EMPLOYER PAY OR PLAY MANDATE – FINAL REGULATIONS EXPLAINED

Starting in 2015, certain large employers may incur the employer shared responsibility (also known as the employer pay or play) excise tax unless they meet certain standards for offering health coverage to their full-time employees. An employer can control its exposure to the pay or play excise tax, but doing so requires measuring the employer’s workforce and individual workers’ hours in various ways, as well as evaluating any health coverage the employer offers against certain benchmarks. The U.S. Treasury Department and Internal Revenue Service (IRS) issued final regulations implementing the pay or play provisions and, while not dramatically different from the proposed regulations, they provide important details and clarifications on the measurements and evaluations that determine whether an employer might incur the excise tax.

PAY OR PLAY BASICS

The rules governing the pay or play excise tax are complex. Even determining which employees are considered full-time calls for detailed analysis. Despite the “pay or play” shorthand reference, these provisions are best thought of as including two separate excise tax provisions.

- One excise tax (we call it the “cliff” but it is also known as the Section 4980H(a) penalty) usually will be very large if it applies, but it is easily avoidable.
- The other excise tax (which we call the “drop-off,” but it is also known as the Section 4980H(b) penalty) usually will be small by comparison but is more difficult to avoid completely.

These excise taxes apply only to large employers (50 or more full-time employees [including full-time equivalents] in the last calendar year). Also, neither the cliff nor the drop-off applies unless the employer receives a certification that at least one of its full-time employees has obtained coverage through a public insurance exchange (also known as the health insurance marketplace) and has qualified to receive premium assistance or cost-sharing reduction with respect to that coverage. Very generally, full-time employees are those employed for an average of at least 30 hours of service per week.
The cliff may apply if an employer fails to offer minimum essential coverage (which includes almost any employer-sponsored medical benefits, regardless of cost or value) to substantially all of its full-time employees and their dependent children (up to age 26). The cliff excise tax is $2,000 annually – $166.67 per month – for every one of an employer’s full-time employees. The $2,000 penalty is indexed in 2015 and future years. Depending on corporate structure, up to 30 of the employer’s full-time employees are disregarded (transitional guidance available for 2015 provides that an employer may reduce its number of full-time employees by 80 rather than 30). For an employer that is part of a controlled group, its allocation is equal to 30 (or 80 for 2015) allocated ratably among all members of the controlled group on the basis of the number of full-time employees employed by each applicable member of the controlled group during the calendar month.

If an employer avoids the cliff, it may still incur the drop-off if it does not offer each full-time employee minimum essential coverage that is both minimum value (at least 60% actuarial value) and affordable (no more than 9.5% of the employee’s household income, which can be determined by the employee’s W-2 pay, the employee’s rate of pay, or the federal poverty line for a single individual). The drop-off excise tax is $3,000 annually – $250 per month – for each full-time employee for whom the employer receives a certification of premium assistance or cost-sharing reduction, unless the cliff would be a lower amount. The drop-off penalty is capped so that it cannot exceed the amount of the cliff penalty that would apply if no coverage was offered by the employer. The $3,000 penalty is indexed for 2015 and future years.

**WHO IS A LARGE EMPLOYER**

The pay or play mandate applies to large employers. An employer is not subject to any pay or play excise tax, regardless of what coverage it does (or does not) offer, unless the employer (including certain affiliated companies) is a large employer. A large employer is defined as an employer that employed an average of at least 50 full-time employees on business days during the preceding calendar year (please see below for information on a transition rule available to certain large employers employing fewer than 100 full-time [including full-time equivalent] employees).

Tax-exempt, charitable, religious or governmental organizations are not exempt from the pay or play provisions. Employees of all employers that are part of a single controlled group or affiliated service group (defined under the rules for qualified retirement plans) are added together when establishing whether the individual group members are large employers. However, for purposes of determining whether the pay or play excise tax has been incurred, each entity within the controlled group is considered a separate employer and generally has no responsibility for the other group members.

For purposes of calculating whether an employer has 50 or more full-time employees, full-time equivalent employees (FTE) as well as full-time employees are taken into account. The number of FTEs for each calendar month in the preceding calendar year is determined by calculating the aggregate number of hours of service for that calendar month for employees who were not full-time employees (but not more than 120 hours of service for any employee) and dividing that number by 120. In determining the number of FTEs for each calendar month, fractions are taken into account. The final regulations provide that, as an option, an employer may round the resulting monthly FTE calculation to the nearest one hundredth (i.e., a calculation of 30.544 FTEs for a calendar month may round the number to 30.54 FTEs). Because part-time employees essentially count as fractions when making the large employer determination, a company with only a few employees working 30 or more hours per week may be a large employer.

An employer is not considered to employ more than 50 full-time employees if (1) the employer’s workforce exceeds 50 full-time employees for 120 days or fewer during the calendar year, and (2) the employees in excess of 50 employed during such 120-day period are seasonal workers. For this purpose, the term *seasonal worker* is defined as a worker who performs labor or services on a seasonal basis.

When determining whether a company is a large employer for 2016 and later calendar years, employment during all 12 months of the previous calendar year must be factored in. Under a transition rule available for the 2015 calendar year, the determination of whether a company is a large employer may be made based on any period of at least six consecutive calendar months during 2014.
TRANSITIONAL GUIDANCE

In addition to the transitional rules referenced above, the final regulations provide a number of other transitional rules that delay the application of the pay or play mandate to certain employers and lower the thresholds for different aspects of the law. The following summarizes these rules.

EMPLOYERS WITH 50-99 EMPLOYEES

The final regulations grant a one-year delay (until 2016) to employers with 50-99 full-time employees (including FTEs). This means that for 2015, a large employer is one that employs at least 100 full-time (including FTEs) employees. The same rules that determine an employer's status as a large employer, including the controlled group aggregation rules, apply for purposes of determining whether an employer has 50-99 full-time employees (including FTEs). An employer seeking to take advantage of this transitional guidance must meet certain conditions:

- **Limited Workforce Size** The employer employs on average at least 50 full-time employees (including FTEs) but fewer than 100 full-time employees (including FTEs) on business days during 2014.
- **Maintenance of Workforce and Aggregate Hours of Service** During the period beginning February 9, 2014 and ending on December 31, 2014, the employer does not reduce the size of its workforce or the overall hours of service of its employees in order to satisfy the workforce size condition except for bona fide business reasons, such as reductions of workforce size or overall hours of service because of business activity (e.g., the sale of a division, changes in the economic marketplace in which the employer operates, terminations of employment for poor performance, or other similar changes unrelated to eligibility for the transition relief).
- **Maintenance of Previously Offered Health Coverage** During the period beginning February 9, 2014 and ending on December 31, 2014 (for an employer with a non-calendar year plan, the period beginning on February 9, 2014, ending on the last day of the plan year that begins in 2015), the employer cannot eliminate or materially reduce the health coverage, if any, it offered as of February 9, 2014. An employer will meet this requirement if:
  - It continues to offer each employee who is eligible for coverage during the coverage maintenance period an employer contribution toward the cost of employee-only coverage that is either at least 95% of the dollar amount of the contribution toward such coverage that the employer was offering on February 9, 2014, or is the same (or a higher) percentage of the cost of coverage that the employer was offering to contribute toward coverage on February 9, 2014;
  - In the event there is a change in benefits under the employee-only coverage offered, that coverage provides minimum value after the change; and
  - The employer does not alter the terms of its group health plans to narrow or reduce the class or classes of employees (or the employees’ dependents) to whom coverage under those plans was offered on February 9, 2014.
- **Certification of Eligibility for Transition Relief** The employer certifies to the IRS that it meets the eligibility requirements described above. This certification will be done in conjunction with the Form 6056 reporting requirement (annual reporting on health coverage by large employers under the pay or play mandate).

REDUCED PERCENTAGE OF EMPLOYEES OFFERED COVERAGE

For purposes of the cliff penalty, for an employee to be treated as having been offered coverage for a month (or any day in that month), the coverage offered, if accepted, must be applicable for that month (or that day). The cliff may apply if an employer fails to offer minimum essential coverage (which includes almost any employer-sponsored medical benefits, regardless of cost or value) to substantially all of its full-time employees and their dependents. An applicable large employer member is treated as offering coverage to its full-time employees (and their dependents) for a calendar month if, for that month, it offers coverage to 95% or, if greater, five of its full-time employees. This relief applies to a failure to offer coverage to the specified number or percentage of employees (and their dependents), regardless of whether the failure to offer was inadvertent. For 2015, the percentage is reduced to 70%. While this change gives employers some additional flexibility, it only avoids the cliff penalty. An employer remains subject to the drop-off penalty for those full-time employees not offered coverage that is both affordable and provides minimum value and for whom the employer receives a certification that the employee has obtained coverage through a public insurance exchange and has qualified to receive premium assistance or cost-sharing reduction with respect to that coverage.
SHORTER MEASUREMENT PERIODS

Those employers using the look-back measurement period to determine their full-time employees (as described below) may adopt a transition measurement period beginning in 2015. The transition rule provides that employers may adopt a transition measurement period that is shorter than 12 consecutive months but that is no less than six consecutive months and that begins no later than July 1, 2014 and ends no earlier than 90 days before the first day of the plan year beginning on or after January 1, 2015 (90 days being the maximum permissible administrative period). The employer could then have a 12-month stability period. The general rule under the look-back measurement method is that for those employees deemed full-time, the stability period must be the same length as the measurement period but cannot be less than six months. This transition rule can only be used with regard to those individuals who are employees as of the first day of the measurement period.

DEPENDENT COVERAGE

In order to avoid pay or play penalties, the employer must offer coverage to its full-time employees and their dependent children (to age 26). Transitional guidance gives employers until 2016 to offer coverage to dependents – a large employer will not be liable for a pay or play penalty solely because it did not offer coverage to dependent children in the 2014 or 2015 plan year. Note: this transition rule only applies to employers who do not offer dependent coverage, offer dependent coverage that does not constitute minimum essential coverage, or offer dependent coverage to some but not all dependents. Transition relief is not available to the extent the employer offered dependent coverage during either the 2013 or the 2014 plan year and subsequently dropped that coverage. This relief applies only for dependents who were without an offer of coverage from the employer in both the 2013 and 2014 plan years and if the employer takes steps during the 2014 and 2015 plan year (or both) to extend coverage under the plan to dependents not offered coverage during the 2013 or 2014 plan year (or both).

Dependent is defined as a child of an employee who has not attained age 26. Dependent does not include the spouse of an employee. The final regulations exclude both foster children and stepchildren from the definition of dependent. Employers are only required to cover an employee’s biological or adopted children. It also excludes a child who is not a U.S. citizen or national, unless that child is a resident of a country contiguous to the United States or is within the exception for adopted children. A child is a dependent for the entire calendar month during which he or she attains age 26.

MULTIEMPLOYER PLANS

The final regulations extend the guidance in the proposed rules regarding multiemployer plans. The guidance applies to employers that are required by a collective bargaining agreement or an appropriate related participation agreement to make contributions, with respect to some or all of their employees, to a multiemployer plan that offers affordable coverage that provides minimum value to individuals and their dependents who satisfy the plan’s eligibility conditions. Under this interim guidance, the applicable large employer member will not be treated, with respect to those employees, as failing to offer the opportunity to enroll in minimum essential coverage to full-time employees (and their dependents) for purposes of the pay or play penalties.

In determining whether coverage under the multiemployer plan is affordable, participating employers may use any of the affordability safe harbors set forth in the final regulations (the safe harbors, described in more detail below, are the employee’s W-2 pay, the employee’s rate of pay, or the federal poverty line for a single individual). Coverage under a multiemployer plan will also be considered affordable with respect to a full-time employee if the employee’s required contribution, if any, toward self-only health coverage under the plan does not exceed 9.5% of the wages reported to the qualified multiemployer plan, which may be determined based on actual wages or an hourly wage rate under the applicable collective bargaining agreement or participation agreement. If any assessable payment were due, it would be payable by the large employer and the employer would be responsible for identifying its full-time employees for this purpose (which would be based on hours of service for that employer). If the large employer contributes to one or more multiemployer plans and maintains a single employer plan, the interim guidance applies to each multiemployer plan but not to the single employer plan.
While most of the transition rules provided in the final regulations are of limited duration (generally the 2014 and 2015 plan years), this guidance appears to apply until additional guidance is issued. Any future guidance that limits the scope of the interim guidance will be applied prospectively and will apply no earlier than January 1 of the calendar year beginning at least six months after the date of issuance of the guidance.

**NON-CALENDAR YEAR PLANS**

The pay or play provisions generally are effective for large employers and plans on January 1, 2015. An employer that wishes to determine whether it is a large employer for 2015 or to identify its full-time employees using the look-back measurement method (as described below) must track employees’ hours of service during 2014 in order to implement on January 1, 2015.

The final pay or play regulations expand on the rules under the proposed regulations that allow a large employer (100 or more full-time, including FTE, employees) with a non-calendar year plan year to begin meeting its shared responsibility obligations as of the first day of the plan’s 2015 plan year instead of January 1, 2015. Rather than simply provide large employers with non-calendar year plan years a post-January 1, 2015 delayed effective date until the start of their 2015 plan year (like the other health care reform law requirements), these revised rules require the employer to prove it is entitled to the delayed effective date by meeting three sets of requirements. (The transition relief is only available for the period between January 1, 2015 and the first day of the 2015 plan year.)

1. **Maintenance of Unmodified Non-Calendar Year Plan**
   - The employer must have maintained a non-calendar year plan as of December 27, 2012 (the date the proposed regulations were initially released); and
   - The plan year must not be modified after December 27, 2012, to begin at a later calendar date (e.g., change the start of the plan year from April 1 to December 1).

2. **Transition Rules** – The employer must comply with one of the following three transition rules:
   - **Pre-2015 Eligibility Transition Rule** – Employees, regardless of when they are hired, are eligible for coverage effective beginning on the first day of the 2015 plan year under the eligibility terms of the employer’s plan in effect on February 9, 2014. This rule also applies to employees who terminated employment and are not rehired prior to the first day of the plan’s 2015 plan year. Note the regulations merely state that “employees” must be eligible and does not limit this rule to full-time employees, making it unclear whether this rule is intended to apply to all employees or just full-time employees.
   - **Significant Percentage Transition Guidance (All Employees) Rule** – As of any date that the employer chooses in the 12 months ending on February 9, 2014, one of the following applies:
     - At least 1/4 of all of the employer’s employees are covered (not just offered coverage) under the plan; or
     - At least 1/3 of all of the employer’s employees are offered coverage during the open enrollment period that ended most recently before February 9, 2014.
   - **Significant Percentage Transition Guidance (Full-Time Employees) Rule** – As of any date that the employer chooses in the 12 months ending on February 9, 2014, one of the following applies:
     - At least 1/3 of the employer’s full-time employees are covered (not just offered coverage) under the plan; or
     - At least 1/2 of the employer’s full-time employees are offered coverage during the open enrollment period that ended most recently before February 9, 2014.

3. **Coverage Rule**
   - Each full-time employee is offered affordable coverage that provides minimum value no later than the first day of the 2015 plan year; and
   - The full-time employee is not eligible for coverage under any group health plan maintained by the employer as of February 9, 2014, that has a calendar year plan year. Note that group health plan is broadly defined and it is unclear whether it excludes a health flexible spending account (health FSA).
An employer who complies with these rules still must offer coverage in accordance with the percentage-of-covered-employees requirement discussed above. As applied to employers with non-calendar year plan years who are seeking transition relief, that requirement is modified somewhat as discussed below.

- If the employer modified its plan year after February 9, 2014 to begin on a later calendar date, the employer must offer minimum essential coverage to at least 95% or, if greater, five of its full-time employees as of the first day of its 2015 plan year or be subject to the pay or play penalty.
- An employer who does not modify its plan year in the manner described above must offer minimum essential coverage to at least 70% of its full-time employees as of the first day of its 2015 plan year or be subject to the pay or play penalty.

Because these rules are complex and confusing, and because of the penalties involved, we strongly recommend that employers review them carefully and consult with legal counsel before applying them in connection with their non-calendar year plans.

**AFFORDABILITY**

Liability for pay or play penalties only arises if the employer receives a certification that at least one of its full-time employees has obtained coverage through an insurance exchange and has qualified to receive premium assistance or cost-sharing reduction with respect to that coverage. For an employee who is offered coverage by an employer to be eligible for such premium assistance or cost-sharing reduction, the coverage offered must either fail to provide minimum value, or fail to be affordable to that employee, or both. For purposes of eligibility for tax credits, affordability is determined by the taxpayer’s household income. Because an employer generally will not know the taxpayer employee’s household income, the regulations set forth three separate safe harbors under which an employer could determine affordability based on information that is readily available. These three safe harbors, which are generally unchanged from the proposed regulations, are (1) the Form W-2 wages safe harbor, (2) the rate of pay safe harbor; and (3) the federal poverty line safe harbor.

If an employer meets the requirements of the safe harbor, the offer of coverage is deemed affordable for purposes of the employer pay or play mandate regardless of whether it is affordable to the employee for purposes of determining eligibility for the tax credit. These safe harbors are all optional. An employer may choose to use one or more of these safe harbors for all of its employees or for any reasonable category of employees, provided it does so on a uniform and consistent basis for all employees in a category. The final regulations clarify that reasonable categories include specified job categories, nature of compensation (e.g., salaried or hourly), geographic location, and similar bona fide business criteria. An enumeration of employees by name is not considered a reasonable category.

**W-2 SAFE HARBOR**

Under the Form W-2 wages safe harbor, the employee-only cost for coverage during a calendar year cannot exceed 9.5% of the amount reported in Box 1 of an employee’s Form W-2 for that calendar year. To qualify for this safe harbor, the employee’s required contribution must remain a consistent amount or percentage of all Form W-2 wages during the calendar year (or during the plan year for plans with non-calendar year plan years), so that an applicable large employer member is not permitted to make discretionary adjustments to the required employee contribution for a pay period.

If an employee was not employed by the employer throughout the year, the employee-only cost is calculated only for periods of employment and compared to the W-2 wages reported for the year. If the employee was eligible for coverage for a shorter period than the period of employment during the calendar year, the Form W-2 wages are adjusted to reflect the period when the employee was offered coverage compared to the period of employment during the calendar year. For example, if an employee was employed by the employer for six months during 2015, and coverage was offered to the employee with respect to all six months, the normal 9.5% of wages reported in Box 1 affordability test would apply. If, however, the employee was employed for six months, but only offered coverage for four months, the wages reported in Box 1 would be multiplied by 2/3 and the 9.5% affordability test would be applied to that prorated amount.

As is apparent, this calculation is made on an employee-by-employee basis after the end of the year. Therefore, it may not be possible for an employer to know at the time it offers coverage (and sets the required contribution for that coverage) what amount of contribution will be considered affordable under this alternative.
RATE OF PAY SAFE HARBOR
Under the rate of pay safe harbor, an employer’s offer of coverage to an hourly employee is treated as affordable for a calendar month if the employee’s required contribution for the calendar month for the lowest cost self-only coverage that provides minimum value does not exceed 9.5% of an amount equal to 130 hours multiplied by the lower of the employee’s hourly rate of pay as of the first day of the coverage period (generally the first day of the plan year) or the employee’s lowest hourly rate of pay during the calendar month.

An employer’s offer of coverage to a non-hourly employee is treated as affordable for a calendar month if the employee’s required contribution for the calendar month for the lowest cost self-only coverage that provides minimum value does not exceed 9.5% of the employee’s monthly salary, as of the first day of the coverage period (instead of 130 multiplied by the hourly rate of pay); provided that, if the monthly salary is reduced, including due to a reduction in work hours, the safe harbor is not available. For an hourly employee, the employer uses an assumed rate of 130 hours per calendar month multiplied by an hourly employee’s rate of pay, regardless of whether the employee actually works more or less than 130 hours during a calendar month.

The affordability calculation under the rate of pay safe harbor is not altered by a leave of absence or reduction in hours worked. The final regulations permit an employer to apply the rate of pay safe harbor to an hourly employee even if the employee’s rate of pay is reduced during the year. In this situation, the rate of pay is applied separately to each calendar month rather than to the entire year, and the employee’s required contribution may be treated as affordable if it is affordable based on the lowest rate of pay for the calendar month multiplied by 130 hours. The rate of pay safe harbor cannot be used, as a practical matter, for tipped employees or for employees who are compensated solely by commissions.

FEDERAL POVERTY LEVEL SAFE HARBOR
The federal poverty level safe harbor sets an affordability “floor,” establishing a dollar amount for an employee-only cost that is deemed affordable for all employees. Under the federal poverty line safe harbor, an employer’s offer of coverage to an employee is treated as affordable if the employee’s required contribution for the calendar month for the lowest cost self-only coverage that provides minimum value does not exceed 9.5% of a monthly amount determined as the federal poverty line for a single individual for the applicable calendar year, divided by 12. The applicable federal poverty line is the federal poverty line for the state in which the employee is employed. Employers are permitted to use the guidelines in effect six months prior to the beginning of the plan year. For 2014, the federal poverty level for an individual (for the 48 contiguous states and the District of Columbia) is $11,670 so, for a calendar year plan, this floor amount would be $92.39 per month if calculated for 2015.

OFFERS OF COVERAGE
The final regulations provide that if an employee has not been offered an effective opportunity to accept or decline coverage, the employee will not be treated as having been offered the coverage for purposes of the pay or play mandate. An effective opportunity to decline is not required for an offer of coverage that provides minimum value and is offered either at no cost to the employee or at a cost, for any calendar month, of no more than 9.5% of a monthly amount determined as the federal poverty line for a single individual for the applicable calendar year, divided by 12. The final regulations further provide that an offer of coverage exists when an employee’s election of coverage from a prior year continues for every succeeding plan year until the employee affirmatively elects to opt out of the plan.

IDENTIFYING FULL-TIME EMPLOYEES
The pay or play mandate defines a full-time employee as being employed for an average of at least 30 hours of service per week. An employee is an individual who is an employee under the common law standard and does not include a leased employee, a sole proprietor, a partner in a partnership, a 2-percent S corporation shareholder or a worker described in section 3508 of the Internal Revenue Code (real estate agents and direct sellers). Please note that holders of H-2A and H-2B visas are not generally exempted from the definition of employee.
HOURS OF SERVICE

The definition of an hour of service for purposes of pay or play provisions generally translates to any hour for which an employee is paid (or entitled to payment) being counted as an hour of service. When counting an employee’s hours of service, the final regulations offer employers several options and impose several requirements.

- An employer has the option, if applied on a reasonable and consistent basis, to treat 130 or more hours of service in a calendar month as equivalent to an average of 30 or more hours of service per week.
- The employer must count actual hours of service recorded in its payroll records for each hourly-paid employee.
- For employees paid on a non-hourly basis, the employer may use one of three methods (which may change each calendar year and may differ among reasonable and consistent classifications of employees):
  - Count actual hours of service recorded in the employer's payroll records; OR
  - If it would not substantially understate the employee's hours, count either
    - Eight hours of service for each day on which the employee is credited with an hour of service; OR
    - Forty hours of service for each workweek during which the employee is credited with an hour of service.

DETERMINATION OF FULL-TIME STATUS FOR CERTAIN EMPLOYEE CATEGORIES

Although assigning employees to employment classifications such as full-time, part-time or temporary has almost no relevance to the pay or play provisions, the final regulations do provide guidance for the following occupations and employee categories in determining if an individual is considered a full-time employee:

- **Volunteers** Bona fide volunteers for a government or tax-exempt entity (e.g., volunteer firefighters and emergency responders) are not considered full-time employees.
- **Seasonal Employees** Positions for which the customary annual employment is six months or less are generally not considered to be full-time (seasonal employees are discussed in more detail below).
- **Educational Employees** Teachers and other educational employees are not treated as part-time for the year based solely on the school being closed or operating on a limited schedule during the summer.
- **Student Work-Study Programs** Service performed by students under federal or state-sponsored work-study programs is not counted in determining whether the students are full-time employees. All hours of service for which a student employee of an educational organization (or an outside employer) is paid or entitled to payment in a capacity other than through the federal work-study program (or a state or local government’s equivalent) must be counted as hours of service.
- **Adjunct Faculty** Employers are required to use a reasonable method of crediting hours of service that is consistent with the law. Until further guidance is issued, a reasonable method would include crediting an adjunct faculty member of an institution of higher education with 2 ¼ hours of service (representing a combination of teaching or classroom time and time performing related tasks, such as class preparation and grading of examinations or papers) per week for each hour of teaching or classroom time, and separately crediting an hour of service per week for each additional hour outside of the classroom the faculty member spends performing duties he or she is required to perform (such as required office hours or required attendance at faculty meetings).
- **Employees with Layover Hours** (including airline and other transportation industry employees) – Employers are required to use a reasonable method of crediting hours of service that is consistent with the law.
- **Employees with On-Call Hours** (including health care and information technology professionals) – Employers are required to use a reasonable method of crediting hours of service that is consistent with the law.

Employers of other employees whose hours of service are particularly challenging to identify or track, or for whom the final regulations’ general rules for determining hours of service may present special difficulties, such as commissioned salespeople, are required to use a reasonable method of crediting hours of service that is consistent with the law.
METHODS FOR DETERMINING FULL-TIME EMPLOYEE STATUS

The final regulations provide two methods for determining full-time employee status – the monthly measurement method and the look-back measurement method. These appear to be the only methods available and neither, unfortunately, is simple and easy to apply.

The rules are clear that an employer cannot adopt the look-back measurement method for variable hour and seasonal employees while using the monthly measurement method for employees with more predictable hours of service. There are certain enumerated categories of employees for which an employer can apply different measurement methods (look-back measurement method and monthly measurement method) as well as different starting and ending dates and lengths of measurement and stability periods. The categories specified in the regulations are:

- Salaried employees and hourly employees
- Employees whose primary places of employment are in different states
- Collectively bargained employees and non-collectively bargained employees
- Each group of collectively bargained employees covered by a separate collective bargaining arrangement

In addition, those employers that are part of a controlled group that qualifies as an applicable large employer may use different starting and ending dates and lengths of measurement and stability periods, as well as different measurement methods.

Special rules apply to those situations in which an employee experiences a change in employment status from a position for which the look-back measurement method is used to a position for which the monthly measurement method is used (or vice versa), as well as when employees are rehired or return from a leave of absence. The final regulations retain the rehire rules contained in the proposed regulations but reduce the length of the break in service required before a returning employee may be treated as a new employee from 26 weeks to 13 weeks (except for educational organization employers). This break-in-service period applies for both the look-back measurement method and the monthly measurement method. To avoid the treatment of employees of educational organizations as new employees resuming services after a scheduled academic break, however, the final regulations provide that, for employees of educational organizations, the 26-week break-in-service period under the rehire rules provided in the proposed regulations continues to apply.

MONTHLY MEASUREMENT METHOD

The final regulations introduce the monthly measurement method. Under this method, an employer looks at each calendar month in order to determine whether the employee worked sufficient hours in that month to be deemed a full-time employee. Note that this method may be administratively burdensome for some employers given that this method will cause those employees whose hours frequently fluctuate above and below 30 hours per week to bounce in and out of the plan. However, some employers, particularly those that make coverage available to all of their employees (including those working below 30 hours per week) or that have very few employees with fluctuating hours, may find the monthly measurement method easier to apply than the look-back measurement method.

If using the monthly measurement method, the final regulations allow an employer to determine an employee’s full-time employee status for a calendar month based on the hours of service over successive one-week periods. A week means any period of seven consecutive calendar days applied consistently by the employer for each calendar month of the year. Under this optional method, referred to as the weekly rule, full-time employee status for certain calendar months is based on hours of service over four-week periods and for certain other calendar months on hours of service over five-week periods. For calendar months using four-week periods, an employee with at least 120 hours of service is deemed full-time. For calendar months using five-week periods, an employee with at least 150 hours of service is deemed full-time. In general, the period measured for the month must contain either the week that includes the first day of the month or the week that includes the last day of the month, but not both.
LOOK-BACK MEASUREMENT METHOD

Under the look-back measurement method, an employer determines each employee’s full-time employee status by looking back at the employee’s hours of service over a period of time. While a full discussion of the look-back measurement method is beyond the scope of this alert, it is important to note that the look-back measurement method is largely unchanged from the proposed regulations.

Under the look-back measurement method, an employer determines an employee’s full-time status by looking back over a measurement period of at least three months but not more than 12 months, as determined by the employer. The employer determines the months in which the measurement period starts and ends, provided that the determination is made on a uniform and consistent basis for all employees in the same category. If the employer determines that an employee was employed on average at least 30 hours of service per week during the measurement period, then the employer treats the employee as a full-time employee during a subsequent stability period, regardless of the employee’s number of hours of service during the stability period, so long as the worker remains an employee. An employer using the look-back measurement method may, at its option, elect to add an administrative period of no longer than 90 days between the measurement period and the stability period.

For new employees with variable hours (cannot be determined at the employee’s start date whether reasonably expected to be employed on average at least 30 hours of service per week), who are seasonal (hired into a position for which the customary annual employment is six months or less) or who are part-time (reasonably expected to be employed on average less than 30 hours of service per week), an employer is permitted to measure their hours of service first to determine whether such employees have worked 30 or more hours per week during the measurement period and must, therefore, be treated as full-time employees. Please note that the likelihood of the employee failing to continue employment through this initial measurement period may not be taken into account in determining whether the employee is a variable hour employee. For new employees who are reasonably expected at their start date to be full-time employees (and are not seasonal employees), an employer determines the employees’ status as full-time employees based on the employees’ hours of service for each calendar month.

The application of the look-back measurement method to a new employee depends on the employer’s reasonable expectations with respect to the status of the new employee at his or her start date. Whether it is reasonable to determine that a new hire is or is not not a full-time employee depends on the facts and circumstances. Factors to consider include whether the employee is replacing an employee who was or was not a full-time employee, the extent to which employees in the same or comparable positions are or are not full-time employees, and whether the job was advertised or otherwise communicated to the new hire or otherwise documented (for example, through a contract or job description), as requiring hours of service that would average 30 (or more) hours of service per week or less than 30 hours of service per week. Educational organization employees cannot take into account the potential for, or likelihood of, an employment break period in determining their expectations of hours of service.

When an employee experiences a change in employment status from full- to part-time, the employer may apply the monthly measurement method to such an employee within three months of the change, if:

- The employee actually averages less than 30 hours of service per week for each of the three months following the change in employment status, and
- The employer has offered the employee continuous coverage that provides minimum value from at least the fourth month of the employee’s employment.

Otherwise, under the look-back measurement method, full-time employee status in a stability period is based on hours of service in the prior applicable measurement period, regardless of whether the employee experiences a change in employment status either during the measurement period or during the stability period. In general, under the look-back measurement method, if the change in employment status results in a change in hours of service, that change is captured in a subsequent stability period.
SEASONAL EMPLOYEES

An employer can treat its seasonal employees in the same manner as it treats its variable hour employees. This means that an employer is not required to treat seasonal employees like full-time employees for purposes of offering coverage even if they anticipate that the seasonal employee will work 30 or more hours per week or 130 hours a month. Instead, the employer can apply either the monthly measurement method or the look back measurement method to determine if the seasonal employee should be treated like a full-time employee.

In the final regulations, a seasonal employee means an employee in a position for which the customary annual employment is six months or less. The reference to customary means that by the nature of the position an employee in this position typically works for a period of six months or less, and that period should begin each calendar year in approximately the same part of the year, such as summer or winter. In certain unusual instances, the employee can still be considered a seasonal employee even if the seasonal employment is extended in a particular year beyond its customary duration (regardless of whether the customary duration is six months or is less than six months). For example, if ski instructors at a resort have a customary period of annual employment of six months but are asked in a particular year to work an additional month because of an unusually long or heavy snow season, they would still be considered seasonal employees.

An employee in a seasonal position might be promoted or transferred to a permanent position. For example, a ski instructor might be moved to the position of grounds manager, which is anticipated as year round employment. Under the final regulations, in general, if a seasonal employee experiences a change in employment status before the end of the initial measurement period in such a way that, if the employee had begun employment in the new position or status, the employee would not have been a seasonal employee (and would have reasonably been expected to be employed on average at least 30 hours of service per week), the employer has until the first day of the fourth month following the change in employment status, or, if earlier, the first day of the first month following the end of the initial measurement period (plus any applicable administrative period) if the employee averaged 30 hours of service per week or more during the initial measurement period, to treat the employee as a full-time employee.

SHORT-TERM EMPLOYEES AND HIGH-TURNOVER EMPLOYEES

In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on the treatment of short-term employees, defined as employees who are reasonably expected to average at least 30 hours of service per week and are hired into positions expected to continue for less than 12 months (but not including seasonal employees, who are employees in positions that also last a certain limited period but are expected to recur on an annual basis). They also requested comments on the treatment of employees in high-turnover positions, defined as positions in which a significant percentage of employees can be expected to terminate employment over a reasonably short period of time (for example, over a six-month period).

 Concerned with the potential for abuse if an exception were made for these types of employees, the preamble to the final regulations makes it clear that short-term and high turnover employees are not treated any differently from other employees under the pay or play mandate. The preamble does state that a short-term employee with a tenure of under three months should not raise issues under the pay or play mandate as the employer generally would not be subject to a penalty with respect to those employees, provided the employer sponsors a group health plan for which the employee would have been eligible had the employee continued working beyond the three months.

PERIODS WHEN THERE IS NO PAY OR PLAY LIABILITY

In various circumstances, the final regulations stipulate that an employer will not be subject to a pay or play penalty for certain employees during certain periods of time, known as limited non-assessment periods. The final regulations clarify that these non-assessment periods are available only if the employee is offered coverage that is affordable and provides minimum value by the first day of the month following the end of the applicable period.
If a new employee who is reasonably expected to be a full-time employee at his or her start date is offered coverage that is affordable and provides minimum value by the first day of the month immediately following the conclusion of the employee’s initial three full calendar months of employment (and if the employee was otherwise eligible for an offer of coverage during those three months), the employer is not subject to an assessable payment for those initial three full calendar months of employment. An employee is otherwise eligible for an offer of coverage in a month if the employee meets all conditions to be offered coverage under the plan other than the completion of a waiting period. This rule applies only once per period of employment of an employee and applies with respect to each of the three full calendar months for which the employee is otherwise eligible for an offer of coverage under a group health plan of the employer.

An employer using the monthly measurement method will not be subject to an assessable payment with respect to an employee for the first three full calendar month period beginning with the first full calendar month in which an employee is first otherwise eligible for an offer of coverage. An employee is otherwise eligible for an offer of coverage in a month if the employee meets all conditions to be offered coverage under the plan other than the completion of a waiting period.

An employer using the look-back measurement method will not be subject to an assessable payment during an initial measurement period (or the associated administrative period) in regard to its variable, seasonal and part-time employees who are deemed full-time employees.

If a new employee who is in the initial measurement period (or the associated administrative period) experiences a change to full-time employee status during the initial measurement period, the employer will not be subject to a pay or play penalty for the period before the first day of the fourth full calendar month following the change in employment status (or, if earlier and the employee averages 30 or more hours of service per week during the initial measurement period, the first day of the first month following the end of the initial measurement period [including any optional administrative period associated with the initial measurement period]).

If an employee (who was not offered coverage by the employer at any point during the prior calendar year) is offered coverage by a large employer for the first time on or before April 1 of the first calendar year for which the employer is a large employer, the employer will not be subject to a pay or play penalty by reason of its failure to offer coverage to the employee for January through March of that year.

An employer will not be subject to an assessable payment with respect to an employee for the first month of an employee’s employment with the employer, if the employee’s first day of employment is a day other than the first day of the calendar month.

**NEXT STEPS**

The final regulations provide additional clarification on what employers need to do to avoid the pay or play penalties. While the penalties have previously been delayed, employers cannot rely on them being delayed again. As such, employers need to finalize their strategy for dealing with the pay or play penalties. This includes determining whether the employer will “pay” or “play,” or a combination of the two, and, to the extent the employer chooses to play, setting up the necessary administrative processes to accurately capture which employees work 30 or more hours per week (and could potentially trigger pay or play penalties) and offering such employees coverage that meets the requirements on a timely basis.

As always, Willis’s National Legal & Research Group will monitor developments and provide information as they occur.
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