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Pay or Play Penalty—Special Rules for Temporary Staffing Firms

The Affordable Care Act (ACA) imposes a penalty on large employers that do not offer minimum essential coverage to "substantially all" full-time employees and dependents. Large employers that do offer coverage may still be liable for a penalty if the coverage is unaffordable or does not provide minimum value.

The employer mandate provisions were set to take effect on Jan. 1, 2014. However, on July 2, 2013, the Treasury announced **the delay of the employer mandate 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 provisions of the ACA are affected by the delay.

On Feb. 12, 2014, the IRS published **final regulations** on the ACA's employer shared responsibility rules. These regulations finalize provisions in proposed regulations released by the IRS on Jan. 2, 2013. **Under the final regulations, applicable large employers that have fewer than 100 full-time employees generally will have an additional year, until 2016, to comply with the pay or play rules.** Large employers with 100 or more full-time employees must comply with the pay or play rules starting in 2015.

These rules can be particularly challenging when a temporary staffing firm or professional employer organization (PEO) is involved. The IRS has provided some guidance on issues for these entities in the final regulations.

WHO IS CONSIDERED AN "EMPLOYEE"?

A **common law standard** applies to define the terms "employee" and "employer." Under this 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 ACA's pay or play provisions. Also, independent contractors, sole proprietors, partners in a partnership, 2-percent S corporation shareholders 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.** The final regulations generally treat **130 hours of service in a calendar month** as the monthly equivalent of 30 hours per service per week.

Hours of Service

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

- Each hour for which the 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, 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.

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 employees as full-time employees. However, 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.

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 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. The details of the safe harbor vary based on whether the employees are ongoing or new, and whether new employees are expected to work full time or are variable or seasonal employees.

Employers can use the look-back measurement method for new variable hour employees, seasonal employees and ongoing employees. As long as the employer complies with the requirements, it will not be subject to penalties for these employees. However, if an employee is expected to work full-time, the employer must offer coverage to that employee by the end of the first three calendar months of employment.

The term variable hour employee means an employee if, 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. The final regulations include a number of factors to consider in making this determination.

TEMPORARY STAFFING FIRMS

Because of its unique employment structure, a temporary staffing firm may find it difficult to determine who the employer is with respect to each employee for purposes of the employer mandate. Although the general rule is that leased employees are not considered employees of the service recipient, the final regulations do not adopt a special rule for temporary staffing firms. Thus, the **common law standard** applies.

Offer of Coverage

Under the final regulations, when the temporary staffing firm is *not the common law employer* of the employee, an offer of coverage will be treated as **made by the client employer** for purposes of the employer mandate if:

- The temporary staffing firm makes an offer of coverage to the employee on behalf of the client employer under a plan established or maintained by the temporary staffing firm; and
- The fee the client employer would pay to the temporary staffing firm for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay for the same employee if that employee did not enroll in health coverage under the plan.

An applicable large employer that does not offer coverage to substantially all full-time employees (and dependents) may be subject to a penalty equal to the number of full-time employees (minus 30) multiplied by 1/12 of $2,000 for any applicable month. The final regulations include transition relief for 2015 that allows employers with 100 or more full-time employees to reduce their full-time employee count by 80 when calculating this penalty.

Application of the Look-back Measurement Method

The final regulations recognized that applying the look-back measurement method may be particularly challenging for temporary staffing firms, because of the distinctive nature of their employees' work schedules. Temporary staffing firms vary widely in the types of assignments they fill for their clients and in the anticipated assignments that a new employee will be offered.

As a result, the final regulations **do not adopt a generally applicable presumption** that new employees of a temporary staffing firm are variable hour employees, rather than full-time employees, for purposes of the look-back measurement method.

However, to accommodate these variations and provide additional guidance, the final regulations set forth additional factors relevant to the determination of whether a new employee of a temporary staffing firm intended to be placed on temporary assignments at client organizations is a variable hour employee. These factors generally relate to the typical experience of an employee in the position with the temporary staffing firm (assuming the temporary staffing firm employer has no reason to anticipate that the new employee's experience will differ).

Factors to consider in determining whether the employee is reasonably expected to be full-time during the initial measurement period include (but are not limited to) whether, as part of their continuing employment, other employees in the same position of employment with the temporary staffing firm:

- Retain the right to reject temporary placements that the temporary staffing firm offers the employee;
- Typically have periods during which no offer of temporary placement is made;
- Typically are offered temporary placements for differing periods of time; and
- Typically are offered temporary placements that do not extend beyond 13 weeks.

No factor is determinative. In addition, the determination of whether an employee is a variable hour employee is made on the basis of the temporary staffing firm's reasonable expectations at the start date. Thus, an employee may be classified as a variable hour employee if this categorization was appropriate based on the employer's reasonable expectations at the start date, even if the employee, in fact, averages 30 or more hours of service per week over the initial measurement period.

Separation and 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). 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. However, the break-in-service period for employees of educational organizations is **26 weeks**.

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.

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.

The final regulations do not adopt special rehire rules for employees of temporary staffing firms. Thus, **the general rules for rehired employees applies**. The Treasury noted that special rehire rules for temporary staffing firms may encourage employers to use temporary staffing firms to provide firm employees to perform certain services in order to attempt to improperly avoid offering coverage or incurring penalties under the employer mandate.

In addition, until further guidance is issued, temporary staffing firms (like all employers generally) may determine when an employee has separated from service by considering all available facts and circumstances and by using a reasonable method that is consistent with the employer's general practices for other purposes (such as the qualified plan rules, COBRA and applicable state law).

Examples

The following examples from the IRS illustrate the look-back measurement method as applied with respect to temporary staffing firms. In all of the following examples, the ALE has **200 full-time employees** and **offers all of its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage** under an eligible employer-sponsored plan that is affordable and provides minimum value. In addition, the employer:

- Is in the trade or business of providing temporary workers to numerous clients that are unrelated to the employer and to one another;
- Is the common law employer of the temporary workers based on all of the facts and circumstances;

- Offers health plan coverage only to full-time employees (including temporary workers who are full-time employees) and their dependents; and
- Uses a 12-month initial measurement period (IMP) for new variable hour employees that begins on the start date and applies an administrative period from the end of the IMP through the end of the first calendar month beginning after the end of the IMP.

Example 1: Facts. Employer W hires Employee D on Jan. 1, 2015, in a position under which Employer W will offer assignments to Employee D to provide services in temporary placements at clients of Employer W, and employees of Employer W in the same position as Employee D, as part of their continuing employment, retain the right to reject an offer of placement. Employees of Employer W in the same position of employment as Employee D typically perform services for a particular client for 40 hours of service per week for a period of less than 13 weeks, and for each employee there are typically periods in a calendar year during which Employer W does not have an assignment to offer the employee. At the time Employee D is hired by Employer W, Employer W has no reason to anticipate that Employee D's position of employment will differ from the typical employee in the same position.

Conclusion. Employer W cannot determine whether Employee D is reasonably expected to average at least 30 hours of service per week for the 12-month IMP. Accordingly, Employer W may treat Employee D as a variable hour employee during the IMP.

Example 2: Facts. Employer V hires Employee E on Jan. 1, 2015, in a position under which Employer V will offer assignments to Employee E to provide services in temporary placements at clients of Employer V. Employees of Employer V in the same position of employment as Employee E typically are offered assignments of varying hours of service per week (so that some weeks of the assignment typically result in more than 30 hours of service per week and other weeks of the assignment typically result in less than 30 hours of service per week). Although a typical employee in the same position of employment as Employee E rarely fails to have an offer of an assignment for any period during the calendar year, employees of Employer V in the same position of employment, as part of their continuing employment, retain the right to reject an offer of placement, and typically refuse one or more offers of placement and do not perform services for periods ranging from four to 12 weeks during a calendar year. At the time Employee E is hired by Employer V, Employer V has no reason to anticipate that Employee E's position of employment will differ from the typical employee in the same position.

Conclusion. Employer V cannot determine whether Employee E is reasonably expected to average at least 30 hours of service per week for the 12-month IMP. Accordingly, Employer V may treat Employee E as a variable hour employee during the IMP.

Example 3: Facts. Employer T hires Employee F on Jan. 1, 2015, in a position under which Employer T will offer assignments to Employee F to provide services in temporary placements at clients of Employer T. Employees of Employer T in the same position typically are offered assignments of 40 or more hours of service per week for periods expected to last for periods of three to 12 months, subject to a request for renewal by the client. Employees of Employer T in similar positions to Employee F are typically offered and take new positions immediately upon cessation of a placement. At the time Employee F is hired by Employer T, Employer T has no reason to anticipate that Employee F's position of employment will differ from the typical employee in the same position.

Conclusion. Employer T must assume that Employee F will be employed by Employer T and available for an offer of temporary placement for the entire IMP. Under that assumption, Employer T would reasonably determine that Employee F is reasonably expected to average at least 30 hours of service per week for the 12-month IMP. Accordingly, Employer T may not treat Employee F as a variable hour employee during the IMP.

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Anti-abuse Rule

The IRS also expects to issue future guidance that includes an anti-abuse rule to prevent employers from using temporary staffing firms to avoid the pay or play rules. Under the anticipated anti-abuse rule, if an individual performs services as an employee of an employer, and also performs the same or similar services for that employer in the individual's purported employment at a temporary staffing firm, then **all the hours of service are attributed to the employer** for purposes of the pay or play rules.

Similarly, to the extent an individual performs the same or similar services for the same client of two or more temporary staffing firms, it is anticipated that:

- **All hours of service for that client are attributed to the client**, if the client is the common law employer; or
- **All hours of service are attributed to one of the temporary staffing firms that purports to employ the individual** with respect to services performed for that client, if the client is not the common law employer.

PROFESSIONAL EMPLOYER ORGANIZATIONS

Because of its unique employment structure, a professional employer organization (PEO) may find it difficult to determine who the employer is with respect to each employee for purposes of the pay or play rules. A PEO is an entity that takes on certain employee management tasks for a client company (such as employee benefits, payroll, recruiting and training) by hiring the employees of that company. Through this practice, known as **co-employment**, the PEO becomes the employer of record for tax purposes, while the client company maintains control over the employees' day-to-day activities.

The final regulations do not address how the employer mandate applies to PEOs. Although the general rule is that leased employees are not considered employees of the service recipient for purposes of ACA's pay or play provisions, it is still unclear as to how this applies to PEOs. Until further guidance is issued on the pay or play rules with respect to PEOs, these organizations should use the common law standard to determine whether an employment relationship exists.

Under the final regulations, if certain conditions are met, an offer of coverage made to an employee performing services for a client employer (in the typical case in which the PEO is not the common law employer of the individual) on behalf of the client employer under a plan established or maintained by the PEO is **treated as an offer of coverage made by the client employer for purposes of the employer mandate**. For this purpose, an offer of coverage is treated as made on behalf of a client employer only if the fee the client employer would pay to the PEO for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay for the same employee if the employee did not enroll in health coverage under the plan.

Source: Internal Revenue Service