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BUSINESS BRIEF

THE EMPLOYER MANDATE HEALTH CARE REFORM: A DECISION POINT FOR SMALLER COMPANIES

In 2013, business owners with 50 or more full-time employees are expected to be finalizing their plans in response to the employer mandate health care reform, which becomes effective in 2014. Among the choices for business owners will be complying with the employer mandate or planning to pay the penalties for opting out, or executing plans to avoid the employer mandate by trimming their workforce or selling all or a portion of their business before 2014.

Beginning January 1, 2014, the so-called “employer mandate” under the Patient Protection and Affordable Care Act (the “PPACA”) requires employers with 50 or more full-time equivalent employees (“FTEs”), with “full-time” defined as working at least 30 hours per week, to offer “minimum essential” and “affordable” health insurance to those employees and their dependents. Employers who do not comply will be subject to potentially significant penalties. Employers are not required to provide health care coverage for part-time employees, however, part-time employees must be counted as partial employees when determining whether an employer has 50 FTEs. There will also be various other new requirements under the PPACA effecting employers beginning in 2014 that are beyond the scope of this piece.

Many business owners are considering what they can do to get their FTE count below 50 and avoid the employer mandate and the associated cost increases and regulatory burdens. Beware, however, that a reduction below this threshold effective January 1, 2014 may not avoid the employer mandate. The proposed regulations provide that a business could be subject to the employer mandate if during 2013 it averaged 50 or more FTEs. Employers would have the option to determine their 2013 headcounts by averaging the full 12 months of 2013 or any consecutive six-month period during 2013. These regulations are in the process of being promulgated and are not yet final.

Additionally, the rules regarding who is an “employer” are not straight forward and contain traps for the unwary, and can render some plans to dodge the employer mandate ineffective. Similarly, having a basic understanding of the rules should alert business owners to seek advice if two or more related businesses may be considered as a single “employer” under the employer mandate rules.

Before a company can begin counting its FTEs, it must determine whose employees must be counted. The applicable test is found under the “controlled group” rules of the Internal Revenue Code, which generally places the emphasis on direct ownership or overlapping, or common, ownership rather than on actual control. Under the controlled group rules, all employees who are employed by a common group of companies or business partners are treated as being employed by a single employer.

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This means that employees of organizations related through parent-subsidiary structures and/ or brother-sister structures (where businesses are not linked together by direct ownership, but by the presence of common owners) are treated as being employed by a single employer under the PPACA.

A parent-subsidiary controlled group exists where one organization owns at least 80% of the equity or voting power in another organization.

A brother-sister (or common) controlled group exists where five or fewer persons or entities collectively own (i) at least 80% of the equity in two organizations or (ii) more than 50% of the equity in two organizations, considering only the ownership that is identical with respect to each of the two organizations (i.e., if X owns 10% of A and 20% of B, considering only 10%).

Service organizations such as accounting firms, staffing companies and third party administrators, are also subject to the "affiliated service group" rule. This rule applies when separate organizations that are linked by a material level of cross-ownership closely collaborate in the services they provide.

The key to determining the organizations that need to be included within the controlled group and will be considered to be the same "employer" is ownership, and except under the affiliated service group rule, the organizations do not need to have the same management or operate in the same industry or location.

The controlled group rules are also subject to family attribution rules that are designed to prevent owners of closely-held organizations from avoiding the controlled group rules. Under the attribution rules, an individual's ownership interest is attributed to certain family members (and trusts) and this can cause otherwise unrelated organizations to be subject to the controlled group rules, such as between business owners who are married to each other. Another rule requires that any interest in an organization owned by an employee, but subject to restrictions or limitations on the employee's right to dispose of such interest, is ignored for the purposes of identifying common owners under the controlled group rules.

While it is not yet clear how the regulators will enforce these rules in the context of the employer mandate, any challenge by a business owner could lead to a prolonged proceeding that is subject to uncertainty. Additionally, whenever there is a potential ownership change in a commonly owned organization, the participants should be aware that the change may alter their tax reporting obligations.

While owners of smaller businesses may be considering, among other things, spin-offs, sales of divisions or the creation of new holding companies, because of the controlled group and attribution rules, it is unlikely that any transfer to someone other than an unrelated third party buyer would be effective to dodge the requirements of the employer mandate. In fact, for some business owners, opting out of providing the health care coverage and paying the penalties may be the most cost effective measure, but a range of factors and good advice should be considered in implementing such an approach.

The penalties for noncompliance with the employer mandate are $2,000 per year multiplied by the employer's total number of FTEs, less 30. Even if the employer does offer a benefits plan, but the plan is "unaffordable" under the PPACA (i.e. the employee share of the premium exceeds 9.5% of the employee's total household income), the employer will be subject to an excise tax of $3,000 per employee who enrolls in health insurance through a state-run health care exchange. There are however, various other levels of penalties for failure to meet other requirements of the employer mandate and if an organization is part of a controlled group the 30 FTE reduction is shared among the other members of the controlled group.

For some business owners, the employer mandate may be an impetus or a contributing factor leading the execution of planned exit by December 31, 2013. In any event, planning in response to the employer mandate should begin early to address employee retention and moral issues and for employers to have a strategy in place later in the year when employee benefit enrollment periods begin and the new government regulated health care exchanges are schedule to become operational.