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NEW HEALTH CARE REFORM RULES

Textbook Regulating 101. Issue a regulation on one of the last workdays of the old year. The Department of Treasury and the IRS get the prize for 2012. The Department of Treasury and IRS have issued proposed rules covering the process for determining whether a business is a large employer for the purposes of the health care reform law, the Patient Protection and Affordable Care Act (PPACA). The proposed regulations also cover the processes for determining whether a large employer might be liable for the two potential penalties for: 1) not offering adequate coverage to all full time employees (and their dependents), or 2) offering coverage and having an employee obtain coverage from an exchange anyway.

There are 144 pages in the new proposed regulation release. Most of the text is the "preamble" explaining the new rules. On balance, while there are some things that could have come out more favorably for large employers (common ownership rules for example will be a disappointment), it does appear the Department of Treasury and IRS tipped a few of the swing decisions in favor of the large employers. We will see if that assessment holds up through the third and fourth "reads."

While these are proposed rules, they state that employers may rely upon them until final guidance is issued. A copy of the proposed rules can be found at http://www.irs.gov/pub/newsroom/reg-138006-12.pdf and there are some Q&As at http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act

Since we serve the small business community, much of this is a matter of curiosity (the determination that a spouse is not a dependent leads that list) rather than a matter of necessity, but the following is some of the more notable elements of the new proposed rule.

LARGE EMPLOYER DETERMINATION RULES

BASIC DEFINTION

An employer's status as an applicable large employer for a calendar year is determined by taking the sum of the total number of full-time employees (including any seasonal workers) for each calendar month in the preceding calendar year and the total number of FTEs (including any seasonal workers) for each calendar month in the preceding calendar year, and dividing by 12. The result, if not a whole number, is then rounded to the next lowest whole number. If the result of this calculation is less than 50, the employer is not a large employer for the current calendar year. If the result of this calculation is 50 or more, the employer is a large employer for the current calendar year, unless the seasonal worker exception applies.

If the sum of an employer's full-time employees and FTEs exceeds 50 for 120 days or less during the preceding calendar year, and the employees in excess of 50 who were employed during that period of no more than 120 days are seasonal workers, the employer is not considered to employ more than 50 full-time employees (including FTEs) and the employer is not a large employer for the current calendar year. For purposes of this aspect of the law only, four calendar months may be treated as the equivalent of 120 days. The four calendar months and the 120 days are not required to be consecutive.

The identification of full-time employees for purposes of determining status as a large employer under the law is performed on a look-back basis using data from the prior year, taking into account the hours of service of all employees employed in the prior year (full-time employees and non-full-time employees). The determination of whether an employer is a large employer for a year is based upon the actual hours of service of employees in the prior year.

The IRS did provide transition relief allowing use of a shorter look-back period in 2013 for purposes of determining applicable large employer status for 2014.

FULL TIME EQUIVALENTS

All employees (including seasonal workers) who were not full-time employees for any month in the preceding calendar year are included in calculating the employer's FTEs for that month by (1) calculating the aggregate number of hours of service (but not more than 120 hours of service for any employee) for all employees who were not employed on average at least 30 hours of service per week for that month, and (2) dividing the total hours of service in step (1) by 120. This is the number of FTEs for the calendar month.

In determining the number of FTEs for each calendar month, fractions are taken into account. For example, if for a calendar month employees who were not employed on average at least 30 hours of service per week have 1,260 hours of service in the aggregate, there would be 10.5 FTEs for that month. However, after adding the 12 monthly full-time employee and FTE totals, and dividing by 12, all fractions would be disregarded. For example, 49.9 full-time employees (including FTEs) for the preceding calendar year would be rounded down to 49 full-time employees (and thus the employer would not be a large employer in the current calendar year).

HOURS OF SERVICE

The proposed rules use “hours of service” instead of, for example, “hours worked.” “Hours of service” includes not only hours when work is performed but also hours for which an employee is paid or entitled to payment even when no work is performed. The proposed regulations provide that an employee’s hours of service include the following: (1) each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer; and (2) each hour for which an employee is paid, or entitled to payment by the employer on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

For employees paid on an hourly basis, employers must calculate actual hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

For employees not paid on an hourly basis, employers are permitted to calculate the number of hours of service under any of the following three methods: (1) counting actual hours of service (as in the case of employees paid on an hourly basis) from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence; (2) using a days-worked equivalency method whereby the employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service under these service crediting rules; or (3) using a weeks-worked equivalency of 40 hours of service per week for each week for which the employee would be required to be credited with at least one hour of service under these service crediting rules.

Although an employer must use one of these three methods for counting hours of service for all non-hourly employees, under the proposed regulations, an employer need not use the same method for all non-hourly employees. Rather, an employer may apply different methods for different classifications of non-hourly employees, so long as the classifications are reasonable and consistently applied. In addition, an employer may change the method of calculating non-hourly employees' hours of service for each calendar year. The proposed regulations prohibit use of the days-worked or weeks-worked equivalency method if the result would be to substantially understate an employee's hours of service in a manner that would cause that employee not to be treated as a full-time employee.

A method of crediting hours would not be reasonable if it took into account only some of an employee’s hours of service with the effect of recharacterizing, as non-fulltime, an employee in a position that traditionally involves more than 30 hours of service per week. For example, it would not be a reasonable method of crediting hours to fail to take into account travel time for a travelling salesperson compensated on a commission basis, or in the case of an instructor, such as an adjunct faculty member, to take into account only classroom or other instruction time and not other hours that are necessary to perform the employee's duties, such as class preparation time.

The proposed regulations treat 130 hours of service in a calendar month as the monthly equivalent of 30 hours of service per week ((52 x 30) ÷ 12 = 130). This monthly standard takes into account that the average month consists of more than four weeks. The 130 hour monthly standard may also be lower than an average of 30 hours per week during other longer months of the calendar year (for example, the seven calendar months that consist of 31 days) and, therefore, any effect of this approximation will balance out over the calendar year (for example, over a 12-month measurement period, over two successive six-month measurement periods, or over four successive three-month measurement periods). According to the IRS, in the interest of administrative simplicity, the proposed regulations retain the 130-hour standard as a monthly equivalent of 30 hours per week.

SEASONAL WORKERS

The proposed regulations provide that, solely for purposes of the seasonal worker exception in determining whether an employer is a large employer, an employer may apply either a period of four calendar months (whether or not consecutive) or a period of 120 days (whether or not consecutive). Because the 120-day period is not part of the definition of the term seasonal worker, an employee would not necessarily be precluded from being treated as a seasonal worker merely because the employee works, for example, on a seasonal basis for five consecutive months.

For purposes of the definition of a large employer, PPACA defines a seasonal worker as a worker who performs labor or services on a seasonal basis, as defined by the Secretary of Labor, including (but not limited to) workers covered by 29 CFR 500.20(s)(1) (certain agricultural workers) and retail workers employed exclusively during holiday seasons. This definition of seasonal worker is incorporated in the proposed regulations.

After consultation with the Department of Labor (DOL), the Treasury Department and the IRS have determined that the term seasonal worker, for this specific purpose, is ***not*** limited to agricultural or retail workers. Until further guidance is issued, employers may apply a reasonable, good faith interpretation of the statutory definition of seasonal worker, including a reasonable good faith interpretation of the standard set forth under the DOL regulations for migrant and seasonal agricultural workers (*"[l]abor is performed on a seasonal basis where, ordinarily, the employment pertains to or is of the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year. A worker who moves from one seasonal activity to another, while employed in agriculture or performing agricultural labor, is employed on a seasonal basis even though he may continue to be employed during a major portion of the year."*), **applied by analogy** to other workers and employment positions not otherwise covered under those DOL regulations.

INDEPENDENT CONTRACTORS COULD BE EMPLOYEES

The proposed rules indicate the IRS will use common law rules for determining whether an individual is an employee for the purpose of determining whether the business is a large employer as it does now for other purposes.

The IRS said, as it has said many times over the years,: "Under the common law standard, an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. Under the common law standard, an employment relationship exists if an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so."

For some businesses that have used what is known as Section 530 to prevent reclassification of independent contractors as employees, ***PPACA itself, not these rules, created a problem.*** Section 530 allows a business to assert even if it has a "soft" common law case for its classification of individuals as independent contractors, that it is permitted to continue to do so for a variety of reasons, one of the most common of which is that it is a long-standing practice of the industry. The problem is Section 530 applies to employment taxes under Subtitle C of the tax code. The employer shared responsibility penalties are penalties under Subtitle D. Potentially a business could end up with the odd anomaly of counting these specific "independent contractors" for determining whether it a large employer and calculating employer shared responsibility penalties if it is, and treating them as independent contractors for employment tax purposes.

Bottom line: If you use independent contractors extensively, you need to make sure you have the most stringent protocols in place to ensure they are indeed independent.

TRANSITION RULE FOR 2013 FOR LARGE EMPLOYER DETERMINATION

If a business is on the bubble of the large employer threshold now, the Treasury Department and the IRS have concluded that transition relief is appropriate for those employers because they will be becoming familiar with the large employer determination method and applying it for the first time in 2013. Specifically, transition relief is provided for purposes of the large employer determination for the 2014 calendar year that allows an employer the option to determine its status as a large employer by reference to a period of at least six consecutive calendar months, as chosen by the employer, in the 2013 calendar year (rather than the entire 2013 calendar year). Thus, an employer may determine whether it is a large employer for 2014 by determining whether it employed an average of at least 50 full-time employees on business days during any consecutive six-month period in 2013.

This will allow these employers to choose to use either, or both, a period to prepare to count their employees and a period afterward to ascertain and implement the results of the determination. For example, an employer could use the period from January to February, 2013 to establish its counting method, the period from March through August, 2013 to determine its large employer status and, if it is an a large employer, the period from September through December, 2013 to make any needed adjustments to its plan (or to establish a plan) in order to comply with the law.

PENALTY ASSESSMENT ISSUES

PPACA created two potential penalties for large employers. If a large employer does not offer affordable health coverage that provides a minimum level of coverage to its full-time employees, the employer may be subject to an employer shared responsibility payment if at least one of its full-time employees receives a premium tax credit for purchasing individual coverage on one of the new Exchanges.

The second penalty results when the large employer offers health coverage to its full-time employees, but at least one full-time employee receives a premium tax credit to help pay for coverage on an Exchange, which may occur because the large employer did not offer coverage to that employee or because the coverage the employer offered that employee was either unaffordable to the employee or did not provide minimum value.

SPOUSES ARE NOT DEPENDENTS

One of the quirkiest drafting elements of PPACA was this phrase in the steps that trigger an employer shared responsibility penalty: "any applicable large employer fails to offer to its fulltime employees ***(and their dependents)*** the opportunity to enroll in minimum essential coverage under an eligible employer sponsored plan." Since passage, the question, "What does it mean?" has plagued large employers. We now know what it means, and a spouse is not a dependent.

The proposed regulations define an employee's dependents for purposes of employer shared responsibility penalty as an employee's child who is under 26 years of age. A child attains age 26 on the 26th anniversary of the date the child was born. For example, a child born on April 10, 1986 attained age 26 on April 10, 2012. Employers may rely on employees' representations concerning the identity and ages of the employees' children. The term dependents, as defined in the proposed regulations for purposes of employer shared responsibility penalty, does NOT include any individual other than children as described in this paragraph. ***Thus, an offer of coverage to an employee's spouse is not required for purposes of employer shared responsibility penalty.*** The IRS was quick to note this definition of dependents applies only for purposes of employer shared responsibility penalty and does not apply for purposes of any other section of the Code.

The proposed rule does provide a transition rule regarding dependent coverage. Any large employer that takes steps during its plan year that begins in 2014 toward satisfying the provisions relating to the offering of coverage to full-time employees' dependents will not be liable for any assessable payment solely on account of a failure to offer coverage to the dependents for that plan year.

COVERAGE OFFERED TO ALL – A NEW 95 PERCENT RULE

PPACA requires a large employer to offer coverage to all of its full-time employees. What if for some reason, one of those full time employees is inadvertently NOT offered coverage. The IRS is providing a margin of error – a 95 percent rule.

The proposed regulations provide that a large employer member will be treated as offering coverage to its full-time employees (and their dependents) for a calendar month if, for that month, it offers coverage to all but five percent or, if greater, five of its full-time employees (provided that an employee is treated as having been offered coverage only if the employer also offered coverage to that employee's dependents).

According to the IRS, "The alternative margin of five full-time employees (and their dependents), if greater than five percent of full-time employees (and their dependents), ***is designed to accommodate 'relatively small' large employers*** because a failure to offer coverage to a handful of full-time employees (and their dependents) might exceed five percent of the large employer's full-time employees."

EMPLOYEE FAILURE TO PAY

A large employer will not be treated as failing to offer to a full-time employee (and his or her dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan for an employee whose coverage under the plan is terminated during the coverage period solely due to the employee failing to make a timely payment of the employee portion of the premium.

ESSENTIAL COVERAGE, MINIMUM VALUE, AND AFFORDABILITY RULES

PPACA set out the standards for what must be included in a large employer's health care coverage, the minimum value of the coverage (60 percent), and whether it is considered affordable (not to exceed 9.5 percent of household income). The essential benefits issue is being handled by the Department of Health and Human Services (HHS) and it has issued guidance. These proposed rules handle the minimum value and affordability issues.

A minimum value calculator will be made available by the IRS and the HHS. The minimum value calculator will work in a similar fashion to the actuarial value calculator that HHS is making available. Employers can input certain information about the plan, such as deductibles and co-pays, into the calculator and get a determination as to whether the plan provides minimum value by covering at least 60 percent of the total allowed cost of benefits that are expected to be incurred under the plan.

If an employee's share of the premium for employer-provided coverage would cost the employee more than 9.5 percent of that employee's annual household income, the coverage is not considered affordable for that employee. If an employer offers multiple healthcare coverage options, the affordability test applies to the lowest-cost option available to the employee that also meets the minimum value requirement.

Because employers generally will not know their employees' household incomes, employers can take advantage of one of the affordability safe harbors set forth in the proposed regulations. Under the safe harbors, an employer can avoid a payment if the cost of the coverage to the employee would not exceed 9.5 percent of the wages the employer pays the employee that year, as reported in Box 1 of Form W-2, or if the coverage satisfies either of two other design-based affordability safe harbors.

SECTION 1411 CERTIFICATION

In theory, if no employee of a large employer went to an exchange for premium assistance or cost reduction, a large employer would not be subject to a penalty even though the large employer was otherwise at risk. In the case of not offering coverage, that is more difficult to imagine, since the employee would be subject to the individual mandate. If the large employer offers the appropriate coverage and the employee still goes to the exchange, it should happen less often.

Either way, the words “Section 1411 Certification” will probably become dreaded words in the large employer’s HR world.

A large employer is subject to an assessable penalty if at least one full-time employee of that employer has been certified to the employer under section 1411 of PPACA as having enrolled in a qualified health plan with respect to which a premium tax credit is allowed or paid. Section 1411(a) of PPACA gives the Secretary of Health and Human Services (HHS) the authority to determine whether individuals are eligible to enroll in qualified health plans through the Exchange and whether they are eligible for a premium tax credit.

According to the IRS, it is anticipated that, in upcoming regulations to be proposed under section 1411(a) of PPACA, HHS will establish a process under which employees who have enrolled for a month in a qualified health plan with respect to which an applicable premium tax credit or cost-sharing reduction is allowed or paid with respect to the employee will be certified to the employer and that, pursuant to the proposed regulations, the certification to the employer will consist of methods adopted by the IRS to provide this information to an employer as part of its determination of liability. Existing HHS regulations also provide for a separate process for notification of employers.

LOTS OF OTHER STUFF

Much of the proposed rules is devoted to how large employers deal with the fact they really will not know whether employees are full time or not until after the fact. There are a variety of safe harbors and lookback options in the rule for dealing with these issues with which all large employers will need to become familiar.

The proposed rules deal with new employees, variable hour employees, common ownership of companies and much more. All things most small businesses should never have to worry about.