ACA: APPLICABLE LARGE EMPLOYERS

Under the ACA employer mandate, employers with at least 50 full-time employees (FTEs) (including equivalents) – known as "applicable large employers" (ALEs) – must offer affordable coverage or pay a tax penalty. The requirement, also known as the "employer shared responsibility" provision, has been in effect since 2015. This publication provides information on which entities are considered ALEs; it highlights the process to determine ALE status and notes special considerations. For detailed information about the employer mandate penalties and affordability, see the PPI publication **ACA: Employer Mandate Penalties and Affordability**.

AFFECTED EMPLOYERS

Employers that employ at least 50 FTEs (including equivalents) in the preceding calendar year are considered "applicable large employers" and are therefore subject to the employer mandate.

Virtually all large public and private employers with an average of 50 or more FTEs (including equivalents) in the preceding calendar year must offer their FTEs (and their dependents) the opportunity to enroll in minimum essential coverage (MEC) for the subsequent calendar year 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 (95%) of its FTEs (and dependents). 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) in the preceding calendar year, then the employer is considered an ALE and is therefore subject to the employer mandate.

Determining the Employer in Controlled Groups

The employer mandate incorporates the controlled group rules that apply in many other areas of tax law, including retirement plan administration. Under these rules – found in IRC Section 414 – two or more companies are treated as a single employer if they have sufficient common ownership or are under common control. A detailed discussion of Section 414 is outside the scope of this publication, 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. Employers should consult with legal or tax advisors as needed to confirm their controlled group status.

If the controlled group rules apply, all employers in the controlled group are added together to determine if the controlled group constitutes an ALE. If the controlled group consists of 50 or more 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 "ALE member."

> **Example:** Two individuals own 100% 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 ALE 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.

COUNTING EMPLOYEES

ALE status is determined for each calendar year based on the average number of employees during the prior calendar year. Employers must count both the number of FTEs and the number of full-time equivalents. Both of these counts are then combined to determine whether the employer is an ALE. This is a three-step process.

Step 1: Count Full-Time Employees

The term "FTE" refers to employees who are employed, on average, for 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 an employer is subject to the employer mandate for a calendar year. For this purpose, hours of service include not only hours worked, but hours for which the employee is entitled to pay but did not work (e.g., vacation, holiday, sick time, military duty, and jury duty).

To determine 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 each month. The employer then divides the 12-month total by 12 to determine the total number of FTEs. Set this Step 1 number to the side and proceed to Step 2.

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., excluding FTEs already counted in Step 1) during each calendar month in the preceding calendar year and dividing this sum by 120. While fractions are taken into account, an employer may round the resulting monthly full-time equivalent calculation to the nearest one-hundredth (two decimal places).

Step 3: Total Both Counts

In Step 3, the employer adds the FTE count from Step 1 to 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 ALE for the current calendar year. But, if the result of this calculation is 50 or more, the employer is an ALE for the current calendar year (unless the seasonal employee exception applies — more on that below).

> **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 or more hours per week, the employer has a total of 51.67 FTEs (16.67 + 35). For this purpose, fractions are disregarded, meaning that this employer has 51 FTEs. Since the employer has 50 or more employees, it is an ALE.

SPECIAL CONSIDERATIONS

Owners

Sole proprietors, partners in a partnership, and 2% S-corporation shareholders are not considered employees for the purpose of determining ALE status and should be excluded from all FTE and full-time equivalent calculations.

Leased Employees and Temporary Staffing Firms

Leased employees are also excluded from the FTE calculation because a true leased employee does not meet the common-law definition of employee. A leased employee is defined in 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 for the purpose of determining ALE status. 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 potentially a joint employer. Employers should confer with legal counsel as needed to determine whether the employment arrangement constitutes a common-law or joint employer relationship under these circumstances.

Non-US Source Income and Residency

Additionally, only those employees performing work in the US should be considered in determining an employer's ALE status. Thus, if a foreign-owned company has fewer than 50 employees performing work in the US, the employer would not be considered an ALE and would not be subject to the employer mandate. However, all employees receiving US source income must be counted, because application of the employer mandate does not depend on residency or citizenship status of the employee (although other labor laws, which are outside the scope of this discussion, may be implicated).

The category of non-US source income employees 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 US.

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 the employer's ALE status. That being said, if these workers meet the overall definition of seasonal workers (see below) and are the sole reason the employer's count exceeds 50 FTEs (including equivalents), the employer is not subject to the employer mandate in the current calendar year.

Seasonal Workers

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) in the previous calendar year, then the employer is not considered to employ more than 50 FTEs (including equivalents) and the employer is not an ALE 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 FTE calculation when the only compensation received is in the form of expense reimbursements or 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 interns/externs. 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 purposes of the employer mandate. 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. However, when student workers, interns, or externs are compensated for their services, their hours of service must be counted toward determining the 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, a new employer must look to current calendar year data to determine if it is an ALE. The standard for a new employer 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).

SUMMARY

The ACA employer mandate requires employers that meet the definition of an ALE to offer affordable coverage to their employees or pay a tax penalty for their failure to do so.

RESOURCES

Final Regulations
IRS Determining if an Employer is an ALE
IRS Frequently Asked Questions