

Straight Talk: What the ACA Employer Mandate Means for Large and Small Businesses

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Type into Google "Affordable Care Act". Nearly 43 million results surface. We start this article, which is the second in our multi-part series on the Affordable Care Act (ACA), with this quick statistic because it demonstrates the level of interest, thus, perhaps, importance that the landmark bill has fostered in everyone.

Here's another stat for you: 27 percent of those Google results focus on the penalties that employers will experience if they don't comply with the Employer Mandate of the ACA.

Clearly, employers, whether small businesses or *Fortune* 500 corporations, are concerned with how this complex law is going to impact their ability to hire, grow and be successful. Many employers already offer not only the minimum required benefits to comply with the ACA, but much more. However, some employers are staring into a black hole, trying to either provide cost-effective minimum essential coverage to employees or paying steep penalties and/or shared responsibility payments to the IRS.

The intention of this article is to enable employers to navigate the new, complex path that we anticipate will take effect January 1, 2014. Let's start first with a few definitions.

Large Employers

According to the new law, a large employer is one who employs 50 or more full-time or full-time equivalent employees for more than 120 days during the calendar year. Employers are excluded from this definition if the employees in excess of 50 are considered seasonal employees. Seasonal employees are employees who work exclusively during holiday season or who meet the definition employed by the Department of Labor¹. A small employer is defined as

¹ <http://law.justia.com/cfr/title29/29-3.1.1.1.1.1.1.25.12.html> , see subsection (s)(1).

one who employs 49 or fewer employees. A full-time employee is generally defined as one who works an average of 30 or more hours per week. The IRS issued a safe harbor on August 31, 2012, in Notice 2012-58, for determining whether a variable-hour employee is considered a full-time employee. For ongoing employees (who have been employees for at least one standard measurement period), the employer selects a standard measurement period of at least three months, but not more than 12 months, and determines whether the employee works an average of over 30 hours during this period. If the employee is determined to be a full-time employee, then the employer must treat the employee as such during a stability period of at least six months (but no shorter than the standard measurement period). The employer may utilize a 90 day administrative period following the standard measurement period to determine an employee's status and enroll employees determined to be full-time employees in its health coverage.

For new employees expected to be variable-hour or seasonal employees, the employer may use an initial measurement period of between three and 12 months, and generally apply the same provisions described above. If a newly hired employee is reasonably expected to be a full-time employee, then the employer may use an administrative period of up to three months to enroll the employee in its health coverage.

What is a "full-time equivalent" employee? A full-time equivalent employee is actually two or more part-time employees whose combined hours per week add up to a single full-time employee. For instance, Carl works an average of 20 hours per week and Jonas works an average of 15 hours per week. Together, Carl and Jonas work an average of 35 hours per week, which is equivalent to one full-time employee's hours. Therefore, Carl and Jonas together equal one full-time employee. These calculations are only used to determine whether or not the employer is a large or small employer and not used in calculating penalties or premium costs.

As a large employer, the ABC Company employs 150 people but only has a total of 75 full-time employees who work an average of 30 or more hours per business week. The other 75 people are part-time or seasonal employees whose combined work hours equal 37 full-time equivalent employees. Therefore, according to the ACA, the ABC Company has a total of 112 full-time employees and is considered a large employer for the ACA.

Now that we know how many full-time employees the Company has, what does this mean for them regarding the health care insurance that they need to provide to their employees?

The full-time equivalent employees are not counted for the purpose of health coverage, but are counted only for the purpose of calculating whether the ABC Company is a large or small

employer. The ABC Company does not have to provide or offer health insurance coverage to their part-time or seasonal employees and will not incur a penalty for not providing such coverage.

According to the ACA's Employer Mandate, the ABC Company must provide affordable health insurance premiums and minimum essential health coverage to all of their full-time employees – in this case, 75 employees. A plan is affordable to an employee if the employee's premiums do not exceed 9.5% of the employee's household income. However, the IRS will permit employers to compute affordability based on the employee's W-2 Box 1 wages rather than household income at least through the end of 2014, pending further guidance. Note that the employer is only required to *offer* affordable health care insurance to its employees, not pay the premiums on *behalf* of its employees. If all employees are offered health insurance and can afford the ABC Company's group health insurance plan, the ABC Company is not liable for a shared responsibility or assessable payment penalty. If any one of ABC Company's employees cannot afford to enroll in the minimum essential coverage plan offered, then the ABC Company will be subject to a shared responsibility payment. For our example, we assume that 15 employees cannot afford to enroll in the plan because the premiums exceed 9.5% of their W-2 Box 1 wages. This penalty is calculated only on the number of employees who cannot afford to enroll in the employer's plan.

Large employers who offer health coverage will have to pay a penalty of \$250 per month per employee if they have any employee who receives a tax subsidy or cost-reduction benefit per the Individual Mandate. The penalty is indexed to inflation for years after 2014. As in the example above, the ABC Company has 15 employees who cannot afford the minimum essential coverage plan premiums. These 15 employees are certified to ABC as having received a premium tax credit, which thus brings the penalty to \$45,000 ($\$3,000 \times 15$) for the ABC Company. The IRS has not released clear guidance on when employers will receive notification that any of their employees have received a premium subsidy or tax credit, or the frequency of penalty collection from the employer.

For employers who do *not* offer minimum essential health coverage and have *an* employee who receives the tax credit, the penalty for that employer is \$166.67 per month per full-time employee after exempting the first 30 full-time employees. Returning to our example, suppose the ABC Company employs 75 people for the entire year, has 15 employees who receive a tax subsidy or cost-reduction benefit, and does not offer coverage to any of its employees. 30 of those employees are exempt when determining the penalty, bringing the total head count of employees to 45 full-time employees. The ABC Company is responsible for paying \$90,000 in penalties ($\$166.67 \times 12 \times 45$). The table below offers a comparison of the monthly amount and employee base for the two penalties:

	Employer Not Providing Health Insurance	Employer Health Insurance is Unaffordable
Full-time Employees	75	75
# of Employees Receiving Health Care Subsidy	15	15
Penalty (per month)	\$166.67	\$250
Months	12	12
#Employees to which penalty is applied	45	15
Total Penalty	\$90,000	\$45,000

Employers not meeting the definition of large employer are *not* required to offer health care insurance to their employees. Additionally, if certain other requirements are met, an employer not required to offer health care insurance to its employees may be eligible for a tax credit if it chooses to provide health care insurance to its employees.

Small Employers

As of 2010, small employers are eligible to receive a Health Insurance Tax Credit of 35% under the ACA, which will increase to 50% after 2013. For non-profit or tax-exempt small employers, the Tax Credit is 25% and will increase to 35% after 2013. Small employers, for purposes of the Health Insurance Tax Credit, are those who employ less than 49 people and of those 49, only 25 can be full-time employees. The average annual wage for the full-time employees is less than \$50,000. The company must also have a maintained “qualifying arrangement,” as provided in Notice 2010-44, which defines a qualifying arrangement as an arrangement under which the employer pays premiums for each employee enrolled in health insurance coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage. The credit is gradually phased out for employers who employ between 10 and 25 full-time equivalent employees, as well as for average annual wages in excess of \$25,000. Due to these strict limitations, few employers will find themselves in a position where they are eligible for this credit.

The credit is a general business credit, and so generates no current tax benefit for taxpayers with a net loss for the year. The credit may be carried back one year or carried forward 20 years for use when you have taxable income. Additionally, the credit may be used to offset any Alternative Minimum Tax (AMT) liability. Tax-exempt small employers may use the credit to offset their payroll tax liability.

For tax years after 2013, a small employer must participate in an insurance exchange to claim the credit, and there may be further modifications and restrictions. An enhanced version of the

credit will be effective beginning in January 2014. According to the Government Accountability Office, only 170,300 small employers out of an estimated pool of between 1.4 and 4 million small employers claimed this credit in 2010, so most small employers are not taking advantage of this tax credit. Below are examples of the Tax Credit calculation for both for-profit and not-for-profit small employers.

DEF Corp. is a for-profit small business and has 12 full-time employees with an average annual wage of \$30,000. DEF Corp. pays \$30,000 per year in health care premiums for their employees' and dependents' health insurance. DEF Corp.'s maximum credit is calculated as 35% of their health care costs, or \$10,500. The credit is partially phased-out based on 2 employees in excess of 10 and \$5,000 of wages in excess of \$25,000, leaving a residual credit of \$3,100 and reducing DEF's health care costs to \$26,900, over 10% savings.

XYZ is a qualifying not-for-profit business and has 15 full-time employees whose average annual wage is \$35,000. XYZ pays \$48,000 per year in health insurance premiums for their employees' and dependents' health care coverage. XYZ will then be eligible to receive a maximum 25% tax credit of \$12,000 for that year. The phase-out is calculated based on 5 employees in excess of 10 and \$10,000 of wages in excess of \$25,000, resulting in a credit of \$3,200 and net health care costs of \$44,800.

LMNOP Corp. is a for-profit small business and has 10 full-time employees with an average annual wage of \$75,000. LMNOP pays \$ 25,000 per year in health care premiums for its employees' and dependents' health insurance. LMNOP is not eligible for a Health Insurance Credit because the average wage exceeds \$50,000. If the average annual wage were only \$40,000, LMNOP's maximum credit at 35% is \$8,750. The credit is partially phased-out based on \$15,000 of wages in excess of \$25,000. LMNOP would then receive a credit of \$3,500.

Conclusion:

Operating a business, regardless of size, revenue or industry, is perhaps more uncertain today than at any other time in the last decade. Many companies are still recovering from the U.S. recession, carefully watching global economic trends, and waiting for clarity around the domestic political environment. Uncertainty enables complexity. How do you manage and grow a business when you're not sure which tax policies will be in place or which regulations, like the ACA, will be enforced? These are the realities and the questions that our clients face and ask us every day. What we do know is that each company will have a unique set of circumstances when it comes to implementing the Employer Mandate of the ACA. We also know that the IRS will likely continue to offer guidance on the implementation as we get closer to January 1, 2014. Over the next year, we're encouraging our clients to stay close to us. As questions arise, call us for additional insights and clarity around the Employer Mandate of the

ACA. As we collaborate, the path toward proper implementation will become clear and you can focus once again on growing your company.

For more information about the ACA Employer Mandate and what it means for large and small businesses, contact Mitchell Kopelman at Mitchell.kopelman@hawcpa.com or 404-898-8231.