



# HEALTH CARE REFORM

## EMPLOYER MANDATE: FULL-TIME EMPLOYEES

Beginning in 2015, PPACA's employer mandate (also known as the "employer shared responsibility" provision or the "pay or play" requirement under health care reform) generally requires large employers to offer coverage to all full-time employees (FTEs) and their dependents or risk paying a penalty. Employers need to understand the possible impact of the employer mandate on plan designs, contribution strategies and workforce planning. This white paper assumes that the employer has already made the determination of whether it is subject to the employer mandate (and for what year it becomes applicable) and focuses on which employees are FTEs to whom the employer must offer coverage. Separate white papers address monthly or look-back measurement periods for seasonal and variable hour employees and which employers are subject to the employer mandate. Contact your advisor for copies.

**The employer mandate requires employers to identify and offer coverage to full-time employees — those working 30 hours of service per week**

### DETERMINING WHICH EMPLOYEES ARE FULL-TIME

Generally, under the employer mandate, employers must offer coverage to substantially all FTEs, defined as those who are employed on average at least 30 hours of service per week (or 130 hours of service per month). Note that this requirement does not include part-time employees or employees who were counted when determining full-time equivalency (because they work less than 30 hours of service per week) for the purpose of determining whether the employer mandate applies. Therefore, understanding the term "hours of service" is very important for determining which employees for whom an employer is at risk for paying a penalty. This term is defined below.

**Hours of Service:** each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer, and each hour for which an employee is paid, or entitled to payment by the employer, for a period of time during which no duties are performed [e.g., vacation or other paid time off (PTO), illness, incapacity (including disability), holiday, layoff, leave of absence, military leave, jury duty, etc.]

For most companies, counting what hours of service were worked and determining eligibility for coverage based on the result will be straightforward. Simply count the employee's service hours, as follows:

#### Hourly Employees

For hourly employees, the employer must calculate actual hours of service from records of hours worked and hours for which payment is made or due (even those when the employee did not work but meets the definition under "hours of service" for paid or unpaid time off). Employers are likely already tracking these hours to pay these employees to ensure compliance with existing federal laws.



### Non-hourly and Salaried Employees

For non-hourly and salaried employees, the employer must calculate hours of service using one of three methods:

1. Actual hours of service from records of hours worked (includes non-working hours for which payment is made or due)
2. A days-worked equivalency, in which the employee is credited with eight hours of service for each day that the employee earns at least one hour of service
3. A weeks-worked equivalency, in which the employee is credited with 40 hours of service for each week that the employee earns at least one hour of service

An employer is not required to use the same method for all non-hourly employees. The employer may apply different methods for different classifications of non-hourly employees, provided the classifications are reasonable and consistently applied. Whatever the method, the result may not substantially understate an employee's hours in a manner that would cause the employee to be treated as not full-time.

Most employers are likely already tracking employees' hours of service for purposes of PTO or leave rights. For example, most large employers are already required to track hours for purposes of protected leave under the federal Family and Medical Leave Act (FMLA) or Fair Labor Standards Act (FLSA), or they choose to track hours for purposes of the employer's PTO plan. If, however, an employer is not currently tracking employees' hours of service, it will have to implement some sort of system to do so (perhaps through a third-party payroll vendor). Whatever the system, employers will need to track employees' hours on a monthly basis since the employer mandate penalties are calculated on a monthly basis. Ask your advisor if you need help with this process.

### SPECIAL RULES FOR EMPLOYEES WITH NONTRADITIONAL WORK SCHEDULES

While the general rule of counting hours for hourly and salaried employees is fairly straightforward, its application to some types of businesses and employees may be more complicated. For example, employers who are in the retail, restaurant, construction and landscaping industries may have high employee turnover, and it may be difficult to track their hours. In addition, commission-based employees and employees with unique work schedules, such as adjunct faculty and employees who are "on-call," may not fit neatly into the above categories for hourly or salaried employees.

Special rules apply to these nontraditional employees, including adjunct faculty, commission-based employees, employees with layover hours (such as the airline or transportation industries) and on-call hours, rehired employees, short-term employees, staffing and leased employees and independent contractors, student workers, teachers and variable hour and seasonal employees. As mentioned previously, a white paper that discusses seasonal and variable hour employees, including the use of measurement and look-back periods, is available from your advisor. Guidelines for tracking hours for the other types of nontraditional employees are outlined below.

#### Adjunct Faculty

In many cases, the compensation for adjunct faculty is not directly tied to the number of hours that they work (e.g., compensation often is tied to classroom hours and does not take into account time spent on non-classroom activities such as lesson preparation, grading papers and exams or counseling students).

For these employees, employers should use a special method, which credits 2.25 hours of service (representing a combination of teaching or classroom time and time performing related tasks such as class preparation and grading of examinations or papers) for each hour of teaching or classroom time. In other words, for each hour spent teaching in the classroom, the employer would credit an additional 1.25 hours for activities such as class preparation and grading. In addition, the employer would credit one hour of service for each additional hour the faculty member spends on other non-classroom duties (such as required office hours or required attendance at faculty meetings). Employers may rely on this method at least through the end of 2015.

#### Commission-based Employees

Employers with commission-based employees will need to use a reasonable method of crediting hours for those employees, which would include travel and preparation time (among other things), not just the time in sales meetings.

### Layover Hours

Special rules apply for employees who may have layover hours, such as airline and transportation industry employees (pilots, flight attendants, train engineers, truck drivers, etc.). If an employee receives compensation for a layover hour beyond any compensation that the employee would have received without regard to the layover hour, or if the layover hour is counted by the employer toward the required hours of service for the employee to earn his or her regular compensation, an employer is required to credit an hour of service for this time.

However, in cases when layover hours are not compensated or are not counted by the employer toward required hours of service, it would be reasonable for an employer to credit an employee with eight hours of service for each day on which an employee is required, as a practical matter, to stay away from home overnight for business purposes. That is, the employer should credit eight hours each day (or 16 hours total) for the two days encompassing the overnight stay. Importantly, the employee must be credited with the employee's actual hours of service for a day if crediting eight hours of service substantially understates the employee's actual hours of service for the day (including layover hours for which an employee receives compensation or that are counted by the employer toward required hours of service).

### On-call Hours

Until further guidance is issued, employers are required to use a reasonable method for crediting hours of service for employees with on-call hours, whether that employee remains on the employer's premises or not during the on-call time. It is unreasonable not to credit an hour of service where the employee

is paid for the on-call hour, where the employee remains on the employer's premises for the on-call hour, or if the employee cannot use the on-call hour effectively for his or her own purposes.

### Rehired Employees

A special rule applies where the employee is terminated but rehired shortly thereafter. If an employee does not earn an hour of service for 13 consecutive weeks and is rehired, then the employee's status (as a full-time, variable hour or seasonal employee) will be determined at the time of rehire. So, in essence, an employee must be rehired 13 weeks (approximately 3.5 months) after termination to exclude any prior hours of service in making the full-time status determination. This special rule would prohibit an employer from firing employees at or around 90 days to avoid the application of the mandate (since employers generally will not be liable for a penalty for the first 90 days of employment if a 90-day waiting period is implemented) and rehiring them shortly thereafter. The rule also comes into play for measurement periods for seasonal and variable hour employees.

### Short-term Employees

Short-term employees whose work or service hours are known to be full time at the time of hire will generally be considered FTEs. For example, if the employer hires an intern who will work 30 hours or more per week for five months, the intern will be considered an FTE. In other words, the employer cannot treat the intern as a variable hour employee (and thereby use a measurement period for the intern), since the intern's schedule is known at the time of hire to be full time, and therefore must offer coverage to the intern.

That being said, employers can implement a 90-day waiting period to exclude employees from coverage for the first 90 days of employment. Specifically, employers will not be liable for an employer mandate penalty if the employee is excluded under a 90-day waiting period (so long as the employee is offered coverage thereafter). Therefore, the employer could avoid the penalty for the first 90 days under a waiting period but then would have to consider the employee an FTE for any full-time employment period beyond the 90 days. In the above example, the intern would not be considered an FTE for the first three months (i.e., 90 days) of the internship, but would be an FTE for the last two months of the internship (and therefore must be offered coverage to avoid a penalty).

### Staffing, Leased Employees and Independent Contractors

Employers that use temporary employee staffing or leasing companies face special issues when determining FTE status. The first step is to determine whether the employees are employees of the recipient organization (RO), which is the employer leasing or using the temporary staffing employees or the staffing/leasing company itself. This is called the "common-law employer" analysis, which turns on which entity has the right to control the employee's work—a facts and circumstances analysis that is beyond the scope of this paper. This is generally the same analysis applicable to the issue of misclassification of independent contractors, also discussed in this section.

**Staffing Employees:** The analysis for staffing employees is very similar to the analysis that should be performed in determining independent contractor/ employee status — which employer (either the RO or staffing agency) is responsible for controlling the employee's work. The IRS has issued basically three different "control" factors that should be used in making the determination:

- Behavioral Control: Does the RO control scheduling, tools, supplies and individual assignments of the individual?
- Financial Control: Does the RO pay the individual directly, or does the staffing agency?
- Relationship Created: Was there an employee offer letter from the RO to the individual? Is the arrangement on a permanent or temporary basis? Does the RO offer the individual other benefits?

The entities would have to go through the analysis and weigh whether enough factors are there, such that the individual is an employee of the RO or of the staffing agency.

### ***When the Employer Is the Staffing Company***

When it has been determined that the staffing company is the common-law employer, the staffing company is responsible for offering coverage to the employee (if he/she is a full time employee) or must pay a penalty under the employer mandate. The next natural question is whether the employee is a variable hour employee. Because temporary staffing firms vary widely in the types of assignments they fill for their recipient clients and in the anticipated assignments that a new employee will be offered, there is not a general presumption either way, but there are some general guidelines.

A new employee will be determined to be a variable hour employee based on several factors related to the typical experience of an employee in the position with the temporary staffing firm that hires the new employee (assuming the temporary staffing firm employer has no reason to anticipate that the new employee's experience will differ). These factors include:

- Whether employees in the same position with the temporary staffing firm retain as part of their continuing employment the right to reject temporary placements that the employer's temporary staffing firm offers the employee
- Whether employees typically have periods during which no offer of temporary placement is made
- Whether employees typically are offered temporary placements for differing periods of time
- Whether employees typically are offered temporary placements that do not extend beyond 13 weeks

More details about the special rules that pertain to variable hour employees are available in our white paper titled "Employer Mandate: Measurement and Look-back Periods." Ask your advisor for a copy.

### ***When the RO Is the Employer***

When it has been determined that the RO is the common-law employer of the employee, then the RO will be responsible for offering coverage (if the individual is an FTE) or risk paying a penalty under the employer mandate. Similar to the rules for multiemployer plans, an RO may meet its obligation to offer coverage to the employee if the staffing company offers coverage to the individual, and that coverage is affordable and meets minimum value. However, the fee that the RO pays to the staffing company must reflect payment for health coverage.

Whether it is the RO or the staffing company, the common-law employer will be considered the employer for purposes of the employer mandate. At that point, the common-law employer will need to determine whether the employee is expected to work at least 30 hours or more per week. If so, then the employee is considered an FTE and must be offered coverage.

Importantly, employees that satisfy a specific definition of a "leased employee," discussed next, may be excluded from consideration as FTEs.

**Leased Employees:** A "leased" employee may be excluded (from the RO's determination of FTEs) for purposes of the employer mandate. This means that if the employee is truly a "leased" employee, the RO would not be considered the employer and would

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The term "leased employee" means any person who is not an employee of the recipient and who provides services to the recipient if:

- Such services are provided pursuant to an agreement between the RO and any other person (usually the leasing company)
- Such person has performed such services for the recipient on a substantially full-time basis for a period of at least one year
- Such services are performed under primary direction or control by the RO

So, somewhat counterintuitively, if the individual has been “leased” to the RO, and that individual has worked for the RO (and under the RO’s primary direction/control) for at least one year, the RO may consider that individual as a leased employee and therefore would not need to offer that individual coverage. In other words, a “leased employee” is not an employee of the RO; he or she is an employee of the leasing company. In that case, the leasing company would be responsible for offering coverage to the employee or would face a penalty (assuming the leasing company is an “applicable large employer” subject to the mandate).

In summary, a leased employee would be considered the employee of the RO the first year and would need to be offered coverage if he or she works more than 30 hours per week if the employer wants to avoid the employer mandate penalty. After the first year, the leased employee would then be considered the employee of the leasing organization. This would mean that the leasing organization, as the individual’s employer, would need to provide coverage to FTEs or pay a penalty (assuming they have 50 or more FTEs, including equivalents).

**Independent Contractors:** The determination of who is an employee versus an independent contractor is based on the nature of the individual’s employment. It includes an analysis of factors such as who directs the individual’s work, provides tools, determines work processes, etc. In plain terms, a contractor is given a project or goal to accomplish. The contractor determines how the project gets completed. If the employer dictates exactly how a project must be completed, then the individual is most likely an employee.

Courts have used the following factors to determine whether an individual is an employee or independent contractor:

- The hiring party’s right to control the manner and means by which the product is accomplished
- The source of the instrumentalities and tools
- The location of the work
- The duration of the relationship between the parties
- Whether the hiring party has the right to assign additional projects to the hired party
- The extent of the hired party’s discretion over when and how long to work
- The method of payment
- The hired party’s role in hiring and paying assistants
- Whether the work is part of the regular business of the hiring party
- Whether the hiring party is in business
- The provision of employee benefits
- The tax treatment of the hired party<sup>i</sup>

Generally speaking, an employer would want to limit its offerings – including tools, supplies, equipment and benefits – to contract employees. If there is too much integration of the employer and the contractor, the IRS may determine the employee to be a misclassified employee. This would have tax implications for the employer as well as past liability on the group health plan<sup>ii</sup>.

Related to the employer mandate, the determination of who is an employee for the employer mandate purpose is based on the nature of the individual’s employment, not the fact that they are called an independent contractor and receive a Form 1099 rather than a Form W-2. It is based on that same test of behavioral and financial control. If the individual truly is a Form 1099 independent contractor, then he or she would not be included as an employee and not offered coverage under the employer’s plan. The offer of coverage to an individual actually adds weight to the argument that they are more of an employee than an independent contractor.

The U.S. Department of Labor (DOL) has made misclassification a focal point of investigation over the last couple of years. Penalties can be high for misclassifying an employee as an independent contractor to get out of paying taxes on them or offering them benefits. The DOL has two helpful resources, as well as information about the misclassification initiative on this issue. These links are available under “Additional Resources” below.

### **Student Workers and Interns/Externs**

Importantly, there is no general exception for student workers or interns/externs. All hours of service for which a student employee of an educational organization (or of an outside employer) is paid or entitled to payment in a capacity other than through the federal work study program or a state or local government’s equivalent are required to be counted as hours of service. However, services by an intern or extern do not count as hours of service to the extent that the student does not receive, and is not entitled to, payment in connection with those hours. Therefore, when student workers, interns or externs are compensated for their services, their hours of service must be counted when determining if the employer is at risk for payment of the employer mandate penalty. Further, student workers, interns or externs who are expected to work 30 hours or more per week may be entitled to coverage under the eligibility terms of group health plan coverage.

## Teachers and Other Employees of Educational Institutions

Considering the traditional summer and winter breaks in academic school years, work schedules of teachers present a clear challenge for educational institutions that are attempting to determine full-time status of their teachers and faculty. There is also a difference depending on whether the employer is using the monthly measurement period to determine whether the employee is a full-time employee, versus the look-back measurement period.

### Look-back Measurement Period

If the leave is **paid**, then the employer must follow the general “hours of service” rule: Hours of service include hours for which the employee is paid even if the employee is not actually working.

If the leave is a period of **unpaid leave, and the employer is using the look-back measurement period**, then the employer may use two alternative methods to calculate the employee’s hours.

- Under the first method, the employer would simply disregard the employment break and use the average over the remaining school year.
- Under the second method, the employer would credit the employee with hours of service during the employment break on a rate equal to the average weekly rate at which the employee is credited during the rest of the school year.

### Monthly Measurement Period

If the leave is paid, then the employer must follow the general “hours of service” rule outlined above: Hours of service include hours for which the employee is paid even if the employee is not actually working.

If the leave is unpaid, and the employer is using the monthly measurement period, the employer must determine whether an employee is a ‘new’ employee upon return from a break in service. The averaging method for periods of special unpaid leave and employment break periods do not apply under the monthly measurement period, regardless of whether the employer is (or is not) an educational organization.

In other words, if an educational organization is counting hours of teachers using the monthly measurement method, a teacher that is unpaid during a summer break is not considered an FTE for the summer months, and therefore need not be offered coverage. However, if they are paid an annual salary, then they would be a FTE (since their salary is paid even if they are not working). There could be situations where teachers are not necessarily a full-time permanent teacher, yet works full-time hours in the teaching months and zero hours during the break, in which case under the monthly measurement period would mean that the teacher is not necessarily an FTE during the summer months.

## EXCLUSIONS

### Members of Religious Orders

Members of religious orders are not treated as FTEs; thus employers should not count as an hour of service any work performed by an individual who is subject to a vow of poverty as a member of that order when the work is in the performance of tasks usually required (and to the extent usually required) of an active member of the order. It is likely that further guidance will be issued clarifying this point.

### Volunteers

Hours of service are generally disregarded for service performed by volunteers for a government entity or a tax-exempt organization (such as volunteer firefighters). However, these individuals may only be excluded from offers of coverage when the only compensation received is in the form of reimbursements for expenses incurred or reasonable benefits or fees customarily paid by similar entities in connection with the services provided by the volunteers.

## ADDITIONAL RESOURCES

### Final Regulations

### IRS FAQs

### DOL Misclassification Initiative

### DOL Fact Sheet

### eLaws Advisor

<sup>1</sup>*Nationwide Mutual Insurance Company v. Darden*, 60 USLW 4242, (March 24, 1992).

<sup>2</sup>*Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997).

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