Feature

By Aaron Borden, JD, CPA

Applicable LARGE Employer Status Under the Affordable Care Act

Even though Notice 2013-45 delayed employer penalties under the Affordable Care Act until 2015, employers and their advisers should be planning for the law now because employment decisions in 2014 will determine if the employer is an applicable large employer subject to penalties in 2015.

Employers could be subject to a penalty under Code Section 4980H in 2015 if at least one of their employees receives a tax credit or cost-sharing subsidy for purchasing health insurance through a health insurance exchange; however, the penalty is only imposed on "applicable large employers." The Code defines an applicable large employer as an employer who employed an average of at least 50 full-time employees, including full-time equivalents, during the preceding calendar year.

It is important to note that the applicable large employer status is determined by the employer's prior year employment. Employment in 2014 will determine whether an employer is an applicable large employer in 2015. Thus, employers near the 50-employee threshold need to make adjustments in 2014 if they want to avoid applicable large employer status and the associated penalties in 2015.

THE APPLICABLE LARGE EMPLOYER DETERMINATION IS A FIVE-STEP PROCESS

From Code Section 4980H, Prop. Treas. Reg. Section 54.4980H-1, -2, and -3, a five-step process can be developed for determining if an employer is an applicable large employer. First, determine if the employer is a member of a group of employers that must be considered as a single employer. Second, determine which employees are included in the calculation of the average number of employees. Third, determine the hours of service for each employee. Fourth, calculate the average number of employees, and finally determine if the employer is an exempted seasonal employer.

STEP 1: DETERMINE IF THE EMPLOYER IS A MEMBER OF A GROUP OF EMPLOYERS THAT IS CONSIDERED A SINGLE EMPLOYER

The employer is a member of a group that must be considered a single employer for purposes of determining applicable large employer status if the group would be a single employer under sections 414(b), (c), (m) & (o) of the Code (the employer is a member of a controlled group of corporations, a member of a group of businesses under common control, or a member of an affiliated group). All employees of all members of the group of employers are included in a single calculation of average number of employees to determine if the group is an applicable large employer.

STEP 2: DETERMINE WHICH EMPLOYEES ARE INCLUDED IN THE CALCULATION OF THE AVERAGE NUMBER OF EMPLOYEES

For purposes of determining applicable large employer status, the common law definition of an employee, as defined in Reg. § 31.3121(d)-1(c), is used to determine employees. The primary factor indicating an employer – employee relationship being the employer's right to direct the work to be performed and the method in which it is to be accomplished. All full-time and part-time employees employed during the prior calendar year are included in the calculation, including those who are no longer employed by the employer. Independent contractors and leased employees are not included in the calculation. In addition, sole proprietors, 2 percent or more shareholders in an S corporation, and partners in a partnership are not employees for purposes of determining an employer's status as an applicable large employer.

STEP 3: DETERMINE THE NUMBER OF HOURS OF SERVICE FOR EACH EMPLOYEE DURING EACH CALENDAR MONTH OF THE PRECEDING YEAR

An hour of service is defined as each hour for which an employee is paid or entitled to payment for the performance of duties, vacation, holiday, illness, incapacity, layoff, jury duty or leave of absence. For hourly employees, the employer must determine actual hours of service from their employment records. For employees who are not paid on an hourly basis, the proposed regulations allow an employer to use a days-worked or weeks-worked equivalency as an alternative to the actual hours of service. The days-worked equivalency credits the employee with eight hours of service for each day that the employee had at least one hour of service. The weeks-worked equivalency credits the employee with 40 hours of service for each week in which the employee has at least one hour of service. However, the employer cannot use the days-worked or weeks-worked equivalency if it substantially understates an employee's hours of service. Work performed outside the United States is not included in an employee's hours of service.

Example of an employer not permitted to use the days-worked equivalency: Employer has salaried employees who work three 12-hour days per week. Employer must use actual hours of service to determine employment status because the employees would be part-time employees with 24 hours of service per week using the days-worked equivalency, which substantially understates the actual 36 hours worked per week.

STEP 4: CALCULATE THE AVERAGE NUMBER OF EMPLOYEES

First determine the employer's number of full-time employees during each calendar month of the previous calendar year. Employees are full-time if they averaged at least 30 hours of service per week during the month, and 130 hours of service in a calendar month is treated as the equivalent of 30 hours of service per week.

Then, determine the number of full-time-equivalent employees during each calendar month of the previous calendar year. Full-time-equivalent employees for a calendar month are determined by dividing the total hours of service of all part-time employees during the month (but not more than 120 hours

Figure 1: Example of the number of employees calculation:
Hours worked:

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
Manager	160 hrs	160 hrs	163 hrs	180 hrs	160 hrs	160 hrs	160 hrs	130 hrs	120 hrs	129 hrs	220 hrs	110 hrs
Employee 1	130 hrs	150 hrs	129 hrs	180 hrs	160 hrs	140 hrs	130 hrs	130 hrs	120 hrs	129 hrs	110 hrs	220 hrs
Employee 2	130 hrs	120 hrs	129 hrs	180 hrs	160 hrs	140 hrs	125 hrs	130 hrs	120 hrs	129 hrs	110 hrs	220 hrs
Employee 3	130 hrs	120 hrs	129 hrs	10 hrs	70 hrs	110 hrs	125 hrs	130 hrs	120 hrs	129 hrs	110 hrs	0 hrs
Employee 4	0 hrs	0 hrs	0 hrs	0 hrs	0 hrs	0 hrs	10 hrs	30 hrs	70 hrs	34 hrs	0 hrs	0 hrs

Calculation of total employees per month:

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
Full-time	4	2	1	3	3	3	2	4	0	0	1	2
Full-time Equiv	0	2	3	0.083	0.583	0.917	2.083	0.25	4.583	4.283	2.75	0.917
Total	4	4	4	3.083	3.583	3.917	4.083	4.25	4.583	4.283	3.75	2.917

continued on next page

Applicable Large Employer Status Under the Affordable Care Act

continued from page 23

for any one employee) by 120. If the resulting number is a fractional number, the number is not rounded to the nearest whole number at this step. The number of full-time-equivalent employees for each month is added to the number of full-time employees for each month to determine the total number of employees for each month.

Determine the average number of employees for the preceding year by dividing the sum of the total number of employees for all 12 months in the calendar year by 12. If the resulting number is a fractional number, it is rounded down to the nearest whole number. If the number is 50 or more, the employer is an applicable large employer.

STEP 5: DETERMINE IF THE EMPLOYER IS AN EXEMPTED SEASONAL EMPLOYER

There is an exemption for employers who exceed the 50-employee threshold due to seasonal employees. An employer is not considered an applicable large employer if the employer's workforce exceeds 50 full-time and full-time-equivalent employees for 120 days (or four calendar months) or less and the excess employees during the 120-day period were seasonal workers. The 120 days or four calendar months need not be consecutive. In addition, the seasonal employees can work more than 120 days so long as the employer does not exceed 50 employees for more than 120 days or four calendar months. (Note the discrepancy between the general rule and the exemption: the exemption applies to employers who do not exceed 50 employees for more than 120 days, whereas an employer must have less than 50 employees to satisfy the general rule.)

See Figure 1 on page 23 for examples of the number of employees calculation.

Hours worked: (Note: In each month the employees had a total of 550 hours of service, the calculation of the total number of employees ranged from 2.971 to 4.583. Also, each highlighted cell exceeds the 120-hour cap for calculation of full-time equivalents, but does not meet the 130 threshold for full-time employee; thus, 120 hours is used in the calculation of full-time equivalents.)

Calculate average for preceding year:

(4+4+4+3.083+3.583+3.917+4.083+4.25+4.583+4.283+3 .75+2.917)/12=3.871=3 full-time employees for purposes of determining if the employer is an applicable large employer. (Note: Use the decimal number determined each month in calculating the average for the year, but always round the average for the year down.)

EXAMPLE 1: THE IMPACT OF FULL-TIME VERSUS PART-TIME EMPLOYEES ON THE CALCULATION OF TOTAL EMPLOYEES

Employer has 19 full-time employees working 130 hours per month and 60 part-time employees working 65 hours per month for every month in 2014. The employer would be an applicable large employer in 2015 (19 full-time employees each month and 32.5 full-time equivalents per month = 51 full-time employees). As an alternative, the employer could employ 30 full-time employees working 130 hours per month rather than the 60 part-time employees. The employer would not be an applicable large employer in 2015 because the employer did not have 50 or more employees on average in the preceding year.

EXAMPLE 2: THE IMPACT OF INCREASING HOURS WORKED PER FULL-TIME EMPLOYEE VERSUS ADDITIONAL EMPLOYEES

Employer has 60 full-time employees working 130 hours per month during every month in 2014. The employer would be an applicable large employer in 2015. As an alternative, the employer could employee 49 full-time employees working 160 hours per month during every month in 2014. The employer would not be an applicable large employer in 2015 because the employer does not have 50 or more employees on average in the preceding year.

EXAMPLE 3: SEASONAL EMPLOYER WITH 50 FULL-TIME EMPLOYEES

Employer operates a chain of water parks. Employer has 50 full-time employees during every month of 2014. In addition, from May 15 until September 10 of 2014, employer has an additional 200 full-time seasonal employees and 1500 part-time seasonal employees working an average of 100 hours per month. Employer is within the exemption for seasonal employers and is not an applicable large employer for 2015.

EXAMPLE 4: SEASONAL EMPLOYER WITH SEASONAL EMPLOYEES THAT WORK MORE THAN 120 DAYS

Employer operates a ski resort. Employer has five full-time employees during every month of 2014. In addition, employer has 120 seasonal employees from Nov. 1 through April 30 of each year. In 2014, the 120 seasonal employees were full-time during the months of January, February, March and December. During the months of November and April, the seasonal employees were part-time and had a total of 4800 hours of service in November and 5400 hours in April. Employer is within the exemption for seasonal employers and is not an applicable large employer for 2015.

PLANNING OPPORTUNITIES FOR AVOIDING APPLICABLE LARGE EMPLOYER STATUS

As illustrated by the five-step process and the above examples, employers near the 50-employee cut-off can make adjustments in 2014 to avoid being an applicable large employer in 2015. As seen in the first and second example, employers can increase the allocation of hours of service to full-time employees to reduce the number of total employees for purposes of making the applicable large employer determination. As seen in examples 3 and 4, an employer can utilize seasonal employees to significantly exceed the

50-employee threshold so long as it does not do so for more than 120 days. In addition, employers should consider outsourcing some functions to independent contractors, or adding additional S corporation shareholders or partnership partners if either of those strategies is appropriate for their situation.

OFFERING HEALTH INSURANCE COVERAGE AS AN ALTERNATIVE

Employers can also avoid penalties in 2015 by offering health insurance that is affordable and provides minimum essential coverage to at least 95 percent of full-time employees in 2015. Even if the employer is an applicable large employer and the employer has an employee who receives a tax credit or cost-sharing subsidy in 2015, the employer will not be subject to the penalty under Section 4980H of the Code if the employer offered the employee and his/her dependents the opportunity to enroll in coverage that provided minimum essential coverage and was either affordable or meets one of the affordability safe harbors in Prop. Treas. Reg. § 54.4980H-5.

The coverage is affordable if the employee's cost for the lowest cost employee-only coverage does not exceed 9.5 percent of the employee's household income. The coverage provides essential minimum coverage if it covers 60 percent of the covered expenses as determined by actuarial standards. Thus, an employer, as an alternative to avoiding applicable large employer status, can avoid penalties in 2015 by offering employees and their dependents the opportunity to enroll in affordable coverage that provides minimum essential coverage.

AVOIDING PENALTIES

If an employer cannot, or does not, avoid applicable large employer status and chooses not to offer its full-time employees the opportunity to enroll in minimum essential coverage, it can also avoid penalties in 2015 by employing 30 or fewer full-time employees in each calendar month of 2015. The penalty imposed on applicable large employers is calculated based on full-time employees and does not include full-time-equivalent employees, and Code Section 4980H(c)(2)(D)(i) excludes the first 30 full-time employees from the calculation of the penalty.

Thus, the employer in Example 1 above would not be liable for a penalty in 2015, even though it is an applicable large employer, so long as it does not employ more than 30 full-time employees in any calendar month in 2015. ■

Aaron Borden, JD, CPA, is a tax and white-collar attorney with Meadows Collier in Dallas, Texas.