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**The Affordable Care Act: Guidance for Alabama Employers.** Alabama small-business owners must plan for the impact that changes in federal health care laws will have on their businesses. While the majority of the new taxes, mandates and administrative requirements begin in January 2014, some major provisions take effect in 2013. Taking time now to understand how these requirement will impact your business will help you plan for 2013 and 2014.

**Q and A Session**

**1) Which Alabama small businesses will be affected by the employer mandate?**

The penalty tax (or assessable payment) applies to “applicable large employers.” An applicable large employer for a calendar year is an employer who employed an average of at least 50 “full-time employees” on business days during the preceding calendar year. So what you do relative to the number of employees in your business in 2013 will have a direct impact on how your business will be affected by the **The Affordable Care Act** in 2014.

## **2.) What is the penalty under the employer mandate?**

Beginning in 2014, certain “applicable large employers” may be subject to a penalty tax (also called an “assessable payment”) for (1) failing to offer minimum essential health care coverage for all full-time employees; or (2) offering eligible employer-sponsored coverage that is not “affordable” (exceeds a specified percentage of the employee's household income) or does not offer “minimum value” (the plan's share of the total allowed cost of benefits is not at least 60%). The penalty tax is due if any full-time employee is certified to the employer as having purchased health insurance through an Exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee. These requirements are also referred to as the shared employer responsibility provisions.

Beginning in 2014, an applicable large employer will pay a penalty tax (i.e. make an assessable payment) for any month that:

- (1) the employer fails to offer its full-time employees the opportunity to enroll in “minimum essential coverage” under an “eligible employer-sponsored plan” for that month; and
- (2) at least one full-time employee has been certified to the employer as having enrolled for that month in a QHP for which health coverage assistance is allowed or paid.

We call this penalty the “No-Eligible-Plan Penalty” in order to distinguish it from the penalty applicable when eligible employer sponsored coverage is offered, but it fails to satisfy the minimum value or affordability requirement (the “Eligible-Plan Penalty”). The IRS has indicated that it contemplates that the proposed regulations would make clear that an employer offering coverage to “all, or substantially all, of its full-time employees” would not be subject to the penalty under Code § 4980H(a). The penalty tax (assessable payment) is equal to the product of the “applicable payment amount” and the

number of individuals employed by the employer (less the 30-employee reduction) as full-time employees during the month. The “applicable payment amount” for 2014 is \$166.67 with respect to any month (that is, 1/12 of \$2,000). The amount will be adjusted for inflation after 2014.

The No-Eligible-Plan Penalty only applies if the employer fails to offer adequate coverage and at least one employee enrolls for subsidized exchange coverage. If it offers “minimum essential coverage” to all full-time employees, an applicable large employer will not be liable for the No-Eligible-Plan Penalty tax. Most employer-provided group health coverage will meet the very broad definition of minimum essential coverage. The definition includes any coverage under an “eligible employer-sponsored plan”—a term that means a group health plan or group health insurance coverage offered by an employer to an employee that is (a) a governmental plan, or (b) any other plan or coverage offered in a state’s small or large group market.

Even though an applicable large employer does not offer minimum essential coverage to all of its full-time employees, the employer will not necessarily be liable for the No-Eligible-Plan Penalty. Before the penalty will apply for a given month, at least one full-time employee must enroll in a qualified health plan through an Exchange for that month and must receive an applicable premium tax credit for that month’s coverage.

A number of factors will affect whether an employee qualifies for a premium tax credit. For example, any of the following factors could result in the employee not qualifying for a premium tax subsidy:

- The employee elects not to purchase health coverage at all or elects to purchase coverage other than through an Exchange;
- The employee’s household income exceeds the threshold (400% of poverty level) for which the premium tax credit is available;

- The employee has coverage through a spouse that is both affordable and provides minimum value; or
- The employee is eligible for Medicare or Medicaid coverage.

If the employee does not receive the subsidy, the applicable large employer will not be liable for the tax penalty. That is, even though it elected not to play, the employer does not have to pay. However, it should be noted that these factors are largely beyond the employer's control, so the employer may be taking a large risk if it decides not to offer minimum essential coverage. If a full-time employee does receive a premium tax credit for coverage purchased through an Exchange, then the No-Eligible-Plan Penalty is based on all of the employer's full-time employees (minus the first 30), even if only one employee qualifies for the premium tax credit.

### **Compare: Essential Health Benefits.**

Minimum essential coverage is the term used to describe the coverage required to fulfill the individual mandate—and that employers may need to offer to avoid the play or pay tax. Essential health benefits, on the other hand, is the term used by health care reform to describe the benefits that QHPs are required to cover. Pending further guidance, coverage under an employer-sponsored health plan can be “minimum essential coverage” even if it does not cover all essential health benefits.

Even though an employer offers minimum essential coverage to all full-time employees, the employer may still be liable for what we refer to in this Section as the “Eligible-Plan Penalty.” This is because employees eligible for minimum essential coverage under an employer-sponsored plan may still qualify for the premium tax credit if the plan fails the minimum value or affordability requirement.

Beginning in 2014, an applicable large employer that offers coverage to full-time employees will pay a penalty tax (i.e., make an assessable payment) for a month if at least one full-time employee of the employer has been certified to the employer as having enrolled for that month in a QHP for which a premium tax credit or cost-sharing reduction is allowed or paid. Therefore, as with the No-Eligible-Plan Penalty, the key to triggering the penalty is at least one full-time employee's purchase of coverage on an Exchange and receiving a premium tax credit in connection with the Exchange-based coverage.

Even though an employer offers minimum essential coverage to all full-time employees, the employer may still be liable for the Eligible-Plan Penalty. This is because employees eligible for minimum essential coverage under an employer-sponsored plan may still qualify for the premium tax credit if the plan fails either of the following tests:

- *Minimum value test:* the plan's share of the total allowed costs of benefits provided under the plan is less than 60% of those costs; or
- *Affordability test:* the premium exceeds 9.5% of the employee's household income (guidance has been issued that will allow employers to use W-2 wages).

If an applicable large employer does not offer affordable coverage that provides minimum value, and at least one employee receives a premium tax credit for coverage purchased through an Exchange, then the employer will be liable for the penalty tax.

The penalty tax is calculated monthly. It is equal to \$250 (1/12 of \$3,000, adjusted for inflation after 2014) times the number of full-time employees for any month who receive premium tax credits. Unlike the “no coverage” tax, this number is not reduced by 30. This penalty tax is capped so that it cannot exceed the amount of the “no coverage” penalty tax.

### **3.) What is the difference between full-time, part-time, full-time equivalent, and seasonal employee?**

The penalty tax (or assessable payment) applies to “applicable large employers.” An applicable large employer for a calendar year is an employer who employed an average of at least 50 “full-time employees” on business days during the preceding calendar year. In general, an employee who averages at least 30 hours of service per week is considered a full-time employee. For purposes of determining whether an employer is an applicable large employer subject to the pay or play provision, an employer must take into account full-time equivalent individuals for part-time employees (even though such individuals would not trigger the tax by receiving a premium subsidy). The IRS has described potential approaches to interpreting the statutory provision.

All entities treated as a single employer under the controlled group rules are treated as a single employer for purposes of § 4980H (the pay or play mandate). Thus, the employees of all employers within the controlled group are taken into account in determining whether any member of the controlled group is an applicable large employer. This rule prevents an employer from circumventing applicable large employer status by setting up separate business entities and assigning fewer than 50 employees to each of them. Code § 4980H also provides that an employer includes a predecessor employer, but it does not include any criteria for evaluating “predecessor” status.

Although the statute does not define an hour of service, the IRS has indicated that 130 hours of service in a calendar month likely will be treated as the monthly equivalent of at least 30 hours of service per week. As under existing DOL regulations, an employee's hours of service would include paid work hours, as well as paid hours when an employee is absent from work due to vacation, holiday, illness, disability, layoff, jury duty, military duty, or leave of absence (except the paid non-work hours would be limited to 160 hours for each continuous period when the employee was entitled to payment but

performed no duties).

For employees paid on an hourly basis, the employer would be required to calculate actual hours of service from records of hours worked and hours for which payment is made or due (payment is made or due for vacation, holiday, illness, incapacity, etc., as described above).

For employees not paid on an hourly basis, the employer would be permitted to calculate the number of hours of service under any of the following three methods: (a) counting actual hours worked and non-worked hours for which payment is due, as described above; (b) using a days-worked equivalency method (eight hours of service for each day for which the employee is entitled to pay for worked or non-worked time, as described above); or (c) using a weeks-worked equivalency (40 hours of service per week for each week for which the employee is entitled to pay for worked or non-worked time, as described above). While an employer would be required to use one of these three methods for counting hours of service for all non-hourly employees, an employer could use different methods for different classifications of non-hourly employees, if the classifications are reasonable and consistently applied. However, the number of hours of service calculated using an equivalency method would be required to reflect generally the hours actually worked and the hours for which payment is made or due. An employer would be permitted to change the method of calculating non-hourly employees' hours of service for each calendar year. For example, for all non-hourly employees, an employer may use the actual hours worked method for the calendar year 2014, but may use the days-worked equivalency method for counting hours of service for the calendar year 2015.

The statute defines full-time employees as those who, with respect to any month, work at least 30 hours per week. Further, the statute provides that "full-time" includes

full-time-equivalent employees. Therefore, the employer must take part-time employees into account to determine whether it is an applicable large employer.

In Notice 2011-36, the IRS described a potential approach for converting part-time employees to full-time equivalents. This approach includes two steps:

- Step 1: Calculate the aggregate hours of service in a month for employees who are not full-time employees for that month. (Do not include more than 120 hours of service for any employee.)
- Step 2: Divide the total hours of service from Step 1 by 120.

The result is the number of full-time equivalent employees for the month.

#### **4.) How do I determine whether an employee is Full-time?**

The test to determine applicable large employer status is typically retrospective. Therefore, once that year ends, the employer's status will be fixed for the current year or (as described below) the applicable stability period. However, under the statute, the test for the play or pay penalties looks at employees' hours on a monthly basis, on a real-time basis. This creates a practical problem for employers. If they were required to determine an employee's full-time status based on hours worked during each month, they would not know whether an employee was full-time until the end of the month. If the employee averaged at least 30 hours per week during that month, the employee would have to be considered full-time. But by the time the determination was made, it would be too late to offer the employee coverage for that month, possibly exposing the employer to play or pay penalties. The IRS identified these issues early on and adopted voluntary safe harbors that employers can use to mitigate the impact of month-to-month determinations. Currently, employers can rely on the safe harbor through at least the end of 2014. The safe harbors use the following defined terms:

- The “measurement period” is the look-back period over which hours are calculated to determine whether an employee has averaged at least 30 hours per week.
- The “standard measurement period” is used for ongoing employees.
- The “initial measurement period” is used for new employees.
- The “stability period” is the look-forward period for which an employee’s status (determined during the measurement period as full-time or not) is locked in, regardless of the employee’s actual hours during this period (provided that the employee continues to be an employee during this period). The stability period begins at the end of the measurement period (and any administrative period, if the employer elects to have one).
- The “administrative period” is a period after the end of a measurement period—and before the beginning of the next stability period—during which the employer can perform administrative tasks, such as calculating the hours for the measurement period, determining eligibility for coverage, providing enrollment materials to eligible employees, and conducting open enrollment.
- An “ongoing employee” is an employee who has been employed for at least one complete standard measuring period.
- A “new employee” is an employee who has not been employed for at least one complete standard measuring period.
- An employee is a “variable hour employee” if it cannot be determined on the employee’s start date that the employee is reasonably expected to work

an average of at least 30 hours per week (based on the facts and circumstances on the employee's start date).

The following examples illustrate the safe harbors for ongoing employees and new employees.

Facts - XYZ Co. sponsors a group health plan with a calendar-year plan year. XYZ chooses a 12-month standard measurement period (Oct. 15 to Oct. 14), a 12-month stability period that corresponds to the plan year (also the calendar year), and an administrative period from Oct. 15 to Dec. 31 (to allow time to calculate hours from the measurement period, determine eligibility, distribute enrollment materials, and conduct open enrollment). Under XYZ's health plan, only employees who average at least 30 hours per week are eligible.

**Ongoing employees.**

Employee A and Employee B were hired in 2007 and have worked continuously for XYZ since then. They are considered ongoing employees because they have been employed for at least one complete standard measurement period. Employee A averaged 38 hours per week from October 15, 2013 to October 14, 2014. As long as Employee A remains an employee, Employee A must be treated as a full-time employee for the period January 1 to December 31, 2015, the stability period that corresponds to the standard measurement period that ended on October 14, 2014. This is the result regardless of Employee A's actual hours during the 2015 calendar year. If Employee A averages less than 30 hours per week during the measurement period from October 15, 2014 to October 14, 2015, Employee A must still be treated as a full-time employee for all of 2015. Employee A would not be treated as a full-time employee for 2016 (the stability period related to the standard measurement period that ended October 14, 2015).

Employee B averaged 28 hours per week during the period October 15, 2013 to October 14, 2014. Employee B is not treated as a full-time employee for the period January 1 to December 31, 2015, regardless of how many hours Employee B works in 2015. However, XYZ must also measure Employee B's hours during the period October 15, 2014 to October 14, 2015 and if Employee B averages at least 30 hours per week during this standard measurement period, Employee B must be treated as a full-time employee for the period January 1 to December 31, 2016.

### **New employees.**

Same facts as above. Employee C is hired on May 10, 2014. Therefore, C's initial measurement period is May 10, 2014 to May 9, 2015. If C averages at least 30 hours per week during this measurement period, then C will have to be treated as a full-time employee for the stability period running from July 1, 2015 to June 30, 2016. The administrative period runs from May 10 to June 30, 2015. (June 30 is the last day of the first calendar month that begins after the end of the initial measurement period.) XYZ Co. may use this administrative period to calculate C's average hours, provide enrollment information, and complete C's enrollment in the plan. C will have full-time status during the stability period regardless of the actual hours worked during the stability period. If C terminates employment, then full-time status ends on the termination date. XYZ must also measure C's hours during the standard measurement period running from October 15, 2014 to October 14, 2015. If C averages at least 30 hours per week during the standard measurement period, C must be treated as a full-time employee from January 1 to December 31, 2016. (Note that C already has full-time employee status from January 1 to June 30, 2016, based on full-time status during the initial measurement period.) C must be treated as a full-time employee for the 2016 calendar year, regardless of the hours actually worked during 2016.

## **5.) What is the reinsurance fee for States that operate an Exchange?**

Each state that operates an Exchange is required to establish a temporary reinsurance program for non-grandfathered plans individual market, to which health insurers and group health plans are required to contribute. This program is scheduled to be in operation from 2014 through 2016—it is basically insurance for insurers; that is, it shifts the risk of covering high expenses from the primary insurer to a reinsurer.

Contributing Entities are required to make contributions toward reinsurance payments. A “contributing entity” is defined as an insurer or third-party administrator on behalf of a self-insured group health plan. With respect to insured coverage, insurers are liable for making reinsurance contributions. With respect to self-insured plans, the plan is liable, although a third-party administrator or administrative-services only contractor may be used to transfer reinsurance payments on behalf of a self-insured plan, at that plan's discretion. Thus, although self-insured plans are “ultimately liable” for reinsurance contributions, a third-party administrator or administrative-services only contractor may be used for transfer of the contribution payments.

Reinsurance contributions must be made for all “reinsurance contribution enrollees,” a term that includes all individuals covered by a plan for which reinsurance contributions must be made.

The reinsurance contribution is calculated by multiplying the average number of covered lives of reinsurance contribution enrollees during the applicable benefit year by the contribution rate for the applicable benefit year.

Each contributing entity would make the reinsurance contributions annually. The preamble to the proposed regulations notes that HHS intends to collect and pay out reinsurance funds annually to minimize costs of administering the program and the

burden on contributing entities. Also, HHS proposes to collect contributions on behalf of states and will be collecting amounts for both insured and self-insured plans under a national contribution rate. Under the proposed regulations, a contributing entity would submit an annual enrollment count of the average number of covered lives of reinsurance contribution enrollees to HHS. Within 15 days of the submission of this annual enrollment count, or by December 15th if later, HHS would notify the contributing entity of the reinsurance contribution amount to be paid for that year. The contributing entity would remit the contribution to HHS within 30 day after the notification date.

The proposed regulations provide several methods for counting covered lives, insured plans would use an actual method, snapshot method, or member months method. Self-insured plans would use an actual method, snapshot method, or Form 5500 method. The regulations propose that if a plan sponsor maintains two or more self-insured plans that collectively provide major medical coverage for the same covered lives, then those multiple plans should be treated as a single self-insured group health plan for purpose of calculating the reinsurance contribution amount. The proposed regulations provide that this could be the case even if an insured benefit also is offered. An exception is provided that specifies that a plan sponsor would not be required to include as part of a single self-insured plan coverage that consists solely of excepted benefits or that only provides benefits related to prescription drugs. In addition, the plan sponsor must report to HHS the counting method used and the names of multiple plans being treated as a single group health plan.

HHS has indicated that the amount of the reinsurance contribution would be based on the statutory requirement to collect \$12 billion for 2014 (\$10 billion for the reinsurance program and \$2 billion for the U.S. Treasury). (The combined amount will decrease to \$8 billion for 2015 and \$5 billion for 2016.) Needing to raise \$12.02 billion for 2014 (which includes an estimated \$20 million to administer the program), HHS proposes a nationally uniform contribution rate of \$63 per covered life per year (\$5.25

per month), payable annually. HHS is seeking comments on whether statutory requirements would permit a delay until 2016 in the collection of the \$2 billion for the U.S. Treasury, thereby lowering the contribution rate in 2014.

The IRS has indicated that insurers and plan sponsors generally can deduct reinsurance contributions as ordinary and necessary business expenses. According to HHS, the DOL has advised that these contributions would be a valid plan expense under ERISA.

## **6.) What Is the Small Business Health Care Tax Credit?**

Eligible small employers that offer health insurance coverage to their employees are entitled to a tax credit of up to 35% of the nonelective contributions they make toward the premium cost. The rules governing this tax credit are found in Code § 45R, which was created by the Patient Protection and Affordable Care Act (PPACA). The tax credit was first available to eligible small employers for the 2010 tax year.

There are three requirements that an employer must satisfy to be an “eligible small employer.” With respect to any tax year:

- the employer must have no more than 25 full-time equivalent (FTE) employees for the tax year;
- the employer's FTEs must have average annual wages that do not exceed \$50,000 (for 2010 through 2013); and
- the employer must have a contribution arrangement in effect that meets the requirements of Code § 45R(d)(4).

For tax years 2010 through 2013, the maximum tax credit available to an eligible small employer is 35% of certain contributions the employer makes toward the premium

cost of health insurance coverage the employer offers to its employees. The percentage is applied to the lesser of (1) the aggregate nonelective contributions the employer made on behalf of its employees during the tax year, or (2) the aggregate amount of nonelective contributions the employer would have made if each employee for whom contributions were made had enrolled in health insurance coverage with a premium equal to the amount that HHS determines is the average premium for the small group market in the State in which the employer is offering health insurance coverage (or for such area within the State as is specified by HHS).

For tax years beginning in 2014 and later, the maximum small business health care tax credit available to eligible small employers increases to 50% of nonelective contributions, but the requirements for the contribution arrangement are different from those applicable to earlier tax years. The nonelective contributions for 2014 and later tax years must be made on behalf of employees who enroll in a qualified health plan offered to employees by the employer through an Exchange.

The other change for 2014 and later is that the contributions to which the percentage is applied are the lesser of (a) the aggregate nonelective contributions the employer made on behalf of its employees during the tax year toward the qualified health plan premiums, or (b) the aggregate amount of nonelective contributions the employer would have made if each employee for whom contributions were made had enrolled in a qualified health plan which had a premium equal to the average premium (as determined by HHS) for the small group market in the rating area in which the employee enrolls for coverage. In addition, the small business health care tax credit that is available beginning in 2014 is only available to an employer for two consecutive tax years. This means that the tax credit is potentially available for a total of six years (the four years from 2010 through 2013, plus the two-year credit period beginning in 2014 or later).

The small business health care tax credit is only available to offset actual tax liability and is claimed on the employer's tax return as a general business credit. It is not payable in advance to the employer, nor is it refundable. IRS Form 8941 (Credit for Small Employer Health Insurance Premiums) is used by small businesses to calculate the health care tax credit. Small businesses that qualify for the tax credit report the amount calculated using Form 8941 as part of their general business credit on Form 3800 (General Business Credit). Revisions to the 2011 version of Form 8941 included shortening the form to remove the reporting of carryforwards, carrybacks, and passive activity limitations for the credit, which are instead reported directly on Form 3800. Both Forms 3800 and 8941 are to be filed as attachments to the tax return of a small business that is claiming the health care tax credit.

**7.) What is required for Alabama businesses that fall below the 50-employee threshold?**

Employers who do not have over 50 FTEs are not need to provide employees health insurance coverage. However, if a small employer does choose to offer employee health coverage, they will have an additional option starting in 2014. In 2014, states are required to establish health insurance "exchanges" for employers (with less than 50 employees) who choose to provide health care to employees though a group health insurance policy. This will be an option that may help offset some of the additional costs that will be associated with health care coverage.

A number of PPACA's provisions, such as essential health benefits, age 26 dependent, and the elimination of annual and lifetime caps apply to the fully-insured market (most small businesses and individual policyholders). This could have the effect of increasing the cost of premiums for small employers. In addition to the potential cost increase, insurance companies are beginning to eliminate some of their offerings, such as limited-coverage "mini-med" policies and other smaller policies.

8.) What steps should an Alabama small businesses consider taking today to prepare for this requirement?

*First Consider “Should I Go Small” (under 50 Full Time and FTEs) ?*

- **First Count the Cost – audit your liability;**
- **Make it part of strategic business plan;**
- **Understand IRS Aggregation and Attribution and Rules on the common control of entities where they may be viewed as one employer for compliance purposes;**
- **Outsource Certain Distinct Business Functions;**
- **Use Independent Contractors Carefully because if not done properly can be classified as employee for compliance purposes;**
- **Consult legal and accounting talent;**

*Employee Handbook Review and Update Changes to Consider*

*New Employee Classifications to be Added?*

- **Full Time Employee 30 hours of service a week (130 hours month) reasonably expected at time of hire (for health care coverage eligibility);**
- **Full Time for other benefit eligibility may be considered;**
- **Part Time Less than 30 reasonably expected at time of hire;**
- **Variable Hour Employee less than 30 hours of service a week reasonably expected and works a variable number of hours each week;**
- **Seasonal Employee – traditionally seasonal type work (agricultural) or holiday if retail;**
- **Leased Employee - Employed by Professional Employer Organization**
- **Temporary Employee**

*ERISA Disclaimer Language Section in Handbook and Plan Document?*

*Many employer benefits included in a benefit plan and employee handbook may be considered an employee welfare benefit plan covered under the Employee Retirement Income Security Act of 1974 (ERISA)*

- **Deal with conflicts between summary plan descriptions and Plan Document;**
- **Preserve right to modify or amend or eliminate benefits;**
- **Preserve sole discretionary authority to interpret benefits;**
- **Preserve sole discretionary authority to determine benefit eligibility;**
- **Completely revise the benefits section of your handbook;**

***Benefits Sections Changes in Handbook?***

- **Adopt Plan Year – typically already in our health insurance contract;**
- **Adopt Initial Measurement Period;**
- **Adopt Administrative Period;**
- **Adopt Stabilization Period;**
- **Review explanation of benefits currently in your Employee Handbook.**

***Plan Review and Amendment?***

- **Have plan reviewed for statutory compliance**
- **Amend Plan to be consistent with Employee Handbook Amendments**
- **Strategically decide how your Employee Benefits fit within your overall Business Plan**

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