provide correct information returns) still apply.[199]

Reporting for ALE's with Fewer than 100 Full-Time Employees Eligible for Transition Relief under Section 4980H

For ALE's with at least 50 and fewer than 100 FTEs and who qualify for transition relief under the final regulations under Section 4980H, there is a special rule for 2015 providing relief from the Section 6056 reporting requirement. Such employers must certify on its Section 6056 transmittal form for 2015 (that it will file in 2016) that they meets the eligibility requirements in XV.D.6.(a)(1) through (3) of the preamble to the final Section 4980H regulations.[200]

Practice Tip: It appears that this certification is all that is required, but the preamble didn't specify the relief that was provided, presumably it is relief from the requirement that employers furnish the forms 1095-C to the employees.

Combinations of Alternative Reporting Methods

An ALE Member may use alternative reporting methods for particular groups of employees that in many cases wouldn't be identical at the employers election as permitted in the instructions and forms.[201] Two examples of combined alternative reporting methods/safe harbors are explained below.

95 percent Safe Harbor/Transition Rules for the Penalty Tax and Related Alternate Rule for Reporting on Coverage Offered

The penalty tax regulations included a safe harbor permitting an employer to avoid the penalty for failure to offer coverage if the employer met the safe harbor by offering affordable coverage to all but 5 percent of its employees, or if greater to all but 5 employees.

This safe harbor is expanded for 2015 to permit employers to avoid the penalty tax under Section 4980H(a) for

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[196] *Id.*; Treas. Reg. § 301.6056-1(g).

[197] 79 Fed. Reg. 13231, 13241 (March 10, 2014); Treas. Reg. § 301.6056-1(j)(1).

[198] 79 Fed. Reg. 13231, 13241 X.A.2. (March 10, 2014); Treas. Reg. § 301.6056-1(j)(1).

[199] 79 Fed. Reg. 13231, 13232 (March 10, 2014); Treas. Reg. § 301.6056-1(j)(2).

[200] 79 Fed. Reg. 13231, 13242-3, 13242-13243 X.C. (March 10, 2014).

[201] 79 Fed. Reg. 13231, 13243 X.D. (March 10, 2014).

failure to offer affordable coverage if the employer offers affordable coverage to all but 30 percent of its FTEs, or it offers affordable coverage to at least 70 percent of its employees as of the first day of the 2015 plan year, then no 4980H(a) penalty applies for the months in the plan year during calendar year 2015. This expansion of the safe harbor applies for 2015 if certain other requirements are satisfied.[202]

If an employer uses this safe harbor with respect to avoiding the penalty tax, there is an alternative method to comply with the reporting requirements related to offers of coverage by certifying that at least 95 percent of its FTEs, spouses and dependents were offered coverage, and if this certification is made, the employer may instead of providing Form 1095-C to all of its FTEs, provide to each of its FTEs a statement to be defined in the instructions to the form regarding whether the employee received a qualifying offer of health coverage for all, some or none of the months, and if less than all, for which months, along with other information. Note this statement is still required to be provided to only FTEs. This reporting alternative is available for 2015 as an optional method.[203]

95 Percent Safe Harbor Rule for the Penalty Tax Combined with the 98 Percent Alternate Reporting Rule

However, if the 95 percent safe harbor from the shared-responsibility penalty tax is combined with the 98 percent safe harbor reporting relief (explained below), the ALE Member can avoid determining whether any particular employee is a shared-responsibility penalty tax "full-time employee" until an employee goes to the exchange and gets a premium tax credit and the IRS assesses a penalty tax on such individual. At the time of such assessment, the employer must then be able to either determine if the individual wasn't a FTE or it must pay the assessed penalty tax.

It is important to remember that even if the employer uses this safe harbor to avoid imposition of the 4980H(a) penalty for failure to offer coverage, it still may be subject to the penalty under 4980H(b) when an employee seeks coverage from the marketplace and obtains a premium tax credit if the employer's coverage is either not affordable or doesn't provide minimum value. The employer then must be able to pull the data to defend itself against the penalty tax.[204] The reporting regulations related to the offer of coverage included a new temporary safe harbor to avoid certain portions of the reporting requirements, but no relief was provided for the penalty tax, if the employer offered coverage to 98 percent of *all* employees; however this provides relief from a portion of the reporting requirement on Form 1095-C and doesn't negate all of the reporting requirements, nor does it fully eliminate the need to determine which employees are full-time.

If the individual uses only the 98 percent safe harbor for reporting relief, it will not exempt the ALE Member from any penalties if it failed to report on a FTE. Thus, this alternative method may provide some temporary relief and it delays determining full-time status until contacted by the IRS, but at that contact, the ALE Member must be able to either prove the individual was not a "full-time employee" based upon its records of hours worked, or it must pay the applicable shared responsibility penalty and the penalties for failure to report on the FTE.[205]

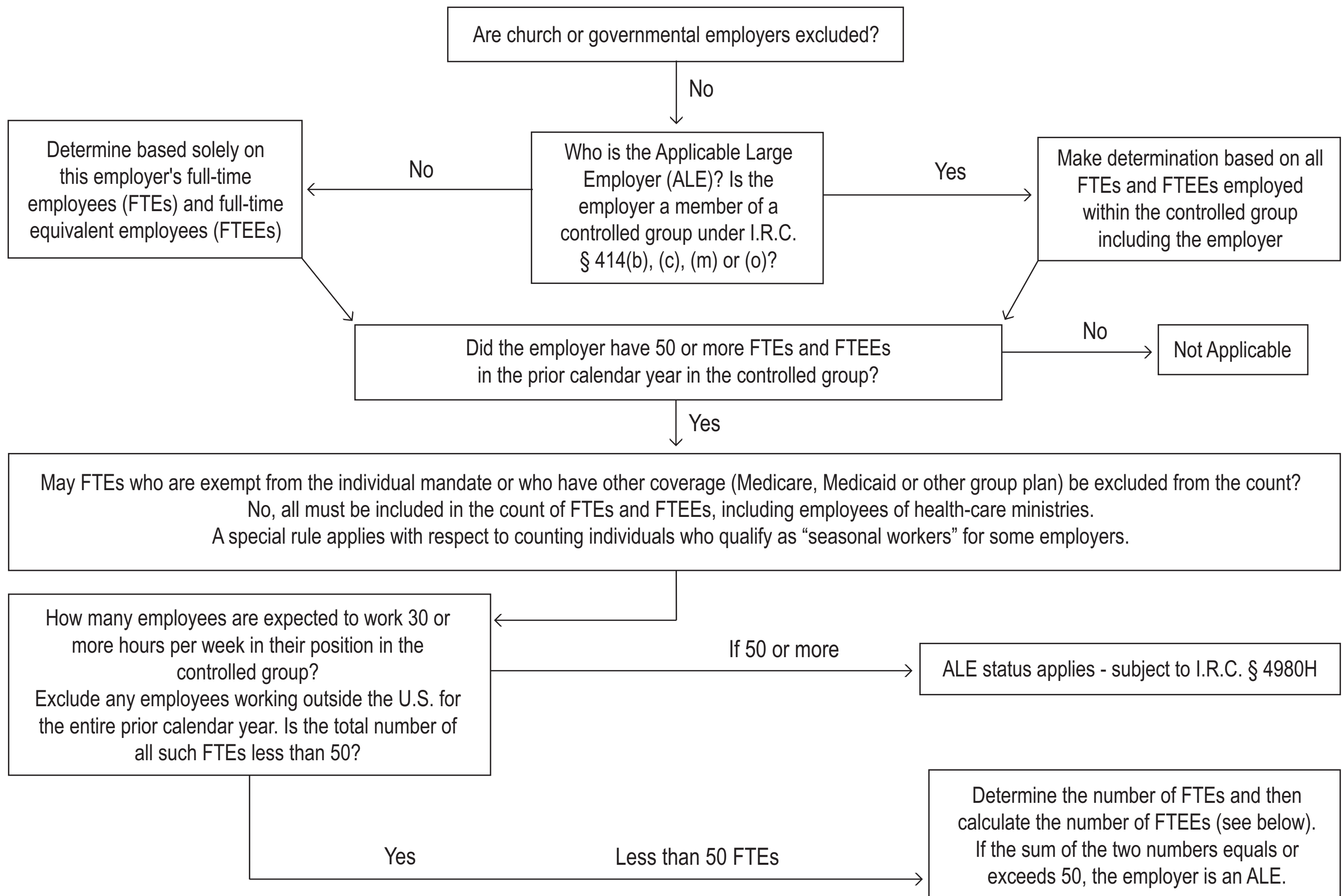
[Published June 2014]

[202] 79 Fed. Reg. 8544, 8575 XV.D.7. (Feb. 12, 2014).
[203] 79 Fed. Reg. 13231, 13241 X.A.2. (March 10, 2014).
[204] 79 Fed. Reg. 8544, 8575 XV.D.7. (Feb. 12, 2014).
[205] 79 Fed. Reg. 13231, 13241 X.A.2. (March 10, 2014).

Are You an Applicable Large Employer Subject to Section 4980H

(This Flowchart Does Not Address Transition Rules)

Applicable large employers are employers who employ 50 or more full-time or full-time equivalent employees on 20 or more days in the month



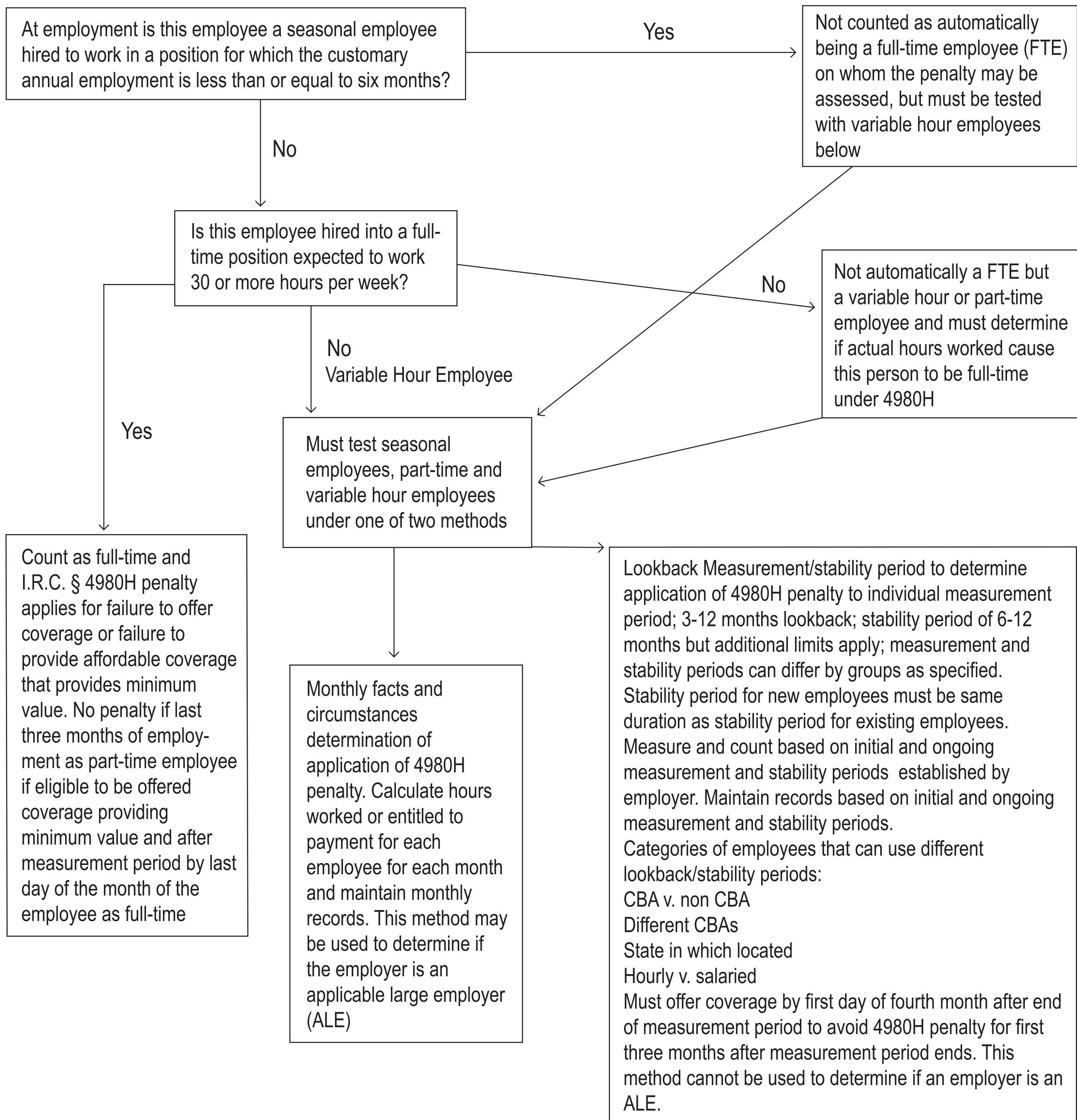
Calculating Full-Time Equivalent Employees for Section 4980H Determination of Applicable Large Employers

1. Identify all employees who are not employed on the average at least 30 hours per week for a calendar month in the preceding calendar year.
2. Calculate the aggregate number of hours each non-FTE had in each month and then sum up all of the non-FTEs' monthly hours by month for a total number of hours worked by non-FTEs for each month, but limit the hours worked by each employee in each month to 120 hours.
3. Divided the total number of hours worked by non-FTEs for each month by 120 and that resulting number is the number of FTEEs for that month. The resulting number for each month can be rounded to the nearest one-hundredth.
4. Review the resulting number of FTEs plus the month's FTEEs (rounded to the next lowest whole number). If the employer had seasonal workers (not seasonal employees), the seasonal workers' hours are included in the calculation of FTEEs. (Treas. Reg. § 54.4980H-2(e)(i)). However, if the sum of employer's FTEs and FTEEs exceeds 50 for 120 days or less in the prior calendar year *and if* the employees employed during the period (when the number was in excess of 50) and those employees who were in excess of 50 were seasonal workers, the employer is not considered to be an ALE and the seasonal worker exemption applies. (Treas. Reg § 54.4980H-2(b)(2)). (Seasonal workers perform labor or services on a seasonal basis as defined by the Secretary of Labor, including workers covered by 29 C.F.R. § 500.20(s)(1) and certain retail workers employed exclusively during the holiday season.) Seasonal employees are persons hired into a position in which the customary annual employment is six months or less.

Source: Greta E. Cowart, Winstead PC

A BNA Graphic/bpr414g1

4980H–Full-Time Status Determination under the Final Regulations for Determining on Which Employees the Penalty May Be Assessed



Source: Greta E. Cowart, Winstead PC

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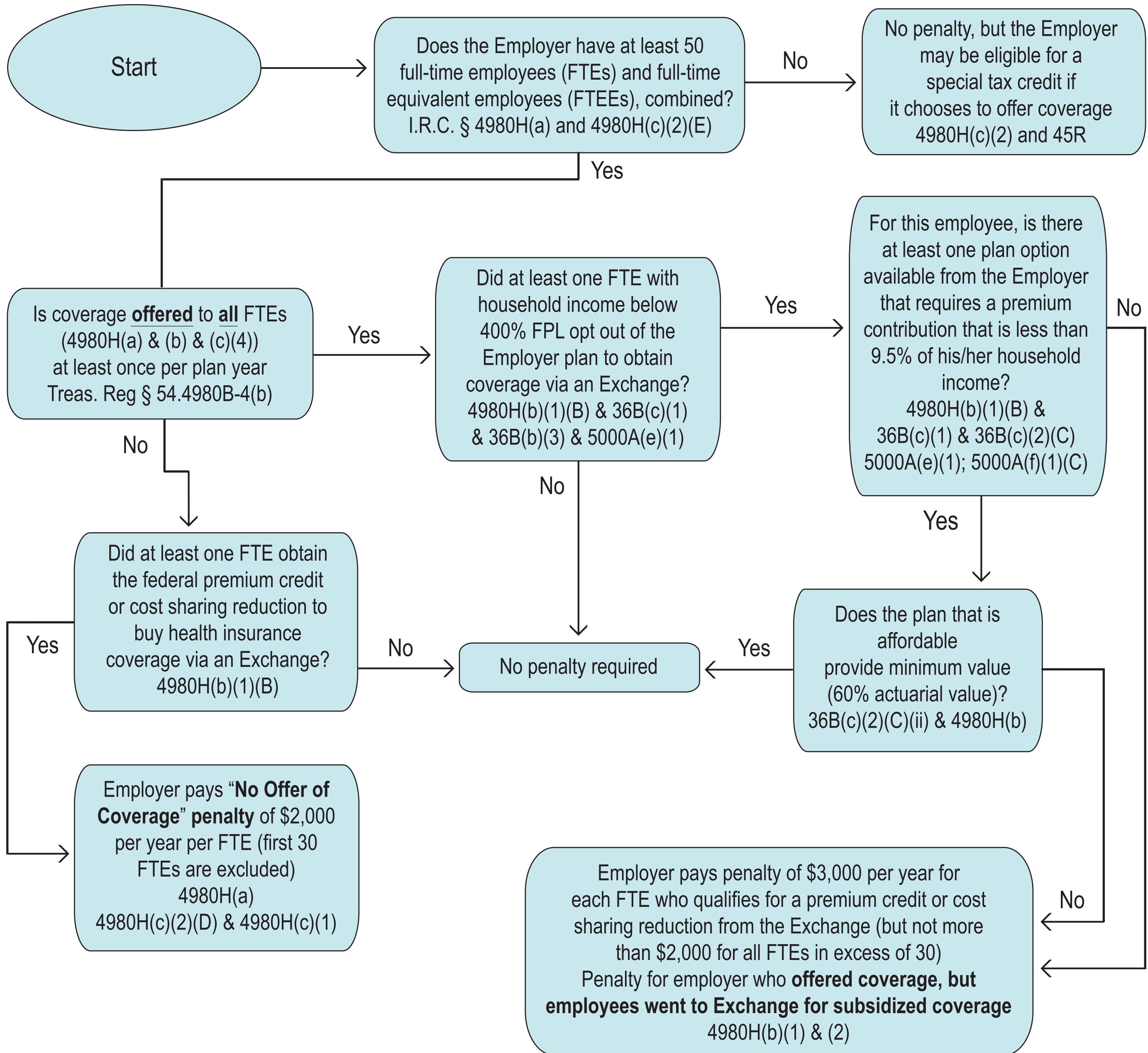
High Level Overview of Employer Shared Responsibility Penalty Analysis (Effective 1-1-2014)



An applicable larger employer member cannot be liable for both the penalty under 4980H(a) and under 4980H(b) in the same month. Treas. Reg. § 54.4980H-5(d). This only addresses the shared responsibility penalty and does not address PCORIs, reinsurance fees, additional Medicare taxes or other costs that result from the decision.

Source: Greta E. Cowart, Winstead PC

A BNA Graphic/bpr414g3