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Pay or Play Penalty—Identifying Full-Time Employees: The Monthly 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 constitutes **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 credited 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

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.

Monthly Measurement Method

The monthly measurement method must be used to identify full-time employees by all ALEs electing not to use the look-back 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.

Under the monthly measurement method, an ALE determines each employee's status as a full-time employee by counting the employee's hours of service for each calendar month. An employee will generally have to be treated as **full-time for any month in which he or she averages at least 30 hours of service per week**. An employee does not have to be treated as full-time for any month in which he or she averages less than 30 hours of service per week.

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.

Employees First Otherwise Eligible for an Offer of Coverage

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.

For this purpose, an employee is otherwise eligible for an offer of coverage in a month if the employee meets all conditions to be offered coverage under the plan other than the completion of a waiting period. An employee is first otherwise eligible if the employee has not previously been eligible or otherwise eligible for an offer of coverage under a group health plan of the employer during the employee's period of employment.

The Weekly Rule

To provide additional flexibility and reduce administrative burden on employers, the final regulations allow an employer to determine an employee's full-time employee status for a calendar month under the monthly measurement method based on the hours of service over successive one-week periods. Under this optional method—referred to as the weekly rule—full-time status for certain calendar months is based on hours of service over **four-week periods**, and for certain other calendar months on hours of service over **five-week periods**.

- For calendar months calculated using four week periods, an employee with **at least 120 hours of service** is a full-time employee.
- For calendar months calculated using five week periods, an employee with **at least 150 hours of service** is a full-time employee.

In general, the period measured for the month must contain either the week that includes the first day of the month or the week that includes the last day of the month, but not both. For this purpose, "week" means any period of seven consecutive calendar days applied consistently by the ALE for each calendar month of the year. Thus, under the weekly rule, an employer may determine an employee's full-time status for a calendar month based on hours of service over a period that:

- Begins on the first day of the week that includes the first day of the calendar month, provided that the period over which hours of service are measured does not include the week in which falls the last day of the calendar month (unless that week ends with the last day of the calendar month, in which case it is included); or
- Begins on the first day of the week immediately subsequent to the week that includes the first day of the calendar month (unless the week begins on the first day of the calendar month, in which case it is included), provided the period over which hours of service are measured includes the week in which falls the last day of the calendar month.

However, for purposes of coordination with both the ACA's premium tax credits and the individual mandate, which are applied on a calendar month basis, an ALE is only treated as having offered coverage for a calendar month if it offers coverage to a full-time employee **for the entire calendar month**, regardless of whether the employer uses the weekly rule.

Rehire Rules

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). Under the monthly measurement method, an employee must be treated as a continuing employee, rather than a new hire, unless the employee has had a period of **at least 13 weeks** during which no hours of service were credited (26 weeks for an employee of an educational organization).

However, the final regulations provide a rule of parity where the employee may be treated as a new hire 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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A continuing employee treated as full-time is treated as having been offered coverage upon resumption of services if the employee is offered coverage:

- As of the first day that employee is credited with an hour of service; or
- If later, as soon as administratively practicable. (For this purpose, offering coverage by no later than the first day of the calendar month following resumption of services is deemed to be as soon as administratively practicable.)

Special Unpaid Leave and Employment Break Periods

The final regulations also include special rules for averaging hours under the **look-back measurement method** during special unpaid leave periods or employment break periods. "Special unpaid leave periods" include leave under the Family and Medical Leave Act (FMLA) or the Uniformed Services Employment and Reemployment Rights Act (USERRA) and leave for jury duty. An "employment break period" is a period of at least four consecutive weeks (disregarding special unpaid leave), measured in weeks, during which an employee of an educational organization is not credited with an hour of service.

Under the monthly measurement method, the special unpaid leave and employment break period rules do not apply. This is the case regardless of whether the employer is (or is not) an educational organization. This is because determinations under the monthly measurement method are based on hours of service during that particular calendar month, and are not based on averaging over a prior measurement period.

International Transfers

An employer may treat an employee as having terminated employment if the employee transfers to a position at the same ALE (including a different ALE member that is part of the same ALE) if:

- The position is anticipated to continue indefinitely or for at least 12 months; and
- Substantially all of the compensation will constitute income from sources outside of the United States.

If, however, substantially all of the compensation will constitute U.S. source income, the employer may treat that employee as a new hire to the extent consistent with the rules related to rehired employees.

EXAMPLES

The following examples illustrate the rules for the monthly measurement method. In each example, the employer is an ALE with 200 full-time employees (including FTEs) that uses the monthly measurement method to identify full-time employees and offers coverage only to employees who are full-time employees (and their dependents).

Example 1—Employee First Otherwise Eligible for an Offer of Coverage

Facts: Employer Z uses the monthly measurement method. Employer Z hires Employee A on Jan. 1, 2016. For each calendar month in 2016, Employee A averages 20 hours of service per week and is not eligible (or otherwise eligible) for an offer of coverage under the group health plan of Employer Z. Effective Jan. 1, 2017, Employee A is promoted to a position that is eligible for an offer of coverage under a group health plan of Employer Z, following completion of a 90-day waiting period. For January 2017 through March 2017, Employee A meets all of the conditions for eligibility under the group health plan, other than completion of the waiting period. The coverage that would have been offered to Employee A under the terms of the plan, but for the waiting period, during those three months would have provided minimum value. Effective April 1, 2017, Employer Z offers Employee A coverage that provides minimum value. Employee A averages 40 hours of service per week for each calendar month in 2017.

Conclusion: Because Employer Z offers minimum value coverage to Employee A no later than the first day following the period of three full calendar months, beginning with the first full calendar month in which Employee A is otherwise

eligible for an offer of coverage under a group health plan of Employer Z, Employer Z is not subject to a pay or play penalty for January 2017 through March 2017 by reason of its failure to offer coverage to Employee A during those months. For calendar months after March 2017, an offer of minimum value coverage may result in a pay or play penalty with respect to Employee A for any month for which the offer is not affordable and for which Employer Z has received a premium tax credit. Employer Z is not subject to a pay or play penalty by reason of its failure to offer coverage to Employee A during each month of 2016 because, for each month of 2016, Employee A was not a full-time employee.

Example 2—Rehire Rules for Employers that are not Educational Organizations

Facts: Same as Example 1, except that Employee A has zero hours of service during a nine-week period of unpaid leave (that constitutes special unpaid leave) beginning on June 25, 2017, and ending on Aug. 26, 2017. As a result of the nine-week period during which Employee A has zero hours of service, Employee A averages less than 30 hours of service per week for July 2017 and August 2017. Employee A averages more than 30 hours of service per week for each month between and including September 2017 through December 2017. Employer Z does not use the rule of parity, and Employer Z is not an educational organization.

Conclusion: Because Employee A resumes providing services for Employer Z after a period during which the employee was not credited with any hours of service of less than 13 consecutive weeks, Employer Z may not treat Employee A as having terminated employment and having been rehired. Therefore, Employer Z may not treat Employee A as a new employee upon the resumption of services, and, accordingly, Employer Z may not again apply the rule for employees first otherwise eligible for an offer of coverage. Although the nine consecutive weeks of zero hours of service constitute special unpaid leave, the averaging method for periods of special unpaid leave does not apply under the monthly measurement method. Therefore, Employer Z may treat Employee A as a non-full-time employee for July 2017 and August 2017.

Example 3—The Weekly Rule

Facts: Employer Y uses the monthly measurement method in combination with the weekly rule for purposes of determining whether an employee is a full-time employee for a particular calendar month. For purposes of applying the weekly rule, Employer Y uses the period of Sunday through Saturday as a week, including the week that includes the first day of a calendar month and excluding the week that includes the last day of a calendar month (except in any case in which the last day of the calendar month occurs on a Saturday). Employer Y measures hours of service for:

- The five weeks from Sunday, Dec. 27, 2015, through Saturday, Jan. 30, 2016, to determine an employee's full-time employee status for January 2016;
- The four weeks from Sunday, Jan. 31, 2016, through Saturday, Feb. 27, 2016, to determine an employee's status for February 2016; and
- The four weeks from Sunday, Feb. 28, 2016, through Saturday, March 26, 2016, to determine an employee's status for March 2016.

For January 2016, Employer Y treats an employee as a full-time employee if the employee has at least 150 hours of service (30 hours per week × 5 weeks). For February 2016 and March 2016, Employer Y treats an employee as a full-time employee if the employee has at least 120 hours of service (30 hours per week × 4 weeks).

Conclusion: Employer Y has correctly applied the weekly rule as part of the monthly measurement method for determining each employee's status as a full-time employee for the months January, February and March 2016.

MORE INFORMATION

Please contact Sullivan Benefits for more information on the ACA’s pay or play requirements.

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