

## **IRS Issues Request for Comments on Employer Shared Responsibility Provisions of New Code Section 4980H**

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On May 3, 2011, the Internal Revenue Service (“IRS”) issued Notice 2011-36 (“Notice”), which requests comments related to the employer shared responsibility provisions – the so-called “pay or play” provisions – in new section 4980H of the Internal Revenue Code of 1986, as amended (“Code”). Code section 4980H, which was added by section 1513 of the Patient Protection and Affordable Care Act (“PPACA”),<sup>1</sup> imposes new shared responsibility requirements on employers regarding the offering of health coverage by employers to their full-time employees, effective for months beginning after December 31, 2013.

The IRS makes clear that the Notice itself does not provide guidance, but rather welcomes comments on a number of topics currently under consideration by the IRS and the Department of the Treasury (“Treasury”) in connection with Code section 4980H, described below. Comments must be submitted by June 17, 2011.

### ***Overview of Code Section 4980H***

Effective for months beginning after December 31, 2013, Code section 4980H generally provides that an “applicable large employer” will be liable for an “assessable payment,” *i.e.*, tax penalty, if certain health care coverage requirements are not satisfied. Specifically, liability for the assessable payment will be imposed on an applicable large employer if any “full-time employee” of the employer is certified as eligible to receive an applicable premium tax credit or cost-sharing reduction, and either:

- the employer fails to offer its “full-time employees (and their dependents)”<sup>2</sup> the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan (very generally equal to \$2,000 per each full-time employee, less the first 30 full-time employees),<sup>3</sup> or

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<sup>1</sup> Pub. L. No. 111-148 (as amended by section 1003 of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152).

<sup>2</sup> The statute expressly refers to “full-time employees (and their dependents).” Given the parenthetical, many have wondered, for purposes of determining any assessable payments, *i.e.*, penalties, under Code section 4980H, whether one must provide only qualifying self-only coverage, or whether one must also provide dependent coverage. The answer to this question is likely to have significant implications regarding the cost of compliance with Code section 4980H for those employers who seek to “play,” as well as the ability of individual employees to access very significant federal premium subsidies through the exchange. We expect that this issue will be addressed by Treasury in future guidance.

<sup>3</sup> For this purpose, the terms “minimum essential coverage” and “eligible employer-sponsored plan” are defined in Code section 5000A(f).

- the employer offers its “full-time employees (and their dependents)” the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan that, with respect to a full-time employee who has been certified for the advance payment of an applicable premium tax credit or cost-sharing reduction, either is unaffordable or does not provide minimum value (very generally equal to \$3,000 per full-time employee who receives a premium tax credit and obtains coverage through a state health exchange).

Liability under Code section 4980H is only imposed on applicable large employers if the health care coverage requirements described above are not satisfied. An employer is generally an applicable large employer for a calendar year if it employed an average of at least 50 full-time employees (counting full-time equivalents, as discussed below) on business days during the preceding calendar year. The amount of any assessable payment turns on how many full-time employees (not including full-time equivalents) are employed by an employer in a given year.<sup>4</sup>

The statutory language of Code section 4980H provides that a full-time employee with respect to any month is one who is employed on average at least 30 hours of service per week.

### *Highlights of the Notice*

- **Definitions of “Employer” and “Employee.”** The Notice states that, for purposes of Code section 4980H, the terms “employer” and “employee” would have their common-law meanings. In addition, all entities treated as a single employer under the controlled group rules of Code section 414(b), (c), (m), or (o) would be treated as a single employer for purposes of determining whether an employer is an applicable large employer. An employer would also include a predecessor employer. Code section 414(n) “leased employees” would not be employees for purposes of Code section 4980H.

**Comment:** Many employers have asked whether they will be able to disaggregate on a reasonable basis, *e.g.*, on a geographic basis or with respect to a separate line of business, for purposes of applying the provision’s coverage requirements. For example, an employer might seek to “play” for purposes of one division but “pay” for another. Although the Notice indicates that one must look across the controlled group for purposes of determining whether an employer is an “applicable large employer,” the Notice is silent regarding whether employers within a controlled group may be permitted to disaggregate for purposes of the coverage requirements. If Treasury decides to issue rules permitting such disaggregation, we suspect such rules will be very limited (perhaps by reference to the qualified retirement plan rules regarding reasonably nondiscriminatory classifications or qualified separate lines of business (“QSLOBs”)).

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<sup>4</sup> The assessable payment under Code section 4980H(a) is based on all (excluding the first 30) full-time employees, while the annual assessable payment under Code section 4980H(b) is based on the number of full-time employees who are certified to receive an advance payment of an applicable premium tax credit or cost-sharing reduction.

- **Determination of Status as an “Applicable Large Employer.”** Only applicable large employers are subject to the assessable payments imposed under Code section 4980H. An employer is an applicable large employer with respect to a calendar year if it employed an average of at least 50 full-time employees (including full-time equivalents and seasonal employees (except as provided below)) on business days during the preceding calendar year.
  - **New Employer.** As contemplated by the Notice, an employer not in existence for the entire preceding calendar year would be an applicable large employer for the current calendar year if it is reasonably expected to employ an average of at least 50 full-time employees (including full-time equivalents) on business days during the current calendar year.

**Comment:** New employers may find it very difficult to anticipate how many full-time employees or full-time equivalents it reasonably expects to employ during an upcoming year. Query to what extent a transition rule would be helpful for employers in this situation.

- **Full-Time Equivalents.** A full-time equivalent is a fiction created in Code section 4980H. Solely for purposes of determining whether an employer is an applicable large employer for a month, an employer is required under the statute to include, in addition to the number of full-time employees for a given month, the number of full-time equivalents. The number of full-time equivalents would be determined with respect to any month by dividing (i) the aggregate number of hours of service of employees who are not full-time employees for such month, by (ii) 120.
- **Seasonal Employees.** The Notice mirrors the statute in providing that a seasonal employee would be defined as an employee who performs labor or services on a seasonal basis.<sup>5</sup> If an employer’s workforce exceeds 50 full-time employees for 120 days or fewer during a calendar year and the only employees in excess of 50 were seasonal employees, the employer would not be an applicable large employer. The Notice proposes that, for this purpose only, four calendar months would be treated as the equivalent of 120 days.

**Comment:** Many interesting issues are likely to arise with respect to seasonal employees, including with respect to the application of the 90-day waiting period (such as the fact that some seasonal employees are likely to become eligible for enrollment just prior to their seasonal employment ending, and that employers may find it beneficial to consider the use of seasonal employees to stay under the 50 full-time employee/equivalent threshold).

There is a disconnect in the statutory language whereby an employer becomes an applicable large employer if it “employed an average of at least 50 full-time

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<sup>5</sup> “Seasonal employees” include workers covered by 29 C.F.R. § 500.20(s)(1) and retail workers employed exclusively during holiday seasons.

employees on business days during the preceding calendar year,” but the seasonal employee exception only causes an employer to “not be considered to employ more than 50 full-time employees.” Under a strict reading, it would seem that an employer could still be viewed as employing an average of at least 50 full-time employees, and therefore be an applicable large employer, even if it satisfies the seasonal employee exception.

- **Definition of “Hours of Service.”** Pursuant to Code section 4980H, it is necessary for an employer to determine the number of hours of service an employee works in a week or month, both for purposes of determining whether it is an “applicable large employer” and whether the employee is a “full-time employee.” As under Department of Labor regulations, hours of service would include: (i) each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer; and (ii) each hour for which an employee is paid, or entitled to payment, on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity, layoff, jury duty, military duty, or leave of absence.<sup>6</sup>

**Comment:** In the absence of clarifying guidance, there is some concern that requiring employers to count non-worked hours (such as paid-time-off) may result in higher numbers of full-time employees. This is because an employer may need to hire another full-time employee or otherwise convert a part-time employee to full-time status (for purposes of Code section 4980H) to perform the work responsibilities of the non-working employee; yet, both employees will count toward the total number of full-time employees.

The Notice does not address the treatment of third-party payments, such as short-term disability and workers’ compensation payments. Hopefully when guidance is ultimately issued, it will clarify that such payments are not counted.

- **Calculation of Hours of Service.** Calculation of an employee’s hours of service turns on whether the employee is paid on an hourly basis.
  - *For hourly employees* – As contemplated in the Notice, employers would have to take into account actual hours of service worked, as well as other non-worked hours for which the employee is paid or entitled to payment.
  - *For non-hourly employees* – One of three methods could be used reasonably and consistently within a category of employees:<sup>7</sup> (i) counting actual hours of service worked, as well as other non-worked hours for which the employee is paid or entitled to payment; (ii) crediting an employee with eight hours of service for each day for which the employee would be required to be credited with at least 1 hour of service (“days

<sup>6</sup> The Notice states that it is contemplated that no more than 160 hours of service would be counted for an employee on account of any single continuous period during which the employee was paid, or entitled to payment, but performed no duties.

<sup>7</sup> An employer may change the calculation method for non-hourly employees for each calendar year.

worked”); or (iii) crediting an employee with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service (“weeks worked”).<sup>8</sup>

- **Counting the Number of Full-Time Employees.** The Notice states that Code section 4980H defines a full-time employee to be, with respect to a given month, an employee who has an average of at least 30 hours of service per week. The Notice sets forth a proposal that 130 hours of service in a calendar month would be treated as the monthly equivalent of at least 30 hours of service per week. (This standard would take into account the fact that an average month consists of more than four weeks.)

**Comment:** The disconnect between the number of monthly hours of service for purposes of determining full-time employee status and full-time equivalent status (130 vs. 120) may add some complexity to the determination of whether an employer is an applicable large employer.

- **Determining Assessable Payments under Code Section 4980H.** The statute contemplates determining an applicable large employer’s potential assessable payment on a month-to-month basis. Although unclear, the Notice appears to view the month-to-month determination as the default process. Noting the practical difficulties of the month-to-month determination, including the inability to forecast or avoid assessable penalties, the Notice describes a possible alternative for determining assessable payments (and encourages submission of comments on this and any other alternatives). The alternative would create a safe harbor whereby employers could choose to use a look-back/stability period to determine full-time employees for a particular coverage period.

- Under the safe harbor, an employer would determine an employee’s full-time status by looking back to a “measurement period” of three to twelve consecutive calendar months to determine whether the employee averaged 30 hours of service per week (or had 130 hours of service per calendar month) during the measurement period. If so, then the employee would be treated as a full-time employee during the subsequent “stability period” of at least six consecutive months (which is no shorter than the measurement period) regardless of actual hours of service during the stability period so long as he or she remained an employee.
- If the employee is not a full-time employee during the measurement period, then the employer can choose to not treat the employee as a full-time employee during the stability period (but the stability period could not exceed the length of the measurement period).

**Comment:** Many have wondered how the safe harbor would work given that Code section 4980H will not be effective until 2014. Examples in the Notice use a

<sup>8</sup> These equivalents are based on similar equivalents set forth in Department of Labor regulations.

measurement period beginning on January 1, 2014, suggesting to some that compliance with Code section 4980H is not necessary until after the close of the look-back period. Informal statements by agency officials indicate that the regulators believe the provision should apply effective at the start of 2014 and, therefore, to the extent an employer chooses to use a measurement period, the measurement period would need to be with respect to 2013 employment. Put differently, it appears that applicable large employers will be subject to assessable payments beginning on January 1, 2014.

Under the above interpretation, for employers that want to use a look-back period in 2014, it would seem they would need to determine their assessable penalties on a month-to-month basis during the measurement period, but could then use the safe harbor on a going-forward basis following the close of the measurement period.

Employers would likely benefit from some administrative period following the close of the measurement period in order to enroll “full-time employees” in qualifying coverage. Employers need time to enroll eligible employees following determination of eligibility. Hopefully, future guidance regarding Code section 4980H will permit an administrative period for this purpose. It may be helpful to have guidance clarifying that the 90-day waiting period permitted under PPACA may be utilized following the close of the measurement period.

The IRS seeks comment regarding possible use of one measurement period and one stability period for all of an employer’s employees in order to minimize concerns for manipulation.

- ***Interaction of Code Section 4980H and the 90-Day Waiting Period Limitation.*** PPACA amended the Public Health Service Act (“PHSA”) to provide that group health plans and health insurance issuers cannot apply a waiting period that exceeds 90 days.<sup>9</sup> Statutory language defines the term “waiting period” to mean “the period that must pass with respect to the individual before the individual is eligible to be covered for benefits under the terms of the plan.” Applicable final regulations define the same term to mean “the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective.”<sup>10</sup> Comments are requested on the 90-day waiting period limitation, including how to coordinate Code section 4980H with the limitation. The Notice also requests comments as to the interaction of Code section 4980H with other PPACA provisions.

***Comment:*** It is unclear how the proposed look-back/stability period safe harbor would work in light of the 90-day waiting period. As noted above, employers would likely benefit from some administrative period following the close of the

<sup>9</sup> See PHSA § 2708. The provision was incorporated into the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Code. See ERISA § 701(b)(4); Code § 9801(b)(4).

<sup>10</sup> See 26 C.F.R. § 54.9801-3(a)(3)(iii); 29 C.F.R. § 2590.701-3(a)(3)(iii); 45 C.F.R. § 146.111(a)(3)(iii).



look-back period to enroll “full-time employees” in qualifying coverage. Whether the 90-day waiting period may be available for this purpose is unknown at this time.

- **Next Steps.** Treasury and the IRS intend to publish proposed regulations both on the Code section 4980H issues addressed in the Notice and on a broader set of issues under Code section 4980H.

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