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## Pay or Play Penalty—Changes in Employment Status under the Look-back Measurement Method

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

On Feb. 12, 2014, the Internal Revenue Service (IRS) published [final regulations](#) on the employer shared responsibility rules. These final rules provide an optional safe harbor method, called the **look-back measurement method**, which employers can use to determine full-time employee status. The final rules also provide guidance on how to treat employees who change employment status under the look-back measurement method.

On Sept. 18, 2014, the IRS issued [Notice 2014-49](#). This notice describes a **proposed approach for applying the look-back measurement method, if the measurement period for a particular employee changes**. This might occur when an employee transfers from one position to another, where a different measurement period is used for the new position. The approach in Notice 2014-49 is not finalized, but taxpayers may rely on the proposed approach until further guidance is issued—at least **through the end of 2016**.

### THE LOOK-BACK MEASUREMENT METHOD

For purposes of the pay or play rules, a full-time employee is an employee who was employed, on average, at least **30 hours of service per week**. The final rules provide two methods for determining full-time employee status: the monthly measurement method and the look-back measurement method.

Under the look-back measurement method, an employee is generally treated as full time for any month within a **stability period** if the employee averaged 30 or more hours of service per week during the applicable **measurement period** preceding the stability period. ALEs using the look-back measurement method establish two separate measurement periods, subject to certain rules on minimum and maximum length:

- The **standard measurement period** (SMP), used for ongoing employees (generally, all employees who have been employed for at least one full SMP); and
- The **initial measurement period** (IMP), used for new variable hour, seasonal or part-time employees.

**In general, an ALE must use the same measurement method for all employees, although** ALEs may use different measurement methods (or different measurement periods) for the following specified categories of employees:

Each group of collectively bargained employees covered by a separate bargaining agreement	Employees whose primary places of employment are in different states
Salaried and hourly employees	Collectively bargained and non-collectively bargained employees

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## CHANGES IN EMPLOYMENT STATUS

Special rules may apply when an employee experiences a change in employment status. The special rules that apply will differ depending on whether the employee is ongoing or new, and depending on the circumstances surrounding the change.

## RULES FOR NEW EMPLOYEES UNDER THE LOOK-BACK MEASUREMENT METHOD

The look-back measurement method includes a special rule for variable hour and seasonal employees who experience a change in employment status during the IMP. This rule applies in situations where, if the employee had begun employment in the new position or status, the employee would have reasonably been expected to be employed, on average, at least 30 hours of service per week (or, he or she experiences a change in employment status from part time to full time).

In general, the employer will not be subject to a penalty for these employees until **the first day of the fourth full calendar month following the change in employment status**, if the employer provides coverage:

- At the end of that period; or
- If earlier and the employee is a full-time employee based on the IMP, the first day of the first month following the end of the IMP (including any optional administrative period associated with the IMP).

## RULES FOR ONGOING EMPLOYEES UNDER THE LOOK-BACK MEASUREMENT METHOD

In general, under the look-back measurement method, full-time employee status in a stability period is based on hours of service in the prior applicable measurement period. This is the case **regardless of whether the employee experiences a change in employment status** during the measurement period or stability period. Normally, if the change in employment status results in a change in hours of service during a stability period, that change is captured in a subsequent measurement period, which will affect full-time status in a subsequent stability period.

However, there is an exception in some situations where a full-time employee changes to part-time status during a stability period. This is a limited exception and specific requirements must be met.

### ***Special Rule for Employees Who are Continuously Offered Minimum Value Coverage***

The final regulations provide a special rule for an employee who changes to a position in which the employee will average less than 30 hours of service per week, in limited circumstances. This special rule allows an employer to begin applying the monthly measurement method sooner than required under the standard rules governing changes in methods for an employee to whom the look-back measurement method has been applied.

This rule can be used for an employee only if:

- The employee was offered minimum value coverage from at least the first day of the month after the initial three full calendar months of employment through the month in which the change in employment status occurs.
- The employee has less than 30 hours of service per week, on average, during each of the three full calendar months following the change in employment status.

If these requirements are met, an ALE may apply the monthly measurement method to the employee in lieu of the otherwise applicable stability period. The ALE can make this change beginning on the first day of the fourth full calendar month following the change in employment status.

Under this rule, an employer may apply the monthly measurement method to an employee even if the employer does not apply the monthly measurement method to employees in the same category. The employer may continue to apply

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the monthly measurement method through the end of the first full measurement period (and any associated administrative period) that would have applied under the applicable look-back measurement method.

## RULES FOR ONGOING EMPLOYEES SWITCHING MEASUREMENT METHODS

Different rules also apply to an employee who experiences a change in employment status from a position for which the look-back measurement method is used to a position for which the monthly measurement method is used (or vice versa). In general, these rules are intended to protect an employee's status as a full-time employee during the transition period.

### ***Transfer From a Look-back Measurement Method Position to a Monthly Measurement Method Position***

The following rules apply for an ongoing employee who transfers from a position for which the employer is using the look-back measurement method to a position for which the employer is using the monthly measurement method. If, at the time of the transfer, the employee is in:

A stability period during which he or she is **treated as full time**

The employee must continue to be treated as a full-time employee during the remainder of the stability period

A stability period during which he or she is **not treated as full time**

The employer may continue to treat the employee as not a full-time employee during the remainder of the stability period

For the stability period that immediately follows the stability period during which the employee transferred, the employee must be treated as full time for any calendar month during which he or she would be full time under either:

- The previously applicable look-back measurement method (and thus not lose the hours of service accumulated during the measurement period during which the transfer occurs); or
- The applicable monthly measurement method.

After the stability period immediately following, the employer may determine the employee's status solely using the monthly measurement method.

### ***Transfer From a Monthly Measurement Method Position to a Look-back Measurement Method Position***

For an employee transferring from a position in which the monthly measurement method applies to a position in which the look-back measurement method applies, the rules generally require that the employer **recreate the stability periods that would apply based upon the employee's hours of service before the transfer**.

However, for the stability period immediately subsequent to the transfer, the employee must be treated as a full-time employee for any calendar month that the employee would be a full-time employee under either the previously applicable monthly measurement method or the applicable look-back measurement method. The final regulations provide several examples to illustrate the application of these rules.

## NOTICE 2014-49

On Sept. 18, 2014, the IRS issued [Notice 2014-49](#), which describes a proposed approach for applying the look-back measurement method if the measurement period for a particular employee changes. This notice addresses measurement period changes resulting from the following situations:

- An employee transfers from one position to another within the same ALE (or ALE member), where a different measurement period is used for the new position; or
- The ALE changes the measurement period applicable to a category of employees.

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The approach in Notice 2014-49 is not finalized, and the IRS has invited comments on the proposal. However, taxpayers may rely on the proposed approach until further guidance is issued—at least through the end of 2016.

## ***Measurement Period Changes Initiated by Employee Transfer***

First, Notice 2014-49 addresses changes in measurement methods for employees who:

- Were employed by an ALE member in a position for which the employer uses the look-back measurement method; and
- Transfer to a second position for the same ALE (whether or not with the same ALE member) for which the employer uses a different measurement period under the look-back measurement method.

For this purpose, two measurement periods are different if they are of different durations or if they start on different dates (or both). A transfer that may result in a change of a measurement method includes transfers from one ALE member to another ALE member of the same ALE, or from one permitted category of employees to another.

Notice 2014-49 describes how to address these situations, both for employees in a stability period and for those not yet in a stability period at the time of the measurement period change. For this purpose, an employee is deemed to be in a stability period if, as of the date of transfer, the employee has been assigned a status for that stability period as a result of having been employed by the ALE for a full SMP or IMP.

Beginning with the date on which an employee transfers to the second position, Notice 2014-49 proposes that the look-back measurement method would be applied as follows:

- For an employee who is in a stability period (or administrative period) at the time of transfer, the employee retains his or her status through the end of that stability period.
- For an employee who is not in a stability period (or administrative period) at the time of transfer, the employee's status is determined using the measurement period applicable to the second position, but including hours of service in the first position.

However, if a new variable hour, part-time or seasonal employee transfers during the IMP to a second position in which he or she is reasonably expected to be full time, the general look-back measurement method rules apply. Under these rules, the ALE must offer coverage that provides minimum value to the employee no later than the first day of the fourth full calendar month following the transfer, if the employee is still employed on that date.

Hours of service for new employees who are reasonably expected to be full time are not measured using a measurement period right away under the look-back measurement method. Full-time status for these employees is determined based on hours of service in each month (not based on an IMP), until the employee has been employed for a full SMP. In the case of a transfer:

- Until a new employee who is reasonably expected to be full time has been employed for a full SMP applicable to the second position (including service in the first position), the employee's status as full time or non-full time continues to be determined based on hours of service in each calendar month.
- If a new employee who is reasonably expected to be full time has been employed for a full SMP applicable to the second position, but not the first position, as of the date of transfer, the employee's full-time status is determined based on his or her average hours of service during that SMP for the second position (but counting the hours of service accumulated during that SMP for the first position), applied starting on the first day of the first month following the date of transfer and continuing through the end of the associated stability period.

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## ***Employer-initiated Measurement Period Changes***

The employer shared responsibility final regulations do not address whether (or when) an ALE may change the measurement method used for any permitted category of employees. A change in measurement method may include:

- A change from the look-back measurement method to the monthly measurement method (or vice versa); or
- A change in the duration or start date of any applicable measurement period under the look-back measurement method.

Notice 2014-49 would clarify that an ALE may change the measurement method for a category of employees only if, as of the date of the change, each affected employee's full-time status is determined using a special rule provided in the final regulations for employees who have been continuously offered coverage that provides minimum value.

Under this special rule, an ALE that changes the measurement method for a category of employees would apply the monthly measurement method to these employees beginning on the first day of the fourth full calendar month following the change, through the end of the first full measurement period (and any associated administrative period) that would have applied under the applicable look-back measurement method. For the three full calendar months between the change and the application of the monthly measurement method, the affected employees would retain their full-time or non-full-time status from the applicable stability period.

The ALE would apply this special rule as if, on the date of the change, each employee had transferred from a position in which the original measurement method applied to a position in which the revised measurement method applied.

## ***Application to Corporate Transactions***

Notice 2014-49 specifically addresses how the proposed approach would apply in the context of a corporate transaction (such as a merger or acquisition involving employers using different measurement methods). In these corporate transactions, the two (or more) entities may have different measurement methods for their respective employees in a particular category. As a result of the corporate transaction, these groups of employees may become employed by the same ALE member.

Until further guidance is issued, at least through the end of 2016, taxpayers involved in a corporate transaction in which employers use different measurement methods may rely on the proposed approach in Notice 2014-49 for determining an employee's full-time status when an employee transfers to a position using a different measurement period.

## **MORE INFORMATION**

Please contact Cottingham & Butler for more information on the ACA's pay or play requirements.

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