2016 considerations for the Affordable Care Act's employer mandate provisions

As teams are considering the financial statement implications of the ACA, the increased coverage thresholds and classification of workers need to be analyzed for each company.

Employers have had one year of experience with the employer mandate provisions of the Affordable Care Act (ACA), which include a "pay-or-play" excise tax. Now, there is an increased risk of the excise tax being imposed due to changes in ACA requirements beginning in 2016.

Now the law applies to a greater number of employers, and for those applicable employers there is a higher percentage of employees that must be offered coverage. During 2015, Applicable Large Employers (ALEs) were required to offer coverage to at least 70% of all full-time common-law employees or face a potentially large excise tax. As of 1 January 2016, that threshold has been raised to 95% for calendar year plans. If an employer misses those required percentages, even if only one employee obtains coverage on a state insurance exchange with a tax subsidy, the indexed pay-or-play excise tax (originally $2,000, $2,080 for 2015, and $2,160 for 2016) is levied not just for that employee, but on every full-time employee in the ALE, whether they were offered coverage or not.

Under ASC 450, a probable and estimable contingent liability must be recorded on a company's financial statements.

Key concepts

Applicable Large Employer — The ACA coverage requirements apply to organizations determined to be an "Applicable Large Employer" under the ACA regulations. Determination of ALE status generally is based on the total number of full-time employees (plus equivalents) for all the entities in an organization's controlled group.

EIN — The ACA requirements are applied separately to each legal entity (generally, each entity with a separate federal tax ID number) in a controlled group. So, if one entity in the controlled group does not provide a sufficient level of coverage to its total number of full-time employees, then this entity would be subject to the ACA excise tax, but the rest of the entities in the controlled group would not be subject to ACA excise taxes so long as each entity provided a sufficient level of ACA-compliant coverage to the entity's employees. This means that employers should provide separate calculations for each legal entity within the controlled group.

Hour of service — To determine which employees are considered "full-time employees" (FTEs), an employer must determine which employees are averaging at least 30 hours of service per week during the applicable measurement periods. Under the ACA regulations, an employer is required to count all hours "for which an employee is paid, or entitled to payment, for the performance of duties for the employer; and each hour for which an employee is paid, or entitled to payment by the employer for a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence." Determining which hours an employee "is paid or entitled to payment" can be a complicated analysis as many organizations have detailed lists of pay codes which are used to describe the various hours of service rendered to their employer. Some of these pay codes qualify to be considered as an "hour of service" under the ACA regulations and some of these do not qualify.

Look-back method — To determine which employees are averaging 30 hours of service per week, the ACA regulations allow an employer to either use the monthly measurement method or look-back method to determine if an employee is an FTE who should receive an offer of coverage. For certain groups of employees (e.g., variable, part time and seasonal), the look-back method permits employers to choose a measurement period between 3 and 12 months, monitor the employees' hours of service during this period and then determine which employees qualify as FTEs during the measurement period. For employees determined to be FTEs during the measurement period, they must be provided offers of coverage that are in effect for a stability period of between 6 and 12 months.

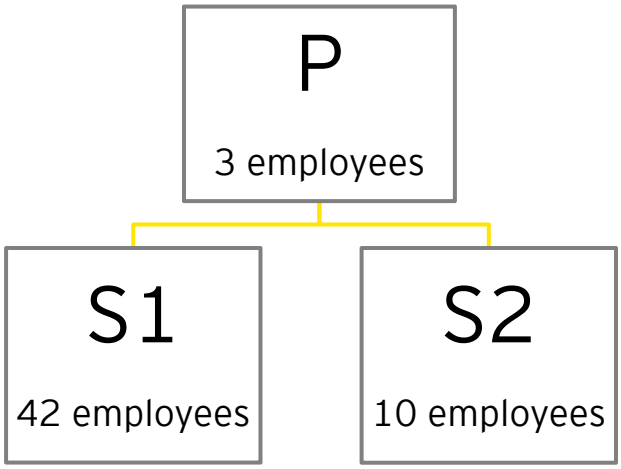
Contingent worker/non-employees — ACA coverage requirements are based on an entity's service providers who are considered common-law employees under IRS control factors. Many organizations have mistakenly only considered the workers to whom the organization provides a Form W-2 and are on the organization's payroll to be "employees" of the organization. The term "contingent workers" is used to capture the workers who provide services on behalf of the organization, but do not receive a W-2 directly from the organization. The most common examples of contingent workers are independent contractors, workers provided by staffing firms/temporary agencies, vendors and outsourced arrangements.

ACA guidance and examples

Legal entities

Many of our clients have multiple subsidiaries. As mentioned above, there is a specific definition for Applicable Large Employer, and each legal entity must have a separate calculation to show appropriate coverage levels.

Example — Applicable Large Employer — If a controlled group consists of a Parent company which wholly owns two separate subsidiaries with Parent (P) company having 3 employees who average at least 30 hours per week, Subsidiary 1 (S1) having 42 employees who average at least 30 hours per week and Subsidiary 2 (S2) has 10 employees who average at least 30 hours per week, then Parent company, Subsidiary 1 and Subsidiary 2 will be considered ALEs subject to the ACA requirements based on the number of employees working at least 30 hours per week in Parent company's controlled group.



Example — Client has 20 subsidiaries-documentation on an EIN basis. Client is organized with a parent company which contains a majority of the organization's core operations and 20 different active subsidiaries. The client provides a calculation showing on a consolidated basis (only one calculation for all legal entities) it is providing offers of coverage to 98% of its full-time employees which is in excess of the 95% ACA-required offer of coverage threshold. Even though the client appears to be in accordance with the ACA coverage requirements on a controlled group basis, the ACA excise taxes are calculated on an entity-by-entity basis. When the client provides a month-by-month, entity-by-entity breakdown of the organization's full-time employee offer of coverage threshold, it is determined that two different subsidiaries covered 88% and 90% of their full-time employees throughout the year which exposes the client to 4980H(a) excise tax based on the number of full-time employees engaged by the two subsidiaries which did not cover at least 95% of their full-time employees.

Determining the correct hours of service

Prior to ACA, the definitions for "benefits-eligible" or "full-time" varied from employer to employer. Now, employers are required to follow the full-time employee definition provided in the regulations and to follow very specific methodologies for calculating 30 hours per week.

This definition requires the counting of actual hours rather than scheduled hours, does not provide exceptions for students or temporary workers, requires employers to count hours on leave of absence and provides a very complex averaging methodology for variable and seasonal employees.

Determining which hours count in determining who works at least 30 hours of service/week. Employees who work, on average, 30 hours or more per week are generally considered full-time. This sounds simple, but even defining "one hour of service" is now very complicated. Employers must account for hourly variations such as overtime or whether an employee's paid time off is counted as hours of service. These calculations have to be made for all employees, pay code-by-pay code. The ACA defines full-time as averaging 30 hours of actual work, not just scheduled, and includes complicated averaging rules found in the regulations.

Example — Determining an hour of service. If an employee uses accrued vacation time to actually take a vacation, then this pay code and the associated hours of service would qualify under the ACA rules. However, accrued vacation time that is cashed out when an employee terminates employment is not considered "hours of service" under the ACA rules. Another common example deals with government-mandated payments such as a meal penalty where the employer is required to make a payment to the employee in the event the employer does not provide the affected employee with the required break for a meal. These meal penalty payments are not considered ACA hours of service. For these reasons, many organizations engage in a rigorous pay code analysis to determine which pay codes should be counted in determining an employee's ACA hours of service.

Use of look-back method to determine FTE status

Clients often use the look-back method to determine full-time employee status of its workforce. In this case, the client indicates that all new employees will be measured based on an initial measurement period of 12 months and ongoing employees will be measured based on a standard measurement period of 12 months. The initial stability period and standard stability period are also each 12 months. While this aforementioned information is necessary in examining the client's ACA compliance efforts, the ACA additionally requires an analysis of 1) newly hired variable hour, part time or seasonal employees; 2) ongoing variable hour, part time, or seasonal employees; 3) newly hired employees expected to work more than 30 hours per week; and 4) ongoing employees working more than 30 hours per week.

Contingent workforce analysis is critical

The ACA's employer mandate includes requirements for determining whether an employee is full-time and, therefore, is entitled to an offer of coverage. In 2016, this most basic determination of who an employee is becomes even more critical. The increased offer-of-coverage threshold also requires a more rigorous compliance effort for employers including workforce analysis of Form W-2 employees and contingent workers. While an employer might not consider contingent workers to be employees of the organization, if a large enough number of the contingent workers should be considered common-law employees under IRS standards and are not offered minimum essential coverage, the employer could become subject to the punitive annual excise tax under Section 4980H(a) (e.g., $2,160 multiplied by all full-time employees of the employer).

Example — Contingent workers counts affecting excise tax liability. Client has 60,000 Form W-2 employees and 50,000 contingent workers. Client provides offers of coverage to 100% of its W-2 workforce and does not provide offers of coverage to contingent workers. ACA coverage requirements as based on "common-law employee" status which can extend to contingent workers based on an organization's degree of control over the contingent worker. Even though the client covers 100% of its traditional employee workforce, it has misclassified 3,158 contingent workers (of the 50,000) and these workers averaged 30 hours per week. The client would be subject to an ACA excise tax in excess of $136,000,000 ($2,160 x 63,158 FTEs) for 2016 since it would be providing offers of coverage to 94.99% of its full-time employees, which is less than the required 95%.

Contingent worker full universe

The ACA excise tax is triggered when the coverage threshold is less than 95%. That coverage threshold is calculated based on the number of full-time employees provided coverage compared to the total number of full-time employees; therefore, it is of the upmost importance that clients accurately determine their total workforce which could potentially be considered "full-time employees" under the ACA regulations to be in compliance. For most clients, determining the number of Form W-2 employees is a relatively simple task that can be achieved by HR or Payroll running a small number of reports. However, many clients have difficulty determining the total number of contingent workers and need to consider additional sources for determining their total potential "full-time employee" workforce.

Example — Full universe of contingent workforce. A client has a total of 99,000 W-2 employees and 1,000 contingent workers. This client provides ACA-compliant offers of coverage to 100% of W-2 employees and has not conducted an analysis regarding the possibility of contingent workers being considered the organization's common-law employees. Based upon these counts, even if the client made a worst-case assumption that all contingent workers were the organization's common-law employees, it would appear the client is compliant with the ACA coverage mandate and the excise tax would not be imposed for the year. However, upon inquiry regarding how the contingent worker count was determined, the client provided the 1,000 total only included independent contractors and did not consider other possible contingent workers. In this case, the client cannot accurately analyze its compliance with the ACA

regulations without a complete count of the full universe of possible contingent workers, which could include workers provided by staffing firms/temporary agencies, outsourced arrangements (janitorial, landscaping, parking attendants, etc.) and vendors, in addition to independent contractors. Often, clients use badge access, network access, flu shot logs, or reports from HR, procurement or accounts payable to determine their full universe of contingent workers.

Potential common-law employee status

One key to evaluating whether an individual is a common-law employee for ACA purposes is understanding the entity which directs and controls that person's day-to-day work schedule and job duties. A common-law employer-employee relationship could exist between an entity contracting for services and an individual if that entity controls not just outcomes but also the means by which that result is accomplished. Employers do not actually need to control every step of the process. It could be enough just that the employer has the right to control it.

The IRS separates the facts that help determine whether a worker is an employee into three categories:

1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?

2. Financial: Are the business aspects of the worker's job controlled by the payer?

3. Type of relationship: Are there written contracts or employee-type benefits (e.g., pension plan, insurance and vacation pay)? Will the relationship continue, and is the work performed a key aspect of the business?

The IRS's three types of control lay out the requirements for determining categories of control. However, the bottom line is that if the control is with the company, these workers could be common-law employees even if they are theoretically hired and paid by a staffing agency, vendor, contractor or the like.

Contingent workers provided by staffing firms and temporary agencies

Most clients use staffing firms or temporary agencies to supplement their Form W-2 workforce on a temporary basis. For many organizations, workers provided by these firms present a risk of being reclassified as common-law employees based on the degree of control clients often exert over these staffing firm/temporary agency-provided workers. To deal with this risk, many clients are modeling their agreements with staffing firms in a manner similar to an ACA regulatory exception which often results in the staffing firm providing offers of coverage to the workers and having the client pay an additional amount per month for each worker who accepts the staffing firm's offer of coverage when compared to the amount the client pays per month for each worker who does not accept the staffing firm's offer of coverage. Additionally, clients need to review the invoices they receive from these staffing firms to make sure they are actually being charged this premium amount.

However, some clients have not modified their contracts with staffing firms to specifically account for ACA coverage. These clients often have contracts with staffing firms which merely provide the staffing firm is responsible for providing employee benefits to the applicable workers it provides to the client. These contracts do not refer to ACA or identify the entity responsible for providing ACA-compliant coverage to the workers provided by the staffing firm to the client. Absent additional information or legal analysis, these staffing firm-provided workers might be at risk for being considered the client's FTEs not under an offer of coverage which could result in the ACA excise tax being imposed.

ACA systems and compliance considerations

One important step in reviewing a client's ACA compliance steps is analyzing the systems and processes the client has in place to comply with the ACA. Generally, the processes related to Form W-2 employees are designed so that the client is offering coverage to the appropriate employees. The contingent worker processes relate to the client designing procedures so that contingent workers are not at risk for later being determined to be the client's FTEs, which could be based on the contingent worker not (i) being considered the client's common-law employee or (ii) averaging 30 hours per week during the applicable measurement period.

Examples of compliance considerations — Form W-2 employees

The following bullets provide some examples of procedures and documentation used by our clients in their ACA compliance efforts.

- Tax memo documenting full-time employee determination — statutory method or look-back, length of look-back period, treatment of rehires, leave of absences (LOAs), system controls *
- Calculation to demonstrate 95% of full-time employees covered (70% in 2015); provide support regarding how that the full universe of the workforce was considered (e.g., network access, Forms W-2, badge access)
- For exempt workforce, demonstrate use of equivalencies to determine hours worked; include any part-time exempt position
- For hourly workforce, show process of calculation of actual hours worked on a weekly or monthly basis and determination of full-time based on statutory or look-back methods
- For any unusual workforce or pay type, describe the method by which they are determined to be full-time or part-time under the ACA regulations. Examples include:
  - Interns, co-ops, students
  - Per diem workers
  - Temporary workers
  - On-call employees
  - Commissioned employees

- Adjunct faculty, graduate assistants, research assistants
- International employees working in the US
- Part-time exempt employees

- Demonstrate that all paid hours are counted, including on-call, leaves of absence, commissions, etc.
- For rehired employees, describe procedures in place designed to make sure they are treated in accordance with the regulations
- For leaves of absence, document how paid LOAs and special LOAs (if look-back used) are treated in accordance with the regulations
- For workforce that is not covered under the plan:
  - System controls should document offer and waiver of coverage for eligible full-time employees.
  - For individuals who are scheduled to work less than 30 hours per week, certain organizations may implement overtime approval or scheduling procedures (e.g., through supervisor approval or systems).
  - Certain organizations may implement IT systems controls to "flag" workers approaching 30 hours per week to make sure they get into the plan on a timely basis.

*Treas. Reg. 54.4980H-3(d)(3)(iii) provides that an employer may apply the look-back measurement method, including the use of an initial measurement period in the year of hire for a newly hired employee, to its variable hour, seasonal and part-time employees. A "variable hour employee" is an employee if, based on the facts and circumstances at the employee's start date, the applicable large employer member cannot determine whether the employee is reasonably expected to be employed on average at least 30 hours of service per week during the initial measurement period because the employee's hours are variable or otherwise uncertain. Treas. Reg. 54.4980H-1(a)(49). A "seasonal employee" is an employee who is hired into a position for which the customary annual employment is six months or less. Treas. Reg. 54.4980H-1(a)(38). A "part-time employee" is a new employee who the employer reasonably expects to be employed on average less than 30 hours per week during the initial measurement period, based on the facts and circumstances at the employee's start date. Treas. Reg. 54.4980H-1(a)(32). Treas. Reg. Section 54.4980H-3(d)(2)(ii) provides that the factors for considering whether an employee is reasonably expected to work more or less than 30 hours per week are "whether the employee is replacing an employee who was (or was not) a full-time employee, the extent to which hours of service of ongoing employees in the same or comparable positions have varied above and below an average of 30 hours of service per week during recent measurement periods, and whether the job was advertised, or otherwise communicated to the new hire or otherwise documented (for example, through a contract or job description), as requiring hours of service that would average 30 (or more) hours of service per week or less than 30 hours of service per week."

Examples of compliance considerations — contingent workers

- Document policies outlining the procedures and systems for hiring and classifying contingent workers as well as documenting how protocols are enforced.
- Starting with entire universe of contingent workers, describe the process by which the various categories of workers will be excluded from the analysis for ACA purposes. The client should describe the method by which the full universe of the workforce was considered (e.g., network access, Forms W-2, badge access).
- For each group of contingent workers excluded from the ACA analysis, document the definition of such category, the process by which workers are categorized, and several examples of types of workers (e.g., vendors) in each such category.
- For the remainder of the contingent workers who are not excluded from the analysis:
  - Document the policies and procedures outlining the determination that there is no common-law employment. Such determination should walk through the IRS's control factors (see above) for each type of worker, business unit or other classification.
  - Document operational procedures that are in place to confirm that the written policies are followed (e.g., regular audits of the hiring, onboarding and extension processes).
  - Document systems which provide information on the exceptions to the policies (e.g., if an individual has been working for more than 12 or 18 months).
  - If workers are provided through a staffing company, inquire to the staffing companies as to whether they are making an offer of affordable coverage to these workers, confirmation that the client (e.g., Company) is paying a higher fee for those who have coverage provided as compared to those who do not have coverage provided.
  - Collect documentation supporting staffing companies' assertions that they are offering affordable coverage to eligible full-time employees.

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