Bloomberg BNA

Daily Labor Report®

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HEALTH CARE

When the Affordable Care Act's employer mandate kicks in, covered employers will be required to provide health benefits for employees and their dependents or they must pay a penalty. The effective date of the requirement varies and employers will need to take inventory of their workforces to determine what their coverage requirements are and when they will take effect, attorneys Wendy K. Voss and Jesse L. Noa say in this BNA Insights article.

In this Part I of a three-part series, Ms. Voss and Mr. Noa of the Wilmington, Del., firm Potter Anderson & Corroon LLP examine the most recent regulations on the issue and offer a rundown of the requirements.

Is Your Company a 'Large Employer' Under the Affordable Care Act? Counting Employees and Assessing the Options

BY WENDY K. VOSS AND JESSE L. NOA

On Feb. 12, 2014, the Internal Revenue Service issued final regulations under the Affordable Care Act (the ACA or the Act) implementing the "shared responsibility" provisions for large employers—more commonly known as the "employer mandate." The regulations establish when and to whom employers must provide affordable health care coverage or face a tax penalty. Employers that will be impacted are "large employers" that employ 50 or more full-time and full-time equivalent (FTE) employees. Employers that are or may be covered should begin the process now of determining whether they are subject to the ACA's coverage mandate and of assessing their potential duties and/or liabilities.

Wendy K. Voss, a partner with Potter Anderson & Corroon LLP in Wilmington, Del., represents management in a wide variety of industries and in locations throughout the United States. She represents clients before the EEOC, NLRB, Delaware Department of Labor, and other state agencies, as well as the Delaware Public Employee Relations Board. Jesse L. Noa is an associate in the firm's Litigation Group. His practice focuses on commercial and employment matters in the state and federal courts of Delaware.

I. Effective Dates

The final regulations (28 DLR A-10, 2/11/14) became effective upon their publication on Feb. 12, 2014, and set varying deadlines for compliance. Large employers with 100 or more full-time/FTE employees will first be required to comply with the shared responsibility provisions of the regulations on Jan. 1, 2015. The application of these requirements to large employers with between 50 and 99 full-time/FTE employees has been delayed until 2016.[1]

[1] *See* Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. 8,577 (Feb. 12, 2014) (to be

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II. The 'Large Employer' Standard—Counting the Prior Year's Employees

Any employer with fewer than 50 full-time/FTE employees is not covered by the ACA's employer mandate and therefore will have no liability if it fails to provide affordable coverage to its employees, or indeed any coverage.[2] Whether an employer is a ''large employer'' and subject to the mandate generally will be determined based on the average number of employees it had during the preceding calendar year. To make this calculation, employers first must determine the number of full-time employees in each calendar month in the preceding year and the total number of FTEs in each calendar month. The sum of those two numbers then is divided by 12. If the result is not a whole number, employers can round down to the next whole number. If the resulting number is less than 50 (or 100, in 2014), then the employer is not a covered ''large employer'' for the year.

III. Identifying Full-Time Employees

A full-time employee is defined by the ACA as an employee who, during the calendar month, ''is employed on average at least 30 hours of service per week.'' For the purpose of assessing full-time status and thus eligibility for benefits, the regulations first distinguish between the method for measuring the hours of service of hourly employees and that for non-hourly employees (e.g., salaried employees).

a. Assessing Hourly Employees. Assessing the status of hourly employees is straightforward, as employers must determine the actual hours of service of these employees from the prior year's records of hours worked and hours for which payment is made or due. The regulations define an ''hour of service'' as each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer.

Thus, employers are required to count not only time during which an employee is actively at work, but also each hour for which an employee is paid or entitled to payment even though no work is performed. Such paid time includes vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

Commentary to the regulations notes that particular categories of time, such as on-call time, may be particularly troublesome to employers, and that further guidance will be forthcoming. Until such guidance is provided, employers are directed to use a ''reasonable method'' of counting such hours, with the caveat that it would not be reasonable to fail to credit any hours for which payment is due, when the employee is required to be on the employer's premises, or when the employee's activities are significantly restricted.

b. Assessing Non-Hourly Employees. When assessing the hours of service for non-hourly employees, including but not limited to salaried employees, employers may use one of three approaches. First, employers may look to the actual hours of service worked or the hours for which payment is made or due in the same manner as for hourly employees.

Second, employers may use a ''days-worked equivalency'' approach whereby the ''employee is credited with eight hours of service for each day for which the employee would be required to be credited with at least one hour of service'' as if she/he was an hourly employee. Under this approach, for example, an employee who works five hours a day, three days a week, would be credited with 24 hours (8 x 3).

Finally, employers can use the ''weeks-worked equivalency'' approach where the ''employee is credited with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service'' as if he/she was an hourly employee. Using this approach, an employer would count 40 hours of service for any employee who worked one or more hours in the week.

Employers are not bound by the particular approach they initially select for non-hourly employees and may change their method of assessing hours of service each calendar year. Further, employers may use one approach for one category of employees and another approach for a different category of employees, so long as the categories are reasonable and consistently applied.

Permissible categories identified in the regulations include employees in specified job categories and those in different geographic locations. The only requirements are that, if different approaches are used, they must be reasonable and consistently applied to the different categories of non-hourly employees.

Further, in all cases, an employer must try to reflect the employees' actual hours worked and, therefore, cannot use a certain approach as a means to understate employees' hours of service so as to avoid being classified as a large employer. For example, an employer may not use a days-worked equivalency in the case of an employee who generally works three 10-hour days per week, because the equivalency would substantially understate the employee's hours of service as 24 hours of service per week.

c. Special Categories. The final regulations contemplate future rules regarding certain types of employees, such as adjunct faculty, commissioned employees, and members of religious orders, and the manner in which certain hours will be credited (such as layover hours for airline employees and on-call hours). Until further guidance is issued, employers may rely upon a reasonable method of crediting hours of service for such employees that is consistent with existing law.

IV. Counting Full-Time Equivalent Employees

In addition to counting their full-time employees in each month, employers also must determine the number of full-time equivalent employees they have. The regulations specifically provide that all employees who were not employed an average of at least 30 hours of service per week for a calendar month must be included in calculating the employer's FTEs for that calendar month.

To calculate the number of full-time equivalent employees in a given month, employers must aggregate the hours of service in that month worked by all em-

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codified at 26 C.F.R. pts 1, 54 & 301) (Shared Responsibility), available at http://op.bna.com/dlrcases.nsf/r?Open=kpin-9jancu. The final regulations affect parts 1, 54, and 301 of Title 26 of the U.S. Code. *See id.*

[2] *See* 26 U.S.C. § 4980H(c)(2).

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ployees (including seasonal employees) who were not full time. However, they should not attribute more than 120 hours of service to any one employee. The aggregate number of hours then must then be divided by 120. Because calculating the number of FTEs may result in fractions, the final regulations allow employers to round the result to the nearest one-hundredth.

For example, an employer will have 20 full-time employees if the employer has 20 employees that each average 35 hours of service per week. If that same employer has 40 additional employees, each of whom averages 90 hours of service per month, it must go through the FTE calculation to determine if it qualifies as a large employer.

The employer must aggregate the total hours of service of the part-time employees, but in no event count more than 120 hours for any one employee. In this example, the result would be 3,600 total hours of service (40 x 90). That number then must be divided by 120 to determine the number of FTEs, which in this example is 30.

Assuming the seasonal worker exception (see below) is inapplicable here, the employer would have 50 full-time/FTE employees (20 full-time plus 30 FTE employees), and the ACA shared responsibility provisions would apply (beginning in 2016).

V. Special Rules for Seasonal Workers

The ACA excludes certain seasonal workers when determining whether an employer is a ''large employer.'' Per the regulations, employers whose workforce exceeded 50 full-time/FTE employees for only 120 days or fewer in a calendar year will not be deemed to be large employers if the higher number of employees during those 120 days (or fewer) was due to the employment of seasonal workers.

Notably, the regulations distinguish between ''seasonal workers'' and ''seasonal employees.'' ''Seasonal employees'' are those individuals hired for positions that customarily are open for six months or less during the same approximate period of the year (e.g., summer or winter employees).

''Seasonal workers'' are limited to retail workers employed during holiday seasons and others who perform work (including agricultural work) that, by its nature, is performed during certain seasons or periods of the year and not continuously throughout the year. In short, seasonal workers constitute a subset of seasonal employees. In determining whether an employee is a seasonal worker, employers may apply a good faith interpretation of the term and whether the work in question is performed on a seasonal basis.

VI. New and Growing Employers

a. Employers Not in Existence During the Previous Calendar Year. Employers that did not exist in the previous year are subject to the same coverage requirements and possible penalties as those that can look back to the previous year to determine whether they are large employers.

New employers are directed in the regulations to use a ''reasonable basis'' to determine if they qualify as large employers, and further advised that they will qualify as covered large employers only if, at the time the business comes into existence, they reasonably expect to employ an average of at least 50 full-time/FTE employees. Those engaging in a new business also should bear in mind that the seasonal worker exception may apply, and serve to lower their employee count.

For planning purposes, new employers should consider that, if they expect to qualify as ''large employers'' in their first year of operation, they are required to offer health care coverage to their full-time employees (and their dependents) by the end of the third full calendar month after the employees are hired or otherwise establish eligibility.

b. Employers That Transition Into Large Employers. Employers that crossed the threshold to become large employers in the previous year have been provided transition relief in the form of a delay in the deadline for the employers to offer coverage (or possibly suffer a penalty). A newly covered large employer must offer adequate coverage on or before April first of the first calendar year after it becomes a ''large employer'' to avoid penalties under the ACA for January through March of that calendar year. Failure to meet this deadline will result in the employer being retroactively penalized for the months of January, February, and March, in addition to April and any subsequent months in which coverage is not provided.

c. Considerations for All Growing and Changing Employers. In addition to the aggregation rules that apply to large employer groups (discussed below), employers should be aware that any reference to an ''employer'' in the regulations is defined to include its predecessor and/or successor employer(s).[3] Thus, those acquiring or divesting an operating business will need to ensure access to employment data from the other entity involved, which must be considered in determining its status as a ''large employer.''

New and changing companies also should be aware that, even though an employer might qualify as a ''large employer'' under the ACA, there could be circumstances in which a failure to provide coverage meeting ACA standards nonetheless would result in no penalties.

First, as discussed above, employers may be able to avoid some penalties through the timing of their offer of coverage. Second, depending on the number of full-time employees (*not* FTEs) employed, penalties might not be assessed at all. For example, assume that an employer has 25 full-time employees and 30 FTEs, and offers no coverage. While the employer would be large enough to be classified as a ''large employer'' under the ACA, no penalty would be due as a result of that failure because the calculation of the penalty amount is based on the total number of full-time employees *less 30*. For 2015, even larger employer could avoid penalties, as the penalty for a failure to offer coverage in that year will be based on the total number of full-time employees less 80.

[3] The Regulations do not define the term predecessor employer or successor employer, but contemplate further guidance on this issue. Until such guidance or regulation is issued, employers may rely upon reasonable, good faith interpretations of the terms. *See* Shared Responsibility at 8,548.

VII. Special Rules Applicable to Large Employer Groups and Their Members

While the basic formula for counting employees may appear to be relatively straight forward, it is important to note that, in certain cases, the employee count from different companies will be aggregated, as will the hours of an employee who works for more than one related company.

The aggregation rules apply to employers that are part of a controlled group, an affiliated service group, or an entity that is part of certain other arrangements, as further defined in the tax code. For example, companies that would be considered to be part of an employer group include parent-subsidiary groups and businesses that are under common control.

To illustrate this point, assume a parent company with two subsidiaries had 30 full-time/FTE employees in the prior year and that the subsidiaries each employed 40 full-time/FTE employees. All three companies would be ''large employers'' for purposes of the ACA's employer mandate because each of the companies would be deemed to have 110 employees. However, whether any penalties would be assessed for failure to provide qualifying health care coverage would be determined on an individual member basis.

More specifically, under the final regulations, each applicable large employer member is liable for its assessable payment, and is not liable for the assessable payment of any other entity in the controlled group comprising the applicable large employer.

VIII. Transition Relief

Certain relief is available under the regulations to assist employers in implementing the ACA's requirements. Briefly stated, the relief allows employers additional time for some purposes and may permit them to avoid penalties that otherwise would apply during 2015.

a. Shorter Period Permitted for Determining Large Employer Status for 2015. For 2015 only, an employer may determine whether it is a covered large employer by reference to a period of at least six consecutive calendar months in 2014, rather than the entire year. In addition, the employer may select the six-month period it will use for this purpose.

b. Transition Relief for Large Employers With Fewer Than 100 Employees. As mentioned above, large employers that employ between 50 and 99 full-time/FTE employees will not have to comply with the employer mandate (or, in the alternative, face penalties) until 2016. To be eligible for this relief, the employers must meet certain eligibility requirements, as follows:

- The number of employees must be determined in accordance with the applicable rules for determining status as a large employer;
- During the period from Feb. 9, 2014, to Dec. 31, 2014, the employer cannot reduce the size of its workforce or the hours of service of its employees to avoid coverage under the ACA; and
- The employer cannot eliminate or materially reduce the health coverage, if any, that it offered as of Feb. 9, 2014. More specifically, the employer's contribution to the cost of coverage must be at least 95 percent of its prior contribution; the coverage offered must provide minimum value; and the employer may not alter the terms of its plan so as to reduce the class or classes of employees (or dependents) to whom coverage is offered.

c. Offers of Coverage for Dependents In addition to offering coverage to its full-time employees, large employers also are required by the ACA to offer coverage to these employees' dependents if they are to avoid penalties. So long as the employers have not offered such coverage in the past and are taking steps during the 2015 plan year (including any portion of a non-calendar plan year that falls in 2016) to offer dependent coverage, the employer will not be liable for penalties for not offering this coverage.

d. Relief for Non-Calendar Year Plans. While a full discussion of transition relief for non-calendar year plans is beyond the scope of this article, employers that sponsor such plans should be aware that transition relief might be available under some circumstances. If an employer qualifies for transition relief, it will not be liable for penalties that otherwise would apply during the ''gap'' period between the inception of the employer mandate on Jan. 1, 2015 and the first day of the (non-calendar year) plan year.

The transition relief rules applicable to these plans are complicated. Transition relief is available only to employers that sponsored the plans as of Dec. 27, 2012, and only if the plan year was not modified after that date to begin on a later date. To avoid penalties, the employer must have offered coverage to a certain percentage of its employees in the past, and also is required to offer coverage to a significant percentage of all of its employees by the first day of the 2015 plan year or, in the alternative, to a significant percentage of its full-time employees, all as further defined in the regulations.

e. Relief for Large Employer Group Members. Under the ACA, individual members of a large employer group will not be subject to an assessable penalty so long as they offer coverage to all but five percent or, if greater, five of their full-time employees. As part of the transition relief that is available under the Act, in 2015 each large group employer member will be required to offer coverage to only 70 percent of their eligible full-time employees.

f. Issues Affecting Certain Other Employers. The final regulations have special rules, including special transition relief rules, for educational organizations, religious orders, and those with volunteer employees (e.g., volunteer fire companies and first responders), which are beyond the scope of this article. In addition, the preamble to the regulations states that ''future guidance'' will be required in regard to the method for classifying certain employees as full-time or part-time, including adjunct faculty members, commissioned salespeople, and those who work for airlines, as well as that for counting certain hours of work, such as layover time and on-call time. Until such guidance is issued, employers are advised to adopt standards that are reasonable under the circumstances.

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Conclusion

Employers that will or may qualify as ''large employers'' under the ACA should make a monthly count of their employees, including full-time equivalent employees, beginning in 2014 to determine their obligations in 2015 and beyond. Those that expect to qualify as large employers based on their 2014 head count will need to make a decision in the very near future whether to comply with the ACA's mandates or to create a reserve or otherwise satisfy any penalties that may be due for noncompliance. To properly weigh the ramifications of their choice, these employers should be working closely with responsible internal personnel as well as with their insurance brokers, tax advisors, and legal counsel.