Health Care: Pay or Play Mandate – What "Full-Time Employees" Must I Cover?

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This is part of a series of articles intended to help guide ISSA members through their new obligations under the health care reform laws and related guidance.

The IRS has issued proposed regulations and Q&As that provide additional guidance intended to help employers determine whether they are subject to the pay or play mandate (the "Mandate") beginning in 2014 and, if so, how to comply.

This article is one of several that discuss the details of this latest guidance. As described in our earlier article found here, if you employ at least 50 full-time equivalent employees (FTEs) on average during the prior year, you are covered by the Mandate (a "large employer"). The Mandate requires that large employers either provide affordable and minimum value coverage to "full-time employees" (and their dependents) or pay a monthly penalty. A "full-time employee" is defined as a common law employee of the large employer who, during the applicable calendar month, was employed on average at least 30 hours of service per week (or 130 hours total).

This article discusses the safe harbors provided by the IRS to help large employers identify "full-time employees" who must be offered affordable and minimum value coverage in order for large employers to avoid penalties under the Mandate.

Hours of Service Defined

For purposes of the 30 hours of service requirement, "hours of service" includes (1) hours for which the employee is paid or entitled to payment for the performance of duties, and (2) each hour for which the 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 duty or leave of absence. This is the statutory definition of hour of service found in 29 CFR 2530.200b-1(a). The originally-proposed 160 hour limit on paid leave has been discarded, so that all hours of paid leave are counted.

Salaried Employee Safe Harbors: The guidance adopts new rules allowing large employers to calculate hours of service for salaried employees (and other employee not paid on an hourly basis) under one of three methods:

- Counting actual hours of service from records of hours worked and hours paid;
- Using a days-worked equivalency method whereby the employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service; or
- Using a weeks-worked equivalency of 40 hours of service per week for each week for which the employee would be required to be credited with at least one hour of service.

Employers can vary the method they use for different classifications of non-hourly employees, so long as the classifications are reasonable and consistently applied. Methods may change from year to year. In all events, however, the days-worked and weeks-worked methods cannot be used if the result would be to substantially understate an employee's hours of service in a manner that would cause that employee not to be treated as a full-time employee.

Impact of Related Employers: In determining an employee's "hours of service" for purposes of the "full-time employee" definition, all hours of service with members of your controlled group or affiliated service group are counted.

However, imposition of penalties under the Mandate is determined on an individual member basis. Therefore, a member of a controlled group of corporations (or affiliated service group) that offers health coverage to its own full-time employees (and dependents) will not be subject to penalties because other members in its controlled group (or affiliated service group) do not offer health coverage to their respective full-time employees. And, if penalties are imposed on you for not providing health coverage to your employees, then calculation of any penalty will be based on the number of full-time employees employed by you and not by the total number of full-time employees of your controlled group or affiliated service group.

Non-U.S. Services: Hours of service do not include hours of service that constitute foreign source income. Thus, as a general rule for both U.S. and non-U.S. employees, hours of service do not include hours of service worked outside the U.S. However, all hours of service for which the employee receives U.S.-source income are hours of service for purposes of the Mandate.

Other Special Classes: The IRS noted that commenters had asked for special rules for professions where compensation is not based primarily on hours (e.g. commissioned salespeople), where hours are subject to safety regulations (e.g. airline pilots), and for adjunct-faculty situations where credit hours are used to determine status.

While no special provisions are included in this guidance to address these groups, comments are requested and, until further guidance is issued, employers may use a reasonable method for crediting hours of service for employees in these groups that is consistent with the Mandate.

Employee Definition

"Employee" for purposes of the Mandate means common law employee, which is a concept based on direction and control and is the same as the definition used for purposes of ERISA (it is not the same as the FLSA definition). The leased employee rules (which treat leased employees as employees of the service recipient for certain purposes) do not apply.

Note that special anti-abuse provisions have been included for temporary staffing agencies (defined as an entity that is the common law employer of the workers providing services to its clients) in an attempt to deter employers from using temporary staffing agencies to avoid their pay or play obligations (the IRS has asked for comments on whether special safe harbors or other special provisions are needed to address temporary staffing issues).

Variable Hour and Seasonal Employee Safe Harbors

The new guidance generally retains the approach outlined in prior August 2012 guidance allowing employers to establish "measurement periods," for counting hours, which must be at least three—and not more than twelve—months long. Measurement periods for ongoing employees are referred to as "standard measurement periods." If a new employee has not been employed by you for one full standard measurement period, you may use a different measurement period referred to as "initial measurement period."

In each case, you must apply the measurement period uniformly to all employees in one of the following permissible classifications—(1) collectively bargained and non-collectively bargained employees; (2) salaried and hourly employees; (3) employees of different business entities; and (4) employees located in different states. An employee's hours during the measurement period determine his or her treatment during the following "stability period" (which is a period of not less than 6 months or the length of the measurement period, if longer).

The proposed regulations made several significant modifications and clarifications to its prior August 2012 guidance on the full-time employee safe harbors as follows:

Special Payroll Period Adjustments Allowed: The standard measurement periods for ongoing employees may be adjusted to coincide with the beginning and end of an employee's regular payroll period. For example, if you designate the calendar year as the measurement period and January 1 falls in the middle of a payroll period, you may begin your measurement period on the first day of the payroll period commencing after January 1 provided that the measurement period does not end until the last day of the payroll period that includes December 31, or vice versa. The length of the employee's regular payroll period must be either one week, two weeks, or semi-monthly to take advantage of this special rule.

Disregard Early Expected Terminations for New Variable Hour Employees: Effective January 1, 2015, you may not take into account the likelihood that an employee's employment will terminate prior to the end of the initial measurement period in determining whether the employee is a variable hour employee. Generally an employee is a variable hour employee if as of his or start date you cannot reasonably determine whether the employee is expected to work on average at least 30 hours of service during the initial measurement period.

Promotions During Initial Measurement Period: A new variable hour or seasonal employee who is promoted to a position reasonably expected to work 30 or more hours per week must be treated as a full-time employee as of the first day of the fourth month following the promotion or, if earlier the first day of the first month following the end of the initial measurement period (including any optional administrative period) if the employee otherwise averaged 30 hours during such period. This rule does not apply to changes in employment status for ongoing employees.

Treatment of Rehired Employees and Leaves of Absence: The proposed regulations contain new rules addressing when an employee who is terminated and rehired or who returns from an unpaid leave of absence may be treated as a new employee subject to the 90 day waiting period and restarting the employee's initial measurement period. If the period during which no hour of service is credited is at least 26 consecutive weeks, the employee may be treated as having been rehired as a new employee.

You may also apply a "rule of parity" for absences less than 26 weeks. Under the rule of parity, the employee is treated as a new employee if the period with no credited hours of service is at least 4 weeks long and longer than the employee's period of employment prior to the leave or termination. For example, if an employee works for you for three weeks and takes a 10 week unpaid leave of absence, that employee may be treated as a new employee. Note, however, that "special unpaid leaves" for jury duty or as required under the Family Medical Leave Act of 1993 (FMLA) and the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) are included in the employee's period of employment in applying the rule of parity.

If under these rules the employee is not treated as a new employee when rehired or returning from unpaid leave, the measurement and stability period that would have applied to the employee if there had been no break in service will continue to apply. For example, if the employee returns during a stability period in which he was treated as a full-time employee, you must offer coverage to the employee as of the first day the employee is credited with an hour of service or as soon as administratively practicable thereafter. In computing an employee's average hours worked for any measurement period that includes periods for which no hours of services are credited, you must compute the average hours of service worked during such measurement period excluding periods of special unpaid leaves. Alternatively, you may choose to treat employees as credited with hours of service for special unpaid leaves 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 leaves.