# Let's Get Small

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Only large employers are required to provide qualifying coverage or pay the associated penalty. But the large/small distinction for that purpose differs from the large/small employer distinction for three related purposes – small employer tax credit eligibility, large vs. small market plan requirements and the large employer automatic enrollment requirement. In general, simple terms, here are the dividing lines:

- Coverage Duty: "small" = < 50 full time employees;
- Tax Credit: "small" = < 25 full time employees;
- Market Size "small" = < 101 employees;
- Automatic Enrollment "small" = < 201 full time employees.

This article addresses only the availability of small employer treatment for purposes of exemption from large employers' duty to provide qualifying coverage (26 U.S.C. § 4980H) and the associated obligation to provide notices to employees, beginning March 1, 2013, of the availability of coverage through an exchange and the possible availability of financial assistance (29 U.S.C. § 218b).

## How to Count "50" Full-Time Employees

If you are an "applicable large employer," then you must pay a "shared responsibility cost" if you fail to offer qualifying coverage, or if you offer that coverage on terms more expensive than the Act allows, so that the employee is eligible for and seeks federal financial assistance. You are an "applicable large employer" if, "with respect to a calendar year," you "employed an average of at least 50 full-time employees on business days during the preceding calendar year." 26 U.S.C. § 4980H(c)(2)(A). Here, full time means an average 30 hour week on an annual basis. Unless and until regulations or court decisions say otherwise, we believe that this means, for example, that if you average 50 or more full-time employees on your payroll for any period of more than a day in 2013, then you will be an "applicable large employer" when the Act begins to bite in 2014. However, § 4980H(c)(2)(B) exempts employers that have more than 50 full-time workers for 120 days or less "during the calendar year" if the excess consisted solely of "seasonal workers," as defined in 29 C.F.R. § 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.

Agricultural employers should be the chief beneficiaries. Exemptions are construed narrowly and the employer seeking an exemption must prove its applicability. In short, unless you can prove that you exceeded 50 full-time employees in 2013 solely because of your employment of seasonal workers, then you will be an "applicable large employer" in 2014.

## Tricks That Won't Work

The "Mississippi Christmas Tree" was a creative legal maneuver by farmers seeking to maximize agricultural support payments. The farmer would partition his farm into multiple legal entities, so that each could maximize the available per entity subsidies. The Affordable Care Act anticipated that covered employers might do the same, hoping to secure small employer status. So, 26 U.S.C. § 4980H(c)(2)(C)(i) adopts the "single employer" aggregation rules of 26 U.S.C. § 414(b),(c),(m) and (o). Here they are:

> **(b) Employees of controlled group of corporations**

For purposes of sections 401, 408(k), 408(p), 410, 411, 415, and 416, all employees of all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(a)(4) and (e)(3)(C)) shall be treated as employed by a single employer. With respect to a plan adopted by more than one such corporation, the applicable limitations provided by section 404(a) shall be determined as if all such employers were a single employer, and allocated to each employer in accordance with regulations prescribed by the Secretary.

**(c) Employees of partnerships, proprietorships, etc., which are under common control**

For purposes of sections 401, 408(k), 408(p), 410, 411, 415, and 416, under regulations prescribed by the Secretary, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer. The regulations prescribed under this subsection shall be based on principles similar to the principles which apply in the case of subsection (b).

**(m) Employees of an affiliated service group**

**(1) In general**

For purposes of the employee benefit requirements listed in paragraph (4), except to the extent otherwise provided in regulations, all employees of the members of an affiliated service group shall be treated as employed by a single employer.

**(2) Affiliated service group**

For purposes of this subsection, the term "affiliated service group" means a group consisting of a service organization (hereinafter in this paragraph referred to as the "first organization") and one or more of the following:

(A) any service organization which—

(i) is a shareholder or partner in the first organization, and

(ii) regularly performs services for the first organization or is regularly associated with the first organization in performing services for third persons, and

(B) any other organization if—

(i) a significant portion of the business of such organization is the performance of services (for the first organization, for organizations described in subparagraph (A), or for both) of a type historically performed in such service field by employees, and

(ii) 10 percent or more of the interests in such organization is held by persons who are highly compensated employees (within the meaning of section 414(q)) of the first organization or an organization described in subparagraph (A).

**(3) Service organizations**

For purposes of this subsection, the term "service organization" means an organization the principal business of which is the performance of services.

**(4) Employee benefit requirements**

For purposes of this subsection, the employee benefit requirements listed in this paragraph are—

(A) paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a), and

(B) sections 408(k), 408(p), 410, 411, 415, and 416.

**(5) Certain organizations performing management functions**

For purposes of this subsection, the term "affiliated service group" also includes a group consisting of—

(A) an organization the principal business of which is performing, on a regular and continuing basis, management functions for 1 organization (or for 1 organization and other organizations related to such 1 organization), and

(B) the organization (and related organizations) for which such functions are so performed by the organization described in subparagraph (A).

For purposes of this paragraph, the term "related organizations" has the same meaning as the term "related persons" when used in section 144(a)(3).

**(6) Other definitions**

For purposes of this subsection—

**(A) Organization defined**

The term "organization" means a corporation, partnership, or other organization.

**(B) Ownership**

In determining ownership, the principles of section 318(a) shall apply.

> **(*o*) Regulations**
> The Secretary shall prescribe such regulations (which may provide rules in addition to the rules contained in subsections (m) and (n)) as may be necessary to prevent the avoidance of any employee benefit requirement listed in subsection (m)(4) or (n)(3) or any requirement under section 457 through the use of—
> (1) separate organizations,
> (2) employee leasing, or
> (3) other arrangements.
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> The regulations prescribed under subsection (n) shall include provisions to minimize the recordkeeping requirements of subsection (n) in the case of an employer which has no top-heavy plans (within the meaning of section 416(g)) and which uses the services of persons (other than employees) for an insignificant percentage of the employer's total workload.

The Mississippi Christmas Tree won't work here, either. You won't be allowed to avoid coverage by formally splitting your covered large business into exempt small employer units.

Another evasion strategy anticipated by the Act is to create a new business entity each year, so that there is never a prior year basis. In such situations, 26 U.S.C. § 4980H(c)(2)(C)(ii) bases your status on the number of employees that you are reasonably expected to employ "on business days in the current calendar year" and § 4980H(c)(2)(C)(iii) includes the employer's predecessor in the relevant definition of "employer."

Finally, you probably cannot evade coverage by cutting below 50 your number of full-time employees and replacing the excess with part timers. The Act's full-time equivalency rule, 26 U.S.C. § 4980H(c)(2)(E), is more aggressive than you might expect, so watch carefully how this works.

> Solely for purposes of determining whether an employer is an applicable large employer under this paragraph, an employer shall, in addition to the number of full-time employees for any month otherwise determined, include for such month a number of full-time employees determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120.

Suppose that Bubba Enterprises, LLC has 70 full time and 10 part time employees in mid-2012 and wants to get small for 2013 (the year prior to full ACA impact) by cutting 25 full timers back to part time, then adding 10 more part timers, working these schedules:

> 10 former full timers working 25 weekly hours = 1,057.50 monthly hours
> 10 former part time employees and 10 new part time employees working 20 hours weekly = 1,692 monthly hours.
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> Total part time monthly hours = 2,749.50
> Total FTE (2,749.50 / 120) = 23 (rounded up from 22.91)
> Total full time employees (45 + 23) = 68

With 68 full-time employees, Bubba Enterprises remains an "applicable large employer."

## Realistic Options for Getting Small or Staying There

Unless you are on the bubble and can stay beneath 50 workers in 2013 (FTE included, seasonal employees excluded), employee leasing is an option that might work, but that may not save expense even if it does work. If you lease employees from a reputable staffing concern that provides minimum qualifying coverage to the leased employees, you would minimize the government incentive to deem them your "joint employees" for that purpose, as federal agencies

typically do under other employee protection laws. The Act does not expressly bar this strategy because Congress elected not to incorporate the leased employee provisions of 26 U.S.C. § 414(n):

> **(n) Employee leasing**
> **(1) In general**
> For purposes of the requirements listed in paragraph (3), with respect to any person (hereinafter in this subsection referred to as the "recipient") for whom a leased employee performs services—
> (A) the leased employee shall be treated as an employee of the recipient, but
> (B) contributions or benefits provided by the leasing organization which are attributable to services performed for the recipient shall be treated as provided by the recipient.
> **(2) Leased employee**
> For purposes of paragraph (1), the term "leased employee" means any person who is not an employee of the recipient and who provides services to the recipient if—
> (A) such services are provided pursuant to an agreement between the recipient and any other person (in this subsection referred to as the "leasing organization"),
> (B) such person has performed such services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least 1 year, and
> (C) such services are performed under primary direction or control by the recipient.
> **(3) Requirements**
> For purposes of this subsection, the requirements listed in this paragraph are—
> (A) paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a),
> (B) sections 408(k), 408(p), 410, 411, 415, and 416, and
> (C) sections 79, 106, 117(d), 120, 125, 127, 129, 132, 137, 274(j), 505, and 4980B.

However, most reputable leasing firms should themselves be "applicable large employers," bound by the same obligations as their customers. Assuming that those costs are passed-through, there should be no net gain to the customer.

Subcontracting some of your functions to an independent employer is another option but, again, if your subcontractor is an "applicable large employer" that can pass-through its health care costs, little or nothing may be gained.

If you're a large employer, not on the bubble, the best you can do, probably, is to watch and work the rules being written by the IRS. They are expected to include substantially these provisions, explained in IRS Notice 12-17:

> At least for the first three months following an employee's date of hire, an employer that sponsors a group plan will not, by reason of failing to offer coverage to the employee under its plan during that three-month period, be subject to the employer responsibility payment under Code section 4980H.
>
> [I]n certain circumstances, employers have six months to determine whether a newly-hired employee is a full-time employee . . . and will not be subject to a section 4980H payment during that six month period with respect to that employee. [This] will depend upon whether . . . the employee is reasonably expected as of the time of hire to work an average of 30 hours or more per week on an annual basis, [with the first three months of work being considered representative.]

IRS Notice 12-17 gave these examples:

> **Example 1: Newly-hired employee expected to work full time.**
> **Facts:** Employer D, an applicable large employer (i.e., an employer with at least 50 fulltime equivalent employees), hires Employee X as a computer programmer on December 1. Employee X is expected to work full-time on an annual basis and does work full-time for the months of December, January, and February. Employer D offers health coverage to its fulltime workers (and their dependents).
> **Conclusion:** Employee X must be able to enroll in coverage beginning in March or the employer potentially would be subject to a section 4980H payment. However, failure to offer coverage to Employee X during the first three months (December-February) would not subject Employer D to a potential section 4980H payment.

**Example 2: Newly-hired employee who seasonally works full-time**
**Facts:** Same as Example 1 except that Employer D hires Employee Y as a salesperson who is expected to work full-time during the holiday season and part-time the rest of the year. Employee Y works an average of 35 hours per week in December, January, and February and 20 hours per week in March, April, and May.
**Conclusion:** If, based on the facts and circumstances at the end of the period, the three month period of December through February is reasonably viewed as not representative of the average hours Employee Y is reasonably expected to work on an annual basis, Employer D may use a second three-month period (March-May) as a look-back period. Failure to offer coverage under Employer D's group health plan to Employee Y during the first (December-February) and the second (March-May) three-month periods would not subject Employer D to a potential section 4980H payment. (Failure to offer coverage to Employee Y for June also would not subject Employer D to a potential section 4980H payment because Employee Y was determined to be part-time during the March-May look-back period.)

Employers with historically high turnover and peak employment levels not far above 50 may find it possible to stay "small" due to these expected rules.

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References: The Affordable Care Act, as codified at 26 U.S.C. § 4980H, 29 U.S.C. § 218b; U.S. Dept. of Labor Regulation at 29 C.F.R. § 500.20(s)(1); the Internal Revenue Code, 26 U.S.C. § 414; IRS Notice 12-17.

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