EMPLOYEE BENEFITS

ARE YOU A LARGE EMPLOYER? Determining if the Affordable Care Act "Play or Pay" Rules Apply to a Business

By Deborah L. Grace

Under the Affordable Care Act, a large employer is subject to penalties if it fails to offer to full-time employees health coverage or if the coverage that it offers is not affordable or does not provide minimum value. These new "shared responsibility" rules are effective as of January 1, 2014, and apply to all employers, including non-profits and governmental entities. This article describes the regulations proposed by the Internal Revenue Service in December 2012 for determining if an employer is a "large employer" for purposes of the shared responsibility rules of Section 4980H of the Internal Revenue Code ("Code").

What is a Large Employer?

For any calendar year, an employer is a "large employer" if it employed an average of at least 50 full-time and full-time equivalent (FTE) employees on business days during the preceding calendar year. The calculation used to determine large employer status seems deceptively easy. An employer totals the number of full-time employees and FTEs that it employed each month and then divides that total by 12. If the resulting number is 50 or greater, the employer is a large employer. An exception is provided for an employer who, for 120 days or less during the calendar year, exceeded the 50 full-time employee threshold due to the employment of seasonal employees. This means that hiring activity for 2013 may affect an employer's status as a large employer for 2014. Note also that this analysis must be made for every calendar year.

Are Employers under Common Control Aggregated?

All employees of entities that are under common control, as determined under Code Section 414(b) or (c), or that are members of an affiliated service group under Code Section 414(m) or (o), are taken into account in determining if the members of the group constitute a large employer. For example, suppose Company A has 20 full-time employees and Company B has 40 full-time employees. Company A owns 80% of the stock of Company B. Under Code Section 414(b), Company A's ownership of at least 80% of the stock of Company B causes Companies A and B to be members of a parent-subsidiary controlled group. Because of the controlled group status, the employees of Company A and B are added together when determining large employer status, resulting in both Company A and Company B being large employers for purposes of the shared responsibility rules.

Who is an Employee?

For purposes of these rules, only common-law employees are counted. A sole proprietor, a partner in a partnership, a member of a limited liability company taxed as a partnership, and a 2-percent or more S corporation shareholder is not counted as an employee. Also excluded from this test's definition of "employee" is any individual who is paid by a staffing agency but provides services to an employer on a substantially full-time basis, including an individual whose services would meet the "leased employee" definition of Code Section 414(n).

How does an Employer Determine if an Employee is Full-Time?

A "full-time employee" is one who is employed by the employer an average of at least 30 hours of service per week or 130 hours of service per calendar month. Consistent with longstanding Department of Labor rules, hours of service include both hours for which the employee is paid for services performed and also hours for which the employee is paid and no services are performed due to vacation, holiday, illness, disability, layoff, jury duty, military duty or leave of absence. If an employee is paid on an hourly basis, then the employer must use those hours to determine if the employee's status for the month is full-time.

Use of equivalencies for non-hourly employees. If an employee is not paid on an hourly basis, then the employer may use one of the following methods to determine the hours that the employee worked: (i) count actual hours worked by the employee; (ii) credit 8 hours of service for any day that the employee would be credited with at least 1 hour of service; or (iii) credit 40 hours for each week that the employee would be credited with at least 1 hour of service. An employer cannot use an equivalency method if it would result in understating an employee's hours. For example, if an employee usually works three 10 hour days a week, the employer cannot use the days-worked equivalency, since that would understate the employee's hours.

Service outside the U.S. Hours worked outside the U.S. where the employee does not receive U.S. source income for that service are disregarded. As a result, a U.S. entity that is a member of a multinational controlled group may, for purposes of determining whether it is a large employer, exclude individuals who do not work in the U.S. For example, a U.S. sales office of a multinational entity with no other presence in the U.S. that has 5 full-time employees will not be a large employer for purposes of the shared responsibility rules. Note, the proposed regulations do not change the rules under COBRA that require all employees, including foreign nationals with no U.S. source income, to be counted when determining if the entity has crossed the 20 employee threshold and thereby be required to offer COBRA continuation coverage to qualified beneficiaries.

How does an Employer Calculate the Number of Full-Time Equivalents (FTEs)?

All employees (including seasonal employees) who were not full-time employees for any month are included in calculating the employer's FTEs for that month. The number of FTEs is determined using a two-step process. First, the employer must calculate the aggregate number of hours of service (but not more than 120 hours of service for any employee) for all employees who were not employed on average at least 30 hours of service per week for that month; second, the total hours for the month for all such non-full-time employees is divided by 120. Fractions are included in determining a monthly FTE count but, as explained in the next paragraph, are disregarded for the determination of whether an employer is a large employer.

How does an Employer Calculate its Large Employer Status?

Once the employer has the number of full-time employees and FTEs that it employs each month during the prior calendar year, the employer totals these monthly numbers and then divides that total by 12 to determine the average. Fractions are disregarded for this purpose. For example, an employer that has on average 49.9 full-time employees (including FTEs) for the preceding calendar year is allowed to round the total down, and therefore would not be a large employer.

Transition Rule. For 2014, an employer may determine its large employer status by using a period of at least 6 consecutive months in 2013 rather than the full 2013 calendar year. This transition rule will allow an employer who is close to the 50 full-time employee threshold time to determine its status for 2014 and make any needed adjustments to its health plan to comply with Code Section 4980H. For example, an employer could determine its large employer status during the period of March through August 2013 and then decide what changes are needed for its health plan (or implement a plan) between September through December 2013.

What is the Seasonal Employee Exception?

An employer that on average exceeds the 50 full-time employee threshold (taking into account FTEs) for 120 days or fewer during a calendar year due to the employment of seasonal workers during that 120 day period is not a large employer. The 120 day period does not need to be consecutive, and an employer may choose to use 4 months as a measuring period in place of 120 days. An employee may be able to be treated as a "seasonal worker" for purposes of the large employer definition if the employee worked on a seasonal basis for more than four consecutive months.

Definition of Seasonal Worker. Under Code Section 4980H, employees who perform services on a seasonal basis as defined by the Secretary of Labor, including migrant and seasonal agricultural workers, and retail workers employed exclusively during holiday seasons qualify as seasonal workers. Under the proposed regulations, the IRS has determined that the term seasonal employee is not limited to agricultural or retail workers, and would include individuals whose employment "is of the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year." Until further guidance is issued, an employer may apply a reasonable good faith interpretation of this definition. For example, it may be reasonable for an accounting firm to determine that the additional staff hired during the months of February through April to prepare individual income tax returns are seasonal workers.

What if the Employer is a New Entity or There has been a Merger or Acquisition?

If an employer is not in existence during all of 2013, then it will be a large employer if it reasonably expects to employ an average of at least 50 full-time employees (taking into account FTEs) on business days during 2014.

In a merger or acquisition situation, Code Section 4980H defines the term "employer" to include any predecessor to such employer. The IRS has indicated that in defining a predecessor employer, it may use rules similar to those that apply for determining a successor employer for employment tax purposes. Under those rules, an employer that acquires all of the property used in a trade or business of another employer is a successor employer to the predecessor business.

What are the Suggested Next Steps?

Determine if your business will be a large employer for 2014, based on the company's anticipated full-time employee count for 2013. If the company and other members of its controlled group regularly employ between 40 and 60 full-time employees and FTEs, establish a 6 month or longer transition period in 2013 to determine large employer status for 2014.

Steps that a large employer will want to take, including determining if the health plan that it offers employees is affordable and provides minimum value and identifying full-time employees who must be offered coverage to avoid a penalty, will be addressed in a subsequent client alert.

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