A Survival Guide for Employers

Much has been written about the Patient Protection and Affordable Care Act since the president signed it into law in 2010. Although most of the act survived the most serious constitutional challenge in *Nat’l. Fed’n. of Indep.*

*Bus. v. Sebelius*, 132 S. Ct. 2566, constitutional tests remain. This article examines what the act requires of employers and also addresses a mounting legal challenge to the constitutionality of the act’s requirement that employer health plans pay for certain forms of contraception.

**Patient Protection and Affordable Care Act Coverage**

The act requires “large employers” to offer “affordable” and “adequate” health insurance coverage to their “full-time employees” as defined by the law, explained later, or pay a penalty under the play or pay provisions. But how does the act define these terms? How does the law define “large employer,” and how do you determine who are “full-time employees?” How are the “penalties” calculated? How are temporary employees taken into account? What should employers consider? Both the Internal Revenue Service (IRS) and the U.S. Department of Labor have issued regulations over the last few years that attempt to answer these important questions.

**Large Employers**

An “applicable large employer” employs an average of at least 50 or more full-time employees or full-time equivalents (FTEs) on business days during the preceding calendar year. 26 U.S.C. §4980H(c)(2). A “full-time employee” is someone who generally works 30 or more hours per week or 130 or more hours per month. *Id.* at 4980H(c)(4); *Shared Responsibility for Employers Regarding Health Coverage*, 78
Fed. Reg. 218, 223 (proposed Jan. 2, 2013) (to be codified at 26 C.F.R. pts. 1, 54, 301). FTES include part-time employees, meaning employees who generally work less than 30 hours per week, variable employees, and seasonal employees, and they must be taken into consideration. An employer’s applicable FTES are calculated by taking the total number of hours worked in a month by employees who are not full time and dividing by 120; this yields the total number of FTES for the month. Id. at 4980H(c)(2)(E); 78 Fed. Reg. at 231.

Example: B Corp. only has 40 full-time employees. But B Corp. has 20 part-time employees, each working 96 hours per month. Thus, the total number of hours per month worked by part-time employees is 1,920 (20 × 96). Dividing by 120, B Corp. would have 16 full-time equivalents (1,920/120). While B Corp. only has 40 full-time employees, it is subject to the act’s play-or-pay provisions and penalties when its part-time employees are included, bringing its total full-time employees and full-time equivalents to 56. But B Corp. is only required to offer affordable and adequate health insurance to the 40 full-time employees.

But if an employer’s workforce is greater than the 50-employee threshold during 120 days or less during the preceding calendar year, and the excess employees were “seasonal” workers, then the employer is not a “large employer.” Id. at 4980H(c)(2).

Example: A company employs 40 full-time employees during all of 2014. But the company also employs 80 seasonal full-time employees from May through August 2014. Therefore, the company has 40 full-time employees for eight months and 120 full-time employees for four months, resulting in an average of 66 full-time employees. But the company’s workforce exceeded 50 full-time employees for no more than 120 days, and the number of full-time employees is less than 50 in those months when seasonal employees are disregarded. Thus, the company is not a large employer for 2015.

Control Groups
All members of commonly controlled corporations, trades, and business groups, that is, affiliated companies, are treated as a single employer with regard to employee benefits and health care plans to under the Employee Retirement Income and Security Act §414(b) and (c). Larry Lawson, Chapter 7: Controlled and Affiliated Service Groups, Internal Revenue Service Tax Exempt and Government Entities Manual (Internal Revenue Serv.), www.irs.gov/pub/irs-tege/epchd704.pdf. Thus, employers cannot circumvent the act’s requirements by simply creating new companies. When determining liability for a penalty, however, each member of a control group is treated as a separate entity. I.R.S. Notice 2011-36, 2011-21 I.R.B. 792.

Example: For 2014 and 2015, A Corp. owns 100 percent of stock of B Corp. and C Corp. For every calendar month in 2013, A Corp. had 20 full-time employees, B Corp. had 30 full-time employees, and C Corp. had 40 full-time employees. A Corp., B Corp., and C Corp. are a control group of corporations. Because together they employ more than 50 full-time employees, A Corp., B Corp., and C Corp. are “large employers.” A Corp. does not offer health insurance coverage, while B Corp. and C Corp. do offer insurance coverage. A Corp. would be subject to penalties. But B Corp. and C Corp. would not be subject to those penalties. Any penalties would be limited to each separate entity.

Full-Time Employees
As noted, a “full-time employee” is someone who generally works 30 or more hours per week or 130 or more hours per month. To calculate whether an employee is “full-time” under the act, an employer must adopt a standard measuring period that looks back three to 12 months and average an employee’s hours for that period. Once a determination is made, an employee must be treated as full time or part time based on the measuring period calculation for a set “stability period.” The stability period cannot be shorter than the chosen measuring period but must be at least six months if the employee is determined to be full time. An employer has 90 days from the conclusion of the measuring period to enroll an employee determined to be full time in the employer’s health insurance. IRS Notice 2011-36, 2011-21 I.R.B. 792. However, coverage must be made effective for employees determined to be full time no later the first day of the calendar month that begins 13 months from the employee’s start date. IRS Notice 2012-59, 2012-41 I.R.B. 443.

Penalties
The act requires large employers to either “play” by offering affordable and adequate coverage to their employees or “pay” a penalty. To understand the potential penalties fully, however, an employer must have a general understanding of the public insurance exchange marketplaces created by the act. Every state must have an exchange, and at the state’s option, each individual state, the federal government, or a combination of the two will manage it. They are designed to be virtual insurance marketplaces where health insurance providers compete for customers among anyone searching for affordable healthcare options. Individuals that meet certain criteria can qualify for premium tax credits or cost-sharing subsidies. To qualify for tax credits or certain subsidies someone must have an income of between 100 percent and 400 percent of the federal poverty line. Open enrollment for the exchanges began on October 1, 2013.

The act establishes two types of penalties under its shared-responsibility-for-employers provisions. Although the act required that the penalties take effect by January 1, 2014, the United States Treasury Department announced on July 2, 2013, that it would delay enforcement of these penalties until January 1, 2015. An “applicable large employer” employs an average of at least 50 or more full-time employees or full-time equivalents (FTEs) on business days during the preceding calendar year.
Penalty for Not Offering Coverage—Section 4980H(a)

An employer that chooses not to offer “adequate” or “affordable” insurance coverage must pay a penalty if at least one of its full-time employees receives a premium tax credit or subsidy and uses the credit or subsidy to obtain insurance through an exchange. Although the large employer calculation must take part-time employees into account, large employers do not incur a penalty for failing to provide health insurance to part-time employees. The formula for the annual penalty is $2,000 multiplied by the number of full-time employees minus 30. 26 U.S.C. §4980H(a).

Example: A Corp., a large employer that does not offer insurance, has 130 full-time employees. Fifty employees purchase insurance through the insurance exchange and receive a premium credit. As a result, A Corp. would be subject to a penalty of $200,000. (130 employees – 30 x $2,000).

The IRS, however, announced that it will not impose the full 4980(a) penalty on employers as long as they offer at least 95 percent of their full-time employees both affordable and adequate coverage. If some of the five percent not offered coverage receive a premium credit or subsidy and use the credit or subsidy to purchase insurance from an exchange, then the employer only receives a $3,000.00 annual penalty for such employee. 78 Fed. Reg. 218, 232.

For control groups, the regulations calculate the 30 full-time employee reduction by allocating it proportionally across the member companies. IRS Notice 2011-36, 2011-21 I.R.B. 792.

Example: A Corp. and B Corp. belong to the same tax control group. A Corp. has 60 full-time employees, while B Corp. has 40 full-time employees. A Corp. offers health insurance, but B Corp. does not. Because an employee receives a premium credit and obtains insurance through an exchange, B Corp. is subject to a penalty. B Corp. is entitled to an employee reduction of 12 ((40/100) x 30 =12), resulting in a penalty of $56,000 ((40 – 12) x $2,000).

Penalties for Failing to Offer Affordable or Adequate Coverage—Section 4980H(b)

If a large employer offers coverage to an employee that the act defines as unaffordable to the employee or inadequate, then the act penalizes the employer $3,000 annually for each employee who also receives a premium tax credit or subsidy and uses the credit or subsidy to purchase insurance through an exchange. This penalty cannot exceed the maximum no-coverage penalty assessable against an employer under the formula outlined in §4980H(a) of the Internal Revenue Code. 26 U.S.C. §§36B(c) (2)(C(i)–(ii); 26 U.S.C. §4980H(b). In other words, if a large employer with 130 full-time employees offers unaffordable coverage as defined by the act to its employees, it will pay an annual penalty of $3,000 multiplied by the number of employees who receive a premium tax credit or subsidy and use the credit or subsidy to purchase insurance through an exchange.

Example: C Corp. offers insurance to its 130 full-time employees, but the coverage is not “affordable” for 20 of the 130 employees. Only 10 of these employees receive a premium credit and use it to purchase insurance through an exchange. Thus, C Corp. is subject to a $30,000 annual penalty ($3,000.00 x 10 employees). But even if all 130 receive a premium credit and use it to purchase insurance through an exchange, the maximum penalty under IRC §4980H(b) cannot be more than $200,000 annually (130 employees minus 30 multiplied by $2,000, the amount of the IRC §4980H(a) no-coverage penalty).

While the 4980H(a) and 4980H(b) penalties are annual penalties, it appears that the IRS will assess them on a monthly basis. So with an annual penalty of $30,000, the monthly assessment is $2,500 a month. 78 Fed. Reg. 218, 233-35. Additionally, the amounts used in the penalty calculation ($2,000.00 and $3,000.00) will be adjusted for inflation on an annual basis. 26 U.S.C. §4980H(c)(5).

Affordable Coverage

Insurance is “affordable” when the cost of coverage for the individual employee does not exceed 9.5 percent of the employee’s household income. 26 U.S.C. §§36B(c)(2)(C) (i). Employers have expressed concern over what constitutes household income and how an employer would know an employee’s “household” income beyond what it pays the employee. In response to these concerns, the IRS has proposed regulations that allow employers to use one of three safe harbor methods to calculate affordability. 78 Fed. Reg. 218, 233–35. If an employer uses one of these three methods, the Form W-2, the rate of pay, or the federal poverty line, and the calculations fall in line with the established parameters, the IRS will deem coverage “affordable.” The regulations have proposed that the following conditions for each safe harbor will qualify coverage as affordable:

1. Form W-2 safe harbor: An employee’s required premium contribution for self-only coverage through the employer’s lowest cost plan that provides minimum value does not exceed 9.5 percent of an employee’s W-2 wages;
2. Rate of pay safe harbor: An employee’s required monthly contribution for self-only coverage through the employer’s lowest cost plan that provides minimum value does not exceed 9.5 percent of an amount equal to 130 multiplied by the employee’s hourly rate of pay (or monthly salary); or
3. Federal poverty line safe harbor: An employee’s required monthly contribution for self-only coverage through the employer’s lowest cost plan that provides minimum value does not exceed 9.5 percent of the federal poverty line.
Adequate Coverage and Minimum Value
Adequate coverage means that an employer’s health insurance provides “minimum value.” “Minimum value” is insurance that pays for at least 60 percent of covered health care expenses. 26 U.S.C. §§36B(c)(2)(C)(ii). According to proposed regulations, employers must also provide coverage for dependents of full-time employees up to age 26 but not for spouses. 78 Fed. Reg. 218, 231–33.

Temporary or Leased Employees
Unfortunately, there is no straightforward answer to the question of whether temporary or leased employees assigned to a client by a temporary employment agency are counted as employees of the temporary agency or the client for purposes of determining large employer status under the act or for penalty calculations. The Congressional Research Service has noted that in determining large employer status, temporary agency employees are generally counted as employees of the temporary agency. Janemarie Mulvey, Potential Employer Penalties Under the Patient Protection and Affordable Care Act, at 3 (Cong. Research Serv. May 6, 2013). The IRS, however, has indicated that for purposes of the act, it will look to the traditional common law test to determine the employer of a temporary or leased employee. IRS Notice 2011-36.

Concerning the common law test used to determine an employer-employee relationship, the IRS has noted that generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is the employer.

IRS Rev. Rul. 70-630, 1970-2 C.B. 229. In that regard, if a temporary agency hires an employee, trains the employee, supplies the employee to a client, and provides a supervisor to direct the activities of the employee, then the temporary agency will likely be considered the employer of the employee under the act. But if a client of a temporary agency maintains sufficient control over an employee, then it risks becoming the employer. Length of service by a temporary or leased employee to a temporary agency’s client may also factor into the analysis with the greater length cutting in favor of the client being the employer. In other words, it may be hard for an employer to argue that a “temporary” employee that has been assigned to it and worked full time for it for over a year is not its employee.

Recognizing that the act presents challenges to temporary employment agencies, the United States Treasury Department and the IRS have invited comment from employers on this matter. IRS Notice 2011-36; 78 Fed. Reg. 218, 22–30. But until they issue further guidance, employers should be careful to consider the potential implications when using temporary employees.

Retaliation Prohibited
Section 1558 of the act amended the Fair Labor Standards Act (FLSA) by adding Section 18c, which prohibits retaliation by employers against employees who receive a tax credit or subsidy; who provide information to their employer, the federal government, or a state attorney general regarding a violation or a perceived violation of the act; who testify or participate in a proceeding regarding such violations; or who object to or refuse to participate in any such violation or perceived violation. 29 U.S.C. §218c. The statute requires that such retaliation complaints must be filed with the U.S. Department of Labor, Occupational Safety and Health Administration (OSHA). OSHA is charged with investigating such complaints and has issued interim final regulations governing whistleblower claims. 78 Fed. Reg. 13,222–36.

An employee must file a complaint with OSHA within 180 days of the alleged retaliation. Id. at 13,224. To establish a claim, an employee must make a prima facie showing that he or she (1) engaged in the protected activity noted above; (2) the activity was known by the employer; (3) the employee suffered an adverse employment action; and (4) the protected activity was a contributing factor to the adverse action. Id. at 13,226–27. OSHA, however, must dismiss the complaint if the employee fails to establish a prima facie case or if the employer shows “by clear and convincing evidence that it would have taken the same adverse action absent the protected activity.” Id. at 13,226. Once OSHA determines whether the claim has merit, either the employee or the employer may file objections and request a hearing before an administrative law judge. Id. at 13,224. Remedies available to an employee include reinstatement, back pay, compensatory damages, and attorney’s fees. 29 C.F.R. §1984.105(a)(1). Conversely, an employer can only recover $1,000 in attorneys’ fees if the administrative law judge finds the complaint was frivolous or filed in bad faith. 29 C.F.R. §1984.105(b).

One concern is whether Section 1558 of the act will be used against employers that decide to reduce their employees’ hours below 30 per week to avoid having to provide the employees with affordable and adequate insurance or pay a penalty. At first, such an assertion seems a stretch because the FLSA has never before required employers to provide all employees with overtime. At first, such an assertion seems a stretch because the FLSA has never before required employers to provide all employees with overtime. Nevertheless, if an employee who has previously worked over 30 hours per week and has historically had health insurance through the employer has his or her hours cut below 30 is not offered insurance by

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the employer and receives a tax credit or subsidy to purchase insurance through an exchange, OSHA might investigate such a claim. Therefore, employers should take care in making a decision to reduce an employee’s hours to avoid liability under the act.

Additionally, employers grappling with whether to reduce their employees’ hours below 30 per week to avoid the provisions of the act should be mindful of Section 510 of ERISA.

Employers grappling with whether to reduce their employees’ hours below 30 per week to avoid the provisions of the act should be mindful of Section 510 of ERISA. Section 510 makes “[i]t… unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan[,]” 29 U.S.C. § 1140. Section 510 restricts an employer’s ability to terminate an employee or reclassify an employee as an independent contractor in an effort to deny the employee benefits to which he or she would have otherwise been entitled. Gitlitz v. Compagnie Nationale Air France, 129 F.3d 554, 559 (11th Cir. 1997). Although it is too early to know whether an employer’s decision to reduce the hours of its workforce to avoid the act can rise to ERISA discrimination claims, employers should at least be aware of this risk.

The Act, Contraception, and the Supreme Court

Although the U.S. Supreme Court upheld the individual mandate in Nat’l Fed’n. of Indep. Bus. v. Sebelius, 132 S. Ct. 2566 (2012), that did not stop the challenges. The act requires a “group health plan and a health-insurance issuer offering group or individual insurance coverage” to provide coverage at no cost for preventive health services. 42 U.S.C. §300 gg-13 (a). Congress, however, did not define preventive health services, choosing instead to give that job to the Health Resources and Services Administration (HRSA). Id. The HRSA guidelines defined preventive health services to include “all [FDA] approved contraceptive methods, sterilization procedures, and patient education and counseling for all women with reproductive capacity.” Women’s Preventive Services Guidelines, Health Res. Servs. Admin., www.HRSA.gov/womensguidelines/ (last visited Dec. 9, 2013). Religious organizations and others voiced religious-based objections to this aspect of the preventive health services requirement. In response to these objections, the HRSA exempted “certain religious employers from the Guidelines where contraceptive services are concerned.” 76 Fed. Reg. 46,621 (Aug. 3, 2011). The final HRSA regulations define a religious employer as “an employer that is organized and operates as a nonprofit entity and is referred to in section 6033(a) (3) (A) (i) or (iii) of the Code.” 78 Fed. Reg. 39,874.

Recognizing that certain nonprofits do not meet the religious-employer definition, the HRSA created a temporary safe harbor—that expired August 1, 2013—for nonprofits that have religious objections to contraceptive coverage. 77 Fed. Reg. 8725 and 8726–8727 (Feb. 15, 2012). Under the temporary safe harbor provision, the federal government agreed not to take any enforcement action against qualifying nonprofit organizations. Both the proposed regulations and the final regulations define a qualifying nonprofit as an entity that

(1) Opposes providing coverage for some or all of the contraceptive services required to be covered under section 2713 of the PHS Act [federal Public Health Services Act] and the companion provisions of ERISA and the Code on account of religious objections;
(2) is organized and operates as a nonprofit entity;
(3) holds itself out as a religious organization; and
(4) self-certifies that it satisfies the first three criteria. 78 Fed. Reg. 39,874.

To avoid the contraceptive coverage, the qualifying nonprofit must submit its self-certification form to its issuer. The issuer is required to “expressly exclude contraceptive coverage… from [the organization’s] group health coverage.” The exclusion can apply to “all contraceptive coverage or coverage of specific contraceptive services if the issuer chooses to customize the exclusion.” 78 Fed. Reg. 39,876. The final regulations require the issuer to provide payment for the excluded contraceptive services “without the imposition of cost sharing, premium, fee, or other charge on plan participants or beneficiaries or on the organization or its plan.” Id.

But the final regulations did not give this same protection to private employers with religious objections to contraceptive coverage. 78 Fed. Reg. 39,875–39,876. So, these employers resorted to the courts to seek protection for their religious beliefs. See, e.g., Liberty University, Inc. v. Lew, 733 F.3d 72 (4th Cir.), cert. denied, ___ S. Ct. ___, 2013 WL 4811562 (2013). Their efforts have met mixed results. Compare Hobby Lobby Stores, Inc. v. Sebelius, 2013 WL 3869832 (W.D. Okla. 2013) (granting an injunction following reversal and remand by the Tenth Circuit, 723 F.3d 1114 (10th Cir. 2013), petition for cert. granted ___ S. Ct. ___, 2013 WL 5297798 (2013); with Autocam Corp. v. Sebelius 730 F.3d 618 (6th Cir. 2013), petition for cert. filed Oct. 15, 2013. (denying injunctive relief because the court concluded that the Religious Freedom Restoration Act’s use of “person” did not include corporations). In Liberty University, Inc. v. Lew, the Fourth Circuit declined to address the challenges to the preventive health services regulations because these challenges were raised for the first time in Liberty University’s post-remand brief. Liberty University, Inc. v. Lew, 733 F.3d at 103. One of the reasons the Fourth Circuit cited for not considering a matter not raised in the district court was that these challenges remained pending in other circuits. Id.
tain contraceptive drugs and services. The Greens argue that the regulations force them to violate their sincerely held religious beliefs and therefore violate the First Amendment and the Religious Freedom Restoration Act (RFRA). Initially, the district court denied the Greens’ motion for injunctive relief. But on appeal the Tenth Circuit held that the Greens established two of the four elements for injunctive relief and remanded for consideration of the other two elements. Because the district court would be considering the issue of injunctive relief under RFRA, the Tenth Circuit declined to reach the issue of whether the Greens were entitled to a preliminary injunction on the constitutional issue. On remand the district court concluded that the Greens were entitled to injunctive relief and found that corporations are persons for purposes of RFRA. In December, the Supreme Court of the United States granted the government’s petition for writ of certiorari. The Seventh Circuit agrees that secular, for-profit corporations can raise religious liberty claims under RFRA. See Grote v. Sebelius, 708 F.3d 850 (7th Cir. 2013).

In a similar case, the Sixth Circuit concluded that secular, for-profit corporations are not “persons” under RFRA and therefore cannot challenge the regulations under RFRA. Autocam Corp. v. Sebelius, 730 F.3d 618 (6th Cir. 2013), petition for cert. filed Oct. 15, 2013. And the Third Circuit concluded that secular, for-profit corporations cannot assert free-exercise claims under the First Amendment. Conestoga Wood Specialties Corp. v. Sec’y of U.S. Dep’t of Health & Human Servs., 724 F.3d 377 (3d Cir. 2013); Gilardi v. Sebelius, 926 F. Supp. 2d 273 (D.D.C. 2013) (holding that the corporations could not assert free-exercise claims).

In these cases, the courts considered the same case law and statutory authority and reached different results. The central question to resolving the disagreement among the courts is whether a closely held corporation is simply an extension of its owners so that the beliefs of one are indistinguishable from the other. See Tyndale House Publishers, Inc. v. Sebelius, 904 F. Supp. 2d at 117.

**Conclusion**

The act has far-reaching implications for your clients. When advising a client you must determine if (1) the client is a large employer with 50 or more full-time employees or full-time equivalents; (2) the client is part of a group of affiliated companies for purposes of deciding if your client and the affiliated companies are considered a single employer; and (3) the client provides affordable and adequate coverage.

You will also want to calculate the penalties that a client would owe for not providing coverage or not providing affordable or adequate coverage as defined by the act if these conditions apply to the client. You will want to remember to help a client decide whether it or a temporary agency employs temporary or leased employees if that condition applies to the client. Next, you will want to assist a client in avoiding retaliation claims. Finally, you will want to help a client decide how to proceed, which will involve a certain amount of Supreme Court predicting, if the client is a closely held company that has religious objections to the preventive health services regulations.