Final “Play-or-Pay” Regulations Provide Relief and Much Needed Clarification

The Affordable Care Act added the so-called “Play-or-Pay” mandate or “Employer Shared Responsibility” provisions to the Internal Revenue Code (the Code). Starting in 2015, certain employers, referred to as “applicable large employers” (ALEs), may be subject to a penalty tax, or “Employer Shared Responsibility Payment,” if they (1) fail to offer the opportunity to enroll in an employer-sponsored health plan that constitutes “minimum essential coverage” (MEC) to substantially all full-time employees and their dependents (Penalty A); or (2) offer MEC that is either unaffordable or does not provide the required minimum value (Penalty B). In general, the penalty taxes are triggered if at least one of the ALE’s full-time employees receives a premium tax credit or cost-sharing reduction for purchasing health insurance through a Health Insurance Marketplace (also referred to as an “Exchange”).

Early last year, the Treasury Department issued proposed regulations providing guidance with respect to the Play-or-Pay mandate, which was originally set to take effect for plan years beginning on or after January 1, 2014. Later in 2013, the Treasury Department published IRS Notice 2013-45 postponing the effective date until January 1, 2015. The Treasury Department published final regulations on February 12, 2014. This Client Update describes some of the major differences between the final regulations and the proposed regulations and also provides an overview of the transition relief.

Applicability Dates

In general, the final regulations are applicable for periods after December 31, 2014. For non-calendar year plans, many provisions of the final regulations will be applicable as of the first day of the first plan year that begins after January 1, 2015. Employers may choose to rely on the final regulations with respect to periods prior to January 1, 2015.

Part I: The Applicable Large Employer Determination

TRANSITION RELIEF: SHORTER DETERMINATION PERIOD

The Play-or-Pay mandate only applies to ALEs. An employer is an ALE for a calendar year if it employed, on average, at least 50 full-time employees, including “full-time equivalent employees” (FTEs), on business days during the preceding calendar year. This is referred to herein as the “50-employee threshold.” As a result, for most employers, the determination of whether it is an ALE for 2015 is based on the number of employees that an employer has this year (2014).

For 2015 only, an employer has the option to determine whether it is an ALE using a reference period of six or more consecutive months during the 2014 calendar year, rather than the entire 2014 calendar year. The employer has the discretion to choose which months it uses. Allowing this shorter period to determine whether the 50-employee threshold is met leaves time for an employer to make any necessary changes as a result of its determination, such as making adjustments to its plan or establishing a plan, in compliance with the Play-or-Pay mandate by the beginning of 2015.

This transition relief is particularly helpful for those employers that may be very close to the threshold. However, the transition relief provides that, with respect to ALE status during 2015, the determination of whether an employer meets the requirements of the “seasonal-worker exception,” described below, must be based on the entire 2014 calendar year; the employer cannot take advantage of the transition relief for that purpose.

TRANSITION RELIEF: APPLICABLE LARGE EMPLOYERS WITH 50 TO 99 FULL-TIME EMPLOYEES

The final regulations have also provided relief for mid-sized ALEs—companies employing 50 to 99 full-time employees and FTEs. Under this relief, no Play-or-Pay penalties will apply during the entire 2015 calendar year. Also, in the case of a non-calendar year plan, no penalties will apply for any months in the plan year that begins in 2015.

To qualify for this relief, the ALE must meet the following:

- It must employ on average 50 to 99 full-time employees and FTEs on business days during 2014;
- Except for reductions for bona fide business reasons, during the period from February 9, 2014 through December 31, 2014, it must not reduce the size of its workforce or its employees’ overall hours of service in order to fall under the threshold described above; and
- During the period beginning on February 9, 2014 and ending on December 31, 2015 for calendar-year plans (or the end of the plan year that begins in 2015 for non-calendar year plans), it does not eliminate or materially reduce the health coverage it...
For these purposes, an ALE will not be treated as having materially reduced its health coverage if (1) its contribution toward employee-only coverage remains at 95 percent or more of the contribution for such coverage made on February 9, 2014; (2) the coverage provides minimum value after any change in benefits with respect to employee-only coverage from what was available on February 9, 2014; and (3) the eligibility terms under the coverage offered on February 9, 2014 are not modified to narrow or reduce the class or classes of employees or their dependents to whom coverage was offered. The ALE must also certify on a form prescribed by the Treasury Department that the three requirements described above have been satisfied.

SEASONAL WORKER EXCEPTION

The term "seasonal worker" is relevant for the determination of ALE status. The final regulations continue to apply the definition of "seasonal worker" from the proposed regulations, which means any worker who performs services on a seasonal basis as defined by the Secretary of the Department of Labor. Employers are allowed to apply a reasonable good faith interpretation of the term seasonal worker based on guidance from the Department of Labor.

The seasonal worker exception is retained in the final regulations. Under this exception, if for the prior calendar year, an employer's full-time employees and FTEs (including all seasonal workers) exceeds 50 for no more than 120 days and the employees in excess of 50 who were employed during those 120 days were all seasonal workers, the employer will not be considered an ALE for the current calendar year. An employer may use four calendar months as the equivalent of 120 days and neither the four months nor the 120 days need be consecutive. As noted above, the transition guidance allowing for a shorter ALE determination period does not apply in this context. Instead, a full calendar year must be used even for 2014.

TRANSITION RELIEF: NEW APPLICABLE LARGE EMPLOYERS

The final regulations provide relief for employers already in existence that newly become ALEs. If an employer did not offer coverage to a full-time employee during the prior calendar year when the employer was not an ALE, but offers coverage that provides minimum value to such employee on or before April 1 of the first calendar year for which the employer is an ALE, no Play-or-Pay penalties will be assessed for the ALE's failure to offer coverage to the employee for the period from January 1 through March 31 of that year. If the ALE fails to provide minimum value coverage by April 1, the employer may be subject to Penalty A for the period from January 1 through March 31 in addition to any other months during which such coverage is not offered. If the coverage offered by April 1 does not provide minimum value, the ALE may be subject to Penalty B for the period from January 1 through March 31 in addition to any other months during which the coverage does not provide minimum value or is not affordable.

This relief is only available with respect to the first year that the employer is ever considered to be an ALE. If the employer was previously an ALE, fell below the 50-employee threshold in a subsequent year, then again became an ALE, the relief is not available with respect to the year in which the employer again became an ALE.

Part II: Play-or-Pay Penalties

DEPENDENT DEFINITION

The final regulations substantially revise the term “dependent” for purposes of the Play-or-Pay mandate. Under the proposed regulations, “dependent” included an employee’s son or daughter (whether by blood or adoption), stepson or stepdaughter, or eligible foster child, who is under the age of 26. Taking comments into consideration, the final regulations retain the under 26 age limit but now define the term “dependent” to include biological and adopted (or legally placed for adoption) sons or daughters but to exclude stepsons, stepdaughters, eligible foster children, and children who are neither United States citizens or nationals unless they reside in the United States, Canada, or Mexico (except for certain foreign adoptees). A child is considered a dependent for the entire calendar month during which he or she turns 26.

The definition does not extend to any other individuals not expressly included in the definition, regardless of whether such individuals are considered tax dependents of the employee. Consistent with the proposed regulations, the definition also excludes an employee's spouse. Employers are allowed to rely on an employee's representations regarding his or her children and the age of such children.

Transition Relief: Dependents

As noted above, ALEs must offer MEC to full-time employees’ dependents in order to avoid the Play-or-Pay penalties. Recognizing that a number of employers that provide health coverage for their employees do not currently provide dependent coverage, the final regulations have extended the transition relief from the proposed regulations to the 2015 plan year. This relief applies with respect to plans that (1) do not offer dependent coverage; (2) offer dependent coverage that is not MEC; or (3) offer MEC to some but not all dependents of full-time employees, with the following limitations:

- The relief is not available if the ALE offered dependent coverage for either the 2013 or 2014 plan year but subsequently dropped that coverage;
The relief applies only with respect to dependents who were not offered coverage during both the 2013 and 2014 plan years; and

The relief is available only if the employer “takes steps” during the 2014 or 2015 (or both) plan years toward offering MEC to dependents who were not offered coverage during the 2013 or 2014 (or both) plan years.

TRANSITION RELIEF: OFFERS OF COVERAGE IN 2015

Under the final regulations, if an ALE fails to offer MEC to a full-time employee for any day of a calendar month, such employee is treated as not having been offered coverage for that entire month. Transition relief in the final regulations provides that with respect to the month of January in 2015, an ALE that offers MEC to a full-time employee on or before the first day of the first payroll period that begins in January, the employee will be treated as having been offered coverage for the entire month.

TRANSITION RELIEF: "SUBSTANTIALLY ALL" REDUCED TO 70 PERCENT

For all of calendar year 2015 and any calendar months in 2016 of a plan year that begins in 2015, for purposes of Penalty A, an ALE is treated as having offered MEC to substantially all of its full-time employees for a calendar month if it offers such coverage to 70 percent of its full-time employees. This is a significant decrease from the general rule equating “substantially all” with 95% of full-time employees. However, ALEs relying on this transition relief may still be subject to Penalty B with respect to any full-time employees who are not offered MEC.

TRANSITION RELIEF: 30-EMPLOYEE REDUCTION ALLOWANCE INCREASED TO 80

For a calendar month in which Penalty A applies, the amount of Penalty A is equal to the product of (1) $2,000 (adjusted for inflation) divided by 12; and (2) the number of full-time employees of the ALE minus 30. For calendar year 2015 and any calendar months in 2016 of a plan year that begins in 2015, the 30-employee reduction allowance is increased to 80.

TRANSITION RELIEF: NON-CALENDAR YEAR PLANS

The preamble to the final regulations provides the following three different pieces of transition guidance relating to non-calendar year plans. This relief is available only for an ALE maintaining a non-calendar year plan as of December 27, 2012 for which the plan year was not modified after that date to begin at a later calendar date.

**Pre-2015 Eligibility.** This rule applies with respect to employees (1) who would be eligible under the terms of the plan as in effect on February 9, 2014 and for whom coverage is effective on the first day of the plan year beginning in 2015; and (2) who are not eligible for any other group health plan coverage offered by the ALE as of February 9, 2014 that has a calendar-year plan year. If such employees are offered MEC that provides minimum value and is affordable no later than the first day of the plan year beginning in 2015, the ALE will not be subject to Play-or-Pay penalties with respect to the period during 2015 prior to the first day of that plan year. This relief is also available for any such employees who otherwise would have been eligible but terminate employment prior to the first day of the 2015 plan year.

**Significant Percentage of All Employees.** This relief applies with respect to an ALE that maintained one or more non-calendar year plans with the same plan year if those plans either (1) covered, as of any date within the 12-month period that ended on February 9, 2014, as least 1/4 of the ALE’s employees (including full-time, part-time, and seasonal employees); or (2) offered coverage to 1/3 or more of the ALE’s employees (including full-time, part-time, and seasonal employees) during the most recent open enrollment period held prior to February 9, 2014. To the extent that the ALE offers MEC that provides minimum value and is affordable no later than the first day of the plan year beginning in 2015 to employees who would not have been eligible under the terms of any calendar-year group health plan maintained by the ALE as of February 9, 2014, the ALE will not be subject to Play-or-Pay penalties with respect to the period during 2015 prior to the first day of that plan year.

**Significant Percentage of Full-Time Employees.** This relief applies with respect to an ALE that maintained one or more non-calendar year plans with the same plan year if those plans either (1) covered, as of any date within the 12-month period that ended on February 9, 2014, as least 1/3 of the ALE’s full-time employees; or (2) offered coverage to 1/2 or more of the ALE’s full-time employees during the most recent open enrollment period held prior to February 9, 2014. To the extent that the ALE offers MEC that provides minimum value and is affordable no later than the first day of the plan year beginning in 2015 to full-time employees who would not have been eligible under the terms of any calendar-year group health plan maintained by the ALE as of February 9, 2014, the ALE will not be subject to Play-or-Pay penalties with respect to the period during 2015 prior to the first day of that plan year. This provision, by focusing only on full-time employees, may prove important for ALEs that have large numbers of seasonal or part-time employees.

If an ALE maintaining a non-calendar year plan fails to comply with the requirements above, the transition relief is not available and the ALE is potentially subject to Play-or-Pay penalties for all months of 2015 during which it does not offer MEC that is both affordable and provides minimum value.

**TRACKING FULL-TIME EMPLOYEES: MONTHLY MEASUREMENT METHOD**
The final regulations provide additional clarity and guidance with respect to the default “monthly measurement” method that applies to the extent that an ALE does not want to rely on the look-back measurement method. Under the monthly measurement method, the determination of whether an employee is a full-time employee is made in much the same way as for purposes of determining an employer's ALE status. The employee's hours for a given month are totaled to determine whether the employee provided at least 30 hours of service per week. The monthly equivalent of 130 hours is also available. For purposes of the Play-or-Pay penalties, however, FTEs are not taken into consideration and coverage need not be offered to any employee who does not meet the definition of full-time.

Under the proposed regulations, the monthly measurement method was largely unworkable because the determination of full-time status was made at the end of a calendar month when it was too late to offer coverage for that month to any employee determined to be full-time. The final regulations provide relief from this problem in the form of an exemption.

In particular, to the extent that an employee first becomes eligible for coverage under the ALE’s group health plan, the ALE will not be subject to Penalty A during the three full calendar months, beginning with the first full calendar month in which the employee is “otherwise eligible for an offer of coverage,” if that employee is offered coverage no later than the first day of the fourth calendar month. To be “otherwise eligible for an offer of coverage” for a calendar month means that the employee meets all of the requirements under the terms of the plan to be eligible for that month other than the completion of the up to 90-day waiting period permissible under the Public Health Services Act Section 2708.

This exemption is available to the ALE only if the employee has not been previously eligible under a group health plan of the ALE during the employee’s period of employment with the ALE. The exemption is available even if the employee terminates employment prior to the first day of the fourth month.

The final regulations also provide that if the coverage offered provides minimum value, the ALE will not be subject to Penalty B during that three-month period. However, the ALE may be subject to Penalty B thereafter to the extent that it is not affordable.

**TREATMENT OF REHIRES AS NEW EMPLOYEES**

With respect to employees who terminated employment or experienced periods during which they performed no hours of service, an ALE may treat such employees as “new” under either of the following rules:

- **13-Week Rule.** An employee may be treated as new if he or she has returned to service after at least 13 consecutive weeks have passed during which no hours of service were credited to the employee immediately preceding his or her return. The proposed regulations used 26 consecutive weeks for all ALEs but the final regulations kept the 26-week period only with respect to ALEs that are educational organizations. This rule only applies for determining whether the returning employee should be treated as either new or continuing.

- **Rule of Parity.** An employee who has returned to service after at least four but less than 13 consecutive weeks have passed during which no hours of service were credited to the employee may be treated as new if his or her prior period of employment was shorter than the period during which no hours of service were credited. As under the rule above, the proposed regulations used a 26-week period rather than 13. However, 26 weeks was retained with respect to ALEs that are educational organizations only.

A full-time employee who must be treated as a continuing employee must be offered coverage upon return and resumption of services no later than the first day of the month following the month during which the employee resumed services, which, under the final regulations is deemed to be “as soon as administratively practicable.”

**TRACKING FULL-TIME EMPLOYEES: LOOK-BACK MEASUREMENT METHOD**

The proposed regulations incorporate, with some changes, the “look-back” method of tracking employee hours that was originally published in IRS Notice 2012-58. The final regulations adopt, in virtually identical form, that method from the proposed regulations.

**SEASONAL EMPLOYEE DEFINITION**

Under the look-back measurement method, the final regulations continue to allow an ALE to treat employees who are categorized as “seasonal employees,” including those who may be expected to work an average of at least 30 hours per week, as variable-hour employees. Additionally, the final regulations provide a definition of the term, “seasonal employee,” which was reserved in the proposed regulations. A seasonal employee is now defined as an employee who is hired into a position for which the customary annual employment is no more than six months. Note that this term is not the same as the term “seasonal worker” described above under the rules for determining ALE status.

The preamble to the final regulations clarifies that “customary” refers to the nature of the position in that it begins in approximately the same part of the year, such as during a specific season like winter or summer. It clarifies further that an employee may still be considered seasonal if his or her employment continues beyond six months under circumstances that are unusual. The example given is a ski instructor who is typically hired to work fewer than six months but is asked to continue employment because of an unusually long and heavy snow season.
NEW PART-TIME EMPLOYEE (NON-SEASONAL) DEFINITION

The final regulations include a definition of “part-time employee,” which was not previously provided in the proposed regulations. A part-time employee is defined as a new employee who the ALE expects will provide on average less than 30 hours of service per week during the initial measurement period. These employees are treated the same as new variable-hour employees for purposes of the look-back measurement method.

Part III: What Should Employers Do Now?

The first step toward compliance with the Play-or-Pay mandate is to determine whether an employer is subject to the requirements. Employers should begin the process of determining whether they are ALEs.

- Employers should consider whether to take advantage of the transition relief that permits them to use a period shorter than 12 but at least six months in 2014 to determine their status as an ALE; and
- Employers that may employ 50 to 99 employees should determine whether they can take advantage of the transition relief effectively postponing the applicability of the Play-or-Pay mandate until 2016.

Those employers that are ALEs will need to determine how they will comply with the Play-or-Pay mandate in order to avoid any penalties. ALEs should create or continue working with an internal task force and with outside advisors to reach the most appropriate compliance and implementation plan for the ALE. In addition:

- ALEs should decide whether to use the monthly measurement method or the look-back measurement method and ensure that policies and procedures are in place to begin tracking employees’ hours of service;
- ALEs that offer dependent coverage, should review plan terms to ensure compliance with the revised definition and requirements; and
- ALEs that currently do not offer dependent coverage but are considering doing so, should evaluate the transition relief for this change.

ALEs maintaining non-calendar year plans should evaluate and comply with the requirements for applicable transition relief, if needed, in order to avoid Play-or-Pay penalties in 2015 before the start of the 2015 plan year.

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