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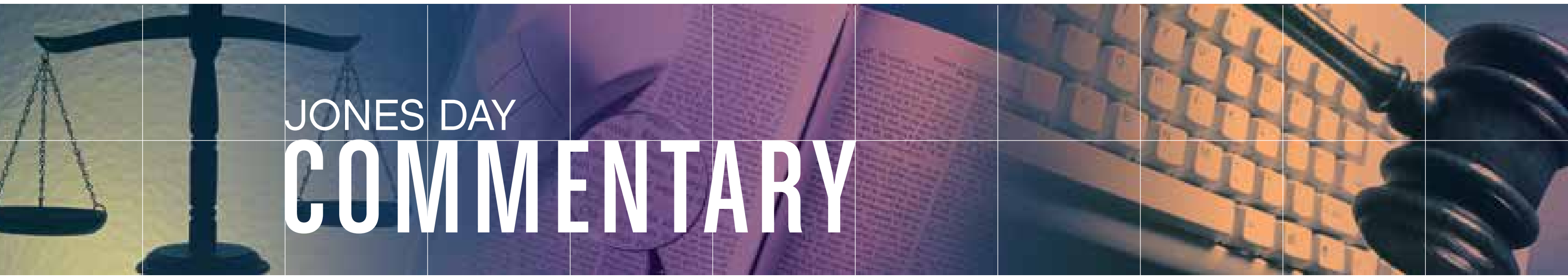


DECIDING WHETHER TO PLAY OR PAY UNDER THE AFFORDABLE CARE ACT

The Patient Protection and Affordable Care Act (the "ACA") adds a new Section 4980H to the Internal Revenue Code of 1986, as amended, which generally requires employers to offer health coverage to their employees (the "Employer Mandate"). Following are Q&As discussing this provision. These Q&As are designed to address some of the more commonly asked questions, including which employers are subject to the mandate, who must be offered coverage to avoid a penalty, the type of coverage that must be offered to avoid said penalty, and the penalties that apply for not offering coverage. These Q&As are based on recently issued proposed regulations; the final regulations, when issued, may change the requirements. 26 C.F.R. 54.4980H-1, *et seq.*

Q&A 1: WHAT IS THE EMPLOYER MANDATE?

On January 1, 2014, the Employer Mandate will change the landscape of health care in the U.S. by requiring large employers to offer health coverage to full-time employees and their children up to age 26 or risk paying a penalty. Large employers will be forced to make a choice: to either "play" by offering affordable health coverage that provides minimum value or "pay" by potentially owing a penalty to the Internal Revenue Service if they fail to offer such coverage. This "play or pay" scheme, called "shared responsibility" in the statute, has become known as the Employer Mandate. Although the Employer Mandate generally takes effect on January 1, 2014, the effective date is deferred for employers with fiscal year plans that meet certain requirements.

Only "large employers" are required to comply with the Employer Mandate. Generally speaking, "large employers" are employers that had an average of 50 or more full-time or full-time equivalent employees on business days during the preceding year. "Full-time employees" include all employees who work at least 30 hours on average each week. The number of "full-time equivalent employees" is determined by aggregating the hours worked by all non-full-time employees. In determining large employer status, certain related employers under common control are considered to be a single employer. (However, as discussed below, while large employer status is determined based on counting the full-time employees and full-time equivalents of all members of a group of related employers under common control, whether any penalty is owed and the amount of such penalty is calculated separately for each related employer.)

To "play" under the Employer Mandate, a large employer must offer health coverage that is "minimum essential coverage," is "affordable," and satisfies a "minimum value" requirement to its full-time employees and certain of their dependents. "Minimum essential coverage" includes coverage under an employer-sponsored group health plan, whether it be fully insured or self-insured, but does not include stand-alone dental or vision coverage, or flexible spending accounts. Coverage is "affordable" if an employee's required contribution for the lowest-cost self-only coverage option offered by the employer does not exceed 9.5 percent of the employee's household income. Coverage provides "minimum value" if the plan's share of the actuarially projected cost of covered benefits is at least 60 percent. More detail about these requirements is included in later Q&As.

If a large employer does not "play" for some or all of its full-time employees, the employer will have to pay a penalty in two scenarios.

The first scenario occurs when an employer does not offer health coverage to "substantially all" of its full-time employees and *any one of* its full-time employees both enrolls in health coverage offered through a State Insurance Exchange, which is also being called a Marketplace (an "Exchange"), and receives a premium tax credit or a cost-sharing subsidy (each an "Exchange subsidy"). In this scenario, the employer will owe a "no coverage penalty." The no coverage penalty is $2,000 per year (adjusted for inflation) for each of the employer's full-time employees (excluding the first 30). This is the penalty that an employer should be prepared to pay if it is contemplating not offering group health coverage to its employees.

The second scenario occurs when an employer does provide health coverage to its employees, but such coverage is deemed inadequate for Employer Mandate purposes, either because it is not "affordable," does not provide at least "minimum value," or the employer offers coverage to substantially all (but not all) of its full-time employees and *one or more* of its full-time employees both enrolls in Exchange coverage and receives an Exchange subsidy. In this second scenario, the employer will owe an "inadequate coverage penalty." The inadequate coverage penalty is $3,000 per person and is calculated, based not on the employer's total number of full-time employees, but only on each full-time employee who receives an Exchange subsidy. (Furthermore, the penalty is capped each month by the maximum potential "no coverage penalty" discussed above).

Because Exchange subsidies are available only to individuals with household incomes of at least 100 percent and up to 400 percent of the federal poverty line (in 2013, a maximum of $45,960 for an individual and $94,200 for a family of four), employers that pay relatively high wages may not be at risk for the penalty, even if they fail to provide coverage that satisfies the affordability and minimum value requirements. Likewise, because Exchange subsidies are not available to individuals who are eligible for Medicaid, employers may be partially immune to the penalty with respect to their low-wage employees, particularly in states that elect the Medicaid expansion. To be sure, Medicaid eligibility is based on household income. Because an employee's household may have more income than the wages he or she receives from the employer, the employee might not be Medicaid eligible, even though the employer pays a very low wage. Thus, it may be difficult for an employer to assume its low-paid employees will be eligible for Medicaid and not eligible for Exchange subsidies. But for employers with low-wage workforces, examination of the extent to which the workforce is Medicaid eligible may be worth exploring.

In addition, Exchange subsidies will not be available to any employee whose employer offers the employee affordable coverage that provides minimum value. Thus, by "playing" for employees who would otherwise be eligible for an Exchange subsidy, employers can ensure they are not subject to any penalty, even if they don't "play" for all employees.

Q&A 2: WHO IS ELIGIBLE FOR A PREMIUM TAX CREDIT OR COST-SHARING SUBSIDY?

As noted in Q&A 1, merely failing to offer full-time employees minimum essential coverage, or coverage that meets the affordability or minimum value requirements, is not enough to trigger liability under the Employer Mandate. Two additional things must occur before any penalty will be assessed. First, one of the employer's full-time employees must enroll in health coverage offered through an Exchange. Second, that full-time employee must receive an Exchange subsidy (a premium tax credit or cost-sharing subsidy). Thus, an employer should consider which of its employees are potentially eligible for an Exchange subsidy when deciding how to comply with the Employer Mandate. It is important to note that the employee must qualify for the Exchange subsidy; receipt of an Exchange subsidy by an employee's dependent (for an example, an adult child who is not a tax dependent of the employee) will not give rise to an Employer Mandate penalty.

Coverage Through an Exchange. In order to be eligible to receive an Exchange subsidy, an individual must enroll in health coverage offered through an Exchange. Under the ACA, an Exchange will be established in each state, either by the state or by the federal government (or a combination of the two). An Exchange is a governmental entity or nonprofit organization that serves as a marketplace for health insurance for individuals and small employers. Health insurance offered through the Exchanges must cover a minimum set of specified benefits and must be issued by an insurer that has complied with certain licensing and regulatory requirements.

Eligibility for an Exchange Subsidy. There are two Exchange subsidies available: the premium tax credit and the cost-sharing subsidy. The premium tax credit is intended to help individuals and families purchase health coverage through an Exchange. The credit is available only to legal U.S. residents whose household income is 100 percent to 400 percent of the federal poverty line ("FPL"). Legal resident aliens also qualify for the credit if their household income is below 100 percent of the federal poverty line because they are not eligible for Medicaid. Individuals who are eligible for Medicaid or Medicare, or certain other government-sponsored coverage like CHIP or veterans' health care, are not eligible for premium tax credits.

The FPL is set annually by the U.S. Department of Health and Human Services ("HHS") and is based on household size. For 2013, the FPL in the continental U.S. is $11,490 for an individual and $23,550 for a family of four; 400 percent of the FPL is $45,960 for an individual and $94,200 for a family of four. The amounts are slightly higher in Alaska and Hawaii.

An employee is not eligible for a premium tax credit if the employee is either (i) enrolled in an employer-sponsored plan or (ii) eligible for an employer-sponsored plan that meets the affordability and minimum value requirements.

Cost-sharing subsidies, which reduce cost-sharing amounts such as copays and deductibles, are available to individuals who have a household income no greater than 250 percent of the FPL and enroll in "silver-level" coverage through an Exchange. An employee whose household income is 200 percent of the FPL may therefore be eligible for a premium tax credit to help defray the cost of monthly insurance premiums, and a cost-sharing subsidy to help reduce the amount of out-of-pocket copays and deductibles to which the Exchange-enrolled employee otherwise would be subject.

"Certification" of Eligibility for an Exchange Subsidy to Employer. The Employer Mandate penalty applies only when the employer has first received "certification" that one or more employees have received an Exchange subsidy. The IRS will provide this certification as part of its process for determining whether an employer is liable for the penalty, which will occur in the calendar year following the year for which the employee received the Exchange subsidy. Under procedures to be issued by the IRS, employers that receive one or more certifications will be given an opportunity to contest the certification before any penalty is assessed.

In addition, Exchanges are required to notify employers that an employee has been determined eligible to receive an Exchange subsidy. The notification provided contemporaneously with the determination will identify the employee, indicate that the employee has been determined eligible to receive an Exchange subsidy, indicate that employer may be liable for an Employer Mandate penalty, and notify the employer of the right to appeal the determination. These notices will be useful in giving employers an opportunity to correct erroneous Exchange information and protect against erroneous penalty notices from the IRS. These notices will also be useful in budgeting for any penalties that may be owed.

PLANNING CONSIDERATION

The Employer Mandate penalty applies only to an employer failing to offer health coverage if one or more of its full-time employees enrolls in insurance coverage through a so-called Exchange, and actually receives either a premium tax credit or a cost-sharing subsidy. Unless a full-time employee enrolls in an Exchange and obtains the tax credit or subsidy, the employer is off the hook. This can lead to some surprising exemptions from the penalty.

Assume Employer X is a software development company with 50 full-time employees—40 are software developers whose annual income exceeds $120,000, and 10 are administrative assistants with annual income, after overtime, of no more than $40,000. None of the 40 software developers will be eligible for a premium tax credit or cost-sharing subsidy under the ACA; they are too highly compensated. Thus, Employer X is in a position of being able to avoid the penalty merely by offering health coverage to 10 of its 50 employees, which it should be able to obtain on a small business (SHOP) Exchange. It may exclude its 40 highly compensated employees from eligibility for this coverage (or require them to pay the full cost of coverage) without being exposed to the Employer Mandate penalty. And by either narrowing the eligibility for health coverage only to its 10 administrative assistants, or passing on the full cost of coverage to its software developers, it considerably reduces the risk that employers will have to bear the inflation in health costs associated with providing health coverage to the entire workforce.

Q&A 3: WHEN IS THE EMPLOYER MANDATE EFFECTIVE, AND WHAT TRANSITION RULES APPLY?

In general, large employers are subject to the Employer Mandate beginning on January 1, 2014. However, the effective date for employers that sponsor fiscal year health plans is deferred if certain requirements are met. There are also special transition rules for offering coverage to dependents, offering coverage through multiemployer plans, change in status events under cafeteria plans, determining large employer status, and determining who is a full-time employee.

Fiscal Year Health Plans. An employer with a health plan on a fiscal year faces unique challenges complying with the Employer Mandate. Because terms and conditions of coverage may be difficult to change mid-year, a January 1, 2014 effective date would, in many cases, force employers with fiscal year plans to be compliant for the entire fiscal 2013 plan year. Recognizing the potential burdens, the IRS has granted special transition relief for employers that maintained fiscal year health plans as of December 27, 2012. Both transition relief rules apply separately to each employer in a group of related employers under common control.

Under the first transition rule, employers will not be subject to a penalty on the basis of any full-time employee who, under the terms of a fiscal year plan in effect as of December 27, 2012, would be eligible for coverage as of the first day of the 2014 plan year. The transition rule applies only if such employee is offered coverage, no later than the first day of the 2014 plan year, that otherwise meets the requirements of the Employer Mandate.

The second transition rule applies if an employer has one or more fiscal year plans (that have the same plan year as of December 27, 2012) and, collectively, either cover at least one quarter of the employer's employees or offered coverage to at least one third of the employer's employees during the most recent open enrollment period that ended prior to December 27, 2012. If one of these prerequisites is met, the employer will not be subject to a penalty on the basis of any full-time employee who (i) is offered coverage, no later than the first day of the 2014 plan year, that otherwise meets the requirements of the Employer Mandate, and (ii) would not have been eligible for coverage under any calendar year group health plan maintained by the employer as of December 27, 2012.

Coverage of Dependents. Large employers must offer coverage not just to their full-time employees but also to their dependents to avoid the Employer Mandate penalty. A "dependent" for this purpose is defined as a full-time employee's child who is under age 26. Because this requirement may result in substantial changes to eligibility for some employer-sponsored plans, the IRS is providing transition relief for 2014. As long as employers "take steps" during the 2014 plan year to comply and offer coverage that meets this requirement no later than the beginning of the 2015 plan year, no penalty will be imposed during the 2014 plan year solely due to the failure of the employer to offer coverage to dependents.

Multiemployer Plans. Multiemployer plans represent another special circumstance because their unique structure complicates application of the Employer Mandate rules. These plans generally are operated under collective bargaining agreements and include multiple participating employers. Typically, an employee's eligibility under the terms of the plan is determined by considering the employee's hours of service for all participating employers, even though those employers generally are unrelated. Moreover, contributions may be made on a basis other than hours worked, such as days worked, projects completed, or a percentage of earnings. Thus, it may be difficult for some participating employers or the plan to determine how many hours a particular employee has worked over any given period of time.

To ease the administrative burden faced by employers participating in multiemployer plans, a special transition rule applies through 2014. Under this transition rule, an employer whose full-time employees participate in a multiemployer plan will not be subject to any Employer Mandate penalties with respect to such full-time employees, provided that: (i) the employer contributes to a multiemployer plan for those employees under a collective bargaining agreement or participation agreement, (ii) full-time employees and their dependents are offered coverage under the multiemployer plan, and (iii) such coverage is affordable and provides minimum value.

This rule applies only to an employer's employees who are eligible for coverage under the multiemployer plan; the employer must comply with the Employer Mandate under the normal rules with respect to its other full-time employees.

Change in Status Events under Fiscal Year Cafeteria Plans. The IRS has also issued transition rules that apply specifically to fiscal year cafeteria plans. (Cafeteria plans are plans that permit employees to make salary reduction elections to pay for qualified benefits, including health benefits, on a pre-tax basis.) Under the tax rules applicable to cafeteria plans, an employee's coverage elections must be made prior to the beginning of the plan year and may not be changed during the plan year, unless the employee experiences a "change in status event." An employee's mid-year enrollment in health coverage through an Exchange or in an employer's health plan to meet the obligation under the ACA's individual mandate to obtain health coverage is not a "change in status event" under the current cafeteria plan rules.

The IRS addresses this issue by providing that a large employer that operates a fiscal year cafeteria plan may amend the plan to allow for mid-year changes to employee elections for the 2013 fiscal plan year if they are consistent with an employee's election of health coverage under the employer's plan or through an Exchange (for small employers whose employees may purchase Exchange coverage through a cafeteria plan). Specifically, the plan may provide that an employee who did not make a salary reduction election to purchase health coverage before the deadline for the 2013 fiscal plan year is permitted to make such an election during the 2013 fiscal plan year, and/or that an employee who made a salary reduction election to purchase health coverage is permitted to revoke or reduce such election once during the 2013 fiscal plan year, regardless of whether a change in status occurs with respect to the employee.

This transition rule applies only to elections related to health coverage and not to any other benefits offered under a cafeteria plan. Any amendment to implement this transition rule must be adopted no later than December 31, 2014 and can be retroactively effective if adopted by such date.

Determining Large Employer Status, and Who is a Full-Time Employee. The IRS has also issued transition rules for determining large employer status and determining who is a full-time employee. In general, large employer status is determined based on the number of employees employed during the immediately preceding year. In order to allow employers to have sufficient time to prepare for the Employer Mandate before the beginning of 2014, for purposes of determining large employer status for 2014 only, employers may use a period of not less than six calendar months in 2013 to determine their status for 2014 (rather than using the entire 2013 calendar year). Likewise, employers may use a special transition measurement period for purposes of determining whether certain employees who work variable schedules are to be considered full-time employees for the 2014 plan year.

Q&A 4: WHICH EMPLOYERS ARE SUBJECT TO THE EMPLOYER MANDATE?

Beginning January 1, 2014, the Employer Mandate requires "large employers" to offer health coverage to full-time employees and their children or risk paying a penalty. The Employer Mandate applies not only to for-profit employers but also to federal, state, local, and Indian tribal governmental entities, as well as to tax-exempt organizations.

Large Employers. An employer is a "large employer" for a calendar year if it employed an average of at least 50 full-time and full-time equivalent employees on business days during the preceding calendar year. The following discussion will help employers determine the employees who must be counted and how to calculate the number of full-time and full-time equivalent employees.

Related Employers In a Controlled Group. Groups of related employers that are in a controlled group are treated as a single employer for purposes of determining large employer status, although Employer Mandate penalties are determined separately for each employer. Whether employers are in a controlled group is determined under the rules of Sections 414(b), (c), (m), and (o) of the Internal Revenue Code. These same rules apply to tax qualified retirement plans and are often called the controlled group rules. Companies in a controlled group include (i) parent-subsidiary groups (80 percent ownership threshold); (ii) brother-sister groups (five or fewer persons owning at least 50 percent of each entity); (iii) groups consisting of three or more corporations that are a combination of parent-subsidiary and brother-sister groups; (iv) trades or businesses (whether or not incorporated) that are under common control; and (v) affiliated service groups consisting of a service organization and another related organization that provides services to or with the first organization.

For example, suppose Company A owns 85 percent of the voting stock of Company B. Company A has 20 full-time employees, and Company B has 35 full-time employees. Neither Company A nor Company B is subject to the Employer Mandate on its own. However, because Company A owns more than 80 percent of the voting stock of Company B, Company A and Company B are members of a controlled group, and the employees of both companies are aggregated to determine large employer status. Thus, both Company A and Company B are large employers subject to the Employer Mandate because together they employ 55 full-time employees.

Definition of "Full-Time Employee." For purposes of the Employer Mandate, "employee" is a common law employee and, in general, a full-time employee is a common law employee who is credited with an average of at least 30 hours of service each week or 130 hours of service each calendar month. A more detailed discussion of who is a full-time employee is provided in Q&A 5, including treatment of variable hour employees, seasonal employees, and rehires.

Determination of Full-Time Equivalent Employees. The term "full-time equivalent employees" reflects the number of full-time employees an employer would have based on the hours for all employees who are not full-time employees (under the definition above). To determine the number of full-time equivalent employees for a calendar month, first calculate the aggregate hours of service (including fractional hours, but not including more than 120 for any one employee) for all employees who are not full-time employees for that month. Then, divide the total number of hours worked by non-full-time employees by 120.

For example, an employer has 40 employees who each have 90 hours of service per calendar month during 2013. This means the employer has 30 full-time equivalent employees for each calendar month in 2013 (40 employees x 90 hours = 3,600 hours, which divided by 120 hours equals 30).

Full-time equivalent employees are counted solely for purposes of determining whether an employer is a large employer. There is no penalty for failing to offer coverage to any employee who is not a full-time employee.

Determining Large Employer Status. To determine whether an employer is a large employer, add the number of full-time employees and the number of full-time equivalent employees for each calendar month of the prior year and divide the total by 12 to determine the average. If this number is 50 or higher, the employer is a "large employer" and is subject to the Employer Mandate, unless an exception applies, as discussed below. Remember that for the members of a controlled group, this calculation includes employees of all related employers under common control.

For example, for each of the first six calendar months of 2014, Company C has 32 full-time employees and 30 non-full-time employees, who equate to 15 full-time equivalent employees. Company C's business increases during the last half of 2014, and all the persons who were non-full-time employees during the first half of the year work enough hours to be full-time employees for each of the last six calendar months. In other words, Company C has 62 full-time employees for the last six months of 2014. To determine whether Company C is a large employer for 2015, add the number of full-time and full-time equivalent employees it has for each month of 2014 (47 + 47 + 47 + 47 + 47 + 47 + 62 + 62 + 62 + 62 + 62 + 62), which equals 654, and then divide the result by 12. This results in Company C having an average of 54 (54.5, rounded down) full-time or full-time equivalent employees in 2014. Because this number it is at least 50, Company C is treated as a large employer for 2015.

In determining large employer status for 2014, a transition rule applies. Under the rule, an employer may use a period of not less than six consecutive calendar months in 2013 to determine its status as a large employer for 2014 (rather than using the entire 2013 calendar year). This allows an employer to determine by as early as mid-2013 whether it is subject to the Employer Mandate for 2014 and, if so, to have sufficient time to assess its response prior to open enrollment for 2014.

Seasonal Worker Exception. Seasonal workers generally are included in the count of full-time and full-time equivalent employees. However, a special rule applies to employers that exceed the 50 full-time equivalent employee threshold for only part of a year, solely because of a seasonal workforce. If the employer has more than 50 full-time and full-time equivalent employees for periods totaling 120 days or less (or totaling four months or less) during a calendar year, and the full-time and full-time equivalent employees in excess of 50 during that period or periods were seasonal workers, the employer is not subject to the Employer Mandate during the following calendar year. Seasonal workers include individuals employed to do work that is exclusively performed at certain seasons of the year, including, but not limited to, seasonal agricultural workers and retail workers employed only during holiday seasons. Until further guidance is issued, employers are permitted to make a reasonable, good-faith determination of who is a seasonal worker.

New Employers and Successor Employers. An employer that did not previously exist is a large employer for the current calendar year if it reasonably expects to employ an average of at least 50 full-time employees (taking into account full-time equivalent employees) on business days during the current calendar year. An employer that is a "successor employer" must take into account any predecessor employers for purposes of determining large employer status.

Foreign Employers and Foreign Employees. An employee's hours worked outside of the U.S. are disregarded both for purposes of determining large employer status and for purposes of determining whether the worker is a fulltime employee if the employee does not receive U.S. source income for those services. Thus, for example, a U.S. entity that is a member of a multinational controlled group may, for purposes of determining whether it is a large employer, exclude individuals who do not work in the U.S. at all, even if they are U.S. citizens.

PLANNING CONSIDERATION

Employers that are part of a controlled group have a planning opportunity because the Employer Mandate penalty applies separately to each related employer in the controlled group. To illustrate, there are three companies in a controlled group that together have more than 50 fulltime employees and full-time equivalents, so all three companies are subject to the Employer Mandate. Two of the companies offer coverage to their employees and the third does not. The Employer Mandate penalty applies only to the third company and is computed only with respect to the third company's employees. Because the penalty applies separately to each related employer, a controlled group can substantially reduce the aggregate amount of the "no coverage" penalty, in particular if it is able to assign employees who are offered coverage to different subsidiaries from those who are not offered coverage. In considering this option, however, it is important for employers to be aware that there are nondiscrimination rules (and penalties) related to providing health coverage, which apply on a controlled group basis. The nondiscrimination rules for self-insured plans are already in force through long-standing regulations. The rules for fully insured plans have not yet been issued. Additional nondiscrimination rules apply if employee contributions are paid through a cafeteria plan. Therefore, employers will want to evaluate implications under the nondiscrimination provisions before engaging in any restructuring designed to limit Employer Mandate penalties.

Q&A 5: WHO MUST BE OFFERED COVERAGE?

Under the Employer Mandate, large employers are required to offer health coverage to full-time employees and certain of their dependents. This Q&A describes who falls into the categories of "full-time employees" and "dependents" who must be offered coverage, as well as a special provision that allows employers to avoid the "no coverage" penalty if coverage is offered to "substantially all" full-time employees.

Definition of "Employee." Under the Employer Mandate, the term "employee" means a common law employee. Generally speaking, an individual who provides services to an employer is a common law employee if the employer has the authority to direct and control the manner in which services will be performed by the employee. An employer need not actually direct and control the work; the mere right to do so creates the employment relationship. Under the proposed regulations, sole proprietors, partners in partnerships, and 2-percent shareholders in Subchapter S corporations are not considered to be "employees" for purposes of the Employer Mandate. In addition, the special rule that requires leased employees to be treated as employees of the service recipient for purposes of qualified retirement plans does not apply for the Employer Mandate. Rather, whether the leasing company or the client has the obligation to offer coverage to a leased employee is based on which of the two is the common law employer.

Definition of "Full-Time Employee." For purposes of the Employer Mandate, a "full-time employee" is a common law employee who is credited with an average of at least 30 "hours of service" per week for an employer (including all related employers in a controlled group). Employers can elect to treat 130 hours of service in a calendar month as equivalent to 30 hours of service per week. This threshold is different than, for example, the 40-hour threshold for overtime eligibility under the Fair Labor Standards Act.

An employee's "hours of service" include all hours for which the employee is paid or entitled to payment from an employer (including all related employers in a controlled group) for performing services or for holidays, vacation, sick leave, jury duty, layoff, military duty, or other leave of absence. However, hours of service performed outside the U.S. are not taken into account, unless it is the rare case when the compensation for those services is considered U.S. source income for tax purposes.

Note that an individual who has more than one role (for example, an employee director) may constitute an employee to the extent, and for the number of hours, that he is an employee. In this case, an employer will need to calculate how many of the individual's hours of service constitute "employee" hours when determining whether the individual is a "full-time employee" entitled to coverage.

Coverage for "Substantially All" Full-Time Employees. The statutory language of the Employer Mandate applies a penalty if an employer fails to offer coverage to "its employees." To avoid the harsh result that would come from reading the language to require the employer to cover all of its employees, the proposed regulations treat an employer as having offered coverage to its full-time employees during any month if it offers coverage to all but the greater of five full-time employees or 5 percent of its full-time employees. This proposed rule applies whether the failure to offer coverage is intentional or unintentional. However, this proposed rule does not shield the employer from the penalty for offering inadequate coverage if any of the full-time employees, including those who are not offered coverage at all, receive an Exchange subsidy (a premium tax credit or cost sharing subsidy) for purchasing coverage through an Exchange.

PLANNING CONSIDERATION

The news has highlighted stories about employers considering limiting employee hours to less than 30 per week to keep their employees from being treated as full-time for purposes of the Employer Mandate. Based on current guidance, this may be a viable option for reducing the potential Employer Mandate liability. Of course, employers will need to consider whether this is a realistic strategy from a business perspective. In addition, employers should be aware that certain nondiscrimination laws may impact whether and how employee hours can be limited. First, ERISA section 510 (29 U.S.C. § 1140) prohibits "discrimination against a participant … for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan…." At present, there is no regulatory guidance on how this section may apply to employer actions to limit employee hours when they would cause the affected employees to lose eligibility to participate in the employer's group health plan. Second, under current nondiscrimination rules for self-insured health plans, employees who work at least 25 hours per week may need to be taken into account in determining whether the health coverage improperly discriminates in favor of highly compensated individuals. Therefore, in making decisions about limiting hours or limiting coverage to employees with certain hours, employers should consider the impact of applicable nondiscrimination rules.

Estimation of Hours for Salaried Employees. In general, an employer must calculate an employee's hours of service based on the actual number of hours for which the employee is paid. However, in the case of salaried employees (where hours typically are not tracked), employers can estimate an employee's hours of service using one of two methods: the "days-worked method" and the "weeks-worked method." Under the days-worked method, each salaried employee is treated as having eight hours of service for each day on which the employee has at least one actual hour of service. Under the weeks-worked method, each salaried employee is treated as having 40 hours of service for each week during which the employee has at least one actual hour of service.

An employer can apply a different estimation method to different categories of salaried employees, as long as the categories used are reasonable and applied consistently. However, an estimation method can be used only if it generally reflects the employee's actual hours of service. For example, if an employee generally works three 10-hour days per week (30 hours of service per week), the days-worked method could not be used because it would understate the employee's hours of service by crediting the employee with only 24 hours of service (3 days x 8 hours of service). This would cause the employee to be treated as a part-time employee rather than a full-time employee.

Nonresident Alien Employees. Employers with a global presence need not offer coverage to employees who work abroad and have no U.S. source income. Generally, income is not considered to be from a U.S. source if the services to which it relates are performed outside of the U.S. As such, large employers generally do not need to offer coverage to nonresident aliens and U.S. citizens working in another country.

Resident aliens who are paid for services performed in the U.S., however, do receive U.S. source income. Further, such individuals are eligible for a premium tax credit if their household income is at or below 400 percent of the poverty line and they are not eligible for coverage provided by their home country. Therefore, resident alien employees who work in the U.S. may have to be considered when determining whether an employer owes an Employer Mandate penalty.

Definition of "Dependent." The Employer Mandate requires large employers to offer coverage not only to full-time employees, but also to their "dependents." Significantly, the proposed regulations exclude spouses from the definition of dependent; thus, employers need not offer coverage to the spouses of employees in order to avoid a penalty.

The definition of "dependent" instead includes only an employee's children who are below the age of 26. A child includes a natural, step, or adopted child; a child placed with the employee for adoption; and a foster child. An employee's foster child is an individual who is placed with the employee by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction. While the Employer Mandate requires that a foster child be covered up to age 26, the placement or court order would, in most cases, end when the foster child attains the age of majority (age 18 in most states). As such, it would seem that foster children need not be offered coverage after the date on which they cease to meet the definition of "foster child," despite being under age 26 at such time.

Large employers that currently offer coverage to their employees, but not to all individuals who meet this definition of "child," will need to expand the eligibility provisions of their plans in order to avoid a penalty. Recognizing the magnitude of this change, the IRS has issued transition relief to the effect that such employers will not incur a penalty for the 2014 plan year due solely to the failure to cover dependents, provided that they "take steps" during the 2014 plan year to comply with the requirement to offer coverage to dependents and dependent coverage is offered no later than the beginning of the 2015 plan year.

Delinquent Premium Payments. The proposed regulations provide that an employer will be deemed to have offered coverage (and not be subject to a penalty) if coverage is not offered for part of the year because an employee was initially enrolled for the year but then terminated due to the employee's failure to timely pay premiums. The employer will be deemed to have offered coverage for the remainder of the "coverage period," which generally is the remainder of the plan year. Thereafter, the employer will again have to offer coverage to the employee. For these purposes, the proposed regulations incorporate the COBRA rules governing the nonpayment or late payment of premiums to determine when this rule applies.

PLANNING CONSIDERATION

To comply with the Employer Mandate and avoid a penalty, a large employer must offer coverage to full-time employees and their dependents. "Dependent" is defined as a child of an employee who is under age 26, meaning an employee's natural, step, adopted, or foster child. Spouses, however, are not included in the definition of dependent. Due to the increasing cost of coverage, some employers are revising eligibility rules to limit spousal coverage to those spouses who are not eligible for coverage through their own employer. Because employees are likely to prefer having all family members enrolled in the same coverage when possible, if many employers in a geographic area have this restriction on spousal coverage, the employers who do not may find more spouses enrolling, and more dependents as well. Employers should consider whether changes to their own eligibility rules are warranted.

Q&A 6: WHAT ARE THE SAFE HARBORS FOR DETERMINING "FULL-TIME" STATUS?

As discussed in Q&A 5, for purposes of the Employer Mandate, a "full-time" employee is an employee who is credited with on average at least 30 hours of service per week, or 130 hours of service in a calendar month. The proposed regulations include optional safe harbor methods that employers may use to determine who is a "full-time" employee. The safe harbors, though complex to apply, allow an employer to determine in advance whether an employee will be considered "full-time" for a later fixed period of time, regardless of the hours actually worked in that later period. In other words, the optional safe harbors provide employers with comfort about an employee's "full-time" status for periods of time, allowing them to know whether they must offer coverage or anticipate a penalty for that period. The determination is made by looking at hours of service during a "measurement period" and applying the result to a later "stability period."

For example, an employer would not need to use a safe harbor for an employee who always works 35 hours per week, because that employee meets the Employer Mandate's definition of "full-time" employee without the need for further analysis. However, if an employee's hours vary from week to week, or if the employee works only a few months each year, then an employer may choose to use a safe harbor so that the employer can know with certainty whether the employee is treated as full-time in deciding what coverage to offer, if any. One safe harbor is available for all ongoing employees. Another safe harbor is available for new employees who work variable hours or are seasonal employees. As there is some administrative burden involved in using the safe harbors, they will be of primary interest to large employers that have a lot of variable hour or seasonal employees and either (i) want to offer coverage only to full-time employees or (ii) do not offer coverage and want to limit the amount of their Employer Mandate penalty.

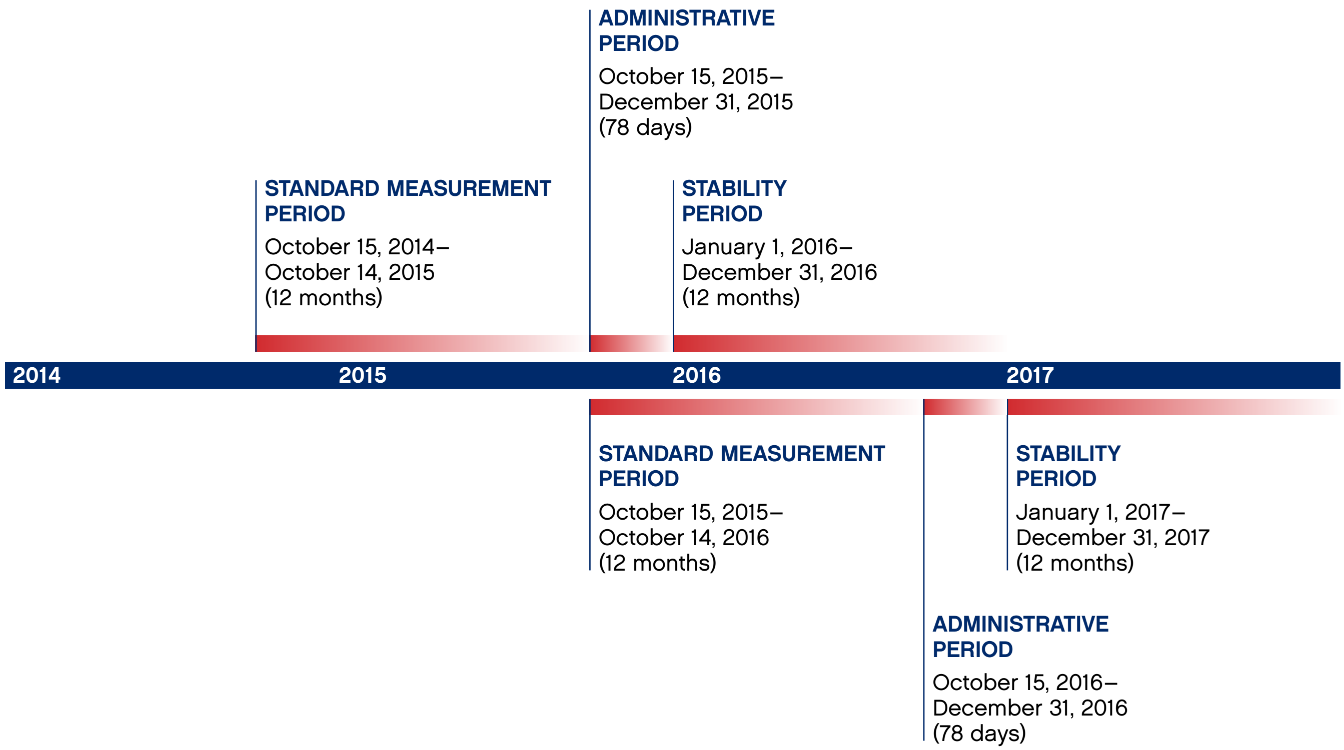
OPTIONAL SAFE HARBOR FOR ONGOING EMPLOYEES

Under the ongoing employee safe harbor, an employer looks back to hours of service during a "standard measurement period" of three to 12 months (the length of which is selected by the employer) to determine an ongoing employee's status as a full-time or non-full-time employee. For administrative ease, the beginning and ending dates of a standard measurement period may be coordinated with an employer's weekly, biweekly, or semi-monthly payroll periods. For example, a measurement period could begin the day after the payroll period that includes January 1 of a year and end on the last day of the payroll period that includes December 31 of that year.

An employee's status (as full-time or non-full-time), determined based on hours of service during the standard measurement period, remains in effect for a "stability period." The stability period, also selected by the employer, must be at least six consecutive calendar months and at least as long as the related measurement period (but no longer than the related measurement period if the employee is determined to not be full-time). The employee will retain the same full-time or non-full-time status throughout the stability period, even if the employee's actual hours of service during the stability period would produce the opposite status. If an employee who is treated as full-time based on the safe harbor terminates employment during the stability period, the employer is not required to continue to offer the employee coverage, except as required by COBRA or similar state law. However, there are special rules that apply to terminated employees who are rehired, which are discussed later in this Q&A.

An employer can choose to have an "administrative period" of not more than 90 days. The administrative period gives the employer time to determine which employees are eligible for coverage based on the standard measurement period and to complete any required employee notifications and enrollments prior to the beginning of the stability period. The three periods must overlap in a way that ensures that employees who are consistently treated as full-time employees do not have a break in coverage.

The diagram and example below illustrate two full cycles of a 12-month standard measurement period, a 78-day administrative period, and a 12-month stability period that satisfy these requirements.



Example: Employee A averages 30 hours of service per week during the standard measurement periods that begin on each of October 15, 2014 and October 15, 2015. Employee A will be treated as a full-time employee. To avoid a penalty, the employer must offer health coverage to Employee A during the corresponding stability periods (the 2016 and 2017 calendar years) that meets the Employer Mandate requirements. Employee B, on the other hand, averages 30 hours of service per week during the standard measurement period that begins October 15, 2014 but averages less than 30 hours of service per week during the standard measurement period that begins October 15, 2015. To avoid a penalty, the employer must offer health coverage that meets the Employer Mandate requirements to Employee B during the 2016 stability period but not during the 2017 stability period. This means that Employee B must continue to be offered this coverage during the administrative period preceding the 2017 stability period (i.e., October 15, 2016–December 31, 2016) because that period overlaps with the 2016 stability period.

Different Measurement and Stability Periods for Different Categories of Employees. An employer may use measurement and stability periods that differ in either length or in their starting and ending dates for the following categories of employees: (i) collectively bargained and non-collectively bargained employees, (ii) each group of collectively bargained employees covered by a separate bargaining agreement, (iii) salaried and hourly employees, and (iv) employees employed in different states. Each related employer in a controlled group may determine its own measurement and stability periods. (See Q&A 4 for a brief overview of the controlled group rules.)

2013 Transition Rule. In the proposed regulations, the IRS provides a transition rule for employers that want to use a 12-month stability period for 2014. As discussed above, the ongoing employee safe harbor requires that the stability period be at least as long as the related measurement period and cannot be longer than the related measurement period when an employee is being treated as non-full-time. Accordingly, in order to have any type of administrative period, an employer would have had to start its measurement period before the proposed regulations were officially issued. To give employers a reasonable opportunity to apply the proposed regulations in connection with a 12-month stability period for 2014, transition relief is provided for the 2014 stability period only. Under this transition relief, an employer may use a measurement period as short as six months, as long as it begins no later than July 1, 2013. The measurement period must end no sooner than 90 days before the first day of the 2014 plan year, which allows for a 90-day administrative period. For this one cycle, the measurement period may be shorter than the stability period.

For example, an employer with a calendar year plan may define its first measurement period as May 1, 2013 through October 31, 2013 and use the remainder of the 2013 calendar year as the administrative period. The employer would then be permitted to treat an employee as full-time or non-full-time for the entire 12-month 2014 plan year, based on the status determined during the six-month measurement period in 2013.

OPTIONAL SAFE HARBOR FOR NEW HIRES

Under the proposed regulations, the approach for determining whether a newly hired employee is full-time depends on whether the employee is reasonably expected to be a full-time employee or is, instead, a variable hour or seasonal employee as of the employee's start date.

New Employees Reasonably Expected to be Full-Time. If a newly hired employee is reasonably expected as of his or her start date to be a full-time employee, a large employer must offer the employee health coverage by no later than the first day after the end of the employee's initial three full calendar months of employment or face a potential Employer Mandate penalty. However, it does not appear that compliance with these proposed regulations results in compliance with the separate 90-day maximum waiting period rule that also is effective for plan years beginning on or after January 1, 2014 and applies to all health coverage (not just health coverage provided by a large employer to its full-time employees). Because the 90-day maximum waiting period rule carries a $100 per-person per-day penalty, pending further guidance, coverage should be offered no later than the 91st day after an employee who is reasonably expected to be full-time becomes eligible in order to satisfy both rules.

New Seasonal and Variable Hour Employees. The proposed regulations also provide a safe harbor for new seasonal and variable hour employees. Interestingly, the preamble to the proposed regulations indicates that use of the new employee safe harbor is limited to employers that use the ongoing employee safe harbor (discussed above), but there is no such requirement in the proposed regulations themselves.

Similar to the ongoing employee safe harbor, under the new employee safe harbor, an employer may determine whether a newly hired variable hour or seasonal employee is full-time or non-full-time based on average weekly hours of service during an "initial measurement period" and then, following an optional administrative period, apply the resulting determination for an initial stability period. An employer using the new employee safe harbor may treat the new variable hour or seasonal employee as non-full-time during the initial measurement period and any accompanying administrative period.

An employee may be treated as a "variable hour employee" if the employer is unable to determine that the employee is "reasonably expected" to work an average of 30 hours per week or more. For the 2014 calendar year only, an employer may consider the likelihood that an employee's employment will be terminated in determining whether an individual is reasonably expected to work an average of 30 hours or more. However, after 2014, employers are not permitted to consider the likelihood of termination when determining an employee's status as a variable hour employee.

There is no current definition of "seasonal employee," but employers may use the definition of seasonal worker (as discussed in Q&A 4) or any other good faith definition. One option is the definition of "seasonal employee" found in the nondiscrimination rules for self-insured health plans under Internal Revenue Code section 105(h). Under this definition, a seasonal employee is either (i) an employee whose customary annual employment is less than nine months if other employers in similar work with the same employer (or, if no employees of the employer are in similar work, in similar work in the same industry and location) have substantially more months; or (ii) an employee whose customary annual employment is less than seven months.

Initial Measurement Period and Initial Stability Period. The initial measurement period may begin on any date between the employee's start date and the first day of the next calendar month and may last for three to 12 months. Because the initial measurement period is unique to each new employee, administration may be cumbersome for employers. However, employers can partially standardize administration by having a single start date for the initial measurement period of all individuals hired during a particular month.

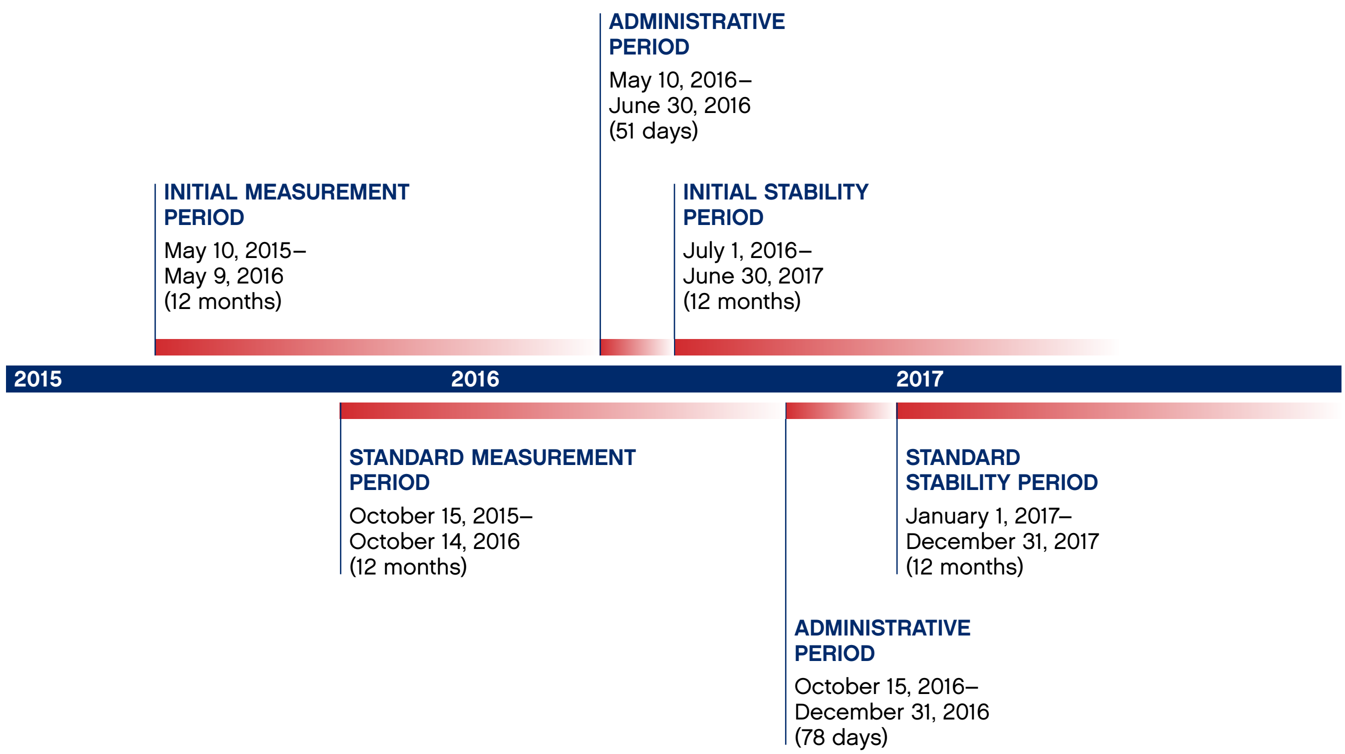
The proposed regulations provide conflicting statements about the length of the stability period for new hires. They first provide that the status determined during the initial measurement period must remain in effect for a stability period that is the same length as the normal stability period that applies for ongoing employees. The proposed regulations then provide that for an employee who is determined to be full-time during the initial measurement period, the initial stability period must be at least six consecutive calendar months and at least as long as the initial measurement period. However, for an employee who is determined to be non-full-time during the initial measurement period, the initial stability period may not be more than one month longer than the initial measurement period. Hopefully, further guidance will clarify how these seemingly contradictory provisions are meant to work together. The stability period also is unique to each new employee.

Subject to certain requirements, an employer can elect to have an administrative period of up to 90 days between the initial measurement period and the related stability period.

Using the new employee safe harbor will also be treated as complying with the 90-day maximum waiting period rule, as long as (i) the effective date of coverage is not later than 13 months from the employee's start date plus, if the employee starts on a day other than the first day of the month, the time remaining until the first day of the next calendar month, (ii) in addition to any measurement period of up to 12 months, no more than 90 days elapse prior to the employee's eligibility for coverage, and (iii) the plan specifically includes the new employee safe harbor rules, including the measurement, administrative, and stability periods chosen by the employer, as a condition of eligibility

Different Initial Measurement and Stability Periods for Different Categories of New Hires. An employer may use measurement and stability periods for purposes of this safe harbor that differ in either length or in their starting and ending dates for different categories of employees in the same manner as for the ongoing employee safe harbor discussed above.

Transition to Ongoing Employee Status. Once an employee has been employed for at least one full standard measurement period, the employer must test that employee for full-time status at the same time and under the same conditions that apply for other ongoing employees, as described above. An employee that is determined to be full-time during an initial measurement period or a standard measurement period must be treated as full-time during the entire associated stability period. The obligation to treat the employee as full-time applies even if the employee had an average of at least 30 hours of service per week during the initial measurement period, but not during the overlapping, or immediately following standard measurement period. Similarly, if an employee who did not have an average of 30 hours of service during his initial measurement employment meets that requirement during the following standard measurement period, he must be treated as full-time during the entire standard stability period, even if that stability period begins before the initial stability period ends. These rules are illustrated by the following diagram and example for an employee hired on May 10, 2015.



Example 1: Employee A is hired on May 10, 2015 to work a schedule that varies from week to week. Because Employee A is a new variable hour employee and the employer is applying the new employee safe harbor, Employee A will be treated as a non-full-time employee during the initial measurement period and administrative period from May 10, 2015 through June 30, 2016. Employee A averages 30 hours of service per week during the initial measurement period that begins on May 10, 2015 and ends May 9, 2016. Employee A will be treated as a full-time employee during the corresponding initial stability period (July 1, 2016 through June 30, 2017). To avoid an Employer Mandate penalty, the employer must offer coverage to Employee A that meets the Employer Mandate requirements during this initial stability period. Because the effective date of coverage is not later than 13 months from Employee A's start date plus the time remaining until the first day of the next calendar month, the 90-day maximum waiting period rule is also met

Employee A then averages *less than* 30 hours of service per week during the standard measurement period that begins October 15, 2015 and ends October 14, 2016. To avoid a penalty, the employer must offer Employee A health coverage that meets the Employer Mandate requirements all the way through the end of his initial stability period (until June 30, 2017), even though it overlaps with a standard stability period during which he otherwise would not be treated as full-time.

Example 2: Employee A is hired on May 10, 2015 to work a schedule that varies from week to week. Because Employee A is a new variable hour employee and the employer is applying the new employee safe harbor, Employee A will be treated as a non-full-time employee during the initial measurement period and administrative period from May 10, 2015 through June 30, 2016. Employee A averages *less than* 30 hours of service per week during the initial measurement period that begins on May 10, 2015 and ends May 9, 2016. Employee A then averages *more than* 30 hours of service per week during the standard measurement period that begins October 15, 2015 and ends October 14, 2016. Although Employee A may be treated as non-full-time from May 10, 2016 through December 31, 2016, Employee A must be treated as a full-time employee for the standard stability period beginning on January 1, 2017, even though that period overlaps with the prior initial stability period during which he was not treated as full-time. To avoid a penalty, the employer must offer Employee A coverage that meets the Employer Mandate requirements during this standard stability period.

Change in Employment Status During Initial Measurement Period. If a newly hired seasonal or variable hour employee ceases to be a seasonal or variable hour employee during the initial measurement period because of a change in employment status or position, and following the change the employee is reasonably expected to be a full-time employee, then the employee must be offered minimum essential coverage no later than the end of the employee's third full calendar month of employment in the new position or, if earlier and the employee averages more than 30 hours of service per week during the initial measurement period, the start of the initial stability period.

REHIRES AND BREAKS IN SERVICE

An employee who is not credited with any hours of service with an employer or any related employer in a controlled group for at least 26 consecutive weeks and who later resumes employment with the employer or any related employer in the controlled group may be treated as a new hire for purposes of the rules for determining full-time status. An employer also may treat as a new hire any employee who has no hours of service for a period that is both at least four consecutive weeks and greater than the number of weeks of the employee's prior employment.

An employee who resumes service with an employer or any related employer in a controlled group and is not treated as a new hire must be treated as a continuing employee. If the employer is using the ongoing employee safe harbor, the employee's status (full-time or non-full-time) for the stability period in which the employee resumes service will be based on the employee's average weekly hours of service during the previous standard measurement period.

Special rules apply to employees who are on leave under the Family and Medical Leave Act of 1993 or the Uniformed Services Employment and Reemployment Rights Act of 1994, unpaid leave for jury duty, or an unpaid leave of absence from an educational organization.

It is unclear how the rules will be applied to an employee who terminates employment with one controlled group member and is rehired by another group member, particularly where the members use different measurement periods and stability periods.

Q&A 7: WHAT HEALTH COVERAGE SATISFIES THE EMPLOYER MANDATE?

As discussed in Q&A 1, a large employer may be subject to Employer Mandate penalties if it does not provide health coverage that meets certain requirements to all or substantially all of its full-time employees. In all cases, a large employer will be subject to these penalties only if one or more of its full-time employees gets an Exchange subsidy (as described in Q&A 2). To meet the applicable requirements, the employer's coverage must be "minimum essential coverage," "affordable," and provide "minimum value," all as described below.

"Minimum Essential Coverage." In order to avoid a penalty, an employer must offer its full-time employees and their children minimum essential coverage. "Minimum essential coverage" includes an "eligible employer-sponsored plan," which is a group health plan or group health insurance coverage, including COBRA and retiree coverage, offered by an employer (including a governmental employer) to any employee or former employee. If an employer relies on its retiree health coverage to provide minimum essential coverage to rehired individuals, however, that retiree coverage may be subject to the ACA's various plan design mandates and not be treated as a "stand-alone" retiree-only health plan that is exempt from these requirements. Also, while an employer may rely on COBRA to provide minimum essential coverage to certain employees, that coverage, even if "affordable," will only disqualify those employees from receiving an Exchange subsidy if they actually enroll in the COBRA coverage.

Minimum essential coverage does *not* include: (i) accident or disability income insurance; (ii) liability insurance; (iii) automobile insurance that pays medical benefits; (iv) on-site medical clinics; (v) long-term care, nursing home care, home health care, or community-based care; (vi) indemnity insurance; (vii) coverage only for vision or dental; (viii) workers' compensation; or (ix) coverage only for a specific disease or condition.

Under current guidance, employer-sponsored health plans meet the definition of "minimum essential coverage" without having to meet any additional requirements. Of course, both the ACA and other state and federal laws already impose a variety of requirements on employer-sponsored health plans, and penalties other than the Employer Mandate penalty can apply if those requirements are not met.

"Affordable" Health Coverage. In order to avoid a penalty, the employer must offer coverage to its full-time employees that is "affordable." Employer-sponsored coverage is "affordable" to an employee if the annual employee contribution for the lowest-cost self-only coverage providing minimum value does not exceed 9.5 percent of his or her household income for the taxable year. In this context, "household income" means the total of adjusted gross income required to be reported on a federal income tax return by the employee and members of the employee's household, plus tax-exempt interest, tax-exempt Social Security income, and tax-exempt income earned while living abroad.

Because an employee's household income is generally unknown to employers, the proposed regulations contain three affordability safe harbors intended to make it easier for employers to determine whether their coverage is affordable. These safe harbors allow affordability to be determined by comparing the employee's contribution for the lowest-cost self-only coverage providing minimum value against either:

- 9.5 percent of the employee's W-2, Box 1 wages;
- 9.5 percent of the employee's rate of pay (i.e., monthly salary for salaried employees or hourly rate of pay times 130 hours per month for hourly employees) as of the beginning of the coverage period (typically the first day of the plan year); or
- 9.5 percent of the federal poverty line for a single individual ($11,490 for 2013).

If an employee does not work the entire year for the employer, an adjusted employee contribution and adjusted income amount is used. An employer can elect to use a different safe harbor for different categories of employees, as long as the basis for differentiating is uniform and consistent for all employees in a category.

The simplest approach to satisfy the affordability requirement may be to calculate 9.5 percent of the federal poverty line and offer at least one self-only health coverage option that limits employee contributions to that amount. This may not be the most cost-effective approach, however, as the other two safe harbors will likely support much higher employee contributions. Alternatively, employee contributions could be limited to 9.5 percent of the employee's wages for each pay period that is reported in Form W-2, Box 1. However, this alternative could result in very small (or no) employee contributions during pay periods in which the employee works limited (or no) hours.

While not addressed in the proposed guidance, it seems that an employer could use a "greater of" combination of safe harbors for a class of employees. For example, employee contributions could be limited to the greater of 9.5 percent of the employee's Form W-2, Box 1 wages or 9.5 percent of the federal poverty line for a single individual. This alternative ensures that the employee contribution is always at least based on the federal poverty line, but it results in employees who can afford to pay more doing so. In using such a combination, employers should take care to structure the formula in a manner that does not inadvertently result in some employees having annual contributions in excess of any safe harbor.

Coverage That Provides "Minimum Value." Finally, in order to avoid a penalty under the Employer Mandate, the affordable coverage offered by an employer to its full-time employees must provide "minimum value."

Coverage under an eligible employer-sponsored plan provides "minimum value" if the plan's share of the total allowed costs of covered services under the plan is at least 60 percent of the actuarially projected average cost of such services. Employers will be required to determine whether the 60 percent threshold has been met. Employers can do this in one of three ways: (i) using an online minimum value calculator developed by HHS and IRS; (ii) using a checklist of plan characteristics to compare the plan's covered services with a benchmark that meets minimum value; or (iii) having an actuary determine and certify that the plan provides minimum value. HHS has released a testing version of the minimum value calculator on its web site at http://cciio.cms.gov/resources/files/mv-calculator-final-2-20-2013.xlsm. Checklists have not yet been issued.

Under final HHS regulations, minimum value for employer-sponsored group health plans (both fully insured and self-insured) is determined using a standard population based on the population covered by self-insured group health plans. There is no requirement that these plans offer all categories of essential health benefits or conform to the essential health benefit benchmarks. However, in order to use the online minimum value calculator or the checklists, a plan may have to follow a standardized structure for coverage and cost-sharing. This would not be the case when using an actuary. Thus, employers will have to compare the cost of hiring an actuary with modifying their plan to make use of the other methods of determining "minimum value."

PLANNING CONSIDERATION

The Employer Mandate requires employers to offer health coverage to full-time employees and their children that is both "affordable" and provides "minimum value" or risk a penalty. Affordability is determined for each full-time employee based on the employee contribution for the lowest-cost self-only coverage option that meets minimum value and is offered to that employee. The employee contribution for other coverage tiers, such as employee plus spouse or family, is not subject to any affordability test. Further, the employee contribution for any tier of more expensive coverage options (including the self-only tier) need not meet the affordability test.

Minimum value, unlike affordability, is not determined for each full-time employee, but rather is determined based on the plan as a whole. To meet the minimum value requirement, the plan must pay at least 60 percent of the actuarially projected total allowed costs of covered services under the plan. The actuarial value of most employer-sponsored health coverage is currently higher than this threshold.

To meet both of these requirements and avoid a penalty, an employer must offer to full-time employees at least one health coverage option that has an actuarial value of 60 percent, for which the employee contribution for self-only coverage meets the affordability threshold. If one health coverage option meets these requirements, other available health coverage options need not. In other words, all other health coverage options could (using the definitions above) be unaffordable or not provide minimum value, or both. This creates a planning opportunity for an employer to simultaneously offer coverage that protects it from an Employer Mandate penalty while also offering coverage that is better aligned with the needs of its workforce. For example, if the employer has a low-paid workforce, it could simultaneously offer coverage that has a lower minimum value, and thus a lower up-front cost. Likewise, if the employer has a relatively high-paid workforce, it could simultaneously offer coverage with a higher minimum value and employee contributions greater than the affordability threshold allows.

In considering these options, employers will also want to consider whether the plan design meets applicable nondiscrimination testing requirements.

Q&A 8: WHAT IS THE PENALTY FOR NONCOMPLIANCE AND HOW IS IT COLLECTED?

Employers can incur a penalty under the Employer Mandate in one of two ways. First, an employer may be subject to a penalty if it fails to offer minimum essential coverage to substantially all of its full-time employees and their children up to age 26. Second, an employer may be subject to a penalty if it offers coverage, but that coverage is not "affordable," fails to provide "minimum value," or is offered to substantially all (but not all) full-time employees. However, neither penalty will apply unless at least one of the employer's full-time employees enrolls in coverage through an Exchange for which the employee receives an Exchange subsidy. The terms used above are discussed in more detail in earlier Q&As.

Failure to Offer Coverage. If an employer fails to offer minimum essential coverage to substantially all of its full-time employees and their children up to age 26, and at least one of its full-time employees enrolls in coverage through an Exchange and receives an Exchange subsidy, the employer will be obligated to pay for each month in which this occurs a nondeductible penalty of $166.67 ($2,000 on an annual basis) for *each* of its full-time employees in excess of 30 for that month. However, as discussed in more detail below, if an employer is a member of a controlled group, it may not be entitled to the full 30-employee exemption because the exemption will be allocated among the controlled group members that are employers.

As noted in Q&A 5, to avoid the "no coverage" penalty, an employer need not offer coverage to every full-time employee. Under proposed regulations, an employer need only offer coverage to "substantially all" full-time employees, which is defined as all but the greater of five full-time employees or five percent of all full-time employees. The "substantially all" rule applies separately to each employer in a controlled group. For example, one member of the controlled group could offer affordable coverage that meets minimum value to 96 percent of its full-time employees and avoid the "failure to offer coverage" penalty, while another member of the controlled group could offer coverage to only 50 percent of its full-time employees and be subject to the penalty. Note, however, that starting in 2015, an offer of coverage is deficient unless it also extends to an employee's children up to age 26.

Making an Effective Offer of Coverage. Under proposed regulations, in order to "offer" coverage, an employer must give a full-time employee an "effective opportunity" to enroll (or decline to enroll) in health coverage at least once each plan year. Whether an employee has an "effective opportunity" is determined based on the facts and circumstances, including whether the employee is adequately informed of the availability of the offer of coverage, the time period to accept or decline, and any other conditions on the offer. Thus, if an employer requires employees to make significant sacrifices to qualify for coverage, it could be at risk of incurring a penalty.

Interestingly, while the regulations appear to require that employees have an effective opportunity to decline coverage at least once each plan year, the preamble to the regulations indicates that this right is limited to offers of coverage that are not minimum value coverage or not affordable. In other words, the preamble language regarding an effective right to decline coverage is narrowly tailored to prevent an employer from rendering an employee ineligible for a premium tax credit by providing mandatory coverage. A plain reading of the proposed regulations themselves yields a broader prohibition on providing mandatory coverage. This broader prohibition may be related to the not-yet-effective automatic enrollment requirement for employers with more than 200 full-time employees, which requires that employees be given an opportunity to opt out of any automatic coverage. It remains to be seen how final regulations will address these various requirements.

As discussed in more detail in Q&A 5, an employer is treated as having offered coverage to an employee for the remainder of a coverage period (generally, a plan year) if coverage is terminated due to the employee's failure to timely pay premiums. The employee must have been provided a grace period for making payment and must be provided the opportunity to reenroll for the next coverage period.

Calculating the Total "No Coverage" Penalty. In calculating the penalty for a failure to offer coverage, the first 30 full-time employees of the employer are disregarded. For example, if an employer employs 50 full-time employees for every month in a year, fails to offer them acceptable health coverage for the entire year, and one of them receives an Exchange subsidy, its annual penalty would equal $40,000 (20 full-time employees multiplied by $2,000).

As noted in a prior Q&A, members of the same controlled group of corporations are treated as one employer for purposes of determining whether all of the members will be treated as large employers subject to the Employer Mandate. However, liability for noncompliance and computation of any penalty owed is determined independently for each controlled group member. For purposes of the 30-employee exclusion, however, the controlled group is treated as one employer. The group may take the 30-employee reduction only once, and that reduction will be allocated pro rata among each member according to the number of its full-time employees, provided that each member of the controlled group will be allocated at least one employee reduction (even if there are more than 30 members of the controlled group). For example, if a parent company has 80 full-time employees and its subsidiary has 20 full-time employees, the two companies are treated together as having 100 full-time employees for purposes of determining large employer status. The 30-employee reduction would be allocated between the two companies, with the parent being allocated 24 employee exclusions

(80 percent) and the subsidiary being allocated six employee exclusions (20 percent).

As discussed in a previous Q&A, an employer must factor in "full-time equivalents" when determining whether it is a "large employer" subject to the Employer Mandate. Full-time equivalents, however, are disregarded when calculating Employer Mandate penalties. Therefore, if an employer is treated as a "large employer" solely because of its full-time equivalents, it will not be subject to a penalty if it has 30 or fewer full-time employees.

Failure to Offer Affordable Coverage that Provides Minimum Value. The second way in which an employer can incur a penalty is if it offers coverage to its full-time employees, but that coverage either is not "affordable," fails to provide "minimum value," or is offered to substantially all (but not all) full-time employees, and one or more of its full-time employees enrolls in coverage through an Exchange for which the employee receives an Exchange subsidy.

The "insufficient coverage" penalty is $250 per month for each full-time employee who receives an Exchange subsidy during a month ($3,000 on an annual basis). Unlike the "no coverage" penalty, the "insufficient coverage" penalty applies only with respect to the number of full-time employees who get Exchange subsidies, rather than to all full-time employees. However, this penalty is capped on a monthly basis by the amount that the employer would have been required to pay had it failed to offer coverage at all to its full-time employees (i.e., $166.67 multiplied by the number of full-time employees in excess of 30). Thus, an employer who offers coverage to its employees can never pay a larger penalty than it would have paid had it offered no coverage at all.

The "insufficient coverage" penalty is generally imposed solely on the company that employs the full-time employee who receives the Exchange subsidy. However, if the employee works for multiple members of a controlled group, the penalty will be allocated pro rata on the basis of the hours that the employee worked for each employer.

Collection of the Penalty. Penalties under the Employer Mandate will be initially determined by the IRS. The IRS will notify employers of proposed assessments and will provide the employer with a chance to respond before making a final determination and assessing any penalty. An employer will not be obligated to pay any penalty (nor will any interest begin to accrue) until the penalty is formally assessed and the employer receives a notice and demand for payment from the IRS. In other words, there is no self-reporting obligation (other than the information reporting requirements described below) with respect to these penalties. In addition, because the information reporting for 2014 will not occur until early 2015, employers should expect that the IRS will not send notice of any proposed assessments until mid-2015 at the earliest. Also, because the information reporting and Exchange subsidies apply on a calendar year basis, the IRS is likely to follow the calendar year, rather than the plan year (if different), in conducting compliance activities. If employers expect to owe such penalties for 2014, they should budget to pay them in 2015.

Information Reporting Requirements. Beginning in 2015, large employers will be required to self-report their compliance with the Employer Mandate by submitting information returns to the IRS for each full-time employee. In completing the return, the employer will be required to report certain information, including basic identification information for the employer and its full-time employees, certain details about whether the employer offered its full-time employees and their children coverage and for what period, the monthly cost of the coverage offered, and the portion of the monthly cost paid by the employee. Further, the employer must give a written statement to each full-time employee included in the return, listing the contact information of the employer and the information that was provided to the IRS regarding that employee's health coverage.

The IRS has not yet published guidance implementing these reporting requirements. The IRS has indicated, however, that the first information returns will be due in early 2015 to reflect coverage offered in the 2014 calendar year.

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