Applicable Large Employer Status
Determination under ACA Play or Pay Rules

Note: This is the first article in a series of articles where we explore different aspects of the ACA Play or Pay Rules.

Applicable large employers are subject to the Play or Pay mandate. An applicable large employer is defined as an employer that employed an average of at least 50 full-time employees (taking into account full-time equivalents) on business days during the preceding calendar year.

For most employers, their status as an applicable large employer will be evident without the need for an actual employee calculation (for example, employers with a number of employees that is well in excess of the 50-employee threshold). For some employers (those close to the 50-employee threshold), a calculation will be required and will be performed for the first time. Other employers will need to consider the controlled group rules (discussed below).

Caution: The look-back measurement method that may be used to identify full-time employees for purposes of calculating the penalty tax does not apply for purposes of determining status as an applicable large employer. Instead, the determination of whether an employer is an applicable large employer for a year is based upon the actual hours of service of employees in the prior year (but transition relief is provided for 2014).

Transition Relief - There is transition relief allowing use of a shorter look-back period in 2013 for purposes of determining applicable large employer status for 2014.

Transition relief for the 2014 calendar year allows an employer the option to determine its status as an applicable large employer by reference to a period of at least six consecutive calendar months, as chosen by the employer, in the 2013 calendar year (rather than the entire 2013 calendar year). An employer may determine whether it is an applicable large employer for 2014 by determining whether it employed an average of at least 50 full-time employees on business days during any consecutive six-month period in 2013.

Applicable large employers include government entities (such as Federal, State, local or Indian tribal government entities) as well as organizations that are exempt from Federal income tax.

Who is an employee? – The proposed regulations define an employee under the common law standard. Under the common law standard, an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. Under the common law standard, an employment relationship exists if an employee is subject to the will and control of the employer not only as to what will be done but how it will be done. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so.

Full-time employee – The term full-time employee means, with respect to a calendar month, an employee who is employed an average of at least 30 hours of service per week with an employer. For this purpose, 130 hours of service in a calendar month is treated as the monthly equivalent of at least
30 hours of service per week, provided the employer applies this equivalency rule on a reasonable and consistent basis.

**Full-time equivalent employee** – The term full-time equivalent employee means a combination of employees, each of whom individually is not treated as a full-time employee because he or she is not employed on average at least 30 hours of service per week. These employees in combination are counted as the equivalent of a full-time employee solely for purposes of determining whether the employer is an applicable large employer.

**Leased Employees** – Leased employees are not treated as employees of the service recipient.

**2% or More Shareholder** – A 2% or more shareholder in an S corporation is not an employee for purposes of determining the number of employees to be included in the applicable large employer status.

**Partner** – A partner in a partnership is not an employee for purposes of determining the number of employees to be included in the applicable large employer status.

**Foreign Employers and Foreign Employees** – According to the IRS Q&As, released on December 28, 2012, a company that employs US citizens working abroad generally would be subject to the Play or Pay mandate only if the company had at least 50 full-time employees (or the equivalent combination of full-time and part-time employees), determined by taking into account only work performed in the US. Employees working only abroad, whether or not US citizens, generally will not be taken into account for purposes of determining whether an employer meets the 50 full-time employee (or equivalents) threshold. For employees working abroad, the time spent working for the employer outside of the US would not be taken into account for purposes of determining whether the employer owes a penalty tax.

**Calculating the Number of Employees for Applicable Large Employer Status**

According to the proposed regulation, an employer takes the sum of the total number of full-time employees (including seasonal workers) for each calendar month in the preceding calendar year and the total number of full-time equivalents (including seasonal workers) for each calendar month in the preceding calendar year, and divides by 12. The result, if not a whole number, is then rounded to the next lowest whole number. If the result of this calculation is less than 50, the employer is not an applicable large employer for the current calendar year. 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 worker exception applies.

**Seasonal Worker Exception** – If the sum of an employer’s full-time employees and full-time equivalent employees exceeds 50 for 120 days or less during the preceding calendar year, and the employees in excess of 50 who were employed during that period of no more than 120 days are seasonal workers, the employer is not considered to employ more than 50 full-time employees (including full-time equivalents). For purposes of the seasonal exception only, four calendar months may be treated as the equivalent of 120 days. The four calendar months and the 120 days are not required to be consecutive.

**Hourly Employees Calculation** – For employees paid on an hourly basis, an employer must calculate actual hours of service from records of hours worked and hours for which payment is made or due.
**Non-Hourly Employees Calculation** – For employees paid on a non-hourly basis, an employer must calculate hours of service by using one of the following methods:

1) Using actual hours of service from records of hours worked and hours for which payment is made or due.

2) Using a days-worked equivalency 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.

3) Using a weeks-worked equivalency whereby 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.

**Employers Not in Existence in Preceding Calendar Year** – An employer not in existence throughout the preceding calendar year is an applicable large employer for the current calendar year if it is reasonably expected to employ an average of at least 50 full-time employees (taking into account full-time equivalents) on business days during the current calendar year and it actually employs an average of at least 50 full-time employees (taking into account full-time equivalents) on business days during the calendar year.

**Calculating the Number of Full-Time Equivalents**

All employees (including seasonal workers) who were not employed on average at least 30 hours of service per week for a calendar month in the preceding calendar year are included in calculating the employer’s full-time equivalents for that calendar month.

The number of full-time equivalents for each calendar month in the preceding calendar year is determined by calculating the aggregate number of hours of service for that calendar month for employees who were not full-time (but not more than 120 hours of service for any employee) and dividing that number by 120. In determining the number of full-time equivalents for each calendar month, fractions are taken into account. The proposed regulation provides a number of examples illustrating the calculation of full-time equivalents.

**Controlled Group Employers**

Employers that are part of a controlled group or an affiliated service group under section 414(b), (c), (m), or (o) are treated as a single employer for purposes of counting the number of full-time employees and full-time equivalent employees. If an employer has under 50 employees and is a part of a controlled group of corporations, all employees of the controlled group must be taken into account in determining whether the one employer with under 50 employees is subject to the shared responsibility provisions. For purposes of aggregating employers, the proposed regulations permit government entities and churches to rely on a reasonable good faith interpretation of the aggregation rules.

*Caution: The controlled group rules are complicated and beyond the service scope of what many TPAs provide. We suggest that TPAs ask their clients to work with their certified public accountants (CPAs) to determine whether or not the client is a part of a controlled group. Once that determination is made, the TPA can begin to assist the employer in understanding how the Play or Pay rules will shape plan design.*

**How do penalties apply to a member of a controlled group?**
Term you need to know – The proposed regulation has created the term “applicable large employer member,” which refers to a company that is a part of a controlled group and is treated as a single employer.

According to the preamble to the proposed regulation, applicable large employer status and the 30-employee reduction is determined on a member-by-member basis. The penalties under Play or Pay are computed separately for each “applicable large employer member,” taking into account that member’s offer of coverage (or lack thereof) and that member’s number of full-time employees.

Example from the Preamble – If a parent corporation owns 100 percent of all classes of stock of 20 subsidiary corporations, and the controlled group is an applicable large employer, each of the 21 members of this controlled group (the parent corporation plus 20 subsidiary corporations) is considered separately in computing the penalty. Each of the 21 group members is liable only for its separate penalty.

How do members of a controlled group take advantage of the 30-employee offset? Each individual member of the controlled group does not get a 30-employee offset. The applicable large employer is permitted one reduction of 30 full-time employees and the reduction must be allocated ratably among the members of the applicable large employer based on each member’s number of full-time employees.

Is an individual member of an applicable large employer controlled group that has under 50 full-time employees subject to the Play or Pay penalties?

The member of an applicable large employer due to controlled group rules may have to pay penalties even if the member has below 50 employees.

The proposed regulation includes an example where one member (Member A) of a controlled group employs 40 full-time employees and does not sponsor a plan. Another member (Member B) of the controlled group employs 35 full-time employees under which all of its full-time employees are eligible for minimum essential coverage. Member A receives a certification from an exchange showing that one full-time employee was eligible for a premium subsidy. According to the example, only Member A would be subject to a penalty based on the number of its employees. The 30-employee offset must be allocated among all the members of the controlled group.

Feb, 2013