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Employer Mandate: Which Employers Have to Comply?

By 2015, employers must decide whether to "pay or play" in the realm of employee benefits. An employer may be required to pay a penalty for failing to offer a group health plan, providing unaffordable coverage or providing coverage that is less than the minimum value requirement. The penalty would be triggered if one of the employer's full-time employees obtained coverage through the exchange and qualified for a premium tax credit or subsidy.

Alternatively, an employer will not pay a penalty if it decides to "play" by offering affordable, minimum value group health coverage for its employees (and their dependents).[1] PPACA refers to the "pay or play" requirement as "shared responsibility," and employers need to understand the possible impact on plan designs, contribution strategies and workforce planning.

Which Employers Have to Comply?

Virtually all large public and private employers (i.e., those with an average of 50+ full-time equivalent (FTE) employees in the preceding year) must offer their full-time employees (and their dependents) the opportunity to enroll in minimum essential health coverage or pay a penalty assessed by the Internal Revenue Service (IRS).[2] This includes for-profit, nonprofit, governmental and Indian tribal government employers. If an employer employs at least 50 FTE employees, then the employer is considered an "applicable large employer" and is thus subject to the shared responsibility requirement.

The controlled group rules, also known as the employer aggregation rules, apply to determine the size of the employer(s) for the shared responsibility requirement.[3] Specifically, the Internal Revenue Code (IRC) treats two or more employers as a single employer if there is sufficient common ownership or a combination of joint ownership and common activity. These rules are described in IRC Section 414(b), (c) and (m). A controlled group of corporations may be composed of a parent-subsidiary controlled group, a brother-sister controlled group or a combined group. Employees of all members of the controlled group will be added together to determine if the controlled group constitutes an "applicable large employer." If the controlled group consists of 50+ FTE employees, all members of the controlled group will be subject to this provision (regardless of size).

For example, two individuals own 100 percent of three companies varying in size: Company A (65 employees), Company B (10 employees) and Company C (five employees). Companies A, B and C are members of a controlled group that is considered an applicable large employer. Companies A, B and C are each considered a large employer, even though Companies B and C have fewer than 50 FTE employees.

In the proposed regulations published on Jan. 2, 2013, the IRS noted that under the IRC, the controlled group rules do not apply to governmental employers or churches; therefore, these employers should rely upon a good faith interpretation of the employer aggregation rules until further guidance is issued.

Which Employees Do We Count to Determine an Employer's Size?

To make this determination, an employer must consider not only full-time employees, but FTE employees who worked part-time during the previous year.

Sole proprietors, partners and 2 percent S corporation shareholders are not considered employees for this purpose and should be excluded from the calculation. Leased employees are also excluded from the calculation of the

[1] The parenthetical reference to "and their dependents" in the statute created some confusion as to whether the congressional intent was that employers must provide family coverage in order to avoid the penalty tax. The proposed regulations published on Jan. 2, 2013, clarified that dependent coverage (not including a spouse) must be offered, but affordability is based on the cost of employee-only coverage.

[2] Internal Revenue Code § 4980H(c)(2)(A).

[3] Public Health Service Act § 2716.

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recipient organization. A leased employee is defined in IRC Section 414(n)(2) and requires that the employee has performed services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least one year, and such services are performed under primary direction or control by the recipient.

The IRS is aware of structures to evade application of Section 4980H and intends to publish an anti-abuse rule. If an individual performs service as an employee of an employer, and also performs the same or similar service for that employer as an employee of a staffing agency, then all the hours of service are attributable to the recipient employer.

Additionally, only those employees performing work in the U.S. should be considered. Thus, if a foreign-owned company has fewer than 50 employees performing work in the U.S., the employer would not be considered an applicable large employer and would not be subject to the shared responsibility requirement.

How Do We Determine the Number of Full-time Employees?

The first step for an employer is to determine the number of full-time employees who have 30 or more hours of service per week. Hours of service include not only hours worked, but hours in which the employee is entitled to pay but did not work (e.g., vacation, holiday, sick time, military duty and jury duty).

Then the employer will determine the number of full-time equivalents by totaling the number of hours worked by part-time employees over a one-month period and dividing by 120. These two numbers are then added together to determine the number of FTE employees for purposes of the shared responsibility threshold.

For example, an employer has 20 part-time employees who work 25 hours a week, for a total of 2,000 hours in one month. This equates to 16.67 FTE employees (2,000 ÷120). If the same employer has 35 employees who work 30+ hours / week, the employer has a total of 51.67 full-time employees (35 + 16.67). For this purpose, fractions are disregarded, meaning that this employer has 51 FTE employees. Since the employer has 50 or more, it is subject to the shared responsibility requirement.

What About Seasonal Employees?

IRS Notice 2011-36 included a special provision for seasonal employees. For this discussion, a seasonal employee is defined as one who performs labor “on a seasonal basis where, ordinarily, the employment pertains to or is of the kind exclusively performed at certain seasons or period of the year and which, from its nature, may not be continuous or carried on throughout the year.”[4] If the employer has 50 or FTE more employees only because of seasonal employees working 120 days or less, then the employer is not considered an applicable large employer for this purpose. In determining seasonal employees, an employer may also use a period of four months rather than 120 days. The four months or 120 days do not have to be consecutive.

What About New Employers?

The proposed regulations published on Jan. 2, 2013, provided clarification regarding new employers. An employer that was not in existence during the entire preceding calendar year is considered a new employer and must rely on the current year to determine if it’s an applicable large employer. The standard for new employers is whether it is “reasonably expected” to employ an average of at least 50 FTE employees on business days in the current calendar year. In other words, a new employer would determine the number of employees that it expects to employ in its first calendar year of operation.

[4] 29 CFR 500.20(s)(1), as referenced by Internal Revenue Code § 4980H(c)(2)(B)(ii).

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