Employer Shared Responsibility Rules (Pay-or-Play Rules)



Applicable Large Employers

Only ALEs are subject to the employer shared responsibility rules.

* ALEs are employers that employ, on average, **at least 50 full-time employees, including full-time equivalent employees (FTEs),** during the preceding calendar year.
* All ALEs are subject to these rules, including for-profit, nonprofit and government employers.

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 is also known as the “employer shared responsibility” or “pay-or-play” rules.

An ALE will face a penalty if one or more full-time employees obtain a subsidy through an Exchange. Full-time employees are those working an average of 30 or more hours per week (or 130 hours in a calendar month). An individual may be eligible for a subsidy either because the ALE does not offer coverage or offers coverage that is “unaffordable” or does not provide “minimum value.”

There are two types of penalties that can apply to ALEs under the pay-or-play rules – the Section 4980H(a) penalty and the Section 4980H(b) penalty. These penalty amounts are adjusted for inflation each year.

This Compliance Overview provides a summary of the ACA’s employer shared responsibility rules and the associated penalties.

Links and Resources

* On Feb. 12, 2014, the IRS published [final regulations](https://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage) on the ACA's employer shared responsibility rules.
* The IRS has also provided [Questions and Answers](https://www.irs.gov/Affordable-Care-Act/Employers/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act) for employers on the employer shared responsibility rules.

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Potential Penalties

* Two separate penalties can apply under the employer shared responsibility rules—the Section 4980H(a) penalty and the Section 4980H(b) penalty.
* Only one of the penalties will apply for an ALE in each situation; both penalties cannot apply to the same ALE at the same time.

Applicable Large Employers

Only an ALE may be subject to shared responsibility penalties regarding employer-sponsored health coverage. An ALE is an employer with, on average, **at least 50 full-time employees, including full-time equivalent employees (FTEs),** during the preceding calendar year.

In determining whether an employer is an ALE, both full-time and part-time employees are included in the calculation. Full-time employees are those working an average of **30 or more hours per week** (or 130 hours in a calendar month). The hours worked by part-time employees (that is, those working less than 30 hours per week) are included in the ALE calculation on a monthly basis by dividing their total number of monthly hours worked by 120. These are called full-time equivalent employees (FTEs).

***Example:*** A company has 35 full-time employees (30+ hours), and 20 part-time employees who all work 24 hours per week (96 hours per month). The part-time employees’ hours are treated as equivalent to 16 full-time employees, based on the following calculation: 20 employees X 96 hours/120 = 1920/120 = 16. This company would be considered an ALE, based on a total FTE count of 51. That is, 35 full-time employees plus 16 FTEs, based on part-time hours.

Table 1 illustrates whether certain groups of employees are counted in determining whether an employer is an ALE and whether they are included in any penalty calculation.

**Table 1. Determination and Potential Application of Employer Penalties for Categories of Employees**

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| **Employee Category** | **How is this category of employee used to determine ALE status?** | **If the employer is an ALE, could it be subject to a penalty if this type of employee received a subsidy?** |
| **Full-time** | Counted as one employee, based on a 30-hour or more work week | Yes |
| **Part-time** | Pro-rated (calculated by taking the hours worked by part-time employees in a month divided by 120) | No |
| **Seasonal** | Counted in initial calculation, but a special rule may apply | Yes, for the month in which the seasonal worker is full-time |
| **Temporary Agency** | Generally, counted as working for the temporary agency (except for those workers who are independent contractors) | Yes, for those counted as working for the temporary agency |

Full-time Employee Status Determinations

Under these rules, ALEs must identify full-time employees for purposes of offering health plan coverage and avoiding an employer shared responsibility penalty.

Who Is Considered An “Employee?”

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| 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 employer shared responsibility rules. Also, an independent contractor, a sole proprietor, a partner in a partnership, a 2% S corporation shareholder and real estate agents and direct sellers (under Code Section 3508) are not counted as employees. |

Who Is a Full-time Employee?

A full-time employee is one who was employed, on average, at least **30 hours of service per week** (or **130 hours of service in a calendar month**).

Hours of Service

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| To determine an employee’s hours of service, an ALE must count: |  | * ***Working Hours***: Each hour for which the employee is paid, or entitled to payment, for the performance of duties for the ALE; 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 considered; 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 Internal Revenue Code’s controlled group and affiliated service group rules must be considered. 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 are not counted to the extent the compensation for those hours constitute **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 shared responsibility rules. However, all hours of service for which an individual receives U.S. source income are hours of service for purposes of these rules.

Various Employee Categories

The IRS provided the following clarifications regarding whether employees of certain types or in certain occupations are considered full-time for purposes of these rules.

* ***Volunteers***: Hours worked by bona fide volunteers for a government or tax-exempt entity (such as volunteer firefighters and emergency responders) will not cause them to be considered full-time.
* ***Educational employees***: Teachers and other educational employees are not considered part-time for the year simply because the school is closed or operating on a limited schedule in the summer.
* ***Seasonal employees***: Seasonal employees are defined as those in positions for which the customary annual employment is six months or less. ALEs can use the look-back measurement method to determine whether seasonal employees are full-time.
* ***Student work-study programs***: Service performed by students under federal or state-sponsored work-study programs will not be counted in determining whether they are full-time employees.
* ***Adjunct faculty***: Until further guidance is issued, employers of adjunct faculty are to use a method of crediting hours of service for those employees that is reasonable in the circumstances and consistent with the employer shared responsibility provisions. However, to accommodate the need for predictability and ease of administration, ALEs may credit an adjunct faculty member with 2¼ hours of service per week for each hour of teaching or classroom time as a reasonable method for this purpose.

IRS Measurement Methods

Two methods for determining full-time employee status are available—the **monthly measurement method** and the **look-back measurement method**. These methods provide minimum standards for identifying employees as full-time employees. ALEs may decide to treat additional employees as eligible for coverage, or otherwise offer coverage more expansively than would be required to avoid a penalty.

**In general, an ALE must use the same measurement method for all employees.** Thus, an ALE generally cannot use the monthly measurement method for employees with predictable hours and the look-back measurement method for employees whose hours vary. However, an ALE may apply either the monthly measurement method or the look-back measurement method to the following groups of employees:

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| 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 ALEs, particularly if employees have varying hours or employment schedules, and could result in employees moving in and out of coverage on a monthly basis.

An ALE will not be subject to an employer shared responsibility 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 for an employee.

Look-back Measurement Method

To give ALEs flexible and workable options and greater predictability for determining full-time employee status, an optional look-back measurement method is available 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 ALE has discretion in deciding how long these periods will last, subject to specified IRS parameters.

Potential Penalties

Regardless of whether or not an ALE offers coverage, it will be potentially liable for a penalty ***only if*** at least one of its full-time employees receives a subsidy for coverage purchased through an Exchange. A full-time employee includes only those individuals working 30 hours or more per week. As shown in Table 1, part-time workers are *not* included in penalty calculations, even though they are included in the determination of whether an employer is an ALE. An ALE will not pay a penalty for any part-time worker, even if that part-time worker receives a subsidy.

Individuals who are not offered employer-sponsored coverage (and who are not eligible for Medicaid or other programs) may be eligible for a premium tax credit for coverage purchased through an Exchange if they have income between 100% and 400% of the federal poverty level (FPL). Individuals who are offered employer-sponsored coverage can only obtain subsidies for Exchange coverage if, in addition to the other criteria above, they also are not enrolled in their employer’s coverage and their employer’s coverage is either **unaffordable** or **does not provide minimum value**.

Other ACA provisions will also affect whether full-time employees can obtain a subsidy for Exchange coverage. For example, Exchanges have “screen and enroll” procedures in place for all individuals who apply for subsidies, which means that individuals who apply for subsidies must be screened for Medicaid and the state Children’s Health Insurance Program (CHIP) eligibility and, if found eligible, are to be enrolled in those programs. Exchange subsidies will not be an option for these individuals. This could affect whether any of an ALE’s full-time employees obtain an Exchange subsidy.

Penalty for ALEs Not Offering Coverage—The 4980H(a) Penalty

Under Section 4980H(a), an ALE will be subject to a penalty if it does not offer coverage to “substantially all” full-time employees (and dependents) and any of its full-time employees receives an Exchange subsidy. However, the 4980H(a) penalty will not apply to an ALE that intends to offer coverage to all of its full-time employees but fails to offer coverage to a few of these employees, regardless of whether the failure to offer coverage was inadvertent.

An ALE satisfies the requirement to offer minimum essential coverage to “substantially all” of its full-time employees and their dependents if it offers coverage to **at least 95%**—or fails to offer coverage to 5% (or, if greater, five)—of its full-time employees (and dependents). The alternative margin of five full-time employees is designed to accommodate relatively small ALEs, because a failure to offer coverage to a handful of full-time employees might exceed 5% of the ALE’s full-time employees.

Under Section 4980H(a), the monthly penalty assessed on ALEs that do not offer coverage to substantially all full-time employees (and their dependents) is equal to **the ALE’s number of full-time employees (minus 30) x 1/12 of $2,000, for any applicable month.**

However, ALEs are not required to include any employees who are in a limited non-assessment period in the penalty calculation. A “**limited non-assessment period**” is a period during which an ALE will not be subject to an employer shared responsibility penalty for a full-time employee, regardless of whether that employee is offered health coverage during that period. These periods include:

* January through March of the employer’s first year as an ALE, for an employee who was not offered coverage by the employer during the prior calendar year;
* A permitted waiting period under either the look-back measurement method or the monthly measurement method;
* A new employee’s initial measurement period under the look-back measurement method;
* The period following an employee’s change in employment status that occurs during his or her initial measurement period under the look-back measurement method; and
* An employee’s first calendar month of employment, if he or she begins employment on a day other than the first of the month.

The $2,000 penalty amount is indexed by the premium adjustment percentage for the calendar year. The adjusted Section 4980H(a) penalty amounts are **$2,880** for 2023, **$2,970** for 2024 and **$2,900** for 2025.

Penalty for ALEs Offering Coverage—The 4980H(b) Penalty

ALEs that do offer coverage to substantially all full-time employees (and dependents) may still be subject to penalties if at least one full-time employee obtains a subsidy through an Exchange because:

* The ALE did not offer coverage to **all full-time employees**; or
* The ALE’s coverage is **unaffordable** or does not provide **minimum value**.

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| Affordability | Employer-sponsored coverage is considered “unaffordable” if the employee’s required contribution for the lowest cost self-only coverage exceeds 9.5% (as adjusted annually) of his or her household income for the year. Because an employer generally will not know an employee’s household income, three optional affordability safe harbors are available for ALEs to determine affordability based on information that is available to them—the Form W-2 safe harbor, the rate of pay safe harbor and the federal poverty level safe harbor.  The affordability contribution percentage is adjusted annually, as follows: 9.12% for 2023; 8.39% for 2024; and 9.02% for 2025. |
| Minimum Value | Employer-sponsored coverage fails to “provide minimum value” if:   * The plan’s share of total allowed costs of benefits provided under the plan is less than 60% of those costs; and/or * The plan does not provide coverage for in-patient hospitalization or physician services.   Four approaches may be used to determine whether an employer’s health coverage provides minimum value—a Minimum Value calculator, safe harbor checklists, actuarial certification or, for plans in the small group market, a “metal level” of coverage. |

Under Section 4980H(b), the monthly penalty assessed on an ALE for each full-time employee who receives a subsidy is **1/12 of $3,000 for any applicable month**. However, the total penalty for an ALE would be limited to the Section 4980H(a) penalty amount.

The $3,000 penalty amount is indexed by the premium adjustment percentage for the calendar year. The adjusted Section 4980H(b) penalty amounts are **$4,320** for 2023, **$4,460** for 2024 and **$4,350** for 2025.

Offer of Coverage

If an employee has not been offered an effective opportunity to accept coverage (or decline to enroll), the employee will not be treated as having been offered the coverage for purposes of the employer shared responsibility rules. This offer must be made at least **once during the plan year**.

The employee must also have an **effective opportunity to decline** an offer of coverage that is not affordable or does not provide minimum value. However, an effective opportunity to decline is not required for an offer of coverage that provides minimum value and is either affordable based on the FPL safe harbor or no cost to the employee. Thus, an ALE may not render an employee ineligible for subsidized coverage by providing an employee with mandatory coverage (that is, coverage which the employee is not offered an effective opportunity to decline) that does not provide minimum value.

For an employee to be treated as having been offered coverage for a month (or any day in that month), the coverage offered, if accepted, must be applicable for that month (or that day). **If an ALE fails to offer coverage to a full-time employee for any day of a calendar month during which the employee was employed, the employee is treated as not being offered coverage during that entire month**. However, a full-time employee who terminates employment in a calendar month will be treated as having been offered coverage during that month if the employee would have been offered coverage for the entire month if he or she had been employed for the entire month.

If an employee enrolls in coverage but **fails to pay the employee’s share of the premium on a timely basis**, the ALE is not required to provide coverage for the period for which the premium is not timely paid but will still be treated as having offered that employee coverage for the remainder of the coverage period (typically the remainder of the plan year) for purposes of the employer shared responsibility rules.

Examples

Table 2 shows four types of scenarios reflecting health coverage offerings of four ALEs (columns A through D) and whether any employer shared responsibility penalty applies. In these ALE scenarios, the employer size is assumed to remain constant, at 50 full-time employees, throughout the year. The table provides examples of the penalty consequences based on whether the ALE offers coverage and whether an employee receives a subsidy.

***Note:******These examples do not take into account adjustments that are made to the penalty amounts for each year.*** *Also, although the penalties are assessed on a monthly basis (with the dollar amounts above divided by 12), these examples use annual amounts, assuming the number of affected employees is the same throughout the year.*

The four scenarios are as follows:

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| SCENARIO A | The ALE does not offer coverage, but no full-time employees receive an Exchange subsidy. No penalty would be assessed. |
| SCENARIO B | The ALE does not offer coverage, and one or more full-time employees receive an Exchange subsidy. The annual penalty calculation is the ALE’s number of full-time employees minus 30, multiplied by $2,000 (as adjusted annually). In this example (using 50 full-time employees), the penalty would not vary if only one employee or all 50 employees received a subsidy. The ALE’s annual penalty would be (50 - 30) x $2,000—or $40,000. |
| SCENARIO C | The ALE offers coverage, and no full-time employees receive an Exchange subsidy. No penalty would be assessed. |
| SCENARIO D | The ALE offers coverage, but one or more full-time employees receive an Exchange subsidy. The number of full-time employees receiving a subsidy is used in the penalty calculation for an ALE that offers coverage. The annual penalty is the lesser of:   * The number of the ALE’s full-time employees minus 30, multiplied by $2,000—or $40,000, for an ALE with 50 full-time employees; or * The number of the ALE’s full-time employees who receive an Exchange subsidy, multiplied by $3,000. |

If an ALE with 50 full-time employees had 10 full-time employees who received a subsidy, then the potential annual penalty for the ALE for those individuals would be $30,000. Because this is less than the overall limitation for this ALE of $40,000, the penalty in this example would be $30,000.

However, if an ALE with 50 full-time employees had 30 full-time employees who received a subsidy, the ALE’s potential annual penalty for those individuals would be $90,000. Because $90,000 exceeds this ALE’s overall limitation of $40,000, the penalty in this example would be limited to $40,000.

**Table 2. Potential Annual Penalties for ALEs**

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| Not an ALE: Less than 50 Full-time (and FTE) Employees | ALE: 50 or more full-time (and FTE) Employees | | | |
| Does not offer coverage to substantially all full-time employees (and dependents) | | Offers coverage to substantially all full-time employees (and dependents) | |
| **Scenario A**  No full-time employees receive an Exchange subsidy | **Scenario B**  One or more full-time employees receive an Exchange subsidy | **Scenario C**  No full-time employees receive an Exchange subsidy | **Scenario D**  One or more full-time employees receive an Exchange subsidy |
| No penalty | No penalty | Number of full-time employees minus 30, multiplied by $2,000 | No penalty | Lesser of:   * Number of full-time employees minus 30, multiplied by $2,000 * Number of full-time employees who receive an Exchange subsidy multiplied by $3,000   Penalty is $0 if the ALE has 30 or fewer full-time employees, because it is based on the lesser of the two calculations |