EMPLOYER MANDATE: APPLICABLE LARGE EMPLOYERS

Over the next few years, employers with at least 50 full-time employees (FTEs) (including equivalents) will make vital decisions concerning whether to "pay or play" with respect to offering employer-sponsored group health coverage. Final regulations clarifying the scope of this requirement were released on Feb. 12, 2014, and require decisions to be made quickly because certain employers may be required to pay a penalty for either failing to offer employer-sponsored group health coverage, providing unaffordable coverage or providing coverage that is not of minimum value. The penalty will be triggered if one of the employer's FTEs obtains coverage through the exchange and qualifies for a premium tax credit or cost-sharing 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). PPACA refers to this pay or play requirement as the "employer shared responsibility" or the "employer mandate."

Large employers must understand the law's impact on plan designs, contribution strategies and workforce planning.

EMPLOYERS AFFECTED

Virtually all large public and private employers with an average of 50+ FTEs (including equivalents) in the preceding year must offer their FTEs (and their dependents) the opportunity to enroll in minimum essential coverage (MEC) or pay one of two possible IRS penalties: Penalty A or Penalty B. Penalty A may apply if the employer fails to offer MEC to substantially all (70 percent in 2015, 95 percent thereafter) FTEs. Penalty B may apply where the employer offers MEC to its employees, but the MEC is not affordable or does not provide minimum value.

Affected employers include for-profit, nonprofit, governmental and Indian tribal government employers. If an employer employs at least 50 FTEs (including equivalents), then the employer is considered an "applicable large employer" and is thus subject to the employer mandate. However, the date of compliance may vary depending on the actual size of the employer. While employers with 100+ FTEs (including equivalents) are required to comply beginning with the first plan year beginning on or after Jan. 1, 2015, there is a one-year delay, until Jan. 1, 2016, available for employers who meet certain qualifications and employ 50–99 FTEs (including equivalents). There is also a delay for employers (of any size of 50 or more) that sponsor non-calendar-year plans, if certain conditions are met.

Determining the Employer in Controlled Groups

The employer mandate incorporates the existing controlled group rules, which already apply in many other areas of tax law, including retirement plan administration. Under these rules – found in Internal Revenue Code (IRC) Section 414 – if two or more companies have sufficient common ownership or are under common control, they are treated as a single employer. A detailed discussion of Section 414 is outside the scope of this paper, but generally, a controlled group of corporations may be composed of a parent-subsidiary controlled group, a brother-sister controlled group or a combined group. Ask your accountant or attorney for more information if you think the controlled group rules may apply to your situation.

If the controlled group rules apply, all employers in the controlled group are added together to determine if the controlled group constitutes an applicable large employer. If the controlled group consists of 50+ FTEs (including equivalents), all employers in the controlled group will be subject to the employer mandate (regardless of size), and are then referred to as an "applicable large employer member."

> **Example:** Two individuals own 100 percent of three companies varying in size: Employer A (65 FTEs), Employer B (10 FTEs) and Employer C (five FTEs). Under Section 414, Employers A, B and C are members of a controlled group, and since the total FTE count is 80 employees, each employer is considered an applicable large employer member. Employers A, B and C are each subject to the employer mandate, even though Employers B and C on their own have fewer than 50 FTEs.

Importantly, the controlled group rules do not apply to governmental employers, churches or conventions or associations of churches. Therefore, these employers should rely upon a reasonable, good faith interpretation of the employer aggregation rules until further guidance is issued.

One-year Delay for Some Employers

Generally, the employer mandate is effective Jan. 1, 2015. However, for employers (including applicable large employer members) with 50–99 FTEs, the employer mandate's effective date is delayed one year, as long as four conditions are met:

- Limited workforce size of 50–99 FTEs on average for any consecutive six-month period in 2014
- Maintenance of workforce size and hours of service between Feb. 9, 2014, and Dec. 31, 2014
- Maintenance of coverage and employer contributions (if coverage is currently provided)
- Certification to the IRS that the above conditions are met

Employers with 50–99 FTEs (including equivalents) that meet those four conditions will not be penalized for either failing to offer coverage or failing to provide affordable, minimum value coverage until the first plan year beginning on or after Jan. 1, 2016. Specific details about these four conditions are available in a separate white paper dedicated to this topic. Ask your advisor for a copy.

COUNTING EMPLOYEES

In determining applicable large employer status and the employer mandate effective date, employers must determine both the number of FTEs and the number of full-time equivalents. Both of these counts are then totaled together to determine whether the employer is an applicable large employer, has 50–99 FTEs (including equivalents) and may qualify for the delay until Jan. 1, 2016, or, whether the employer has 100+ FTEs and will need to be in compliance by Jan. 1, 2015. This is a three-step process, described next.

Step 1: Count Full-time Employees

The term "FTE" refers to employees who are employed, on average, at least 30 hours of service per week. All employees working 30 hours of service per week, regardless of whether coverage is offered to these individuals, must be counted for purposes of determining whether the employer mandate will apply. For this purpose, hours of service includes 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).

As far as the actual count, for each calendar month in the preceding calendar year, the employer must add together the total number of FTEs who worked, on average, at least 30 hours of service per week during that month. The employer then divides the 12-month total by 12 to determine the total number of FTEs. Set this number to the side and proceed to the next step.

Step 2: Count Full-time Employee Equivalents

The employer determines the number of full-time equivalents by totaling the number of hours worked by non-FTEs (i.e., employees already accounted for as FTEs, above) during each calendar month in the preceding calendar year and dividing by 120. While fractions are taken into account, an employer may round the resulting monthly FTE calculation to the nearest one-hundredth.

Step 3: Total Both Counts

As the final step in the process, the employer will total the FTE count from Step 1 with the full-time equivalent count from Step 2. If the result is not a whole number, then it is rounded down to the next lowest whole number. If the result of this calculation is less than 50, then the employer is not an applicable large employer for the current calendar year. But, if the result of this calculation is 50 or more, the employer is an applicable large employer for the current calendar year (unless the seasonal employee exception applies – more on that below – or the delay for employers with 50–99 FTEs applies, described above).

> **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 full-time equivalent employees per month (2,000 ÷ 120 and rounded to the nearest one-hundredth). If the same employer has 35 employees who work 30+ hours per 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 FTEs. Since the employer has 50 or more, it is an applicable large employer. Note that some employers with between 50-99 FTEs may be able to delay the application of employer mandate penalties (but not reporting requirements), although a more detailed analysis would be needed as this is a facts and circumstances determination.

SPECIAL CONSIDERATIONS

Owners

Sole proprietors, partners in a partnership and 2 percent S-corporation shareholders are not considered employees for this purpose and should be excluded from all calculations.

Leased Employees and Temporary Staffing Firms

Leased employees are also excluded from the calculation, because a true leased employee does not meet the common-law definition of employee. 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.

As to temporary staffing firms, as a general rule, the organization that hired the individual for temporary placement (i.e., the staffing agency) at an unrelated entity is the common-law employer, and will need to count the individual. However, where the recipient employer is directing or otherwise influencing the individual's work (along with other factors), the recipient employer could be considered the common-law employer, or at the very least, a joint employer. Ask your advisor for more information if this applies to your situation.

Non-U.S. Source Income and Residency

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 employer mandate. However, all employees receiving U.S. source income must be counted, because application of the employer mandate does not depend on residency or citizen status of the employee (although other labor laws may be implicated, which is outside the scope of this discussion).

This category also affects cruise ship employers, since hours of service are only counted when the compensation paid constitutes income that is taxed as income within the U.S.

Finally, also note that employers employing individuals holding H-2A and H-2B visas also must take those employees into account for purposes of determining whether the employer mandate applies. That being said, if these workers meet the overall definition of seasonal employees (are employed no more than 120 days or four calendar months) and are the sole reason the employer's count exceeds 50 FTEs (including equivalents), the employer will not be subject to the employer mandate in the current calendar year.

Seasonal Employees

If the total count of an employer's FTEs and equivalents exceeds the 50 employee threshold, and the only reason that the count exceeds 50 is due to seasonal workers who were employed no more than 120 days (or four calendar months), then the employer is not considered to employ more than 50 FTEs (including equivalents) and the employer is not an applicable large employer for the current calendar year. The 120 days (or four calendar months) do not necessarily have to be consecutive.

Volunteers, Student Workers and Interns/Externs

Hours of service are generally disregarded for service performed by volunteers for a government entity or a tax-exempt organization (such as volunteer firefighters). However, these individuals may only be excluded from the calculation when the only compensation received is in the form of reimbursements for expenses incurred, reasonable benefits or fees customarily paid by similar entities in connection with the services provided by the volunteers.

Importantly, there is no general exception for student workers or internships/externships. All hours of service for which a student employee of an educational organization (or of an outside employer) is paid or entitled to payment in a capacity other than through the federal work study program or a state or local government's equivalent are required to be counted as hours of service for employer mandate purposes. Additionally, services by an intern or extern do not count as hours of service for purposes of the employer mandate to the extent that the student does not receive, and is not entitled to, payment in connection with those hours. Therefore, when student workers, interns or externs are compensated for their services, their hours of service must be counted toward determining applicability of the employer mandate.

New Employers

An employer is considered a new employer if it was not in existence on any business day during the entire preceding calendar year. Instead of relying on previous calendar-year data, new employers must look to current calendar-year data to determine if it is an applicable large employer. The standard for new employers is whether it "reasonably expects" to employ an average of at least 50 FTEs (including equivalents) on business days in the current calendar year and it actually employs an average of at least 50 FTEs (including equivalents).

ADDITIONAL RESOURCES

Final Regulations
IRS Frequently Asked Questions

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