



## Health Care Reform **Bulletin**

# Pay or Play Penalty—Hours of Service Rules Clarified

Provided by Clarke & Company Benefits, LLC

### Quick Facts

- The employer mandate final rules clarify the hours of service definition.
- The final rules include examples of reasonable methods of crediting hours of service.
- Hours of service do not include any hour for service performed as a bona fide volunteer, as part of a work-study program, or by certain members of religious orders.

**Under the final regulations, an hour of service generally includes each hour for which an employee is paid or entitled to payment.**

The Affordable Care Act (ACA) requires large employers to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. This penalty is known as the shared responsibility or pay or play penalty.

On Feb. 12, 2014, the IRS published [final regulations](#) on the ACA's employer shared responsibility rules. The final regulations clarify the definition of "hours of service" for purposes of the pay or play rules.

### Definition of Hours of Service

In general, an "hour of service" means:

- 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** due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

Under the final regulations, 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 all entities treated as a single employer

under the Code's controlled group and affiliated service group rules must be taken into account.

However, if compensation for hours of service is foreign source income, those hours of service should not be included in an employee's hours of service.

### 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 must calculate hours of service using one of the following three methods:

- Counting actual hours of service from records of hours worked and hours for which payment is made or due;
- Using a days-worked equivalency method under which an employee is credited with eight hours of service for each day with at least one hour of service; or



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- Using a weeks-worked equivalency method under which an employee is credited with 40 hours of service per week for each week with at least one hour of service.

Employers may use different methods for non-hourly employees based on different categories of employees if the categories 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 of service calculated using the days-worked or weeks-worked equivalency must reflect generally the hours actually worked and the hours for which payment is made or due.

#### **Excluded Hours**

Under the final regulations, service performed in certain capacities will not be counted as an hour of service. The Treasury and the IRS continue to consider additional rules for determining hours of service for certain categories of employees whose hours are particularly challenging to identify or track or for whom the final regulations' general rules may present special difficulties.

#### ***Bona fide volunteers***

An hour of service is generally defined as an hour for which an employee is paid or entitled to payment. Accordingly, hours worked by a volunteer who does not receive (and is not entitled to receive) compensation in exchange for the performance of services are not treated as hours of service for purposes of the employer mandate.

In addition, the final regulations provide that the term "hour of service" does not include any hour for services performed as a bona fide volunteer. For this purpose, bona fide volunteers are not limited to volunteer firefighters and emergency medical providers. Rather, a bona fide volunteer is an employee of

a government entity or a tax-exempt organization whose only compensation from that entity or organization is in the form of:

- Reimbursement for (or reasonable allowance for) reasonable expenses incurred in the performance of services by volunteers; or
- Reasonable benefits (including length of service awards), and nominal fees, customarily paid by similar entities in connection with the performance of services by volunteers.

#### ***Work-study Program Participants***

Under the final regulations, the term hour of service does not include any hour for services to the extent those services are performed as part of a federal work-study program or a substantially similar program of a state or political subdivision thereof. The Federal Work-Study Program, as a federally subsidized financial aid program, is distinct from traditional employment in that its primary purpose is to advance education. This exclusion is intended to avoid having the employer mandate interfere with that goal.

However, the final regulations do not include a general exception for student employees or paid interns or 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 for purposes of the employer mandate.

To the extent that the student does not receive, and is not entitled to, payment in connection with those hours, services by an intern or extern would not count as hours of service under the general definition of hours of service contained in the regulations.

#### ***Members of Religious Orders***

Until further guidance is issued, a religious order is permitted to 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.

### ***Section 3508 Employees—Real Estate Agents and Direct Sellers***

Under the final regulations, the categories of workers identified in section 3508 (that is, real estate agents and direct sellers) are not treated as employees for purposes of the employer mandate. Therefore, the hours of service worked by these employees are not taken into account.

### **Application of Hours of Service to Certain Employees—Examples**

Until further guidance is issued, employers of other employees whose hours of service are particularly challenging to identify or track or for whom the final regulations' general rules for determining hours of service may present special difficulties (such as adjunct faculty, employees with layover hours (including the airline industry), employees with on-call hours, commissioned salespeople, etc.) are required to use **a reasonable method of crediting hours of service that is consistent with the employer mandate.**

A method of crediting hours is not reasonable if it takes into account only a portion of an employee's hours of service with the effect of characterizing, as a non-full-time employee, an employee in a position that traditionally involves at least 30 hours of service per week.

The following examples provided by the IRS describe methods of crediting hours of service that are (or are not) reasonable to use with respect to adjunct faculty, layover hours (including for airline industry employees) and on-call hours. These examples are not intended to constitute the only reasonable methods of crediting hours of service. Whether another method of crediting hours of service in these situations is reasonable is based on the relevant facts and circumstances.

### ***Adjunct Faculty***

With respect to adjunct faculty members of an educational organization who are compensated on the basis of the number of courses or credit hours assigned, the Treasury and the IRS have determined that, until further guidance is issued, one (but not the only) method that is reasonable for this purpose would credit an adjunct faculty member of an institution of higher education with:

- **Two and one-quarter 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) per week for each hour of teaching or classroom time (in other words, in addition to crediting an hour of service for each hour teaching in the classroom, this method would credit an additional 1 1/4 hours for activities such as class preparation and grading); and, separately,
- **An hour of service per week** for each additional hour outside of the classroom the faculty member spends performing duties he or she is required to perform (such as required office hours or required attendance at faculty meetings).

Although further guidance may be issued, this method may be relied upon at least through the end of 2015. If future guidance modifies an employer's ability to rely on this method, the period of reliance will not end earlier than Jan. 1 of the calendar year beginning at least six months after the date the guidance was issued (but in no event earlier than Jan. 1, 2016).

### ***Layover Hours for Airline Industry***

With respect to layover hours, it is not reasonable for an employer to not credit a layover hour as an hour of service if:

- The employee receives compensation for the layover hour beyond any compensation that the employee would have received without regard to the layover hour; or



- The employer counts the layover hour towards the required hours of service for the employee to earn his or her regular compensation.

For example, if an employer requires that an employee perform services for 40 hours per week to earn full salary, and credits “layover hours” towards the 40 hours, then it would not be reasonable for the employer to fail to credit the layover hours as hours of service.

For layover hours for which an employee does not receive additional compensation and that the employer does not count towards 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 to stay away from home overnight for business purposes (that is, eight hours each day, or 16 hours total, for the two days encompassing the overnight stay).

The employee must be credited with his or her 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 the employer counts towards required hours of service). Other methods of counting hours of service may also be reasonable, depending on the relevant facts and circumstances.

#### ***On-call Hours***

For purposes of calculating on-call hours, it is not reasonable for an employer to fail to credit an employee with an hour of service for any on-call hour for which:

- Payment is made or due by the employer;
- The employee is required to remain on-call on the employer’s premises; or
- The employee’s activities while remaining on-call are subject to substantial restrictions that prevent the employee from using the time effectively for the employee’s own purposes.

#### **More Information**

For more information on the employer shared responsibility regulations, see the most recent [IRS Questions and Answers](#).

*Source: U.S. Treasury Department*

