How to avoid expensive tax penalties under the Affordable Care Act

By the New York State Association of School Attorneys

A law commonly called "Obamacare" – the Patient Protection and Affordable Care Act or ACA – was signed into law by President Barack Obama nearly three years ago. Since then, school officials have speculated about its practical implications for school districts. But some key issues were clarified on Dec. 28, 2012, when the IRS issued proposed regulations. These regulations explain when employers – including school districts – will be liable for tax penalties under the ACA.

The good news is that districts can take steps to avoid or limit these tax penalties. Because the law uses the number of full-time employees to determine whether sufficient coverage has been provided to meet requirements, districts need to develop expertise on determining when substitute teachers, bus drivers and other "variable hour" employees become full-time employees under the law.

The Play-or-Pay Mandate

The ACA requires employers with at least 50 full-time employees (including full-time equivalents) to offer health care coverage to their full-time employees or potentially pay a penalty. Even employers who provide coverage may have to pay a penalty, depending on the benefits provided and the cost of employee portions of premiums relative to employees' salaries. This is called the "play-or-pay" mandate. The relevant provisions take effect in 2014.

The law authorizes the creation of health benefit exchanges from which individuals can purchase health insurance. All current employees must be given notice, no later than Oct. 1, 2013, explaining the availability of exchange coverage and that they may be eligible for new, refundable tax credits to cover a portion of exchange insurance premiums. Americans with incomes up to four times the federal poverty level may qualify.

The penalty for employers primarily will arise when a full-time employee obtains federally subsidized insurance through an exchange and qualifies for subsidized health insurance based on income.

Under the provisions of Internal Revenue Code section 4980H, an employer will be liable for a tax penalty if one or more of its full-time employees receives a premium subsidy for health insurance purchased through an exchange *unless:* (1) the employer offers coverage to at least 95 percent of its full-time employees (and their dependents) and (2) the employer plan is affordable and provides minimum value.

A plan fails to provide "minimum value" if the plan's share of the total allowed costs of benefits provided under the plan is less than 60 percent of such costs. "Affordable" generally means that the employee portion of the individual premium for the employer's lowest cost coverage that provides minimum value does not exceed 9.5 percent of the employee's W-2 income.

Two penalties can apply:

1. No coverage penalty. Employers that do not offer coverage to at least 95 percent of all full-time employees could be liable for a penalty of up to $2,000 per year for each full-time employee in excess of 30. For example, District A has 500 full-time employees. District A provides a plan, but excludes 30 full-time employees (6 percent). If one of the excluded full-time employees receives subsidized coverage under an exchange, District A would be liable for a $940,000 penalty ($2,000 x (total number of all full-time employees – 30)).

2. Affordability/minimum value penalty. If an employer offers coverage to at least 95 percent of full-time employees, but the coverage is either unaffordable

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When does a substitute teacher become FTE? Sometimes, too late for coverage under ACA

Avoiding denying health coverage to substitute teachers who achieve full-time status will be a challenge for school districts under the Affordable Care Act (ACA). The law calls for employers to consider the number of hours worked on a month-by-month basis, but a district may not know until a month is over which substitutes are full-time. And by then it is too late to offer coverage.

The ACA defines full-time employees as those who average at least 30 hours of service per week (or generally 130 hours of service in a month).

Districts can avoid the possibility of needing to provide health care coverage for substitutes if they ensure that no substitute has more than 130 hours of service per month. But educational needs may require otherwise. In that case, districts should track the number of hours worked by each substitute and follow IRS regulations on what the law calls "variable hour" employees.

A variable hour employee is defined under the regulations as an employee for whom, on the date of hire, the employer cannot reasonably determine the number of hours of service an employee is expected to be employed.

For variable hour employees, districts should take advantage of a safe harbor measurement/stability period described in the IRS regulations. Under the safe harbor, an employer may use a system of looking back to determine if a variable hour employee should be classified as full-time. This system includes three periods of time, a standard measurement period, an optional administrative period and a stability period.

Under this safe harbor, an employer would first establish a measurement period between three and 12 months. The employer would track the hours of service for an employee during this measurement period. The employer then can choose to have an administrative period of up to 90 days to determine if the employee averaged 30 hours a week (or 130 hours of service per month) during the measurement period, and if so, take the steps necessary for providing coverage during the stability period. If, during the measurement period, the employee averaged at least 30 hours of service a week (or 130 hours of service per month), then the employee would be treated as a full-time employee during a stability period regardless of the number of hours of service during the stability period. The stability period would last the longer of the length of the measurement period, or six months.

For newly hired variable hour employees the process will be similar, but rather than looking back at the past service, the measurement period is prospective. The district would establish an initial measurement period, followed by an administrative period (total cannot exceed 13 months) and a stability period.

Continuing employee or new hire?

Substitutes, especially the good ones, may be hired several different times in a month. They may also be hired for a lengthy period of regular employment (i.e., a long-term substitute) followed by a period of intermittent substitute service. When should a district reset the measurement or stability period, and when should it include the unemployed time into the hours of service calculation?

The answer is to measure the length of the break between the termination and rehire dates. If the break is long enough, then the district should treat the substitute as a rehire and restart the initial measurement period. If not long enough, then the district should continue the prior measurement or stability period. If the break in service is at least 26 weeks or meets the requirements of the Rule of Parity (is the longer of the length of the prior employment or 4 weeks), then the break in service is "long enough" for the district to treat the substitute as a new hire.

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or does not provide minimum value, then the employer would be liable for a penalty if a full-time employee receives subsidized coverage under an exchange. The annual penalty would be the lesser of the no coverage penalty or $3,000 times the number of full-time employees that actually receive a subsidy. Using the previous example of District A with 500 full-time employees, suppose all full-time employees are offered coverage but the coverage is unaffordable for 10 employees. If five of those employees receive subsidized coverage through the exchange, then the employer penalty would be $15,000.

Calculating which employees are full-time

School officials will find conforming to the ACA particularly burdensome because of the importance the law places upon calculations involving the number of full-time employees. School districts typically find it difficult, if not impossible, to predict the schedules of certain employees, such as substitute teachers, who, based upon the number of hours worked, can become "full-time employees" for purposes of the ACA (see sidebar, p. 15).

In this context, full-time employees are defined as those who average at least 30 hours of service per week (or generally 130 hours of service in a month). Hours of service include not only hours when work is performed, but also hours for which an employee is paid or entitled to payment even when work is not performed (i.e., holiday, sick leave, disability, paid leave of absence).

Calculating the service time of hourly employees is fairly straight forward: Hours of service for hourly employees include actual hours worked plus paid time off.

For salaried employees, districts can choose from the following three methods to determine hours of service for non-hourly employees: (1) counting actual hours of service for hours worked and hours for which payment is made or due; (2) counting days-worked equivalency method (8 hours per day for each day an employee has at least one hour of service); or (3) weekly equivalency method (40 hours per week for each week an employee has at least one hour of service).

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Two rules apply:

Anti-Abuse Rule. Districts are restricted from the use of an equivalency method if the result would be to substantially understate an employee's hours of service such that it would cause the employee not to be classified as full-time.

Special Rule for Educational Employers. Educational employers present a special situation compared to other workplaces because they typically function on the basis of an academic year, which involves various extended breaks (i.e., summer break). If educational employers take summer break into consideration when calculating hours of service, employees who typically work at least 30 hours per week during the active portion of the academic year would likely drop below the minimum threshold and become part-time employees. To deal with this situation, the proposed regulations include a special rule for educational employers that provides an averaging method for these types of breaks, which generally results in an employee who works full-time during the active portions of the academic year being treated as a full-time employee for purposes of these rules.

In light of the ACA, administrators will have to determine what strategy is best for their district to avoid the penalties. Those strategies may include simply providing coverage or tracking use of variable hour employees, particularly substitute teachers, and offer health care coverage on a more limited basis. Administrators should work closely with their attorney to develop a strategy that works best for their district.

Editor's Note: Beginning in 2018 there will also be tax implications for employees under the ACA's so-called "Cadillac tax" on health plans with high benefits. This could become a collective bargaining issue in affected school districts. A NYSSBA analysis of how many employees and districts will be affected by the law will be summarized in an upcoming issue of *On Board*.

Members of the New York State Association of School Attorneys represent school boards and school districts.

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