

# ACA OVERVIEW

Provided by Mosaic Employee Benefits

## Large Employers Subject to the Pay or Play Penalties

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. This employer mandate is also known as the “employer shared responsibility” or “pay or play” rules.

The employer shared responsibility rules were set to take effect on Jan. 1, 2014. However, the employer penalties and related reporting requirements were **delayed for one year, until 2015**. Therefore, penalties did not apply for 2014. In addition, ALEs that had fewer than 100 full-time and FTE employees in 2014 generally had an additional year, **until 2016**, to comply with these rules.

An important first step when assessing an employer’s potential liability under the employer shared responsibility rules is to determine if the employer meets the ALE threshold. Only ALEs are subject to the ACA’s employer shared responsibility penalties.

### LINKS AND RESOURCES

- On July 9, 2013, the Internal Revenue Service (IRS) issued [Notice 2013-45](#) to provide formal guidance on the one-year delay.
- On Feb. 12, 2014, the IRS published [final regulations](#) on the ACA’s employer shared responsibility rules.
- The IRS has also provided [Questions and Answers](#) for employers on the employer shared responsibility rules.

This ACA Overview is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

### HIGHLIGHTS

#### APPLICABLE LARGE EMPLOYERS

Only ALEs are subject to these rules.

- ALEs are employers that employ, on average, at least 50 full-time and full-time equivalent (FTE) employees during the preceding calendar year.
- All ALEs are subject to these rules, including for-profit, nonprofit and government employers.

#### FULL-TIME AND FTE EMPLOYEES

- A full-time employee is an individual that works, on average, at least **30 hours of service per week** (130 hours per month).
- Hours worked by employees with fewer than 30 hours per week must be counted—and then divided by 120 per month—to determine the number of FTEs.
- The number of FTEs is then added to the full-time employee count.



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## IDENTIFYING AN APPLICABLE LARGE EMPLOYER (ALE)

To qualify as an ALE, an employer must employ, on average, at least **50 full-time employees, including full-time equivalent employees (FTEs)**, on business days during the preceding calendar year. All employers that employ at least 50 full-time employees, including FTEs, are subject to the ACA's employer shared responsibility rules, including for-profit, nonprofit and government employers.

A full-time employee is an individual that works, on average, **30 or more hours of service each week**. For this purpose, **130 hours in a calendar month** is treated as the monthly equivalent of 30 hours of service per week. Hours worked by employees with fewer than 30 hours per week must be counted—and then divided by 120 per month—to determine the number of FTEs. The number of FTEs is then added to the actual full-time employee count.

Employers will determine each year, based on their current number of employees, whether they will be considered an ALE for the next year. For example, if an employer has at least 50 full-time employees (including FTEs) for 2015, it will be considered an ALE for 2016.

### *Employers with Employees Working Abroad*

A company that employs U.S. citizens working abroad generally will be subject to the employer shared responsibility rules only if the company had at least 50 full-time employees (including FTEs), determined by taking into account only work performed in the United States. Hours of service that must be counted when determining ALE status **do not include any hours for which an employee receives compensation from sources outside of the United States**. For this purpose, the United States includes only the 50 states and the District of Columbia, and does not include the U.S. territories.

The final regulations do not exempt employees that hold H-2A or H-2B visas from the definition of “employee” for purposes of the employer shared responsibility rules. Additionally, the final regulations do not adopt a special rule classifying these workers as seasonal employees.

### *Employers with Seasonal Workers*

An employer will not qualify as an ALE if:

- The employer's workforce exceeds 50 full-time (and FTE) employees for 120 days or fewer during a calendar year; and
- The employees in excess of 50 who were employed during that time were seasonal workers.

An employer may apply either a period of **four calendar months** or **120 days** (whether or not consecutive) to determine if it qualifies for the seasonal worker exception.

For this purpose, a seasonal worker means a worker who performs labor or services on a seasonal basis, including (but not limited to):

- **Workers covered by 29 CFR 500.20(s)(1).** (“Labor is performed on a seasonal basis where, ordinarily, the employment pertains to or is of the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year. A worker who moves from one seasonal activity to another, while employed in agriculture or performing agricultural labor, is employed on a seasonal basis even though he may continue to be employed during a major portion of the year.”); and
- **Retail workers employed exclusively during holiday seasons.**

Employers may apply a reasonable, good faith interpretation of the term seasonal worker and a reasonable good faith interpretation of 29 CFR 500.20(s)(1) (including as applied by analogy to workers and employment positions not otherwise covered under 29 CFR 500.20(s)(1)).

## ***New Employers***

An employer not in existence throughout the entire preceding calendar year will be considered an ALE for the current calendar year if it reasonably expects to employ an average of at least 50 full-time employees (taking into account FTEs) on business days during the current calendar year. An employer is treated as not having been in existence throughout the prior calendar year only if it was not in existence on any business day in the prior calendar year.

The determination of whether a new employer is an ALE during its first calendar year is based on the employer’s reasonable expectations at the time the business comes into existence, even if subsequent events cause the actual number of full-time (and FTE) employees to exceed that reasonable expectation.

Also, the seasonal worker exception applies to new employers, so that the employer will not be treated as an ALE if it reasonably expects:

- Its workforce to exceed 50 full-time employees (including FTEs) for 120 days or fewer during the current calendar year; and
- The employees in excess of 50 employed during such 120-day period to be seasonal workers.

## ***Transition Rule for an Employer’s First Year as an ALE***

A transition rule can apply for the first year that an employer is considered an ALE. It does not apply if, for example, if the employer falls below the 50 full-time and FTE employee threshold for a subsequent calendar year and then increases employment and becomes an ALE again. Under this transition rule, an ALE will not be subject to a penalty for failing to offer coverage to an employee for January through March of the first year for which the employer is an ALE if:

- The employee was not offered coverage by the ALE at any point during the prior calendar year;

- The ALE offers coverage to the employee on or before April 1 of the first calendar year; and
- The coverage offered by April 1 provides minimum value.

If the ALE does not offer coverage to the employee by April 1, the ALE may be subject to a penalty with respect January through March of the first calendar year for which the employer is an ALE, **in addition to any later calendar months for which coverage was not offered**. If the ALE offers coverage to the employee by April 1 that does not provided minimum value, the ALE may be subject to a Section 4980H(b) penalty with respect to the employee for January through March of the first calendar year for which the employer is an ALE, in addition to any later calendar months for which coverage does not provide minimum value or is not affordable.

## COUNTING FULL-TIME EMPLOYEES, FTES AND HOURS OF SERVICE

Employers average their number of full-time employees and FTEs across all months in a year to determine if they meet the ALE threshold. The averaging method takes into account fluctuations that many employers experience in their workforce numbers each year.

A **common law standard** applies to define the terms “employee” and “employer”

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 with respect to the result to be accomplished, along with the details and means by which it is done. This is a factual determination and is not necessarily dependent on the label the employer has placed on the relationship in the past.

In general, leased employees are not considered employees of the service recipient for purposes of the employer shared responsibility rules. Also, an independent contractor, a sole proprietor, a partner in a partnership, a 2-percent S corporation shareholder and real estate agents and direct sellers (under Internal Revenue Code Section 3508) are not counted as employees.

However, **aggregation rules apply for companies under common ownership**. All employees of a controlled group or affiliated service group under Internal Revenue Code Sections 414(b), (c) or (m) are taken into account to determine if an employer is subject to the employer shared responsibility rules. If the combined total meets the threshold, each separate member of the group is subject to these rules, even those companies that on their own do not have enough employees to meet the threshold.

### **Full-time Employees**

For purposes of the employer shared responsibility rules, a full-time employee is one who was employed, on average, **at least 30 hours of service per week. 130 hours in a calendar month** is treated as the monthly equivalent of 30 hours per service per week.

## *Full-time Equivalents (FTEs)*

Under the ACA, a full-time equivalent employee (FTE) 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 with an employer, and who, in combination, are counted as the equivalent of a full-time employee solely for purposes of determining whether the employer is an ALE.

An employer must calculate the number of FTEs it employed during the preceding calendar year, and count each FTE as one full-time employee for that year. The final regulations provide a calculation method for FTEs, where all employees who were not full-time employees for any month in the preceding calendar year are included in calculating the employer's FTEs for that month by:

- Calculating the aggregate number of hours of service (but not more than 120 for any employee) for all employees who were not employed, on average, at least 30 hours of service per week for that month; and
- Dividing the total hours of service determined above by 120.

The result is the number of FTEs for a calendar month. Fractions are taken into account in determining the number of FTEs for each calendar month. An employer may, as an option, round the resulting monthly FTE calculation to the nearest one hundredth. For example, an employer with a calculation of 30.544 FTEs for a calendar month may round that number to 30.54 FTEs.

## *Hours of Service*

**To determine an employee's hours of service, an employer must count:**

- **Working Hours:** Each hour for which the employee is paid, or entitled to payment, for the performance of duties for the employer; and
- **Non-working Hours:** Each hour for which an employee is paid, or entitled to payment, on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military leave or leave of absence.

All periods of paid leave must be taken into account; there is no limit on the hours of service that must be credited. Also, all hours of service performed for all entities treated as a single employer under the Code's controlled group and affiliated service group rules must be taken into account. However, if compensation for hours of service is foreign source income, those hours of service should not be included in an employee's hours of service.

## *Hourly Employees*

For employees paid on an hourly basis, an employer must calculate hours of service from records of hours worked and hours for which payment is made or due for vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence.

## Non-hourly Employees

For employees not paid on an hourly basis, employers may calculate hours of service by:

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

2. Using a **days-worked equivalency method**, under which an employee is credited with eight hours of service for each day with an hour of service

3. Using a **weeks-worked equivalency method**, under which an employee is credit with 40 hours of service per week for each week with an hour of service

Employers may use different methods for non-hourly employees based on different classifications of employees if the classifications are reasonable and consistently applied. Employers may change methods each calendar year. However, employers may not use the days-worked or weeks-worked equivalency methods if those methods would substantially understate the hours of service of a single employee or a substantial number of employees.

Service performed in certain capacities will not be counted as an hour of service. The IRS continues to consider additional rules for determining hours of service with respect to certain categories of employees whose hours of service are particularly challenging to identify or track or for whom the final regulations' general rules for determining hours of service may present special difficulties.

- **Volunteer Employees:** The term “hour of service” does not include any hour for services performed as a bona fide volunteer. For this purpose, a “bona fide volunteer” is an employee of a government entity or a tax-exempt organization whose only compensation from that entity or organization is in the form of:
  - Reimbursement for (or reasonable allowance for) reasonable expenses incurred in the performance of services by volunteers; or
  - Reasonable benefits (including length of service awards) and nominal fees customarily paid by similar entities in connection with the performance of services by volunteers.
- **Work-study Program:** The term “hour of service” does not include any hour for services to the extent those services are performed as part of a federal work-study program (or a substantially similar program of a state or political subdivision thereof). However, there is no general exception for student employees or paid interns or externs.
- **Members of Religious Orders:** Until further guidance is issued, a religious order is permitted to not count as an hour of service any work performed by an individual who is subject to a vow of poverty as a member of that order when the work is in the performance of tasks usually required (and to the extent usually required) of an active member of the order.
- **Foreign-source Income:** If compensation for hours of service is foreign source income, those hours of service should not be included in an employee’s hours of service.

Until further guidance is issued, employers of other employees whose hours are particularly challenging to identify or track or for whom the final regulations' general rules for determining hours of service may present special difficulties (such as adjunct faculty, employees with layover hours (including the airline industry), employees with on-call hours, commissioned salespeople, etc.) must use a **reasonable method of crediting hours of service that is consistent with the employer shared responsibility rules.**

A method of crediting hours is not reasonable if it takes into account only a portion of an employee's hours of service with the effect of characterizing, as a non-full-time employee, an employee in a position that traditionally involves at least 30 hours of service per week.

The following examples provided by the IRS describe methods of crediting hours of service that are (or are not) reasonable to use with respect to adjunct faculty, layover hours (including for airline industry employees) and on-call hours. These examples are not intended to constitute the only reasonable methods of crediting hours of service. Whether another method of crediting hours of service in these situations is reasonable is based on the relevant facts and circumstances.

## ADJUNCT FACULTY

With respect to adjunct faculty members of an educational organization who are compensated on the basis of the number of courses or credit hours assigned, the IRS has determined that, until further guidance is issued, one (but not the only) method that is reasonable for this purpose would credit an adjunct faculty member of an institution of higher education with:

- **2 1/4 hours of service** (representing a combination of teaching or classroom time and time performing related tasks, such as class preparation and grading of examinations or papers) per week for each hour of teaching or classroom time (in other words, in addition to crediting an hour of service for each hour teaching in the classroom, this method would credit an additional 1 1/4 hours for activities such as class preparation and grading); and, separately
- **An hour of service per week** for each additional hour outside of the classroom the faculty member spends performing duties he or she is required to perform (such as required office hours or required attendance at faculty meetings).

This method may be relied upon until further guidance is issued. If future guidance modifies an employer's ability to rely on this method, the period of reliance will not end earlier than Jan. 1 of the calendar year beginning at least six months after the date the guidance was issued.

## ON-CALL HOURS

For purposes of calculating on-call hours, it is not reasonable for an employer to fail to credit an employee with an hour of service for any on-call hour for which:

- Payment is made or due by the employer;
- The employee is required to remain on-call on the employer's premises; or
- The employee's activities while remaining on-call are subject to substantial restrictions that prevent the employee from using the time effectively for the employee's own purposes.

## LAYOVER HOURS FOR AIRLINE INDUSTRY

It is not reasonable for an employer to not credit a layover hour as an hour of service if:

- The employee receives compensation for the layover hour beyond any compensation that the employee would have received without regard to the layover hour; or
- The employer counts the layover hour towards the required hours of service for the employee to earn his or her regular compensation.

For example, if an employer requires that an employee perform services for 40 hours per week to earn full salary, and credits “layover hours” towards the 40 hours, then it would not be reasonable for the employer to fail to credit the layover hours as hours of service.

For layover hours for which an employee does not receive additional compensation and that the employer does not count towards required hours of service, it would be reasonable for an employer to credit an employee with eight hours of service for each day on which an employee is required to stay away from home overnight for business purposes (that is, eight hours each day, or 16 hours total, for the two days encompassing the overnight stay).

The employee must be credited with his or her actual hours of service for a day if crediting eight hours of service substantially understates the employee’s actual hours of service for the day (including layover hours for which an employee receives compensation or that the employer counts towards required hours of service). Other methods of counting hours of service may also be reasonable, depending on the relevant facts and circumstances.

### *Exclusion for Certain Veterans*

On July 31, 2015, President Obama signed into law the [Surface Transportation and Veterans Health Care Choice Improvement Act of 2015](#), which allows employers to exclude veterans who have coverage under certain veterans’ health coverage programs when determining the employer’s ALE status. This means that **veterans who have certain types of veterans’ health coverage will not count for purposes of determining whether an employer employs enough employees to be considered an ALE**. This provision is retroactively effective, and applies for months beginning after Dec. 31, 2013.

Specifically, when determining whether an employer is an ALE, an individual will not be taken into account as an employee if he or she has medical coverage under:

- A program for members and certain former members of the armed forces and the Commissioned Corps of the National Oceanic and Atmospheric Administration and of the Public Health Service, including coverage under TRICARE; or
- Health care programs administered by the U.S. Department of Veterans Affairs.

This exclusion allows employers to calculate their ALE status by excluding veteran employees who are covered under these programs. However, the exclusion **only applies for purposes of determining whether an employer qualifies as an ALE**. These employees must still be counted when determining which employees are full-time, and therefore must be offered affordable, minimum value coverage.



The new veteran exclusion applies retroactively for months beginning after Dec. 31, 2013. Due to the complex nature of the ACA's pay or play rules, employers may want to consult with legal counsel to determine the implications of any changes in their ALE status for years prior.

An employer's status as an ALE for future years will be calculated by looking back at its workforce in the prior year. Therefore, when determining their ALE status for future years, employers should exclude any veterans covered under qualifying veterans' health coverage programs that were employed during the prior calendar year.

Employers should also be aware that discrimination issues may arise if any employment decisions are based solely on whether an individual is a veteran or is covered under any veterans' health coverage programs.

## **MORE INFORMATION**

Please contact Mosaic Employee Benefits for more information on the ACA's employer shared responsibility rules.