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Practice Update

Health Care Reform: Recent Guidance on "Play or Pay" Rules for Applicable Large Employers in 2014

January 15, 2013

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Many important aspects of the Patient Protection and Affordable Care Act ("ACA") will go into effect in 2014, including the implementation of health insurance exchanges, and the requirement for certain employers to offer certain health plan coverage to certain employees and dependents. The IRS issued welcome proposed regulations on December 28, 2012 ("Proposed Regulations"), published on January 2, 2013 in 78 Fed. Reg. 217, providing additional details and clarity on a number of open issues related to employer obligations. Employers are able to rely on these proposed regulations until issuance of a final rule.

The focus of this Practice Update is on the threshold determination of which employers are subject to the 2014 coverage requirement.

Which Employers Will Be Subject to the "Play or Pay" Rules in 2014?

Under ACA, certain "applicable large employers" may be subject to a penalty tax for failing to offer health care coverage for all full-time employees and their dependents (but not spouses) or failing to offer minimum essential coverage that provides

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minimum value and is affordable. The rules for determining whether an employer is an applicable large employer are complex.

An applicable large employer is an employer who employed on average at least 50 full-time employees (including full-time equivalents) on business days during the preceding calendar year. So for purposes of determining whether an employer is an "applicable large employer" in 2014, the employer's workforce in 2013 is crucial.

For purposes of determining whether an employer is an applicable large employer for a given calendar year, an employer must count not only its full-time employees from the preceding calendar year, but also a full-time equivalent for employees who worked part-time in the preceding calendar year. A full-time employee for any month is an employee (including a seasonal employee) who averages at least 30 hours of service to the employer per week in the United States. A total of 130 hours of service in a month is treated as the monthly equivalent of 30 hours of service per week. Hours of service include not only time for which the employee was paid for actually performing the employee's duties, but also includes other paid time, such as paid time off for vacation, holidays, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence.

The Proposed Regulations provide the methodology for determining full-time equivalents. In general, if the average count of full-time and full-time equivalents together for a given calendar year is 50 or more, the employer is an applicable large employer for the next succeeding calendar year. The Proposed Regulations also provide additional details, and further describe detailed methods for determining the status of ongoing employees, newly hired employees, and seasonal employees.

What if Individual Companies That Share Common Ownership Each Employ Fewer than 50 Full-Time

Employees?

Even if individual companies remain below the 50 employee threshold, all companies under "common control" under certain qualified retirement plan rules will be treated as one aggregated single employer for purposes of determining whether the average count of employees for a given calendar year is 50 or more.

Internal Revenue Code Sections 414(b) and 414(c) define the term "controlled group". Companies within a controlled group are considered to be a single employer. A controlled group relationship exists if the businesses have a "parent-subsidiary" relationship or a "brother-sister" relationship or some combination thereof.

Another way to aggregate companies is through Code Section 414(m), which provides that all employees of members of an "affiliated service group" shall be treated as employed by a single employer. An affiliated service group includes, among other things, a management group. A management group exists where an entity ("Management Organization") performs management functions for another entity ("Recipient Organization"). If the Management Organization's principal business is to perform these management functions for the Recipient Organization on a regular and continuing basis, then the management group is treated as an affiliated service group. For this particular rule, there is no requirement that either of the entities have an ownership interest in the other entity.

It is important to carefully analyze the relationship between entities in order to determine whether the controlled group rules apply. Individual facts are crucial.

What Transitional Relief Did the Proposed Regulations Provide for Counting Employees in 2014?

The Proposed Regulations allow an employer to determine its status as an applicable large employer for 2014 by using a period of at least six consecutive months in 2013 rather than using the entire 2013 calendar year. This is extremely helpful from an administrative perspective, as it allows the employer to have time to prepare for the calculation, and also to implement the results of its determination.

Under the Proposed Regulations, if the employer chooses to use this transitional relief, in order to determine if it is an applicable large employer in 2014, it will have to determine if the average number of full-time and full-time equivalent employees for the chosen six consecutive month period in 2013 is 50 or more. For example, an employer could use the period of April through September 2013 to determine whether it is an applicable large employer for the 2014 calendar year.

What Should Employers Do Now?

Now is the time for employers to work with qualified counsel to prepare for the full implementation of ACA. The Proposed Regulations provide additional clarity and certain transitional relief related to the "play-or-pay" penalty that will first be imposed in 2014. Many key strategic decisions face employers of all sizes in 2013.

In the near future, employers should be prepared to calculate whether they will be considered applicable large employers, and if so, which of their employees and dependents must be offered affordable minimum essential coverage that provides minimum value in 2014. As a corollary to this evaluation, employers should consider updating the eligibility provisions within their plan documents and summary plan descriptions to accurately reflect the appropriate eligibility service counting methods.

A later Practice Update will discuss portions of the Proposed Regulations that describe the mechanics of the calculation of the penalty beginning in 2014 for

applicable large employers (a) that fail to offer coverage at all or fail to offer coverage to at least 95% of its full-time employees and their dependents, (b) that offer coverage, but that fail to offer affordable coverage (i.e., the cost of self-only health plan coverage exceeds 9.5% of the employee's Form W-2 compensation), or (c) that offer coverage, but that fail to offer coverage providing minimum value (i.e., the health plan does not pay at least 60% of the total allowed costs of benefits provided under the plan). That later Practice Update will also address additional transition rules that were included within the Proposed Regulations, including new flexibility afforded to non-calendar year group health plans.
