WHITE PAPER

Tax Credits and Incentives

Solving the Maze of the ACA's Employer Mandate

Federal health care reform, otherwise known as the Patient Protection and Affordable Care Act (PPACA) or just as the Affordable Care Act (ACA), is so much more than just providing health insurance coverage to employees. There are over 20,000 pages of laws, regulations and other guidance related to all the provisions of the ACA and yet there is still so much unknown on how all the pieces of this program are going to come together over the next couple of years individually and as a whole. This document is intended to look specifically at the Employer Mandate provision of the ACA and help employers summarize some of the more complicated issues related to employee hours and the requirement to offer health insurance coverage.

The focus of this paper can be stated in one sentence: The Employer Mandate requires "Large Employers" to offer affordable, minimum essential coverage to substantially all of their full-time employees and their dependents or potentially pay considerable penalties. Upon reading through the pages of this document, you should have a better understanding of the following:

1. The Large Employer determination
2. The Pay or Play decision
3. Which employees must be offered coverage
4. How the ACA will be monitored and enforced

Everything in this document is based on guidance and resources as they exist today. Although there is a lot of information available regarding the ACA's provisions, there are still many unknowns and there are some expectations that some things could even change before the end of 2013. Even with the uncertainty, businesses need to prepare for the ACA now because it is just too complicated and cumbersome to wait until the last minute.

IRS Delay of Employer Mandate

Originally the Employer Mandate was scheduled to be effective as of January 1, 2014; however, on July 2, 2013 the Treasury Department and the Obama Administration delayed the mandate for one year, until January 1, 2015. This allows the IRS to explore simplifying the coverage requirements, the eligibility rules, and the reporting requirements. The delay also allows the government and employers more time to establish and refine their processes in order to comply in 2015. All other provisions of the ACA remain intact. Although enforcement has been delayed for one year, the IRS did advise in Notice 2013-45 that businesses should go ahead and voluntarily comply with the requirements in 2014.

Large Employer Determination

The Large Employer determination is the first calculation that must be completed as this determines whether a business is subject to the ACA Employer Mandate. A Large Employer is defined as an employer with 50 or more full-time and full-time equivalent ("FTEs") employees. The Large Employer calculation is based on the average number of applicable employees during the preceding calendar year. An employer must count all employees.

A full-time employee is defined as any common law employee who works at least 30 hours per week (or a business can look at it as 130 hours per month). An hour of service or hour worked is basically each hour to which the employee is paid or entitled to payment and this includes vacation, holiday, military duty and a number of other types of paid leave. Generally, identifying full-time employees is not an issue; although, as a point of caution, businesses must remember that currently for ACA purposes a full-time employee is based on 30 hours per week whereas the company policy may have a different threshold. To illustrate the issue consider a company that classifies employees who work more than 35 hours per week as full-time. This company could conceivably have a pool of employees who work between 30-35 hours per week that it classifies as part-time employees but for ACA purposes they are really full-time employees and would have to be offered health care. Without monitoring and reviewing part-time employee hours, this difference in the full-time hour threshold has the potential to cause problems for many employers.

A full-time equivalent employee is determined by looking at your part-time employees (those that work less than 30 hours per week). The number of full-time equivalents is determined by adding up the monthly hours for every non-full-time employee, capping their hours at 120, and then dividing the sum by 120. The resulting number is your full-time equivalents. Remember, full-time equivalents are only important in regards to the Large Employer determination; full-time equivalents are not included in the penalty calculation and don't have to be offered coverage. Here is an example showing how the Large Employer determination works.

Example: Company has 35 full-time employees during the period January through June and increased to 45 employees from July through December. Company also employs for the entire year 45 part-time employees who each work 100 hours per month. In working through the process below, it shows that the business has 77.5 full-time and full-time equivalent employees and therefore, is a Large Employer subject to the Employer Mandate of the ACA.

Determine number of FT employees	Determine number of FTE	Sum FT and FTE employees
(35 FT x 6 months) + (45 FT x 6 months) = 480	45 PT x 100 hrs. each = 4,500 hrs.	40 FT + 37.5 FTE = 77.5 employees
480/12 months = 40 FT employees	4,500/120 = 37.5 FTE	

There are a few specialized issues for some Large Employers under the ACA such as the controlled group concept, international employees and employment of temporary employees.

Controlled Group

For the Large Employer determination a business must consider a controlled group as a single employer. Under §414(c) of the Internal Revenue Code, a controlled group exists when any two or more entities are connected through ownership. There are three types of controlled groups to consider: parent-subsidy group, brother-sister group and a combined group.

A **"parent-subsidiary" controlled group** exists when a parent company directly or indirectly owns 80% of a subsidiary organization.

A **"brother-sister" controlled group** exists where the same five or fewer persons own more than 80% of two or more other entities and own more than 50% when taking into account the ownership of each person only to the extent that it is identical with respect to each such entity.

A **"combined"** controlled group exists where a group includes both parent-subsidiary and brother-sister members.

An important thing to remember is that the controlled group consideration is only part of the Large Employer determination; it does not apply to the penalty calculations under the ACA. If a controlled group's combined total of full-time or full-time equivalent employees is equal to 50 or more, each individual employer is subject to the employer mandate even if such employer itself does not employ enough employees to meet the threshold.

International Employees

The Affordable Care Act only considers employees performing work in the U.S. Employees working outside the U.S. generally will not have hours of service and will not count as full-time employees. Employees working only abroad should not be considered in the large employer determination, should not be included in any penalty calculation, and should not be considered for the employer mandate requirements.

Contract/Temporary Employees

This is one area of the ACA where there is uncertainty and where more guidance is needed. Most likely these situations will be governed on the common law employee and control rules and will be dependent upon the facts and circumstances of each situation. Again, this is an area where more guidance is needed.

The Pay or Play Decision

If a business is a Large Employer it must next decide whether to "Pay" or to "Play" Ultimately, this decision is to offer health insurance to your full-time employees (as defined under the ACA) or pay the penalties for not offering health insurance or not offering adequate health insurance.

Play

Large Employers that have chosen to offer coverage to full-time employees (i.e. Play) must ensure that they offer minimum essential coverage to "substantially all" full-time employees and that the employee cost is affordable. The ACA does not specify any particular health benefits that must be provided as part of MEC. The nuances of the MEC concept are outside the scope of this document. The "substantially all" threshold means at least 95% of the business's full-time employees. The intention of the 95% rule is to act like a safeguard for those instances where a Large Employer accidentally fails to comply.

Under the Affordability requirement, the plan's share of the total cost must be at least 60% (determined through an actuarial valuation) and the employee's share of the premium must not be required to pay more than 9.5% of their household income. This determination is based on the cost for single coverage; which is a key point. The IRS figured out that employers will not be able to ascertain an employee's annual household income so the IRS created Safe Harbors based on rate of pay (effectively W-2 wages reported in Box 1), monthly pay (capped at 130 hours for hourly workers), or the federal poverty level for single individuals.

Pay

Remember the Large Employer determination is based on whether an employer has 50 or more full-time employees (those who work at least 30 hours per week) and full-time equivalent employees (those who work less than 30 hours per week), but penalties are calculated based only on the number of full-time employees.

If minimum essential coverage (MEC) is not offered to substantially all full-time employees and their dependents, and at least one of the employees obtains health coverage through a marketplace and receives the premium tax credit from the government toward purchase of coverage, the employer must pay a penalty tax of $166.67 per month ($2,000 per year) for each full-time employee. There is a small exclusion in regards to the penalty in that the penalty is not assessed on the first 30 full-time employees. For example, an employer with 250 full-time employees offers coverage to 200 of them must pay penalty across 220 of them (250 minus 30) if one of the unoffered full-time employees obtains coverage on the exchange and receives the premium tax credit.

If the employer offers minimum essential coverage (MEC) to substantially all full-time employees and their dependents but the coverage is unaffordable or contains inadequate value, the employer must pay a penalty tax of $250 per month ($3,000 per year) for each full-time employee not offered affordable or valuable coverage that receives government-subsidized exchange plan coverage. However, the total penalty for coverage that is unaffordable or inadequate is capped at the amount that would have been owed under the not offered penalty. This cap was put into place because of the thought that an employer offering coverage even if it is inadequate or unaffordable should not have to pay more than an employer not offering coverage at all.

Large Employer Possibilities

The illustration below details four possibilities for a Large Employer in regards to the pay or play aspect of the ACA. The chart summarizes that a Large Employer who does not offer coverage could be assessed a penalty or may not be assessed a penalty if no full-time employees go to the marketplace, get coverage and receive the tax credit. Conversely, even if the employer offers coverage to its full-time employees, it could be subject to penalties if the coverage is not adequate or affordable. The determining factor in both penalties really is whether a full-time employee gets coverage at the marketplace and receives the premium tax credit.

Illustration	Penalty	No Penalty
No Coverage Offered	• At least 1 FT employee goes to marketplace and receives credit • Penalty assessed on all FT (less 30)	• No FT employee receives credit • NO PENALTY
Coverage Offered	• At least 1 FT employee goes to marketplace and receives credit • Penalty assessed on FT's receiving credit	• No FT employees receive credit • NO PENALTY

Looking Back at Full-Time Status

Once a business has determined it is a Large Employer and it has decided to play, it must begin the evaluation of its employees to determine full-time status under the ACA and which employees must be offered coverage. This is one area of the ACA that can get very complicated and result in a massive administrative burden for employers particularly if the employer is laden with part-time employees.

Initially one might think that the full-time employee analysis would be easy and straight forward but that is not the case. The problem for many employers is that full-time under the ACA is based on 30 hours per week (or 130 hours per month) regardless of what the company considers to be full-time. Subsequent to the passage of the ACA, the IRS realized that determining full-time status on a month to month basis as originally required was way too onerous for employers to monitor and track for all their employees; so the IRS has offered up a look back methodology that averages the employee's hours over a specific period of time.

Under this look back method there are three periods: the measurement period, the stability period, and the administrative period.

The **Measurement period** is the period of time that dictates whether the individual is full-time or not based upon the employee's hours.

The **Administrative period** is the period of time between the measurement period and the stability period in which the employer determines who it must offer coverage to in the stability period.

The **Stability period** is the period of time the individual is covered and considered to be full-time for insurance purposes.

The employer gets to set the length of time for the measurement period anywhere between 3 to 12 months. The stability period must be at least 6 months long but it cannot be shorter than the measurement period and the administrative period cannot exceed 90 days.

The full-time status analysis is completed based on the measurement period and determines whether the employer must offer coverage to the employee during the administrative period for the applicable stability period. If the employee exceeds the hour threshold in the measurement period, the employer must offer coverage to the employee and if the employee selects coverage the employer must cover the employee for the entire stability period so long as the employee is employed regardless of the hours worked by the employee during that stability period.

The full-time status analysis through the look back method is completed differently and separately for ongoing employees than for new employees. The measurement period that the employer chooses to apply to ongoing employees is referred to as the "standard" measurement period; whereas the measurement period applicable to new employees is referred to as the "initial" measurement period.

Ongoing Employees Analysis

Ongoing employees are those employees that have worked for the employer through at least one standard measurement period or were employed on the first day of the first measurement period. If the employer determines that an ongoing employee was employed on average at least 30 hours per week during the standard measurement period, then the employee is treated as a full-time employee during the subsequent stability period. If the employer determines that the ongoing employee did not work full-time during the standard measurement period, the employee may be treated as not a full-time employee during the immediately following stability period.

Once an ongoing employee is determined to be a full-time employee for a stability period, the employee's status as full-time for the entire stability period is not changed even if the individual's hours drop below the full-time status threshold. Likewise, an employee who was determined to be non-full-time is treated as not a full-time employee during the entire stability period even if the employee's hours are increased during the stability period.

The employer must go through this exercise for every employee and then repeat the exercise every year. The look-back calculation and analysis is relatively straight forward for an ongoing employee, just more of a nuisance in terms of the administrative burden; but, if the employee is a variable hour employee then there is more complexity on top of the burden.

New Employee Analysis

The look-back method used to determine full-time status for new employees will vary depending upon whether the new employee is reasonably expected to work on average at least 30 hours or is a variable hour employee or a seasonal employee.

If a non-seasonal, new employee is reasonably expected to work on average 30 hours per week, then the employer must offer coverage to the employee at or before the conclusion of the employee's initial three calendar months of employment or otherwise be subject to possible penalty.

A major complexity of the ACA is when an employer hires new variable hour or seasonal employees. A variable hour employee is defined as every employee not reasonably expected to work at least 30 hours per week based on the facts and circumstances known on the individual's start date. A seasonal employee is someone who performs services on a seasonal basis as defined by the Secretary of Labor, including migrant and seasonal agricultural workers, and retail workers employed exclusively during holiday seasons. Each variable hour and seasonal employee has their separate initial measurement period and stability period unique to them.

The measurement period begins on the employee's start date or it can start the 1st day of the calendar month following the start date. Companies may want to make it a policy to start all variable hour employees' initial measurement period on the 1st of the month following the start date in order to lump all variable hour employees hired within one month into the same measurement period cycle. Once the initial periods are set for the new variable hour employee you may realize that the initial stability period may overlap with the standard stability of the ongoing employees.

During the initial measurement period, the employer measures the hours for the new variable hour employee or seasonal employee and determines whether the employee was employed an average of 30 or more hours per week during this period. If an employee is determined to be a full-time employee during the initial measurement period, then the new employee must be offered coverage during the new employee stability period. The new employee's stability period must be the same length as the stability period for ongoing employees. In addition, this stability period must be at least 6 months and is no shorter in duration than the initial measurement period.

A Vortex in the Maze – the Rehire

Clearly the full-time status analysis detailed above is complex and can be tough to follow even for those immersed in the ACA. But the ACA maze can spiral further into itself when the rules around rehires are considered, and the rehire situation is a common occurrence in many industries. Basically, if an individual has no hours of service for at least 26 consecutive weeks and later returns to work, the employer can treat that individual as a new employee. However, if the separation is less than 26 weeks there is more to consider and the employee could be considered as a new employee or as a continuing employee. This is called the Rule of Parity. Under the Rule of Parity, the employer can consider the employee as a new employee if the break is at least 4 weeks long and is longer than the preceding period of employment. If that is not the case, the employee is considered as a continuing employee. If the rehire is considered a new employee, the full-time status analysis is started over; however, for continuing employees, the measurement and stability periods of the full-time status analysis apply when the employee resumes employment as if the employee had not discontinued employment.

Here are a couple of simple examples to illustrate the rehire issue:

> Employee A works for 10 weeks and then terminates employment for 30 weeks before being rehired. Employee A is a new employee because the break in service exceeded 26 weeks.
>
> Employee B works for 5 weeks and then terminates employment. Employee B is then rehired 12 weeks later. In this case, Employee B may be treated as a new employee upon rehire because the break exceeded 4 weeks and was longer than the initial period of employment.
>
> Employee C works for 20 weeks terminates employment and then is rehired 8 weeks later. In this situation, Employee C is treated as a continuing employee and his measurement and stability periods are resumed upon rehire because even though the break exceed 4 weeks it was not longer than the period of prior employment.

This is a very simplistic look at the rehire issue to show the principle but there can easily be additional facts and circumstances involved that would complicate the rehire analysis, not to mention the challenge of recapturing work data of employees that terminated up to 26 weeks early. If rehiring employees is a part of your business, this is an aspect of the ACA that you must be aware of and quite frankly understand.

Enforcement of the ACA

The Internal Revenue Service (IRS) has been tasked with overseeing and enforcing the ACA. This alone has many employers worried about compliance and what to do to keep the IRS at bay. The requirements of the ACA are dependent upon considerable amounts of data and workforce information and there will be certain things a Large Employer will be expected to report to the IRS.

The IRS released proposed regulations in September 2013 that are intended to clarify the information required to be reported under Code Section 6055 and Section 6056 to the IRS that will allow the IRS to evaluate compliance with the employer and individual mandates and individual eligibility for premium tax credits.

Section 6055 imposes annual information reporting requirements on insurers, employers that self-insure group health plans and certain other providers of minimum essential coverage. Covered entities will report the required information to the IRS on Form 1095-B, or another form the IRS designates, and to covered individuals through a statement providing the policy number, contact information for the entity and information required to be reported to the IRS. This section requires entities providing minimum essential coverage to file annual returns reporting information about the entity and specific information for each individual for whom minimum essential coverage is provided, including identifying information for insured individuals and the months during which each employee was covered by minimum essential coverage.

Section 6056 imposes annual information reporting requirements on applicable large employers regarding health insurance the employer provides to its full-time employees. This section requires applicable large employers that are subject to the employer shared responsibility requirements to file a return with the IRS describing health care coverage the employer provides to its full-time employees, including a list of full-time employees, the coverage offered to each full-time employee and for which months it applied.

This information will be reported to the IRS on Form 1094-C, or another form the IRS designates, and to each of its full-time employees. Applicable large employers are only required to report the employee's share of the lowest cost monthly premium for self-coverage (not the coverage they actually select) because this information is used to determine employer compliance with the employer shared responsibility rules and to determine individual eligibility for premium tax credits.

Expectation that Large Employers must report:

- Company information
- Certification that FT employees offered coverage
- Length of any waiting period
- Months policy was available
- Monthly lowest cost premium option
- Employers share of total cost of benefits
- Number of FT employees for each month during the year

NOTE: The reporting and compliance aspects of the Employer Mandate are still somewhat uncertain as the guidance from the IRS is still in the form of proposed regulations. Even though the IRS provided some concrete guidance in the proposed regulations, the IRS also described various possible administrative simplifications that would be designed to reduce or streamline information reporting and cost burdens on employers including:

- Allowing employers to report offers of minimum essential coverage on Form W-2.
- Eliminating the need to determine an employee's full-time status if applicable coverage is offered to all potentially full-time employees.
- Requiring an employer to report an employee's cost to purchase employer-sponsored health coverage only when that cost is above a threshold amount.
- Limiting reporting for employers offering no-cost coverage to employees and their spouses and dependents.
- Eliminating certain duplicative reporting requirements and there are some other possible simplifications.

The proposed regulations, 78 FR 54986 and 78 FR 54996, are open for public comments and scheduled for hearings in November, 2013 so there is still much to be worked out on the reporting and compliance requirements on Large Employers.

Regardless of the final reporting and compliance requirements, it is imperative that Large Employers have certain documentation ready to substantiate their ACA compliance. This will require accurate, detailed records; taking the time now will most definitely eliminate headaches and inconvenience going forward.

Assessment of Penalties

As indicated in the FAQs published by the IRS, if a penalty is possible the IRS will contact employers to let them know of potential liability and provide them with a period of time to research and respond before the liability is assessed. Business should not expect contact from the IRS until after employees' file their individual tax returns claiming the premium tax credit and after the due date for the employers to meet and file the information return regarding the Large Employer determination, full-time employees and offered coverage.

If a business is assessed a penalty under the ACA, the IRS will send a notice and a demand letter that will include instructions on how to make the payment. The IRS has stated that the payment will not be included on any tax return filed by the employer.

Being Audit Ready for the IRS

- The best practice is to compile information throughout the process and have this material ready before the audit.
- Have accurate, detailed and complete records showing hours worked during the measurement period.
- Have monthly backup documentation for employee counts and the Large Employer determination.
- Have detailed full-time Safe Harbor schedules.
- Have information regarding Employee Coverage.
- Have Insurance Plan information on MEC and costs.

Conclusion

It is not an exaggeration to say that companies are going to have to deal with a substantial increase in the amount of administrative and compliance work related to the ACA. Many companies are asking what they need to do now. With the recent delay of the Employer Mandate, businesses have some time to continue to work through the ACA maze and get things ready. The first step in this process is to confirm their Large Employer status. The second step for a business is to decide whether to pay or play. If the business is playing, it needs to make sure that its insurance plans satisfy the MEC and affordability requirements. Once a business has steps one and two under control, the business must begin the full-time status look back analysis. And finally, the business must make sure that it has the processes in place to monitor and capture workforce data in order to substantiate its compliance with the ACA requirements and to be able to satisfy the reporting requirements with the IRS.

Employers must be vigilant since complying with the ACA is not a one-time event. To ensure compliance with the ACA and to truly mitigate the possibility of penalties, Large Employers, especially those with high turnover and or a large part-time workforce, must continuously monitor and analyze employment data. The best way to achieve this is through a dynamic, on-going analysis of your workforce.

Although changes are expected with the ACA over the next couple months and the IRS has delayed the enforcement of the Employer Mandate until January 1, 2015, businesses would be wise to put into place adequate tools and processes to ensure compliance now. The ACA is a very large maze; set up your map now so that you can navigate that maze with little to no wrong turns when it matters.

First Advantage can help your company determine whether it satisfies the initial requirements and assist with continuous and ongoing monitoring of all the variables to ensure compliance. With decades of expertise in administering programs where stringent reporting is required, First Advantage is well versed in headcount calculations, wage and hourly reporting, as well as IRS program administration and auditing.

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