



Health Care Reform

LEGISLATIVE BRIEF

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Pay or Play Penalty—Identifying Full-Time Employees: The Look-Back Measurement Method

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees (and dependents) or pay a penalty. This employer mandate provision is also known as the “shared responsibility” or “pay or play” rules. An ALE is only liable for a penalty if one or more of its full-time employees receives a premium tax credit or cost-sharing reduction for coverage under an Exchange.

The employer penalty provisions were set to take effect on Jan. 1, 2014. However, in July 2013, the Treasury **delayed the employer penalties and related reporting requirements for one year, until 2015.** Therefore, these payments will not apply for 2014. On July 9, 2013, the IRS issued [Notice 2013-45](#) to provide more formal guidance on the delay. No other ACA provisions were affected by the delay.

On Feb. 12, 2014, the IRS published [final regulations](#) on the employer shared responsibility rules. Under the final regulations, **ALEs that have fewer than 100 full-time (and full-time equivalent) employees generally have an additional year, until 2016, to comply with the pay or play rules.** ALEs with 100 or more full-time (and full-time equivalent) employees must comply starting in 2015.

The final regulations provide guidance on how ALEs should identify full-time employees for purposes of offering health plan coverage and avoiding a pay or play penalty.

WHO IS CONSIDERED AN “EMPLOYEE?”

A **common law standard** applies to define the terms “employee” and “employer.”

Under the common law standard, an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services with respect to the result to be accomplished, along with the details and means by which it is done. This is a factual determination and is not necessarily dependent on the label the employer has placed on the relationship in the past.

In general, leased employees are *not* considered employees of the service recipient for purposes of the pay or play rules. Also, an independent contractor, a sole proprietor, a partner in a partnership, a 2-percent S corporation shareholder and real estate agents and direct sellers (under Tax Code section 3508) are not counted as employees.

WHO IS A FULL-TIME EMPLOYEE?

A full-time employee is an employee who was employed, on average, at least **30 hours of service per week**. Under the final regulations, **130 hours of service in a calendar month** is treated as the monthly equivalent of 30 hours of service per week.

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Hours of Service

To determine an employee's hours of service, an employer must count:

- **Working Hours:** Each hour for which the employee is paid, or entitled to payment, for the performance of duties for the employer; and
- **Non-working Hours:** 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 (including disability), layoff, jury duty, military leave or leave of absence.

All periods of paid leave must be taken into account; there is no limit on the hours of service that must be credited.

Also, all hours of service performed for entities treated as a single employer under the Tax Code's controlled group and affiliated service group rules must be taken into account. For example, an employee who for a calendar month averaged 25 hours of service per week at one employer and 15 hours of service per week at an employer in the same controlled group would be a full-time employee for that calendar month.

However, hours of service performed as a **bona fide volunteer** (for example, a volunteer firefighter) or as part of a governmental **work-study program** are not counted. Also, in determining an employee's full-time status, hours of service are not counted to the extent the compensation for those hours constitute **foreign source income**. This rule applies regardless of the employee's citizenship or residency status. Thus, U.S. citizens working abroad generally will not qualify as full-time employees for purposes of the employer penalty. However, all hours of service for which an individual receives U.S. source income are hours of service for purposes of the employer shared responsibility rules.

Calculation Methods

Hourly Employees

For employees paid on an hourly basis, an employer must calculate hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

Non-hourly Employees

For employees not paid on an hourly basis, employers may calculate hours of service by:

1. Counting **actual hours of service** from records of hours worked and hours for which payment is made or due

2. Using a **days-worked equivalency method** under which an employee is credited with eight hours of service for each day with an hour of service

3. Using a **weeks-worked equivalency method** under which an employee is credit with 40 hours of service per week for each week with an hour of service

Employers may use different methods for non-hourly employees based on different classifications of employees if the classifications are reasonable and consistently applied. Employers may change methods each calendar year.

However, employers may not use the days-worked or weeks-worked equivalency methods if those methods would substantially understate the hours of service of a single employee or a substantial number of employees. The number of hours calculated under the days-worked or weeks-worked equivalency must reflect generally the hours actually worked and the hours for which payment is made or due.

IRS MEASUREMENT METHODS

The final regulations provide two methods for determining full-time employee status—the **monthly measurement method** and the **look-back measurement method**. These methods provide minimum standards for identifying

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employees as full-time employees. Employers may decide to treat additional employees as eligible for coverage, or otherwise offer coverage more expansively than would be required to avoid a pay or play penalty.

In general, an employer must use the same measurement method for all employees. Thus, an employer generally cannot use the monthly measurement method for employees with predictable hours of service and the look-back measurement method for employees whose hours of service vary. However, an employer may apply either the monthly measurement method or the look-back measurement method to the following groups of employees:

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

Monthly Measurement Method

The monthly measurement method involves a **month-to-month analysis** where full-time employees are identified based on their hours of service for each calendar month. This method is not based on averaging hours of service over a prior measurement period. This month-to-month measuring may cause practical difficulties for employers, particularly if there are employees with varying hours or employment schedules, and could result in employees moving in and out of employer coverage on a monthly basis.

The final regulations provide that an employer will not be subject to a pay or play penalty with respect to an employee for not offering coverage to the employee during a period of **three full calendar months**, beginning with the first full calendar month in which the employee is otherwise eligible for coverage. For this rule to apply, health plan coverage must be offered no later than the first day of the first calendar month immediately following the three-month period (if the employee is still employed on that date) and the coverage must provide minimum value. This rule applies only once per period of employment of an employee.

Look-back Measurement Method

To give employers flexible and workable options and greater predictability for determining full-time employee status, the IRS developed an optional look-back measurement method as an alternative to the monthly measurement method. The details of this method vary based on whether the employees are ongoing or new, and whether new employees are expected to work full-time or are variable, seasonal or part-time employees.

The look-back measurement method involves:

- A **measurement period** for counting hours of service (called a standard measurement period or an initial measurement period);
- A **stability period** when coverage may need to be provided depending on an employee's full-time status; and
- An **administrative period** that allows time for enrollment and disenrollment.

An employer has discretion in deciding how long these periods will last, subject to specified IRS parameters.

Ongoing Employees

For ongoing employees, an employer determines each employee's full-time status by looking back at a **standard measurement period** (SMP) lasting between 3 to 12 consecutive months, as chosen by the employer. For example, if an employer chooses an SMP of 12 months, the employer could make it the calendar year, a non-calendar year plan year or a different 12-month period, such as the one that ends shortly before the plan's open enrollment period.

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An ongoing employee is an employee who has been employed by a large employer for at least one complete SMP.

If the employee was employed on average at least 30 hours of service per week during the SMP, the employer **must treat the employee as a full-time employee for a set period into the future, known as the stability period.** This rule applies regardless of the employee’s number of hours of service during the stability period, as long as he or she remains an employee.

If an employer determines that an employee worked full-time during the SMP, the stability period must be at least six calendar months and must be at least as long as the SMP. If an employer determines that an employee did not work full-time during the SMP, the employer may treat the employee as not a full-time employee during the stability period that follows. In this case, the stability period cannot be longer than the SMP.

Because employers may need time between the measurement and stability periods to determine which ongoing employees are eligible for coverage and to notify and enroll employees, employers may use an **administrative period** between the SMP and stability period. The administrative period following an SMP can last **up to 90 days**. The administrative period must overlap with the prior stability period to prevent any gaps in coverage for employees enrolled in coverage because of their full-time status during a prior measurement period.

In general, the SMP and stability period must be uniform for all employees. However, employers may apply different measurement periods, stability periods and administrative periods for the following categories of employees:

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

New Employees Expected to Work Full-Time

For a new employee who is reasonably expected at his or her start date to be a full-time employee (and is not a seasonal employee), the employer determines the employee’s status as a full-time employee based on the employee’s hours of service for each calendar month. Whether an employer’s determination regarding a new employee’s full-time status is reasonable is based on the facts and circumstances at the employee’s start date.

Examples of factors to consider in determining if a new employee is full-time

- Whether the employee is replacing an employee who was (or was not) a full-time employee;
- The extent to which hours of service of ongoing employees in the same or comparable positions have varied above and below an average of 30 hours of service per week during recent measurement periods; and
- Whether the job was advertised, or otherwise communicated to the new hire or documented (for example, through a contract or job description), as requiring hours of service that would average 30 (or more) hours of service per week or less than 30 hours of service per week.

If the employee’s hours of service for the calendar month equal or exceed an average of 30 hours of service per week, the employee is a full-time employee for that calendar month.

Once the new employee becomes an ongoing employee (that is, he or she is employed for at least one complete SMP), the measurement rules for ongoing employees will apply.

Also, the final regulations provide that an employer will not be subject to a pay or play penalty with respect to an employee for not offering coverage to the employee during a period of **three full calendar months**, beginning with

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the first day of the first full calendar month of employment (if, for the calendar month, the employee is otherwise eligible for coverage under the employer's group health plan). For this rule to apply, the employee must be offered coverage no later than the first day of the fourth full calendar month of employment (if the employee is still employed on that day) and the coverage must provide minimum value.

New Variable Hour, Seasonal and Part-time Employees

Under the look-back measurement method, an employer determines whether new variable hour employees, new seasonal employees and new part-time employees are full-time employees by measuring their hours of service during an **initial measurement period** (IMP). During the IMP, the employer is not subject to a pay or play penalty with respect to these employees.

Variable Hour Employee

Based on the facts and circumstances at the employee's start date, the employer cannot determine whether the employee is reasonably expected to be employed on average at least 30 hours per week because the employee's hours are variable or otherwise uncertain. Factors to consider in this determination include, for example:

- Whether the employee is replacing an employee who was a full-time employee or a variable hour employee;
- The extent to which hours of service of for employees in the same or comparable positions have actually varied above and below an average of 30 hours of service per week during recent measurement periods; and
- Whether the job was advertised, or otherwise communicated to the new hire or documented (for example, through a contract or job description), as requiring hours of service that would average 30 (or more) hours of service per week, less than 30 hours of service per week or may vary above and below an average of 30 hours per service per week.

For purposes of determining whether an employee is a variable hour employee, the employer cannot take into account the likelihood that the employee may terminate employment with the employer before the end of the initial measurement period.

Seasonal Employee

An employee who is hired into a position for which the customary annual employment is **six months or less**. The period of employment should begin each calendar year in approximately the same part of the year, such as summer or winter. In certain unusual instances, the employee can still be considered a seasonal employee even if the seasonal employment is extended in a particular year beyond its customary duration (regardless of whether the customary duration is six months or is less than six months).

Part-time Employee

A new employee who the employer reasonably expects to be employed on average less than 30 hours per week during the initial measurement period, based on the facts and circumstances at the employee's start date.

Similar to the method for ongoing employees, **the look-back measurement method for new variable hour, seasonal and part-time employees utilizes a stability period for when coverage may need to be provided, depending on the employee's hours of service during the initial measurement period.** An administrative period can also be used to make eligibility determinations and notify and enroll employees.

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An employer has discretion in deciding when the initial measurement, stability and administrative periods will start and end, subject to specified IRS parameters. **However, the stability period for these employees must be the same length as the stability period for ongoing employees.**

Initial Measurement Period (IMP)

The IMP must last between 3 and 12 consecutive months, as chosen by the employer.

It must begin on the employee's start date or on any date up to and including the first day of the first calendar month following the employee's start date (or on the first day of the first payroll period starting on or after the employee's start date, if later).

Stability Period

Not Full-time Employees: If an employee does not have on average at least 30 hours of service per week during the IMP, the employer may treat the employee as not a full-time employee during the stability period that follows the IMP.

The stability period for these employees cannot be more than one month longer than the IMP and cannot exceed the remainder of the first entire standard measurement period (plus any associated administrative period) for which the variable hour, seasonal or part-time employee has been employed.

Full-time Employees: An employee who was employed an average of at least 30 hours of service per week during an IMP must be treated as a full-time employee during the stability period that follows the IMP.

The stability period for these employees must be a period of at least six consecutive calendar months and cannot be shorter than the IMP.

Administrative Period

An employer may use an administrative period in connection with the IMP and before the start of the stability period. The administrative period cannot exceed **90 days** in total. It includes all periods between the start date of a new variable hour, seasonal or part-time employee and the date the employee is first offered coverage under the employer's health plan, other than the IMP.

Also, the IMP and the administrative period combined cannot extend beyond the last day of the first calendar month beginning on or after the one-year anniversary of the employee's start date (totaling, at most, 13 months and a fraction of a month).

Once a new variable hour, seasonal employee or part-time employee has been employed for an entire standard measurement period, the employee must be tested for full-time status, beginning with that standard measurement period, at the same time and under the same conditions as other ongoing employees.

Rehired Employees and Employees Returning from Leave

The final regulations include guidance for employers on how to classify an employee who earns an hour or more of service after the employee terminates employment (or has a period of absence). If an employee goes at least **13 consecutive weeks** without an hour of service and then earns an hour of service, he or she may be treated as a new employee for purposes of determining the employee's full-time status. The employer may apply a rule of parity for periods of less than 13 weeks. Under the rule of parity, an employee is treated as a new employee if the period with no credited hours of service is at least four weeks long and is longer than the employee's period of employment immediately before the period with no credited hours of service.

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For an employee who is treated as a continuing employee, the measurement and stability periods that would have applied to the employee had he or she not experienced the break in service would continue to apply upon the employee's resumption of service.

"Special Unpaid Leave"—FMLA Leave, USERRA Leave and Jury Duty Leave

The final regulations include a method for averaging hours when measurement periods include special unpaid leave—leave under the Family and Medical Leave Act (FMLA) or the Uniformed Services Employment and Reemployment Rights Act (USERRA) and leave for jury duty. This method only applies to an employee who is treated as a continuing employee upon resuming services for the employer, and not to an employee who is treated as terminated and rehired. Under the averaging method, the employer either:

- Determines the average hours of service per week for the employee during the measurement period excluding the special unpaid leave period and uses that average as the average for the entire measurement period; or
- Treats employees as credited with hours of service for special unpaid leave at a rate equal to the average weekly rate at which the employee was credited with hours of service during the weeks in the measurement period that are not special unpaid leave.

TRANSITION RELIEF

The final regulations include transition relief for employers using the look-back measurement method to determine full-time employee status. Solely for purposes of stability periods beginning in 2015, employers may adopt a transition measurement period that:

- Is shorter than 12 months, but not less than 6 months long; and
- Begins no later than July 1, 2014, and ends no earlier than 90 days before the first day of the first plan year beginning on or after Jan. 1, 2015.

For example, an employer with a calendar year plan could use a measurement period from April 15, 2014, through Oct. 14, 2014 (six months), followed by an administrative period ending on Dec. 31, 2014. An employer with a fiscal year plan beginning April 1 that also elected to implement a 90-day administrative period could use a measurement period from July 1, 2014, through Dec. 31, 2014 (six months), followed by an administrative period ending on March 31, 2015.

This transition guidance applies to a stability period beginning in 2015 through the end of that stability period (including any portion of the stability period falling in 2016), and applies to individuals who are employees as of the first day of the transition measurement period. For employees hired during or after the transition measurement period, the general rules for new employees under the look-back measurement method apply.

MORE INFORMATION

Please contact Risk Management Advisors, Inc. for more information on the ACA's pay or play requirements.

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