Instruction Manual to the Pay or Play Rules:

Helping Employers Make the Right Decision

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About This Instruction Manual

Caution: Nothing contained in this instruction manual is to be considered as the rendering of legal advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel. This instruction manual is intended for educational and informational purposes only.

Prepared by Alston & Bird, LLP for the members of the Society of Professional Benefit Administrators

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Introduction

Effective January 1, 2014, "applicable large employers" will be subject to one of two excise taxes imposed under new Internal Revenue Code Section 4980H if the employer fails to offer a full-time employee health insurance coverage that satisfies certain requirements prescribed in Code Section 4980H during a month and that full-time employee receives a premium tax credit or cost share reduction ("Premium Subsidy") for health insurance in an "Exchange" during that month. These new rules have forced applicable large employers to make a critical decision for the future—to pay or play!!!!

Unfortunately, the decision to pay or play hinges on the employer's understanding of very complex rules and regulations issued by the IRS and other agencies, such as the Department of Health and Human Services ("HHS") and Department of Labor. The rules and regulations, many of which are still in proposed form, contain many nuances that will slip the eye of the casual observer. Employers subject to 4980H will look to their third party administrators and consultants to assist them with analyzing these complex rules so that they can make the appropriate decisions regarding employer provided health coverage beginning in 2014. The following is a step-by-step guide through the 4980H rules for use by administrators to assist their employer clients in properly analyzing the pay or play rules.

Analyzing the 4980H rules is a four step process—each of which is detailed throughout this guide:

Step #1: <u>Determine whether the employer is an applicable large employer</u>.

Generally, an applicable large employer is any controlled group employer that employed, on average, 50 full-time equivalents during the preceding calendar year. Full-time equivalents include both full-time employees (as defined by the statute and the regulations) and full-time equivalencies, which are based on the total hours of service incurred by part-time employees. If the employer is NOT an applicable large employer, the 4980H rules do not apply. However, if the employer is an applicable large employer, the employer is subject to the 4980H rules and must decide whether to pay or play.

This threshold determination involves a fundamental understanding of complex corporate ownership rules ("controlled group rules") which can lead to counterintuitive and surprising results for many presumably "small" employers. For example, an employer with only 40 full-time employees may nevertheless be an applicable large employer subject to the 4980H rules IF the employer is a member of a larger controlled group of corporations and/or the employer has a substantial number of part-time employees.

Step #2: <u>Identify the employer's full-time employees for purposes of compliance with 4980H</u>.

As noted above, the excise taxes imposed under 4980H are imposed for each month that a "full-time" employee of the employer is not offered certain coverage from the employer and also receives a Premium Subsidy in the exchange. Thus, an employer is charged with identifying full-time employees each month to whom 4980H compliant coverage must be offered to avoid penalties or, alternatively, the potential penalty amount in the event 4980H compliant coverage is not offered. Unlike the applicable large employer determination, compliance with 4980H is determined independently for each controlled group member. Thus, one controlled group member's failure to offer 4980H compliant coverage does not subject other controlled group employers to excise taxes. Moreover, the process for identifying full-time employees for purposes of 4980H compliance is different than it is for the applicable large employer determination. Although based on the same general definition of hours of service, the full-time employee determination for purposes of 4980H compliance is generally made for the current month. Employers may find it challenging to identify its full-time employees for a month and also ensure that those employees are offered 4980H compliant coverage for that month. The IRS recognized this problem and as a result, prescribed a safe harbor method for identifying full-time employees for purposes of 4980H compliance. The safe harbor method, which allows employers to average an employee's hours of service over a "measurement period", is extremely complex with many nuances and potential traps.

Practice Pointer: It is during this step that employers must identify potential groups or classes of employees who are not offered coverage but may ultimately be "full-time" during a month. This determination is critical for making the decision to either Pay or Play.

Step #3: Determine if coverage offered by the employer will satisfy certain 4980H requirements.

To determine if coverage offered will satisfy 4980H requirements, the employer must understand the following concepts:

- Eligible Employer Sponsored Plan: As a threshold matter, the plan offered to the employer's full-time employees must qualify as an eligible employer sponsored plan, as defined in Code Section 5000A(f)(2). If the plan is an eligible employer sponsored plan and coverage is offered to a certain percentage of the employer's full-time employees, then the employer will avoid the "Sledgehammer Taxes" described in more detail in the next section.

- Affordability: Although the employer will avoid the Sledgehammer Taxes by offering coverage through an eligible employer sponsored plan, the employer will be subject to the "Tackhammer Tax" if the coverage offered through the eligible employer sponsored plan is not affordable as defined by the rules. The Tackhammer Tax is described in more detail in the next section. The IRS offers various safe harbor methods for determining whether coverage is affordable or not.

- Minimum value: The employer will also be subject to the Tackhammer Tax, even if the coverage is affordable, if the coverage offered through the eligible employer sponsored plan does not provide minimum value. A plan provides minimum value if it pays 60% of the "allowed costs". HHS has issued guidance on when coverage provides "minimum value" and contrary to the belief of many, minimum value is NOT achieved merely by covering 60% of the services or treatments covered by the plan.

Step #4: Determine whether to pay or play.

Once the employer has identified all classes of employees who may qualify as "full-time" as defined by 4980H and has determined whether the coverage offered satisfies 4980H requirements, the employer must then determine whether to pay or play. There are many factors to consider, including but not limited to the following:

- What changes are required to avoid the Sledgehammer Tax?
- What changes are required to avoid the Tackhammer Tax?
- Is it financially prudent to pay instead of play?
- If it is better to play instead of pay, to what extent should the employer play? Should the employer only make changes to avoid the Sledgehammer Tax? Should the employer also make changes to avoid the Tackhammer Tax?

Practice Pointer: Employers may decide to Pay And Play. For example, some employers may decide to offer coverage to substantially all full-time employees as necessary to avoid the Sledgehammer Tax but only offer unaffordable coverage, or coverage that doesn't provide minimum value, to some or all of those full-time employees. While this approach might trigger a Tackhammer Tax for the employer, the Tackhammer Penalty might prove more economically viable than offering affordable/minimum value coverage to all employees.

Overview of 4980H

An employer must first have a fundamental understanding of the excise taxes imposed under 4980H before attempting to analyze whether to pay or play. 4980H imposes one of two excise taxes if a full-time employee of the employer is certified as having received a Premium Subsidy.

First, the taxes are imposed only on "applicable large employers" as defined by Code Section 4980H. We discuss the definition of applicable large employer in the next section of this guide.

Next, the taxes are imposed ONLY to the extent a "full-time employee" of the applicable large employer is certified as having received a Premium Subsidy. Full-time employee is defined by the statute and the regulations—not the employer.

Practice Pointer: **Will 4980H impact how full-time employment is defined**? In the past, employers have had significant flexibility to define "full-time" any way they wanted. For example, some employers have defined "full-time" as 35 hours or more per week. Others have defined "full-time" as 32 hours or more per week. While employers will be free in 2014 to define full-time employment any way they want for employment purposes, employers will be required to treat employees who average 30 hours of service or more per week during a month as full-time for purposes of 4980H.

If a full-time employee is certified as having received a Premium Subsidy, the particular excise tax that is imposed depends on whether the employer offered coverage or, if coverage was offered, whether the employer offered 4980H compliant coverage.

<u>Employer fails to offer coverage</u>: If the applicable large employer fails to offer minimum essential coverage through an eligible employer sponsored plan to its full-time employees (and their dependents) during a month, and one of its full-time employees is certified as having received a Premium Subsidy in the exchange, the employer is subject to a penalty equal to 1/12 of $2,000 x the total number of the employer's full-time employees, reduced by that employer's allocable share of 30. We often refer to this as the "Sledgehammer Tax."

<u>Employer offers coverage</u>: If, however, an employer offers coverage through an eligible employer sponsored plan to its full-time employees, but the coverage is either unaffordable or doesn't provide minimum value, and a full-time employee is certified as receiving a Premium Subsidy in the exchange, the employer is subject to an excise tax equal to 1/12 of $3,000 x the total number of full-time employees who received a Premium Subsidy for that month. We often refer to this as the Tackhammer Tax.

Understanding when these excise taxes are imposed and how much they may be will put the pay or play analysis in the proper framework.

Practice Pointer: **Who is eligible for a Premium Subsidy**? It is important to understand for planning purposes that an applicable large employer member is liable for a 4980H excise tax for a month only to the extent that a full-time employee receives a Premium Subsidy during a month. An employee will not receive a Premium Subsidy under any of the following circumstances:

(i) the employee does not enroll in an Exchange;

(ii)	the full-time employee has household income in excess of 400% of the poverty level;
(iii)	the employee is eligible for coverage that is both affordable and provides minimum value;
(iv)	the employee voluntarily enrolls in minimum essential coverage offered by an employer (i.e. an eligible employer sponsored plan), even if that coverage is unaffordable or doesn't provide minimum value;
(v)	the employee is eligible for Medicare Part A, Medicaid, CHIP or TRICARE;
(vi)	the employee is not a citizen or legal resident.

In addition, applicable large employers must understand each of the following terms and concepts:

- Applicable large employer
- Full-time employee
- Hours of service
- Variable hour employee
- Seasonal employee
- Initial Measurement Period
- Standard Measurement Period
- Minimum essential coverage
- Eligible employer sponsored plan
- Affordable coverage
- Minimum value (not the same concept as "minimum essential coverage")
- Sledgehammer Tax (also referred to as the "no-offer" or 4980H(a) Penalty)
- Tackhammer Tax (also referred to as the "nonqualified coverage" or 4980H(b) penalty)

Practice Pointer-Will affordable, minimum value coverage disqualify Part-time employees from a Premium Subsidy? Part-time employees may also be disqualified from a Premium Subsidy if they are eligible for coverage through an eligible employer sponsored plan that is both affordable and provides minimum value.

NOTE: The proposed regulations issued by the IRS with respect to 4980H provide a number of transition rules, including rules for employers who contribute to multi-employer plans. Attached to the end of this guide is a short summary of the various transition rules.

Step #1: The Applicable Large Employer Determination

Step #1 Overview
• Only applicable large employers are subject to 4980H • The applicable large employer determination is based on IRS controlled group rules. • The applicable large employer determination is based on "full-time equivalency", which includes both "full-time employees" and full-time equivalents, determined in accordance with 4980H. • If there is no question that employer is an applicable large employer, then proceed to step #2.

An applicable large employer is defined generally in Section 4980H(c) as <u>any</u> employer (private, governmental and tax exempt entity) who employed, on average, at least 50 full-time employees (including full-time equivalencies for part-time employees) on business days during the <u>preceding calendar year</u> (without regard to any plan year of a plan sponsored by the employer).

To make the applicable large employer determination, follow these steps:

Step #1.A. Determine if employer is a member of a controlled group of employers as defined in Code Section 414(b),(c),(m) or (o)?

The controlled group rules in the Code are complex and the employer should analyze these rules only with assistance of qualified legal counsel. Nevertheless, it is important to understand the fundamentals. There are three main types of controlled groups: parent/subsidiary, brother/sister, and affiliated service group.

- A Parent/Subsidiary controlled group consists of a parent corporation and one or more subsidiary corporations. A Parent/Subsidiary controlled group exists if the members of the group (other than the common parent) are at least 80 percent owned by other members of the group, and if the common parent owns at least 80 percent of at least one of the member corporations.

- Brother/Sister controlled groups of employers exist where five or fewer shareholders *control* the corporations. For this purpose, control is defined as: (i) ownership of at least 80 percent of the entity and (ii) ownership of more than 50 percent of the entity, taking into account the stock ownership of each such person only to the extent that such stock ownership is identical with respect to each such corporation.

- An "affiliated service group" is defined generally as a service organization that regularly performs services in certain professional fields, such as health, law, engineering, for the "first service organization" and is generally a shareholder or partner in the first service organization (although there is a limited situation in which the service organization does not have to be a shareholder-see Code Section 414(m)(5)).

NOTE: Until subsequent guidance is issued, governmental employers may apply a good faith, reasonable interpretation of the controlled group rules.

Step #1.B. Identify full-time employees each month

A full-time employee is any common law employee of the controlled group employer who is employed on average 30 *hours of service* or more each week during a month (or, alternatively, 130 hours of service may be considered full-time for a month). This determination is made consistent with the following fundamental rules:

- Full-time status is based on the <u>actual</u> *hours of service* in the preceding calendar year—not the scheduled hours.

- The IRS has prescribed specific *hours of service* rules. See appendix A for a summary of the specific hours of service rules prescribed by the IRS.

- Only *common law employees* are considered. The IRS utilizes a 20-factor common law employee test to determine whether an individual is a common law employee of an employer. See Appendix B for an overview of the common law employee test. Partners in a partnership and more than 2% shareholders in a subchapter S are not considered common law employees. Moreover, "leased employees" as defined in Code Section 414(n) are not considered common law employees for purposes of the 4980H rules.

Step #1.C. Determine full-time equivalencies for the month.

The employer must also count full-time equivalencies of the controlled group employer in addition to full-time employees. The number of full-time equivalencies is equal to the total *hours of service* in a month for employees who are NOT full-time employees (not to exceed 120 for each such employee) divided by 120. The number of full-time equivalents is added to the number of full-time employees to determine applicable large employer status.

Step #1.D. Determine if employer is an applicable large employer

The applicable large employer determination is based on the following formula:

a. Determine the monthly full-time employee/equivalency number (#1.B + #1.C)
b. Determine the aggregate full-time employee equivalency amount (The sum of a.)
c. Divide b. by 12

If c. is $\geq$ 50, then the employer is an applicable large employer

You must consider the following fundamental rules when making your determination:

- Fractions are considered in the calculation; however, once the calculation is made for the year, fractions are rounded DOWN to the nearest whole number. Thus, an employer with 49.8 full-time employees/equivalencies is treated as having 49 full-time employees.

- There is a special rule regarding employees who qualify as seasonal. Under the special rule, if the employer exceeds 50 employees for four calendar months (not necessarily consecutive) or 120 days (not necessarily consecutive) and the excess over 50 for those four months or 120 days are seasonal employees, then the employer is not an applicable large employer. Seasonal employee is generally defined as an employee who performs services on a seasonal basis, as defined by the Secretary of Labor, including but not limited to employees covered by 29 C.F.R. 500.20(s)(1) and retail workers employed exclusively during holiday seasons. See "Identifying Full-Time Employees" below for a more detailed discussion of seasonal employees.

If, after performing the analysis above, you have determined that the employer is NOT an applicable large employer,—**the 4980H Rules do not apply to the employer**.

Practice Pointer-Are small employers not subject to 4980H subject to other ACA related rules? Even if the employer is not an applicable large employer, the employer is still not free and clear from the grasp of the ACA if the employer maintains a health plan for its employees. Other ACA related rules, such as the health insurance reforms (e.g., the new wellness program rules and the 90-day waiting period limitation, both of which go into effect for plan years beginning on or after January 1, 2014), the PCORI fee and the reinsurance fee may still have a significant impact on the employer.

If, however, the employer is an applicable large employer, proceed to Step #2.

Step #2. Identifying full-time employees for purposes of 4980H compliance

Step #2 Overview

- Each member of the controlled group is independently responsible for identifying its full-time employees (as defined by 4980H) for purposes of reporting and assessment of taxes (if any)
- Full-time employee determination is based on specific hours of service rules, which includes paid leaves of absence.
- Full-time employee determination is done on a monthly basis UNLESS the employer chooses to use the safe harbor method for identifying full-time employees.
- Safe harbor method for identifying full-time employees allows employers to determine average hours over a measurement period. If the employee is full-time based on the average hours during the measurement period, that employee is a "full-time employee" during a stability period that is generally no shorter in duration than the measurement period.

As noted above, the excise taxes imposed under 4980H are imposed for each month that a "full-time" employee of the employer is not offered certain coverage from the employer and also receives a Premium Subsidy in the exchange. Thus, an employer is charged under 4980H with identifying full-time employees each month to accurately determine the excise tax amounts, if any, that are owed. Employers who wish to avoid the excise taxes also need to identify full-time employees to whom 4980H compliant coverage must be offered.

There are two key differences between 4980H compliance and the applicable large employer determination. First, unlike the applicable large employer determination, each controlled group member is independently responsible for compliance with 4980H. For example, if a controlled member fails to offer 4980H compliant coverage to its full-time employees, the controlled group member may be liable for the excise taxes only with respect to its full-time employees who receive a Premium Subsidy—other controlled group members are not jeopardized by another controlled group member's 4980H failures.

Second, the process for identifying full-time employees for purposes of 4980H compliance is different than it is for the applicable large employer determination. In the case of 4980H compliance, the full-time employee determination is generally made for each month. This means employers who wish to avoid excise taxes must also ensure coverage is offered each month that the employee is a full-time employee, which employers may find challenging. The IRS recognized this challenge so it prescribed a safe harbor method for identifying full-time employees who must be offered certain coverage as a means to avoid excise taxes under the rules. The optional safe harbor method, which allows employers to average an employee's hours of service over a "measurement period", is extremely complex with many nuances and potential traps.

The following step-by-step guide is intended to assist employers with identifying full-time employees for purposes of 4980H compliance, including steps needed to implement the optional safe harbor method.

Step #2.A. Identify classes of employees who may, in any given month, be "full-time" for purposes of the 4980H rules.

Completion of this step enables the employer to properly determine the method by which it will identify its full-time employees for purposes of 4980H compliance. In this step, the employer must apply the following fundamental rules to its employees:

- Full-time definition: An employee is full-time if the employee has, on average, 30 hours of service or more per week during a month. Alternatively, the IRS will consider an employee with 130 hours of service in a month to be full-time. Full-time status for purposes of 4980H compliance is based on the statutory/regulatory guidance—not the employer's typical full-time requirements.

- Hours of Service: Full-time employee status for any given month is based on the employee's *hours of service* in that month. 4980H prescribes specific *hours of service* rules. Generally, an hour of service includes any periods for which the employee is paid or entitled to payment for services performed as well as certain periods during which the employee is paid or entitled to payment even though the employee is not performing services. For more details on the hours of service rules prescribed by 4980H, see Appendix A.

Practice Pointer-Do we round up hours of service? Are employers required to round hours of service up? The proposed regulations do not specifically address this issue with respect to hours of service; however, the regulations refer to labor regulations to help define "hours of service" and those regulations specifically require hours of service to be rounded up. See Appendix A for more details.

- Common Law Employee Definition: All common law employees of the employer are considered. The IRS has prescribed a 20 factor common law employee test. For more details on the common law employee test, see Appendix B. NOTE: Employees who are considered "temporary" or who are provided by a staffing agency may be common law employees of the employer. The common law analysis focuses on who has the right to control the manner in which services are performed, regardless of whether that right is exercised or not. In addition, "seasonal" employees must also be considered in the analysis if they are common law employees of the employer.

Practice Pointer-Are temporary employees, seasonal employees and interns exempt from the definition of full-time employee? The fundamental rule for identifying full-time employees is relatively simple in theory. If an individual is a common law employee of the employer and that employee has the requisite hours during the month, they are a "full-time" employee for that month under 4980H. There are no exceptions for temporary employees, seasonal employees and interns to the extent that they are common law employees of the employer. Fortunately, the IRS has created a safe harbor method for identifying full-time employees that allow employers to make the full-time determination based on average hours over a much longer measurement period.

- Pay or Play Reporting/Recordkeeping: Employers must file a return with the IRS that identifies all of the employer's full-time employees and the duration that such employees (and their dependents) were offered coverage. The employer will also be required to verify an employee's self-reported employment status to an Exchange if that employee applies for a premium Subsidy. Consequently, the employer must keep accurate records regarding each employee's status as full-time or not.

If the employer has a significant number of employees who are not generally considered full-time by the employer and who are not typically offered coverage but who may, from time to time, have the requisite hours of service during a month to qualify as a full-time employee for that month, the employer may want to consider implementing the safe harbor method for identifying full-time employees for purposes of 4980H compliance. Otherwise, the employer must adequately monitor an employee's hours of service each month so that they can be identified as a full-time employee (or not) for that month, and, to the extent determined to be full-time during that month, offered 4980H compliant coverage if the employer wishes to avoid the excise taxes.

Practice Pointer-What if I don't use the safe harbor method? If an employer chooses to monitor full-time status monthly as opposed to implementing the safe harbor method described more fully below, can the employer avoid 4980H excise taxes during an otherwise permissible waiting period? For example, Bob is a long time part-time employee of ABC, Inc. and is not otherwise eligible for coverage under ABC's medical plan. Bob enrolls in the exchange and receives a Premium Subsidy. In June of 2015, Bob is promoted to a full-time position that is expected to have 30 hours of service or more per week in a month. Bob is eligible for coverage under ABC's plan but only after a 90-day waiting period. This waiting period complies with PHSA Section 2708. Despite Bob's promotion, Bob remains eligible for and continues to receive a Premium Subsidy during Bob's waiting period. Is ABC liable for an excise tax for failing to offer coverage to Bob during Bob's waiting period—a period during which Bob is a full-time employee and also receives a Premium Subsidy? This is unclear. Under the existing guidance under 4980H, an employer not using the safe harbor is generally liable for excise taxes for failure to offer 4980H coverage during ANY month to a full-time employee who receives Premium Subsidy. Both 4980H and PHSA Section 2708 indicate that compliance with PHSA Section 2708 does not necessarily equate to compliance with 4980H. In fact, the only time that 4980H appears to specifically coordinate with PHSA Section 2708 is for non-variable new employees. Bob is not a new, non-variable employee. Thus, it would appear *from the face* of the guidance that ABC, who does not use the safe harbor method, could avoid excise taxes for failing to offer Bob coverage during what is an otherwise permissible waiting period under PHSA Section 2708. At least one treasury official has informally indicated that it may be permissible to avoid excise taxes for failing to offer coverage to an existing employee who becomes "full-time" if the waiting period is not longer than 90 days from the first day of the month in which they have the requisite hours to be full time. Nevertheless, additional clarification is needed in the final regulations.

Step #2.B. Implement the 4980H Safe Harbor

The 4980H Safe Harbor provides an optional method for applicable large employer members to use to determine full-time employee status for purposes of compliance with 4980H. The 4980H Safe Harbor generally operates on the following principles:

- Employers who choose to use the safe harbor will establish a *measurement period* during which an employee's aggregate hours of service are collected.

- The employer will determine the employee's average hours over that measurement period during a subsequent *administrative period*.

- Each employee who averages the requisite hours during that measurement period must be treated as full-time during a subsequent *stability period*.

Practice Pointer-Do controlled group rules apply for purposes of 4980H compliance? Compliance with 4980H is determined on a controlled group *member* basis—not on a controlled group basis. Thus each applicable large employer member who chooses to use the safe harbor will choose its own measurement periods and stability periods in accordance with the rules, and those periods may differ from the measurement and stability periods chosen by other applicable large employer members. But, remember that the rules specifically treat an hour of service for one controlled group member as an hour of service with all other controlled group members. For example, an employee who has 15 hours of service during a month for one member of the controlled group and 15 hours of service for another member would presumably be full-time for both members of the controlled group. IRS officials have informally indicated that they are working on clarifying how this rule is actually applied.

The manner in which the 4980H Safe Harbor is applied differs slightly depending on whether the employee is a *new employee* or an *ongoing employee*.

- Ongoing employees are defined in the guidance as employees who have been employed for one entire *standard measurement period*, which is the static measurement period chosen by the applicable large employer member to measure the hours of service for existing employees.

- There are two types of "new employees" (i.e. employees who are not ongoing employees): variable and non-variable. The safe harbor method is applied differently to variable and non-variable employees.

The following steps provide a roadmap for implementing the safe harbor for both ongoing employees and new employees. We begin with ongoing employees.

Step #2.B.1: Implement the safe harbor method for "Ongoing Employees"

As noted above, an *ongoing employee* is an employee who is employed by the employer for an entire standard measurement period. The steps to implement the safe harbor method for such employees is as follows:

- <u>Establish the standard measurement period</u>. The standard measurement period is subject to the following fundamental rules:

    - *Duration of standard measurement period*. The standard measurement period must be no less than three months and generally no more than 12 months. See "Additional Considerations" below for a more detailed discussion regarding additional factors to consider when establishing the standard measurement period.

- *Impact of break in service*. The measurement period established by the employer must take into consideration special break in service rules. Employees who experience a break in service during which the employee has no hours in service (e.g. termination of employment, unpaid leave of absence) during a measurement period that is less than 26 weeks or, if shorter, a period of at least 4 weeks that is also longer than the employee's prior period of employment preceding the period during which there are no hours of service (the "Rule of Parity") are considered to be a continuous employee if they resume hours of service again. When applying this Rule of Parity, the prior period of employment preceding the period with no hours of service is determined AFTER applying the special averaging rule applicable to special unpaid leaves and employment breaks. See Appendix C for an example that applies the break in service rules.

- *Special rules for certain types of "leave"*. There are special averaging rules for continuous employees whose break in service during the measurement period was due in whole or part to a "special unpaid leave" or to "employment breaks" (if the employer is an educational organization). See Appendix D for a more detailed overview of the special averaging rules for special unpaid leaves.

- *Differing measurement periods*. Employers may vary the standard measurement period for certain classes of employees. Each applicable large employer member may vary the initial measurement and stability periods for each of the following groups of employees:

    - Employees subject to a collectively bargained agreement and employees not subject to a collectively bargained agreement
    - Each group of collectively bargained employees covered by a different collectively bargained agreement
    - Salaried and hourly employees
    - Employees located in different states

Practice Pointer: Can the employer apply the safe harbor to some but not all employees? This is not clear. Many employers wish to apply the safe harbor only to ongoing employees who would be variable employees but the safe harbor rules do not make distinctions between ongoing variable and ongoing non-variable employees. Moreover, the proposed 4980H rules indicate that the safe harbor method must be applied uniformly to all employees except to the extent of the permitted variances described above. The answer to this question is critical because it would mean that employees deemed to be full-time to whom coverage is offered would be subject to break in service rules (e.g. if they take an unpaid leave of absence).

- *Impact of employment status change*. Although a change in employment status during a new employee's measurement period will impact the treatment afforded that employee, a change in employment status during a standard measurement has no impact on the application of the standard measurement period to that employee. For example, Joe is hired by Acme Inc. into a position that is considered part-time with hours of service of less than 130 hours in a month. Joe is employed in that position for 5 years; however, in May of 2015—during a standard measurement period—Acme transfers Joe into a position that is considered full-time and is expected to have 130 hours of service or more during a month. Acme is not required to offer Joe coverage at that time. In fact, Acme is not subject to excise taxes, even if Joe enrolls in the Exchange and receives a Premium Subsidy, for failing to offer coverage until the first day of the stability period following a standard measurement period during which Joe averaged the requisite hours of service to qualify as full-time.

Practice Pointer: How does 4980H coordinate with PHSA Section 2708 for ongoing employees? What happens if the stability period is more than 90 days away—does the employer violate PHSA Section 2708 if the employer does not offer coverage until the first day of the stability period? It shouldn't be a violation if the plan is worded properly. Remember, a waiting period begins on the date that an employee becomes eligible under the terms of the plan, provided that the terms of eligibility are not a means by which to evade the requirements under PHSA Section 2708. Presumably, an employer that uses the safe harbor measurement period could establish the eligibility date either as the end of the measurement period or the first day of the stability period, neither of which would violate PHSA Section 2708.

- <u>Establish a stability period for employees determined to be full-time during the standard measurement period</u>. The employer must establish a stability period following the standard measurement period (and any associated administrative period). The stability period for employees who are determined to be full-time during the standard measurement period is subject to the following fundamental rules:

    - *Status during stability period*. The employer member must treat the employee as full-time during the entire, associated stability period (or until the employee's employment is terminated, whichever is earlier)—even if the employee changes employment status during the stability period (e.g. full-time position to a part-time position, or takes a leave of absence).

    - *Impact of break in service*. If an employee deemed to be full-time during a stability period terminates employment during the stability period and then resumes employment as a *continuous employee* during the same stability period, the employee must be treated as a full-time employee as of the first day the employee is credited with an hour of service or as soon as reasonably possible thereafter. See Appendix C for an example that applies the break in service rules.

Practice Pointer/COBRA and the Safe Harbor Method: If an employee who elected coverage for a stability period takes an unpaid leave of absence during a stability period, can the employer offer the employee COBRA coverage without being subject to penalties? This is not clear. As discussed in more detail below, an employer avoids excise taxes to the extent the employer offers an effective opportunity to enroll at least once per plan year in an eligible employer sponsored plan that is both affordable and provides minimum value. COBRA coverage is considered an eligible employer sponsored plan. However, recent regulations indicate that active employees with an offer of COBRA are treated as eligible for an eligible employer sponsored plan for purposes of the subsidy but former employees are not unless they actually enroll. Thus, it would appear that an employer could avoid excise taxes with an offer of COBRA coverage to an active employee (e.g. one that moves from full-time position to part-time position or that takes an unpaid leave of absence) only to the extent the coverage is affordable. Additional guidance is needed to ensure that employers are aware of all the coverage options that may be provided in such situations without being liable for excise taxes.

  - *Duration of stability period for full-time employees*. The stability period following the standard measurement period for such employees must be at least six months, and no shorter in duration than the standard measurement period and it must begin immediately following the standard measurement period and any applicable administrative period. See "Additional Considerations" below for a more detailed discussion on the duration of the stability period.

- <u>Establish a stability period for employees determined to not be full-time during the standard measurement period</u>. The stability period for employees who are determined not to be full-time during the standard measurement period is subject to the following fundamental rules:

  - *Status during stability period*. If an employee is determined during the standard measurement period to be other than full-time, then he or she may be treated as other than full-time during an entire stability period that follows the standard measurement period, as well as any administrative period (i.e., there is no penalty for failing to offer coverage during that stability period)—even if the employee changes employment status during the stability period.

  - *Duration of stability period for other than full-time employees*. The stability period for such an employee cannot be longer than the standard measurement period (even if the standard measurement period is less than six months).

The following chart indicates the applicable stability period options based on the duration of the standard measurement period and the employee's status as full-time employee or not.

Full-Time Status		**Not Full-time**	
Standard Measurement period	*Stability Period*	*Standard Measurement period*	*Stability Period*
3 months	6 months or longer	3 months	3 months
4 months	6 months or longer	4 months	4 months
5 months	6 months or longer	5 months	5 months
6 months	6 months or longer	6 months	6 months
7 months	7 months or longer	7 months	7 months
8 months	8 months or longer	8 months	8 months
9 months	9 months or longer	9 months	9 months
10 months	10 months or longer	10 months	10 months
11 months	11 months or longer	11 months	11 months
12 months	12 months	12 months	12 months

- Establish an administrative period. The administrative period is the period during which employees are identified as full-time or not based on their hours of service during the preceding measurement period and, if identified as full-time, offered the opportunity to enroll. The administrative period following the standard measurement period may not exceed 90 calendar days.

- Additional Considerations: In light of the above mentioned fundamental rules, employers should consider the following factors in establishing their safe harbor and measurement periods:

  - *Equal measurement and stability periods*. Employers should consider establishing a standard measurement period that is the same duration as the stability period. Since the stability period for employees who are NOT full-time must be no shorter in duration than the standard measurement period, an employer who implements a measurement period that is shorter in duration than the stability period applicable to employees who are deemed to be full-time will have to implement two sets of rules—one for employees who are considered to be full-time and another for employees who are not considered to be full-time. See the chart above for more details. This will also result in off-cycle enrollments for employees who are determined to be full-time during the most recent measurement period but were determined during the prior measurement period to not be full-time.

    - *Transition relief for 2014*. With respect to stability periods that begin in 2014, the employer who wishes to establish a 12 month stability period may nevertheless establish a standard measurement period beginning in 2013 that is less than 12 months so long as the standard measurement period beginning in 2013 is at least 6 consecutive months and begins no later than July 1, 2013.

  - *Aligning stability period with plan year*. In addition, employers should consider aligning the stability period with the employer's plan year. Otherwise, the employer will have "annual" enrollment periods that do not correspond with the employer's normal annual enrollment period. Moreover, a standard measurement and stability period that are less than 12 months in duration will result in off cycle enrollments for all employees deemed to be full-time during the most recent measurement period, regardless of whether they were determined to be full-time during the prior measurement period or not.

    - *Transition relief for fiscal year plans*. Employers with a fiscal year plan may avoid excise taxes for full-time employees who receive a Premium Subsidy during months in 2014 that precede the start of the employer's 2014 plan year if certain requirements are satisfied. See Appendix E for a more detailed discussion of the transition relief.

  - *Impact of cafeteria plan rules*. If the plan is offered through the employer's cafeteria plan, the employee's elections are subject to Code Section 125 election rules.

See Appendix F for an illustration of the safe harbor method for ongoing employees, including the impact of cafeteria plan rules on employee's elections for a stability period.

Step #2.B.2: Implement the safe harbor method for "New Employees"

- Offer coverage to non-variable employees within 90 days. A non-variable hour new employee is an employee for whom it can be determined on the start date that the employee is reasonably expected to work, on average, 30 hours of service or more per week during a month, generally without regard to how long the employee is expected to work. The safe harbor method does NOT apply to a non-variable hour new employee. In this case, the employer may be liable for 4980H penalties unless the employer offers the non-variable employee who is determined to be full-time minimum essential coverage through an eligible employer sponsored plan before the end of the employee's initial three full calendar months of employment.

Practice Pointer: How does 4980H coordinate with PHSA Section 2708 in the case of a change in employment status during the initial measurement period? Notwithstanding the avoidance of taxes under 4980H if coverage is offered by the end of the third calendar month of employment, PHSA 2708 prohibits a waiting period in excess of 90 days. Thus, coverage would have to begin by the 91st day following the date of hire in order to avoid violating PHSA Section 2708 for which there is a separate, excise tax imposed under Code Section 4980D.

  - Generally, the duration of employment in excess of 3 months may not be taken into consideration when analyzing whether a new employee is a new, non-variable employee.

- Establish the initial measurement period for variable. If an employee is *variable* the employer may apply an initial measurement period to determine if the employee is "full-time". A *variable hour* employee is any employee for whom the applicable large employer member cannot make a determination on the employee's start date that the employee will be reasonably expected to be employed, on average, at least 30 hours of service or more a week during the initial measurement period (the period chosen by the employer to calculate hours of service following the employee's start date). An employee may be a variable hour employee even if the employee is expected to initially be employed 30 hours of service per week if the period of employment at 30 hours of service is expected to be of limited duration and it cannot be determined that the employee is expected to be employed on average at least 30 hours per week over the initial measurement period. Current IRS guidance also permits an employer to treat a "seasonal" employee as variable. An employee is a seasonal employee if he/she performs services on a seasonal basis as determined by the Department of Labor, including but not limited to employees covered by 29 C.F.R. 500.20(s)(1) and retail workers employed exclusively during the holiday seasons. Employers are permitted to use a good faith interpretation of the term "seasonal worker" and 29 C.F.R. 500.20(s)(1) (including as applied by analogy to employment positions not covered by the Department of Labor's regulations). The initial measurement period is subject to the following fundamental rules:

  - *Duration of initial measurement period*. The initial measurement period must be no less than three months and generally no more than 12 months. It may begin on the date of hire or the first day of the month following the date of hire; however, any delay in the initial measurement period must be factored into the duration of the administrative period (which generally cannot exceed 90 days). Also, the duration of the initial measurement period is impacted directly by the duration of the administrative period. See "Additional Considerations" below for a more detailed discussion on establishing the standard measurement period.

Impact of breaks in service. The initial measurement period established by the employer must take into consideration special break in service rules. Employees who experience a break in service during which the employee has no hours in service (e.g. termination of employment, unpaid leave of absence) during a measurement period that is less than 26 weeks or, if shorter, a period of at least 4 weeks that is also longer than the employee's prior period of employment preceding the period during which there are no hours of service are considered to be a continuous employee if they resume hours of service again. See Appendix C for an example that applies the break in service rules.

- o *Special rule for certain types of leave*. There are special averaging rules for continuous employees whose break in service during the measurement period was due in whole or part to a "special unpaid leave" or to "employment breaks" (if the employer is an educational organization). See Appendix D for a more detailed overview of the special averaging rules for special unpaid leaves.

- o *Differing measurement periods*. Employers may vary the initial measurement period for certain classes of employees in the same manner as the standard measurement period.

- o *Changes in employment status*. If a variable hour/seasonal employee experiences a change in employment status before the end of the initial measurement period such that the employee is reasonably expected to be employed on average at least 30 hours of service per week, the applicable large employer must treat the employee as full-time by no later than the first day of the fourth month following the change in status, or if earlier, the first day of the stability period if the variable hour/seasonal employee is determined to be full-time during the initial measurement period.

- <u>Establish a stability period for employees determined to be full-time during the initial measurement period</u>. The employer must establish a stability period following the initial measurement period (and any associated administrative period). The stability period for employees who are determined to be full-time during the initial measurement period is subject to the following fundamental rules:

  - o *Status during stability period*. The employer member must treat the employee as full-time during the entire, associated stability period (or until the employee's employment is terminated, whichever is earlier)—even if the employee changes employment status during the stability period (e.g. full-time position to a part-time position, or takes a leave of absence).

- *Impact of break in service*. If an employee deemed to be full-time during a stability period terminates employment during the stability period and then resumes employment as a continuous employee during the same stability period, then the employee must be treated as a full-time employee as of the first day the employee is credited with an hour of service or as soon as reasonably possible thereafter. See Appendix C for an example that applies the break in service rules.

- *Duration of stability period for full-time employees*. The stability period following the initial measurement period for such employees must be at least six months, and no shorter in duration than the standard measurement period and it must begin immediately following the standard measurement period and any applicable administrative period. See "Additional Considerations" below for a more detailed discussion on the duration of the stability period.

The following chart indicates the applicable stability period options based on the duration of the standard measurement period and the employee's status as full-time employee or not.

Full-Time Status		**Not Full-time**	
Standard Measurement period	*Stability Period*	*Standard Measurement period*	*Stability Period*
3 months	6 months or longer	3 months	At least 3, no more than 4 months
4 months	6 months or longer	4 months	At least 4, no more than 5 months
5 months	6 months or longer	5 months	At least 5, no more than 6 months
6 months	6 months or longer	6 months	At least 6, no more than 7 months
7 months	7 months or longer	7 months	At least 7, no more than 8 months
8 months	8 months or longer	8 months	At least 8, no more than 9 months
9 months	9 months or longer	9 months	At least 9, no more than 10 months
10 months	10 months or longer	10 months	At least 10, no more than 11 months
11 months	11 months or longer	11 months	At least 11, no more than 12 months
12 months	12 months	12 months	12 months

- <u>Establish a stability period for employees determined to not be full-time during the standard measurement period</u>. The stability period for employees who are determined not to be full-time during the standard measurement period is subject to the following fundamental rules:

- *Status during stability period*. If an employee is determined during the standard measurement period to be other than full-time, then he or she may be treated as other than full-time during an entire stability period that follows the standard measurement period, as well as any administrative period (i.e., there is no penalty for failing to offer coverage during that stability period)—even if the employee changes employment status during the stability period.

- *Duration of stability period for other than full-time employees*. The stability period for such an employee cannot be more than one month longer in duration than the initial measurement period.

• Establish an administrative period. The administrative period is the period during which employees are identified as full-time or not based on their hours of service during the initial measurement period and, if identified as full-time, offered the opportunity to enroll. The administrative period following the standard measurement period may not exceed 90 calendar days. However the duration of the initial measurement period and the following administrative period cannot extend beyond the last day of the month that begins on or after the employee's anniversary date.

• Additional Considerations: In light of the above mentioned fundamental rules, employers should consider the following factors in establishing their safe harbor and measurement periods:

  - *Preferred measurement period duration*. Employers should consider establishing an initial measurement period that is no less than 11 months. Since the stability period for employees who are full-time must be the same as the stability period for ongoing employees who are full-time, and the stability period for employees who are NOT full-time during the initial measurement period must be no more than 1 month longer in duration than the initial measurement, an employer who implements a measurement period that is shorter than 11 months will have to implement two sets of rules—one for employees who are considered to be full-time and another for employees who are not considered to be full-time.

  - *Impact of cafeteria plan rules*. If the plan is offered through the employer's cafeteria plan, the employee's elections are subject to Code Section 125 election rules.

See Appendix F for an illustration of the safe harbor method for ongoing employees.

Step #3. Determine if coverage offered by the employer will satisfy certain 4980H requirements

Step #3 Overview:
• Determine whether applicable large employer member offers coverage through an eligible employer sponsored plan to all but 5% of its full-time employees. If it does, then the applicable large employer member is not liable for the Sledgehammer Tax (but may be liable for the Tackhammer Tax). • Determine whether any coverage option through an eligible employer sponsored plan that also provides minimum value is "affordable". 4980H rules provide three different safe harbor methods for making the affordability determination. • Determine whether the coverage offered provides minimum value. A plan provides minimum value if it pays for 60% of the "allowed costs", which are based on essential health benefits.

Once full-time employees are identified, penalties may be assessed on the applicable large employer member based on the coverage that it offers, or fails to offer its full-time employees. If the employer member fails to offer minimum essential coverage under an eligible employer sponsored plan to its full-time employees (and their dependents) during a month, it may be liable for a Sledgehammer Tax. If the employer offers minimum essential coverage through an eligible employer sponsored plan during a month, but the coverage is not affordable or doesn't provide minimum value, or alternatively, the employer offers affordable, minimum value coverage to more than 95% of its full-time employees (and their dependents) but less than 100%, then the employer may be subject to the Tackhammer Tax with respect to employees either not offered coverage through an eligible employer sponsored plan or are offered coverage that is either unaffordable or doesn't provide minimum. In either case, a penalty is assessed only if one of the employer's full-time employees receives a Premium Subsidy in an Exchange.

The following steps will enable an employer to determine whether it will avoid the Sledgehammer and the Tackhammer taxes.

Step #3.A. Determine whether employer may be liable for the Sledgehammer Tax

To determine whether an employer may be subject to a Sledgehammer Tax, each of the following questions must be answered. NOTE: The analysis relates only to the controlled group member's full-time employees.

The employer will avoid the sledgehammer if each of the following questions is answered "Yes".

- <u>Does the employer offer coverage through an eligible employer sponsored plan to at least 95% of its full-time employees (and their dependents)?</u> Dependents are defined as children (as defined in Code Section 152(f)(1)) who are under age 26.

- See Appendix G for more details regarding the definition of "eligible employer sponsored plan"

- Does the employer provide to such full-time employees an "effective opportunity" to enroll no less than once during a plan year? Whether a full-time employee has been offered an effective opportunity to enroll during a month is based on the facts and circumstances, including but not limited to adequacy of notice, the period of time during which the election may be made and any other conditions of the offer. See 26 C.F.R. 1.401(k)-1(e)(2)(ii) for an analogous provision relating to the effective opportunity to participate.

  - Employers who conduct enrollment electronically should pay special attention to the electronic enrollment safe harbor requirements set forth in 26 C.F.R. 1.401(a)-21. See Appendix H for a summary of the electronic enrollment rules.

- Is the coverage offered generally available for the entire month? In the case of a termination of employment, a full-time employee is treated as having been offered coverage during the entire month if the full-time employee would have been offered coverage for the entire month had he/she remained employed.

- Does the employer apply the following premium payment rules from 26 C.F.R. 54.4980B-8, Q-5 with respect to its full-time employees? The proposed regulations do not consider an employer to have offered coverage for an entire month unless the employer complies with the following, COBRA premium payment rules:

  - 30-day grace period rule (see Q-5(a))

  - Provider response rules regarding status of payment (See Q-5(c))

  - Insignificant shortfall rule (e.g., where payment is insufficient by the lesser of 10 percent of $50) (see Q-5(d))

  - Deemed payment rule (payment deemed received when sent) (See Q-5(e))

NOTE: Even if the answer is yes to each of the above questions, if the employer does not offer coverage through an eligible employer sponsored to 100% of it is employees, or the coverage is not affordable or doesn't provide minimum value, the employer could be liable for a Tackhammer Tax.

If the answer is "No" to *any* of those questions, the employer may be liable for the Sledgehammer Tax for each month that a full-time employee receives a premium Subsidy in the Exchange—even if they otherwise "offer" coverage to 95% or more if its full-time employees.

See Appendix K for a sample Sledgehammer Penalty tax calculation, including an overview of the rule for determining the employer's allocable share of 30.

Step #3.B. Is the employer liable for the Tackhammer Tax?

To determine whether an employer who is otherwise exempt from the sledgehammer (see above) is potentially liable for the Tackhammer Tax, each of the following questions must be answered:

- Does the employer offer coverage through an eligible employer sponsored plan to 100% of its full-time employees (and their dependents)? If the employer merely offers coverage to at least 95% of its full-time employees (and their dependents) but less than 100%, the employer may be liable for the Tackhammer Tax with respect to a full-time employee to whom coverage was not offered, even if the coverage offered to other full-time employees is affordable and provides minimum value.

- Is the coverage affordable? Coverage is considered affordable under the Premium Subsidy rules if the employee's contribution or premium for self-only coverage is less than 9.5 percent of his/her household income (as defined in Code Section 36B). Employers will not know an employee's household income. Consequently, the IRS has prescribed the following safe harbors for determining affordability:

    - W-2 wages safe harbor
    - Rate of Pay Safe Harbor
    - Federal Poverty Level safe harbor

  Each of these is discussed in more detail in Appendix I.

Practice Pointer: How do wellness incentives impact affordability? Proposed regulations recently issued by the IRS regarding minimum value and the Premium Subsidy indicate that wellness incentives that impact employee contributions/premiums are handled for purposes of affordability in accordance with the following rules:

- Everyone is treated as a non-smoker with respect to penalties/incentives tied to tobacco use. For example, if the base premium is $100 per month but smokers are required to pay $110, then the premium for affordability purposes is $100. Likewise, if non-smokers pay $90 instead of $100, the premium for affordability purposes is $90.
- Everyone is treated as failing the applicable standard with respect to incentives not tied to tobacco use. For example, if the premium is typically $100 but individuals who have high cholesterol are required to pay $150 unless they participate in a program, then the premium for affordability purposes is $150.

- Does the plan provide minimum value? A plan provides minimum value for purposes of the Tackhammer Tax if the plan pays at least 60 percent of the total allowed costs. The Proposed Rules do not provide any substantive guidance regarding the minimum value standard; however, the IRS has issued guidance in IRS Notice 2012-31 and HHS has recently issued final regulations and other guidance that provide shape to the rule. For example, the regulations and guidance provide the three general methods for determining minimum value.

Those minimum value methods are described in more detail in Appendix J.

Practice Pointer: How do HRA and/or HSA contributions impact minimum value? Annual contributions by an employer to an HSA are allowed to be included in the minimum value calculation. Also, annual allocations to an HRA are allowed to be included in the minimum value calculation provided that (i) the HRA is "integrated" (which means that participation in the HRA is restricted to those who participate in the major medical plan) and (ii) reimbursements are limited to cost share expenses under the plan.

If the answer is "Yes" to each of those questions, then the employer will avoid the Tackhammer Tax. If, however, the answer is "No" to any of them, the employer may be liable for the Tackhammer Tax with respect to a full-time employee who enrolls in the exchange and receives a Premium Subsidy.

See Appendix K for a sample Tackhammer Penalty tax calculation.

Step 4: Determining Whether to Pay or Play

Step #4 Overview
• Determine whether employer is liable for Sledgehammer Tax based on current terms of eligibility. • If employer is potentially liable for Sledgehammer Tax, identify costs to avoid Sledgehammer Tax (i.e. how much will it cost to offer coverage to at least 95% of the employer's full-time employees versus paying the Sledgehammer Tax) • With respect to coverage offered, determine whether it is affordable and provides minimum value. • If no coverage option is both affordable and provides minimum value, identify costs to make coverage affordable and provide minimum value.

Subject to the transition rules identified above, the employer shared responsibility rules go into effect January 1, 2014, which is just around the corner. Employers must begin assessing the impact of the 4980H Rules sooner rather than later. Digesting the 4980H Rules is a good first step, but additional steps are required. While we await the issuance of final rules, we identify below key, high-level questions that employers must answer to begin the process of identifying the impact of the 4980H Rules:

- Do you currently offer coverage to all employees who may be full-time in any given month (and their dependents)?

- If no, will the cost to offer coverage exceed the Sledgehammer Tax? Keep in mind, the Sledgehammer Penalty is assessed against each applicable large employer member based only on that member's full-time employees and it is only assessed to the extent a full-time employee receives a Premium Subsidy in the Exchange. Moreover, the Proposed Rules prescribe a "Substantially All Test" that enables applicable large employer members to escape the Sledgehammer Penalty to the extent minimum essential coverage is offered by the applicable large employer member to at least 95 percent of the applicable large employer member's full-time employees.

- If you offer coverage, is it affordable? A critical step in making this determination is identifying the affordability safe harbor that is best for you under the circumstances. If not affordable, what is the potential Tackhammer Penalty you may have to pay and will that exceed the cost to make the coverage affordable? Similar to the Sledgehammer Penalty, the Tackhammer Penalty is assessed on each applicable large employer member, except that the Tackhammer is based only on that applicable large employer member's full-time employees who receive a Premium Subsidy.

- If you offer coverage, does it provide minimum value? If not, will the Tackhammer penalty exceed the cost to provide minimum value coverage?

Overview of Transition Rules

- The Proposed Rules provide a transition rule for 2014 that enables employers to use a period of at least six consecutive calendar months in 2013 to determine if they are an applicable large employer for 2014—a determination that is typically based on the entire preceding calendar year.

- The Proposed Rules provide transition relief for fiscal year plans. See Appendix E for details.

- The Proposed Rules provide transition relief for the first stability period that begins in 2014. Under the transition relief, employers who generally desire to use a 12-month stability period beginning in 2014 may nevertheless use a shorter determination (or measurement) period beginning in 2013, so long as the measurement period begins on or before July 1, 2013, and is at least six months long (and ends no sooner than 90 days prior to start of the Stability Period.

- The Proposed Rules (and a subsequent correction) provide a special transition rule through 2014 for applicable large employers that contribute to multiemployer plans. Under the transition rule, an applicable large employer member will not be treated as failing to offer the opportunity to enroll in minimum essential coverage to a full-time employee (or the employee's dependents) for purposes of the Sledgehammer Penalty and will not be subject to a Tackhammer Penalty with respect to a full-time employee if (i) the employer is required to make a contribution to a multiemployer plan with respect to a full-time employee pursuant to a collective bargaining agreement, (ii) coverage under the multiemployer plan is offered to full-time employees (and the employee's dependents) who satisfy the multi-employer plan's terms of eligibility and (iii) the coverage offered is affordable and provides minimum value. Moreover, coverage will be considered affordable if the employee's required contribution for self-only coverage does not exceed 9.5 percent of the wages reported by all employers to the multiemployer plan for that individual.

- The Proposed Rules provide a transition rule for cafeteria plans with a fiscal plan year beginning in 2013. Under the transition rule, employers may amend their cafeteria plans to allow employees to revoke their accident and health coverage election once during the fiscal plan year beginning in 2013 without a corresponding change in status or cost or coverage change. Moreover, the employer may also amend the plan to allow employees to elect to participate in the cafeteria plan during the fiscal plan year beginning in 2013 without a corresponding change in status or cost or coverage change. Amendments to the cafeteria plan must be made by December 31, 2014.

- Any employer that takes steps during its plan year that begins in 2014 toward satisfying the section 4980H provisions relating to the offering of coverage to full-time employees' dependents will not be liable for excise taxes under the 4980H rules solely on account of a failure to offer coverage to the dependents for that plan year.

- Effective January 1, 2015, the employer will be required to assume that an employee (other than seasonal) will be employed by the employer for the entire initial measurement period in making a determination as to whether the employee is variable or non-variable. Consequently, a temporary employee who will only be employed for 5 months but for whom the employer can make a determination on the date of hire that the temporary employee is expected to average 30 hours of service or more during a week will be considered non-variable. Even with respect to 2014, however, the status of any individual employee as a variable hour employee cannot be based on employer expectations regarding aggregate turnover. Rather there must be objective facts and circumstances specific to the newly hired employee at the start date demonstrating that the individual employee's employment is reasonably expected to be of limited duration within the initial measurement period.

Appendix A: Hours of Service Rules

Hours of Service Rules

The following is a summary of the fundamental concepts regarding hours of service calculations prescribed in the Proposed Rules:

- Hours of service means each hour for which the employee is paid or entitled to payment for performance of services AND hours for which the employee is paid or entitled to payment by the employer for a period of time, without limitation, during which no duties are performed due to any of the following (i.e., paid leave):
    - Vacation
    - Holiday
    - Illness or incapacity (i.e., disability)
    - Layoff
    - Jury duty
    - Military duty or leave of absence

  The hours of service rules for periods during which no services are performed are based on the rules set forth in 29 C.F.R. 2530.200b-2(a). These are the rules under ERISA that are generally applicable to retirement and pension plans. Attached is a chart that identifies the differences between the retirement/pension plan rules and the 4980H rules.

Practice Pointer-Do hours of service have to be rounded up? The proposed regulations do not specifically require employers to round hours up; however, the rules in 29 C.F.R. 2530.200b-2(a) do. For example, if an employee has 29.1 hours, the rules in 29 C.F.R. 2530.200b-2(a) would treat the employee as having 30. Did the IRS intend for that rule to apply under 4980H? Additional clarification is needed and will hopefully be addressed in the final regulations.

- Employers must determine hours of service for hourly employees based on actual hours of service from records of hours worked and hours for which payment is due.

- Employers must determine hours of service for non-hourly employees based on one of the following three methods and only these three methods:

    - actual hours of service worked or hours for which payment is due based on the records,
    - a day's equivalency test based on labor rules set forth in 29 C.F.R. 2530.200b-2(a) (an employee is credited with eight hours of service for each day that the employee would be required to be credited with one hour of service), or
    - a week's equivalency test based on labor rules set forth in 29 C.F.R. 2530.200b-2(a) (an employee is credited with 40 hours of service for each week in which the employee would be required to be credited with one hour of service).

- The employer is NOT required to use the same hours of service calculation method for all non-hourly employees as long as the classifications are reasonable and consistently applied.

Practice Pointer: The equivalency tests may not be used if use of the tests substantially understates an employee's hours of service in a manner that would cause that employee to not be treated as full-time.

- Until further guidance is issued, any reasonable method for calculating hours of service may be used for the following types of employees:

  - Commissioned employees
  - Adjunct faculty
  - Transportation employees (e.g., airline pilots)
  - Employees in similar positions

Practice Pointer: Hours of service for adjunct faculty must be based not only on time spent teaching classes, but also time preparing for classes. Hours of service for commissioned employees would also include business travel for a traveling salesperson compensated on a commission basis.

- An employee's hours of service attributable to another applicable large employer member are considered by an applicable large employer when making a determination whether one of its employees was full-time during a month (or during a measurement period if using the safe harbor). This could cause recordkeeping issues for applicable large employers who do not share recordkeeping data (and even some who do).

- Hours of service for which the compensation for such hours constitutes income from sources outside the United States in accordance with Internal Revenue Code Section 862(a)(3) are not counted. In essence, hours of service performed outside of the United States are not considered. Oddly enough, United States is defined to include only the 50 States and the District of Columbia. United States for this purpose does NOT include possessions or territories of the United States, such as Guam or Puerto Rico.

Practice Pointer: Are plans in the territories subject to any of the ACA's provisions? Yes, plans maintained in the territories are subject to other aspects of the ACA, including but not limited to the health insurance reforms.

Appendix B: Common Law Employee Factors

The IRS has issued a 20 factor common law employee test that employers should use to determine if an employee is a common law employee. The following is an overview of those factors:

1. **Instructions:** If the person for whom the services are performed has the right to require compliance with instructions, this indicates employee status.

2. **Training:** Worker training (e.g., by requiring attendance at training sessions) indicates that the person for whom services are performed wants the services performed in a particular manner (which indicates employee status).

3. **Integration:** Integration of the worker's services into the business operations of the person for whom services are performed is an indication of employee status.

4. **Services rendered personally:** If the services are required to be performed personally, this is an indication that the person for whom services are performed is interested in the methods used to accomplish the work (which indicates employee status).

5. **Hiring, supervision, and paying assistants:** If the person for whom services are performed hires, supervises or pays assistants, this generally indicates employee status. However, if the worker hires and supervises others under a contract pursuant to which the worker agrees to provide material and labor and is only responsible for the result, this indicates independent contractor status.

6. **Continuing relationship:** A continuing relationship between the worker and the person for whom the services are performed indicates employee status.

7. **Set hours of work:** The establishment of set hours for the worker indicates employee status.

8. **Full time required:** If the worker must devote substantially full time to the business of the person for whom services are performed, this indicates employee status. An independent contractor is free to work when and for whom he or she chooses.

9. **Doing work on employer's premises:** If the work is performed on the premises of the person for whom the services are performed, this indicates employee status, especially if the work could be done elsewhere.

10. **Order or sequence test:** If a worker must perform services in the order or sequence set by the person for whom services are performed, that shows the worker is not free to follow his or her own pattern of work, and indicates employee status.

11. **Oral or written reports:** A requirement that the worker submit regular reports indicates employee status.

12. **Payment by the hour, week, or month:** Payment by the hour, week, or month generally points to employment status; payment by the job or a commission indicates independent contractor status.

13. **Payment of business and/or traveling expenses.** If the person for whom the services are performed pays expenses, this indicates employee status. An employer, to control expenses, generally retains the right to direct the worker.

14. **Furnishing tools and materials:** The provision of significant tools and materials to the worker indicates employee status.

15. **Significant investment:** Investment in facilities used by the worker indicates independent contractor status.

16. **Realization of profit or loss:** A worker who can realize a profit or suffer a loss as a result of the services (in addition to profit or loss ordinarily realized by employees) is generally an independent contractor.

17. **Working for more than one firm at a time:** If a worker performs more than de minimis services for multiple firms at the same time, that generally indicates independent contractor status.

18. **Making service available to the general public:** If a worker makes his or her services available to the public on a regular and consistent basis, that indicates independent contractor status.

19. **Right to discharge:** The right to discharge a worker is a factor indicating that the worker is an employee.

20. **Right to terminate:** If a worker has the right to terminate the relationship with the person for whom services are performed at any time he or she wishes without incurring liability, that indicates employee status.

Appendix C: Break in Service Rules

John has been employed by Great Benefits Administration, Inc. (GBA) for 6 years when he decides to terminate employment to start his own business on June 1, 2015. GBA has a standard measurement period beginning October 3 each year and ending October 2 the following year. The stability period following GBA's standard measurement period begins January 1 following the standard measurement period and ends December 31. John averaged the requisite hours during the standard measurement period ending October 2, 2014 and was thus required to be treated as a full-time employee through the stability period beginning January 1, 2015 and ending December 31, 2015. In addition, John was in the measurement period beginning October 3, 2014 and ending October 2, 2015 when he terminates employment. John doesn't like owning his own business so he returns to GBA on September 1, 2015.

Is John a continuous employee? Yes, John is a continuous employee because the period during which he had no hours of service is less than 26 weeks. Moreover, the Rule of Parity does not apply here because the period during which John had no hours of service is less than John's prior period of employment (which was 6 years). Consequently, John resumes his standard measurement period ending October 2, 2015 AND, more importantly, John must once again be treated as a full-time employee on September 1, 2015 (or as soon as reasonably practical) through the remainder of 2015—regardless of the position into which John is hired. Whether John must be treated as a full-time employee during 2016 will depend on the aggregate hours of service John has during the standard measurement period ending October 2, 2015.

Appendix D: Special Unpaid Leave Rules

If the employee takes a "special unpaid leave" during which no hours of service are credited to the employee, and the employee resumes service as a "continuous employee" as described above, special treatment is required for purposes of the measurement periods described above if the employee is considered to be a continuing employee as described above. Special leaves are defined as unpaid FMLA leave, USERRA leave, and jury duty. Special leaves are subject to the following rules:

- An employer who uses the safe harbor must treat the duration of the special leave in one of the following ways for purpose of calculating hours during a measurement period:

    - The applicable large employer member may disregard the period that such employee was on a special leave when calculating the hours of service of the employee during the applicable measurement period (i.e., the measurement period for such an employee will be reduced by the period the employee is on a special leave), or

    - The employer may choose to treat the employee as credited with hours of service for any period of special unpaid leave at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not part of the special leave. Employers may use any reasonable method for calculating the average weekly rate.

- Likewise, "employment breaks" are afforded similar treatment as special leaves. Employment breaks are defined as a period of at least four consecutive weeks (disregarding unpaid special leave) during which an employee at an educational organization (as defined in 26 C.F.R. 1.170A-9(c)(1), without regard to whether they are a Code Section 501(c)(3) organization) is not credited with hours of service, other than a special unpaid leave. Unlike special leaves, though, no more than a period of 501 hours of services are required to be excluded or credited (depending on the particular averaging method described above that is used by the employer).

Appendix E: Transition Relief for Fiscal Year Plans

Special transition relief is provided for employers who maintain plans with fiscal plan years. Generally, applicable large employers must comply with 4980H beginning January 1. However, employers with plans that have a fiscal plan year beginning in 2014 may be able to avoid excise taxes for failing to offer coverage to certain full-time employees during months preceding the start of the fiscal plan year in 2014 as long as affordable, minimum value coverage is offered by the first day of the plan year beginning in 2014. This transition relief is provided to segments of employees.

- ***Employees who otherwise meet the eligibility requirements of the fiscal year plan in effect on December 27, 2012***

With respect to applicable large employer members that maintain a plan or plans as of December 27, 2012, with fiscal plan years ("fiscal-year plans"), such employers may not be subject to a penalty for months in 2014 preceding the start of the 2014 plan year with respect to employees who otherwise satisfy the fiscal-year plan's terms of eligibility in effect on December 27, 2012, so long as such full-time employees are offered minimum essential coverage through an eligible employer sponsored plan that is affordable and provides minimum value by the first day of the 2014 plan year. Consider the following example to illustrate the application of this relief:

> Georgia Peach, Inc. maintains a health plan with a fiscal plan year beginning June 1 and ending the following May 31. On December 27, 2012, the plan limited eligibility to those working 35 hours of service or more per week. Georgia Peach will not be treated as failing to offer 4980H compliant coverage for the period preceding June 1, 2014 to employees who work 35 hours or more per week so long as they are offered 4980H compliant coverage by June 1, 2014.

The same transition relief may be available with respect to other employees who wouldn't otherwise satisfy the terms of eligibility in effect on December 27, 2012 and would not have been eligible for a calendar year plan in effect on December 27, 2012 ("Other Employees") so long as certain coverage or eligibility requirements are satisfied. There are two parts to the transition relief determination for Other Employees—coverage requirements and eligibility requirements.

Part I: Coverage Requirement: An applicable large employer member satisfies the coverage or eligibility requirements if 25 percent or more of All of its employees (i.e. not just full-time but all employees) were actually covered under one or more plans with the same fiscal plan year as of December 27, 2012, determined as of the end of the most recent enrollment period on or before December 27, 2012, or any date between October 31, 2012, and December 27, 2012.
Consider the following example to illustrate the application of this relief:

> Georgia Peach must extend coverage to employees working between 30 and 35 hours in order to avoid 4980H taxes. Employees working between 30 and 35 hours are "Other Employees." During the open enrollment period for the plan year beginning June 1, 2012, Georgia Peach had 1000 full-time and part-time employees of which 100 employees enrolled in the plan (at that time, only employees working 35 hours or more were eligible). Georgia Peach does not meet the coverage requirement because only 10% of its employees were enrolled in the plan as of the most recent enrollment period on or before December 27,

> 2012 (assume that no more employees were covered during any date between October 31, 2012 and December 27, 2012).

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Practice Pointer: Can the employer analyze the coverage test based on either the enrollment period preceding December 27, 2012 or any day between October 31, 2012 and December 27, 2012? Presumably, the employer can choose any of those. This would allow the employer to pick the benchmark date with the highest number of covered employees

Part II: Eligibility Requirement: If the coverage requirements are not satisfied, the employer may still take advantage of the transition relief with respect to Other Employees if the employer offered coverage under a plan with the same fiscal plan year to one-third of the applicable large employer member's employees determined as of the most recent open enrollment period preceding December 27, 2012. Consider the following example to illustrate the application of this relief to Other Employees.

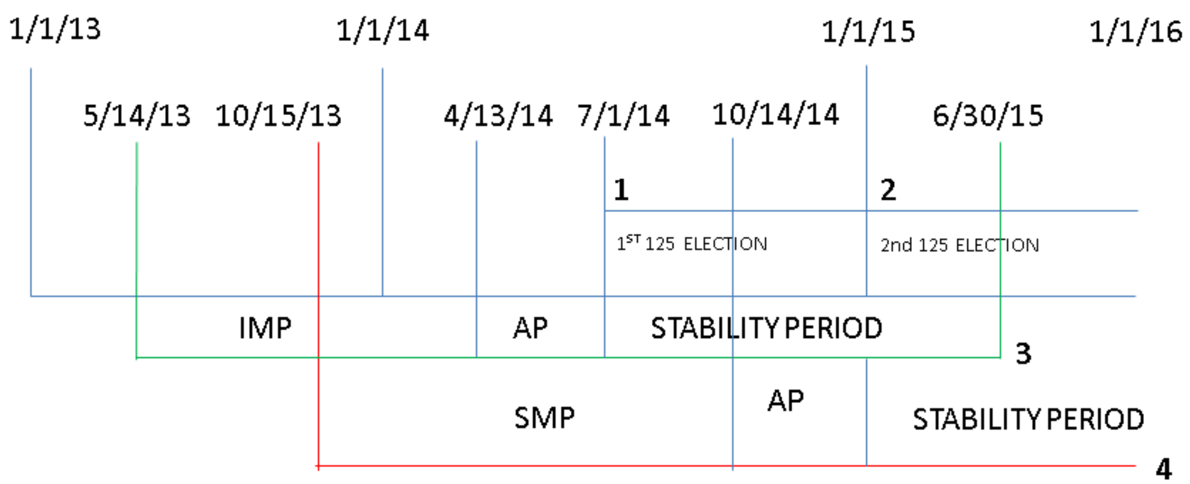
> Same facts as above except that Georgia Peach only offered coverage to 150 employees during the enrollment period preceding May 1, 2012—15% of its total employee workforce. Consequently, Georgia Peach may not take advantage of the transition relief with respect to Other Employees.

Practice Pointer: Can employer go directly to the eligibility test? Yes, an employer may take advantage of the transition relief by satisfying either the coverage or eligibility test.

Appendix F: Safe Harbor Method Illustration

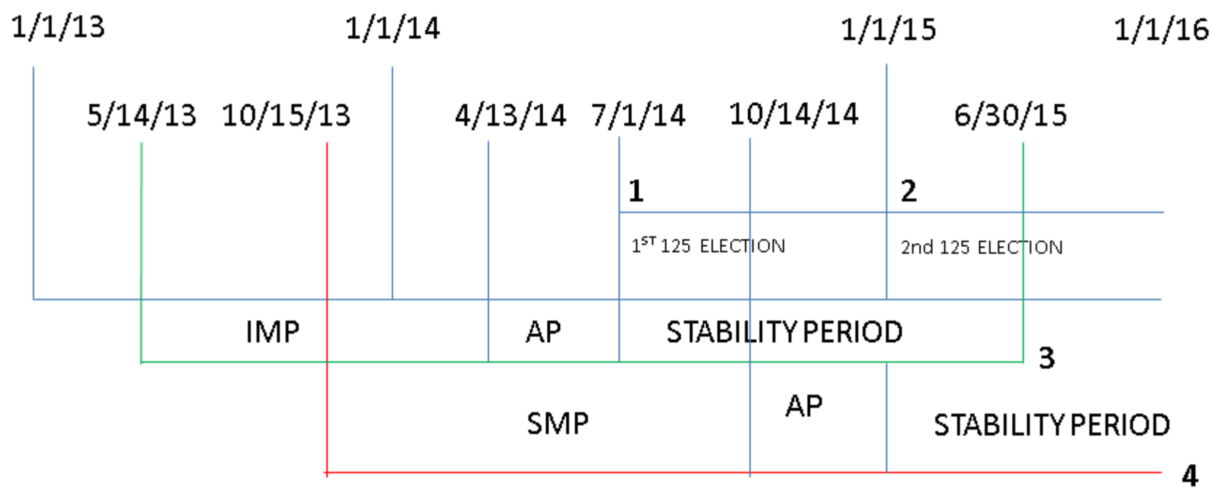
Assumptions:

- ABC maintains a health plan offered through a cafeteria plan
- IMP is 11 months (starting on date of hire)
- Admin period following IMP extend through the end of the month beginning on or after the anniversary date
- Stability Period following IMP begins first day of first month following admin period
- SMP is 10/15-10/14; however, first SMP starting in 2013 is 4/15-10/14
- Bob is hired May 14, 2013. He is a variable hour employee



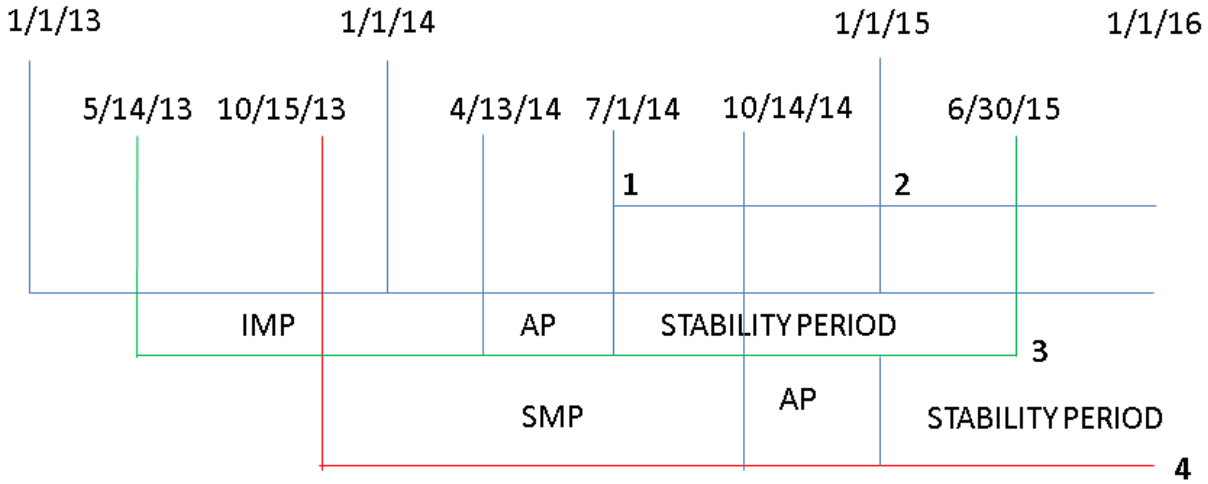
Bob is full-time during IMP but not during SMP ;Bob elects coverage:

1. Bob stability period following the IMP begins. 125 election for p/y/e 12/31/2014
2. Bob participates in annual enrollment. 125 election for 2015 plan year
3. Bob ceases to be eligible. Coverage is terminated and COBRA is offered
4. Bob not f/t during SMP so no coverage required to be offered through remainder of the year



Bob is full-time during IMP and during SMP; Bob elects coverage:

1. Bob stability period following the IMP begins. 125 election for p/y/e 12/31/2014
2. Bob participates in annual enrollment. 125 election for 2015 plan year
3. Bob was f/t during SMP so coverage does not end.
4. Bob's right to coverage ends at end of stability period unless f/t during immediately preceding SMP



Bob is not full-time during IMP but is full-time during SMP:

1. Bob's stability period following the IMP begins. No enrollment opportunity is offered
2. Bob participates in annual enrollment. 125 election for 2015 plan year
3. Although Bob not f/t during IMP, he was f/t during SMP. Stability period following SMP overlaps stability following IMP so coverage continues
4. Bob's right to coverage ends unless f/t during immediately preceding SMP

Appendix G: Eligible Employer Sponsored Plan

Code Section 5000A(f) specifies the types of health plans that qualify as minimum essential coverage for purposes of the individual mandate. Included in the list of health coverage that qualifies as "minimum essential coverage" is coverage through an eligible employer sponsored plan as defined in Code Section 5000(f)(2). Excluded from the list is any coverage that constitutes "excepted benefits" as defined in PHSA 2791(c)(1)-(4) and does not qualify as minimum essential coverage under any circumstance.

Code Section 5000(f)(2) defines—albeit vaguely-- an eligible employer sponsored plan as follows:

> a group health plan or group health insurance coverage offered by an employer to the employee that is: (1) a governmental plan, within the meaning of section 2791(d)(8) of the Public Health Service Act, or (2) any other plan or coverage offered in the small or large group market within a State.

The statute also notes that an eligible employer sponsored plan also includes a grandfathered health plan.

The statutory definition of eligible employer sponsored plan raises more questions than it answers (e.g. can "self-insured" health plans qualify as "eligible employer sponsored plans"?). Fortunately, the proposed regulations provide some clarity.

The proposed regulations generally define an eligible employer sponsored plan as follows:

- A self-insured "group health plan" (including a grandfathered self-insured group health plan[1])
- "Group health insurance" that is a plan sponsored by a governmental employer, any other coverage that is offered in the small or large group market and a grandfathered health plan offered in the group market.[2]

IRS and Treasury officials have also informally indicated that the plans must comply with the applicable health insurance reforms.[3]

The keys to understanding the general definition of eligible employer sponsored plan, and ultimately clarity, are the following definitions: "group health plan", and "group health insurance". A group health plan is defined by reference to PHSA Section 2791(a). PHSA 2791(a) defines a "group health plan" as follows:

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[1] Although compliance with the health insurance reforms is not a specific requirement of Code Section 5000A(f)(2), it is implied even without the informal remarks of treasury and IRS officials. For example, the statute and the regulations indicate that "grandfathered" health plans constitute a separate category of minimum essential coverage and such coverage is defined to include any group health plan to which Section 1251 of the ACA applies.

[2] See Prop. Treas. Reg. 1.500A-2(c)

[3] Although neither the statute nor the regulations specifically note this requirement, it is implied by the fact that grandfathered health plans are specifically identified as minimum essential coverage. If compliance with the applicable health insurance reforms were not a requirement, then there would not be a need to specifically reference such plans.

. . . .an employee welfare benefit plan (as defined in section 3(1) of the Employee Retirement Income Security Act of 1974) to the extent that the plan provides medical care (as defined in paragraph (2)) and including items and services paid for as medical care) to employees or their dependents (as defined under the terms of the plan) directly or through insurance, reimbursement, or otherwise

"Group health insurance" is defined by reference to PHSA Section 2791(b). PHSA section 2791(b) defines group health insurance as health insurance offered in connection with a group health plan.

When you put all the pieces of the puzzle together, a formula for qualifying as an eligible employer sponsored plan appears. Under this formula, a plan qualifies as an eligible employer sponsored plan if it satisfies the following three requirements:

#1: It is a "group health plan"

To qualify as a group health plan, the plan must provide medical care. "Medical care" is defined in Section 2791(a)(1) by reference to PHSA Section 2791(a)(2). PHSA Section 2791(a)(2) defines "medical care" as follows:

> The term "**medical care**" means amounts paid for— **(A)** the diagnosis, cure, mitigation, treatment, or prevention of disease, or amounts paid for the purpose of affecting any structure or function of the body, **(B)** amounts paid for transportation primarily for and essential to medical care referred to in subparagraph (A), and **(C)** amounts paid for insurance covering medical care referred to in subparagraphs (A) and (B).

Consequently, the plan will qualify as a group health plan as long as the benefits offered under a plan fit within any of the categories identified as medical care in PHSA Section 2791(a)(2).

#2: The coverage does not consist of "excepted benefits"

PHSA Section 2791(c)(1)-(4) identify the following as excepted benefits[4]:

- Benefits that are excluded under all circumstances:
  - Accident or disability income insurance;
  - Liability insurance, including general liability and auto liability insurance;
  - Workers' compensation;
  - Automobile medical payment insurance;
  - Credit only insurance;
  - Coverage for on-site medical clinics.
- The following benefits are exempt when offered through a separate policy or, alternatively, if they do not otherwise constitute an integral part of the plan. For this purpose a benefit is not an integral part of the plan if the participant has the right to elect the coverage separately from medical and, if the

[4] Although not specifically listed below, the corresponding regulations indicate that certain "health flexible spending arrangements" as defined in Code Section 106(c)(2) would also qualify as an excepted benefit.

participant elects to receive the coverage, the participant is charged a separate premium or contribution.

- "Limited scope" dental or vision benefits. "Limited scope dental coverage" is defined as coverage substantially all of which consists of treatment of the mouth. Likewise, limited scope vision coverage is defined as coverage substantially all of which is treatment for the eyes.
- Long-term care
- Nursing home care
- Home health care
- Community-based care

• Limited scope specified disease and hospital (or other fixed) indemnity coverage is exempt from HIPAA provided that:

  - Such coverage is provided under a separate policy, certificate or contract of insurance;
  - No coordination exists between the provision of such benefits and any exclusion under any plan maintained by that employer;
  - Benefits are paid for an event regardless of whether benefits are provided under any group health plan maintained by the same plan sponsor.

• The following types of benefits if offered under a separate policy or contract:
  - Medicare supplemental policy;
  - TRICARE supplemental policy;
  - Coverage providing "similar" supplemental coverage to a group health plan.[5]

Although it may be somewhat counterintuitive in light of how limited the benefits under the plan are, but a plan that only provides preventive care does not fit into any of these categories of excepted benefits. Consequently, the benefits provided under the preventive care only plan are <u>not</u> excepted benefits.

#3. The plan complies with the applicable health insurance reforms. Each of the applicable health insurance reforms and whether they apply to grandfathered plans or not is included below.

[5] The final regulations clarify that the exception for "similar supplemental coverage" is limited to coverage that is specifically designed to fill gaps in the primary health coverage such as coinsurance or deductibles (e.g., such as a Medi-Gap or CHAMPUS/TRICARE supplement plan). Coverage that is supplemental only because of the plan's coordination provisions is not "similar supplemental coverage."

HEALTH INSURANCE REFORM TABLE

The following table provides (in chronological order) the effective date of the application of Patient Protection and Affordable Care Act (PPACA) provisions to grandfathered health plans.

Insurance Reform **(PHSA §)**	**Description**	**Applicable to Grandfathered Plans?**
Plan years beginning on or after September 23, 2010		
Prohibition on lifetime/annual limits § 2711(a)	Prohibits group health plans and health insurance issuers offering group or individual health insurance coverage from establishing lifetime limits and annual limits on the dollar	Yes
Prohibition on preexisting condition exclusion of enrollees under age 19 § 2704	Group health plans and health insurance issuers offering group or individual coverage may not impose a preexisting condition exclusion or discriminate based on health status	Yes
Prohibition on rescissions § 2712	Group health plans and health insurance issuers may not rescind health coverage after coverage begins except in the case of fraud or intentional misrepresentation	Yes
Coverage of adult children § 2714	Group health plans and health insurance issuers offering group or individual health insurance coverage that provide dependent coverage must continue to make such coverage available to children until age 26	Yes
Uniform explanation of coverage § 2715	Requires the Federal government to develop standards for use by group health plans and health insurance issuers in compiling and providing an accurate summary of benefits and explanation of coverage for applicants, policyholders or certificate holders, and enrollees. The explanation of coverage must describe any cost sharing, exceptions, reductions, and limitations on coverage, and give examples to illustrate common benefits scenarios	Yes

Insurance Reform (PHSA §)	Description	Applicable to Grandfathered Plans?
Bringing down the cost of health coverage (minimum medical loss ratio) § 2718 Applicable only to fully insured plans	Requires health insurance issuers offering group or individual health insurance coverage to submit annual reports to the Federal government on the percentages of premiums that the coverage spends on reimbursement for clinical services and activities that improve health care quality, and to provide rebates to enrollees if this spending does not meet minimum standards for a given plan year	Yes (provision applies to insured plans only)
Coverage of preventive care (without cost sharing) § 2713	Group health plans and health insurance issuers offering group or individual health insurance coverage must cover certain preventive services, immunizations, and screenings, without any cost sharing	No
Provision of additional information (transparency requirements) §2715A	Requires group health plans and health insurance issuers offering group or individual health insurance coverage to disclose, to the Federal government and the State insurance commissioner, certain enrollee information such as claims payment policies and practices and enrollee rights. Requires such plans and issuers to provide information to enrollees on the amount of cost-sharing for a specific item or service	No
Nondiscrimination rules for insured plans §2716 Applicable only to fully insured plans.	Prohibits fully-insured group health plans from discriminating in favor of highly compensated individuals with respect to eligibility and benefits	No

Insurance Reform (PHSA §)	Description	Applicable to Grandfathered Plans?
Certain reporting requirements (statutory heading is "Ensuring Quality of Care") §2717	Requires the Federal government to develop guidelines for use by health insurance issuers to report information on initiatives and programs that improve health outcomes. Prohibits a wellness program from requiring the disclosure or collection of any information relating to the presence or storage of a lawfully possessed firearm or ammunition in the residence or the lawful use, possession or storage of a firearm or ammunition by an individual	No
Claims appeal procedures § 2719	Group health plans and health insurance issuers offering group or individual health insurance coverage must provide an effective internal appeals process of coverage determinations and claims and comply with any applicable State external review process. If the State has not established an external review process that meets minimum standards or the plan is self-insured, the plan or issuer shall implement an external review process that meets standards established by the Federal government	No
Patient protections (choice of primary care provider and emergency services without prior authorization) §2719A	Group health plans and health insurance issuers offering group or individual health insurance coverage must permit an individual to select a participating primary care provider, or pediatrician in the case of a child. Provides direct access to obstetrical or gynecological care without a referral. Prohibits prior authorization or increased cost sharing for out-of-network emergency services	No
Plan years beginning or after January 1, 2014		
Prohibition on preexisting condition exclusion on ALL enrollees § 2704	Group health plans and health insurance issuers offering group or individual coverage may not impose a preexisting condition exclusion or discriminate based on health status.	Yes
Limitation on waiting periods §2708	Prohibits any waiting periods that exceed 90 days for group health plans and group health insurance coverage	Yes

Insurance Reform **(PHSA §)**	**Description**	**Applicable to Grandfathered Plans?**
Guaranteed renewability of coverage (applicable to health insurance issuers) §2703 <u>Applicable only to fully insured plans</u>	Requires guaranteed renewability of coverage regardless of health status, utilization of health services, or any other related factor. Coverage can only be cancelled under specific, enumerated circumstances.	No
Fair health insurance premiums (limits factors that can be used to determine premiums) §2701 <u>Applicable only to fully insured plans</u>	Health insurance issuers may not charge discriminatory premium rates. The rate may vary only by whether such plan or coverage covers an individual or family, rating area, actuarial value, age, and tobacco use.	No
Guaranteed availability of coverage (applicable to health insurance issuers) §2702 <u>Applicable only to fully insured plans</u>	Health insurance issuers in both the individual and group markets must accept every employer and individual in the State that applies for coverage, but are permitted to limit enrollment to annual open and special enrollment periods for those with qualifying lifetime events.	No
Nondiscrimination based on health status §2705	Retains the HIPAA nondiscrimination provisions for group health plans and group health insurance issuers. Specifically, plans and group health insurance issuers may not set eligibility rules based on factors such as health status and evidence of insurability – including acts of domestic violence or disability. Provides limits on the ability of plans and issuers to vary premiums and contributions based on health status. The Affordable Care Act adds new provisions regarding wellness programs.	No (grandfathered plans remain subject to the rules in effect before health care reform)
Prohibition on discrimination against providers §2706	Prohibits discrimination by group health plans and health insurance issuers against health care providers acting within the scope of their professional license and applicable State laws.	No

Insurance Reform (PHSA §)	Description	Applicable to Grandfathered Plans?
Comprehensive health insurance coverage (requirement to provide essential benefits and OOP and deductible cost sharing provisions) §2707	Requires health insurance issuers in the small group and individual markets (and large group markets in State exchanges) to include coverage which incorporates defined essential benefits, provides a specified actuarial value, and requires all group health plans to comply with limitations on allowable cost sharing.	No
Participation in clinical trials §2709*	Prohibits health insurance issuers from dropping coverage because an individual (who requires treatment for cancer or another life-threatening condition) chooses to participate in a clinical trial. Issuers also may not deny coverage for routine care that they would otherwise provide because an individual is enrolled in a clinical trial.	No

* Due to drafting errors, there are two sections 2709 of the PHSA after PPACA. The section referred to in the table is a new section. The other section 2709 (relating to disclosure of information) is renumbered from prior law PHSA section 2713. Grandfathered plans remain subject to the pre-PPACA requirements that are still in effect.

Appendix H: Electronic Enrollment Rules

The IRS has issued final regulations that establish a safe harbor rule regarding electronic notices and elections under certain plans, including, but not limited to, cafeteria plans. See 26 C.F.R. 1.401(a)-21. The safe harbor establishes two general requirements for electronic benefit plan elections.

First, the electronic system used to facilitate elections must be reasonably designed to provide the information in the election to a recipient in a manner that is no less understandable to the recipient than a written paper election.

Second, the regulations require the electronic process to satisfy the following requirements:

- The individual must have the "effective ability" to access the electronic medium that will be used to make the election. The regulations do not define "effective ability;"
- Safeguards must be established to unauthorized individuals from making an election on behalf of the participant (e.g., via use of a PIN);
- The process must provide the individual the opportunity to review, confirm, modify, or rescind the terms of the election prior to the effective date of the election; and
- Send confirmation of the election to the participant, either in writing or through one of the two approved electronic notice methods described in the regulations

Appendix I: Affordability Safe Harbors

- W-2 Safe Harbor: Coverage is deemed affordable for purposes of the Tackhammer Penalty if the employee's share of the applicable large employer member's lowest cost, self-only coverage that provides minimum value for an entire calendar year is less than 9.5 percent of the employee's W-2, Box 1 wages from the employer for that same calendar year (other than a period during which an employee is receiving COBRA or other continuation coverage).

> **Practice Pointer**: Note that the benchmark is the employer's lowest cost option for self-only coverage that provides minimum value. We do not believe that all of the options offered by an applicable large employer member must be affordable and provide minimum value in order to avoid the Tackhammer Penalty; we believe that the applicable large employer member must only offer one option that is both affordable and provides minimum value. However, this means that the lowest cost, self-only coverage offered by the employer may not be the benchmark for the affordability standard if it doesn't also provide minimum value. In that case, the employer will have to look to the next cheapest, self-only coverage that also provides minimum value.

This W-2 safe harbor is subject to the following additional rules:

- If the offer of coverage is only for a portion of the calendar year, the W-2 wages must be adjusted for the period that coverage was offered during the calendar year. To adjust the W-2 wages, the Form W-2 wages are multiplied by a fraction equal to the number of months during which coverage was offered over the number of months during the year in which the employee was employed.
- The employee contribution must remain a consistent dollar amount or percentage of all W-2 wages throughout the calendar year, or if the plan operates on a fiscal year, within each portion of the plan year during that calendar year.

> **Practice Pointer**: The wages in Box 1 of the W-2 do not include pre-tax salary reductions made through certain employer sponsored plans, such as a 401(k) or cafeteria plans. Thus, the employee's wages for purposes of this affordability safe harbor will be proportionally reduced by the contribution amount used as the basis for the affordability test if the employee enrolls in and elects to pay for such coverage with pre-tax dollars. Some employers may be tempted to increase the margins by requiring such amounts to be paid with after-tax dollars, which will increase the wage base on which that affordability standard is based under this safe harbor and allow the employer to charge a higher premium. Nevertheless, we caution employers so tempted to tread cautiously. This practice, if applied to lower wage employees, would most certainly run afoul of the cafeteria plan nondiscrimination rules. Moreover, it is unlikely that the increased margins gained by increasing the wages through after-tax payroll deductions will prove more valuable than the tax savings garnered from the pre-tax salary reductions. A better practice is to use the rate of pay safe harbor described below.

- Rate of Pay Safe Harbor: Under this safe harbor, coverage is deemed affordable for a month with respect to an employee if the required contributions for the month for the applicable large employer member's lowest-cost self-only coverage that provides minimum value does not exceed 9.5 percent of an amount equal to 130 hours multiplied by the employee's hourly rate of pay as of the first day of the coverage period (generally the first day of the plan year). For non-hourly employees, applicable large employer members must use monthly salary instead of 130 multiplied by hourly rate of pay. This safe harbor may be used only to the extent the full-time employee's hourly rate of pay or monthly wages (as applicable) is not changed during the calendar year by the applicable large employer member or any other applicable large employer to whom the full-time employee is transferred.

- Federal Poverty Line Safe Harbor: The affordability safe harbor is satisfied for a calendar month if the employee's contribution for the applicable large employer member's lowest cost option that provides minimum value does not exceed 9.5 percent of an amount that is 1/12 of the federal poverty line for a single individual for the applicable calendar year. Applicable large employers may use the most recently published poverty guidelines as of the first day of the applicable large employer member's plan year.

Appendix J: Minimum Value

- First, employers must use a minimum value calculator ("MV Calculator") similar to the actuarial value calculator established by HHS for qualified health plans in the Exchanges if they have a standard plan design. The difference is that the MV calculator would be based on continuance tables reflecting claims data of typical self-insured plans. You can find the MV Calculator at http://cciio.cms.gov/resources/regulations/index.html.

Practice Pointer: "Allowed costs" is based on the essential health benefits defined by HHS—not on the scope of covered services under the plan. Self-insured plans and fully insured plans in the large group market are not required to offer essential health benefits so the MV Calculator permits adjustments in the event the plan does not offer essential health benefits. But plan sponsors should beware-- excluding essential health benefits will impact the plan's ability to satisfy the minimum value standard.

- Second, employers may be able to use a benefit plan design checklist. This would be available for plans that provide benefits in the four core categories (physician, hospital and emergency, pharmacy and lab) with cost sharing attributes at least as generous as any of the checklist options.

- Third, a plan with nonstandard features (the first two are for plans with standard features) that is unable to use either of the first two methods described above may obtain an actuarial certification that the plan provides minimum value.

Practice Pointer: Also, as is the case with the AV calculator, employer HSA and HRA contributions are counted, to some extent, when making the minimum value determination. Annual allocations to an HRA are counted only to the extent the HRA is "integrated" with the major medical plan (i.e. participation in the HRA is limited to those who participate in the medical plan) and the reimbursements are limited to cost sharing expenses under the plan.

Appendix K: Tax Examples

The Sledgehammer

Applicable large employer member A and applicable large employer member B are the two members of an applicable large employer. Applicable large employer member A employs 40 full-time employees in each calendar month of 2014. Applicable large employer member B employs 125 full-time employees in each calendar month of 2014. Applicable large employer member A does not sponsor an eligible employer-sponsored plan for any calendar month of 2014, and receives a Premium Subsidy Certification for 2014 with respect to at least one of its full-time employees. Applicable large employer member B sponsors an eligible employer sponsored plan under which 120 of its full-time employees (and their dependents) are eligible for minimum essential coverage. Applicable large employer member B also receives a Premium Subsidy Certification with respect to two of the five employees who are not eligible for coverage provided by applicable large employer B.

In accordance with the 4980H Rules, applicable large employer member A is subject to a Sledgehammer Penalty for 2014 of $64,000, which is equal to 32 x $2,000 (40 full-time employees reduced by eight (its allocable share of the 30-employee offset ((40/165) x 30 = 7.2, rounded up to eight)) and then multiplied by $2,000).

Even though applicable large employer B did not offer coverage to all of its full-time employees, and two of the five who were not offered coverage received a Premium Subsidy, applicable large employer member B is not subject to the Sledgehammer Penalty because applicable large employer B offered coverage to at least 95 percent of its full-time employees and their dependents. Nevertheless, applicable large employer B will be liable for a Tackhammer Penalty with respect to the two full-time employees who weren't offered coverage and who received a Premium Subsidy.

The Tackhammer

Applicable large employer member C and applicable large employer member D are the two members of an applicable large employer. Applicable large employer member C employs 50 full-time employees in each calendar month of 2014. Applicable large employer member D employs 100 full-time employees in each calendar month of 2014. Applicable large employer member C sponsors an eligible employer sponsored plan under which all 50 of its full-time employees (and their dependents) are eligible during each month of the year; however, the coverage is not affordable in 2014. Applicable large employer C receives a Premium Subsidy certification with respect to three of its full-time employees for 2014. Applicable large employer member D sponsors an eligible employer sponsored plan under which 96 of its full-time employees (and their dependents) are eligible for minimum essential coverage. The coverage is affordable and provides minimum value. Applicable large employer member D also receives a Premium Subsidy Certification with respect to two of the four employees who are not eligible for coverage provided by applicable large employer D.

In accordance with the 4980H Rules, applicable large employer member C is subject to a Tackhammer Penalty for 2014 of $9,000, which is equal to a $3,000 assessable payment for 2014 multiplied by the three full-time employees who received a Premium Subsidy for 2014.

Even though applicable large employer D offered affordable, minimum value coverage to 95 percent of his full-time employees and their dependents, two of the four to whom D did offer coverage received a Premium Subsidy for 2014. Consequently, Employer D is subject to a Tackhammer Penalty for 2014 equal to $6000, which is equal to a $3,000 assessable payment for 2014 multiplied by the two full-time employees who received a Premium Subsidy for 2014.