Statement
On behalf of the
National Restaurant Association

HEARING: THE HEALTH CARE LAW, THE EFFECT OF THE BUSINESS AGGREGATION RULES ON SMALL EMPLOYERS

BEFORE: COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

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Statement for the hearing "The Health Care Law, The Effect of the Business Aggregation Rules on Small Employers"

Before the

Committee on Small Business, U.S. House of Representatives

By
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On behalf of the National Restaurant Association

December 4, 2013

Chairman Graves, Ranking member Velazquez, and members of the House Committee on Small Business; thank you for the opportunity to testify today on the effect of the business aggregation rules included in the health care law, on small businesses like mine.

My name is Ellis Winstanley, CEO of Tradelogic Corporation, and I own a variety of small businesses in Austin, Texas, with my brother, parents, and partners. I'm honored to share the perspective of my companies, especially my restaurants, on behalf of the National Restaurant Association.

OUR COMPANIES

I am a business executive with a successful track record of starting up, turning around and growing businesses in the hospitality, construction, software, printing & promotion products, and apparel industries. My brother and I are entrepreneurs who got started in this business while we were students at the University of Texas. We currently own eight restaurants with our partners, which I oversee on a day to day basis. We are partnered together with our parents in two construction and three printing and promotional products businesses which support the restaurant operations. We also own two software development companies, one of which is Tradelogic Corporation, that also serves as our management company. My brother and I are known for rescuing local and historical small restaurant brands, and turning them around to maintain their place in the community as job creators.

THE RESTAURANT AND FOODSERVICE INDUSTRY

The National Restaurant Association is the leading trade association for the restaurant and foodservice industry. Its mission is to help members like me establish customer loyalty, build rewarding careers, and achieve financial success. The industry is comprised of 980,000 restaurant and foodservice outlets employing 13.1 million people who serve 130 million guests daily. Restaurants are job-creators. While small businesses comprise the majority of restaurants, the industry as a whole is the nation's second-largest private-sector employer, employing about ten percent of the U.S. workforce.[1]

The unique characteristics of our workforce create compliance challenges for restaurant and foodservice operators within this law. It's difficult for restaurants to determine how the law impacts them and what they must do to comply. Many of the determinations employers must make to figure out how the law impacts them – for example the aggregation rules and the applicable large employer determination – are much more complicated for restaurants than for other businesses that have more stable workforces with less turnover.

Restaurants are employers of choice for many looking for flexible work schedules and the ability to pick up extra shifts as available. As a result, we employ a high proportion of part-time and seasonal employees. We are also an industry of small businesses — more than seven out of ten eating and drinking establishments are single-unit operators. Much of our workforce could be considered "young invincibles," as 43 percent of employees are under age 26.[2] Hence, high turnover is the norm. In addition, the restaurant business model produces relatively low profit margins of only four to six percent before taxes, with labor costs being one of the most significant line items for a restaurant.[3]

Business owners crave certainty, because it enables us to plan for the future and make decisions that benefit our employees, customers, and communities. One of the most difficult things to predict about the impact of this law is the choices employees will make.

Will they accept restaurant operators' offers of coverage more than they do today?

Will our young workforce choose to pay the individual mandate tax penalty instead of accepting the employer's offer of coverage in 2015, 2016 and beyond?

Will exchange coverage be less expensive than what is currently available and can operators afford to offer under the law?

With the younger, healthier population of the workforce, we may find that more team members will favor the tax penalty because it is less expensive than employer-sponsored coverage. This provides less certainty for employers to predictively model.

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[1] *2013 Restaurant Industry Forecast.*
[2] Bureau of Labor Statistics, U.S. Department of Labor.
[3] *2013 Restaurant Industry Forecast.*

COMPLYING WITH THE HEALTH CARE LAW IS CHALLENGING FOR RESTAURANT AND FOODSERVICE OPERATORS GIVEN THE UNIQUE CHARACTERISTICS OF THE INDUSTRY

Since the law was enacted in 2010, the National Restaurant Association has taken steps to educate America's restaurants about the requirements of the law and the details of the Federal agencies' guidance and regulations. Through the National Restaurant Association Health Care Knowledge Center website (Restaurant.org/healthcare), we offer one place where restaurant operators of every size can go to better understand the law's requirements and determine its impact on their employees and businesses.

The National Restaurant Association has actively participated in the regulatory process, from the beginning, to ensure that the implementing regulations and Federal agencies' guidance consider the implications for businesses that are not just one type or size. As co-leaders of the Employers for Flexibility in Health Care (E-Flex) coalition, we have partnered with other businesses and organizations with similar workforce characteristics. Together we advocate for greater flexibility and options within the implementing regulations, especially for those that employ many part-time, seasonal, or temporary employees.

The overarching challenge restaurant and foodservice operators face in complying with the law is to first understand its complicated and interwoven requirements. By far, the definition of "full-time employee" under the law poses the greatest challenge. It does not reflect current workforce practices and could have a detrimental impact on a restaurant operator's ability to offer flexible schedules for his or her employees.

In addition, the applicable large employer determination is too complex. It stifles smaller employers' ability to manage their workforces, expand their businesses and prepare to offer health care coverage. Finally, the automatic enrollment provision could cause financial hardship and greater confusion about the law for some employees, without increasing their access to coverage.

All of these factors combine to complicate what a restaurant and foodservice operator must consider when adapting their business to comply with the law.

EMPLOYER AGGREGATION RULES

To determine if an employer is considered a large or small employer under the health care law (and if large then subject to the Employer Shared Responsibility[4] and Reporting of Employer Health Insurance Coverage[5] provisions) an employer must first determine who the employer is. This may seem like a simple determination but due to the structure of many restaurant companies – separate legal entities owned by many of the same partners, and often

[4] Internal Revenue Code §4980H.
[5] Internal Revenue Code §6056.

family businesses – determining the employer is more complicated than many expect in the restaurant industry.

Section 1513(c)(2)(C) of the health care law lays out Rules for Determining Employer Size. Subsection (i), Application of Aggregation Rule for Employers, states that "All persons treated as a single employer under subsection (b), (c), (m), or (o) of section 414 of the Internal Revenue Code of 1986 shall be treated as 1 employer." Section 414, (b), (c), (m), (o) of the Tax Code is often referred to as the Common Control Clause.

This is the first section of the health care law employers must look at to begin determining how the law impacts them and their businesses. Typically it is smaller employers in the restaurant industry who are unsure and struggling to understand how these complicated aggregation rules apply to them. Because the rules are so complicated they must consult a tax professional to help them determine the impact of the law, even at the very first step. Larger businesses, where each entity could be considered an applicable large employer on their own, are less concerned about determining if they are one or multiple employers. They are not struggling to understand the these complicated rules as smaller employers are in the industry.

These rules have been part of the Tax Code for years, but this is the first time that many restaurateurs, especially smaller operators, have had to understand how these complicated regulations apply to their businesses. The Treasury Department has not issued, nor to our knowledge plans to issue, regulatory guidance that could be used by smaller operators to understand how Section 414 (b), (c), (m), (o) might apply to them without having to consult a tax professional. The Department of Treasury's Proposed Rule on Employer Shared Responsibility issued January 2, 2013, discusses how the aggregation rules apply when determining the size of an employer's workforce, but does not explain how to determine whether a group of businesses are one or multiple employers. On their website, the Internal Revenue Service (IRS) mentions that certain affiliated employers with common ownership or those part of a controlled group must aggregate employees. It also states that the regulation and that FAQs are available for employers on their website[6], however the FAQ page, last reviewed or updated July 18, 2013, states that "Updated questions and answers will be posted soon" [7] and provides no additional information about the aggregation rules.

Given the lack of easily understood guidance, restaurant and food service operators are forced to hire expensive tax advisors to determine how the complicated rules and regulations associated with this section of the Tax Code apply to their specific situations. Like me, very often entrepreneurs own multiple restaurant entities with various partners, often with family members. Though these restaurateurs consider each operation to be a separate small business, many are discovering that, for the purposes of the health care law, all of the businesses can be considered one employer due to common ownership.

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[6] http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions-for-Employers, 12/2/2013.
[7] http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act, 12/2/2013.

EFFECT OF THE AGGREGATION RULES ON SMALL BUSINESSES

The application of these aggregation rules to determine the employer for the purposes of the health care law is having an impact on small businesses. Businesses, who consider themselves small, must consult a tax professional to determine if they are one or multiple employers, or they assuming they are one employer and an applicable large employer. Most of our small businesses each have less than 50 full-time employee equivalents, and independently would not be considered applicable large employers. Two of our restaurants are highly seasonal businesses and may or may not be considered applicable large employers depending on the calendar month. We are located in a college town and our customer traffic flow and hence staffing levels fluctuate depending on whether the University of Texas is in session or on break. For those restaurants, even if they are large for a few months, the seasonal exemption to the applicable large employer determination may apply if we were allowed to consider each legal entity independently.[8] If the seasonal exemption would apply, the two highly seasonal restaurants may also not be considered large if they were considered as separate entities. However, since my brother and I are partners and own our businesses with family members and other common partners, I believe we will be considered as one employer under the law and must consider all of the employees in all of our businesses as one group.

I have not consulted a tax professional but instead have tried to determine myself if we are considered one or multiple employers under the law. Based on my own understanding of the aggregation rules, we will be one employer and hence an applicable large employer subject to the Employer Shared Responsibility and Reporting of Employer Health Insurance Coverage provisions, among others.

The impact of the aggregation rules, and hence our status as an applicable large employer, will have an impact on each of our small businesses. Simply, the cost of doing business for each will increase, yet they must be able to stand on their own. Labor costs are typically one-third of a restaurant's expenses.[9] Operators only have a finite dollar amount to spend on labor costs given thin margins, including employee benefits such as health insurance coverage, and must manage these costs closely to remain viable. In the end, our status as an applicable large employer as a result of the aggregation rules means we must be extremely careful with our labor dollars and it will impact our decision-making going forward.

Since the recession, everyone has been tightening their belt to manage these costs and in Austin, we are still very much feeling the impact. This puts pressure on the staff, our vendors, our pricing, and in the end our customers. I see the cost associated with offering health care coverage as only adding to that pressure.

[8] Applicable large employer status for calendar year 2015 is determined by measuring January 1 – December 31, 2014. See Applicable Large Employer Determination section.
[9] *2013 Restaurant Industry Forecast*.

OTHER SECTIONS OF THE LAW OF IMPACTING RESTAURANTS

In addition to the aggregation rules, there are several other sections of the law that impact restaurant operators and small businesses. The cost of offering coverage continues to be a top concern for small businesses like me. It remains difficult to project and budget for the cost of coverage even next year. I'm also concerned about the administrative burden that compliance with the law will impose on my businesses. I fear that the administrative cost will be almost as expensive as the coverage itself, which includes having to educate our staff on the law and our health insurance coverage offerings.

APPLICABLE LARGE EMPLOYER DETERMINATION

Once a restaurant or foodservice operator determines what entities are considered one employer, they must determine their applicable large employer status annually. For larger employers, it may be clear that they have more than 50 full-time equivalent employees employed on business days in a calendar year. However, many small businesses will have to complete this calculation annually to determine their responsibilities under the law. That is not so easy given the number of employees' hours of service that must be tracked due to the labor intensive nature of the restaurant and foodservice business.

Unfortunately, operators on the cusp of 50 full-time equivalent employees are struggling to understand how to complete this complicated calculation each year. An employer must consider each employee's hours of service in all 12 calendar months each year. Immediately after they achieve this cumbersome calculation at the end of the year, they must begin to offer coverage January 1st.

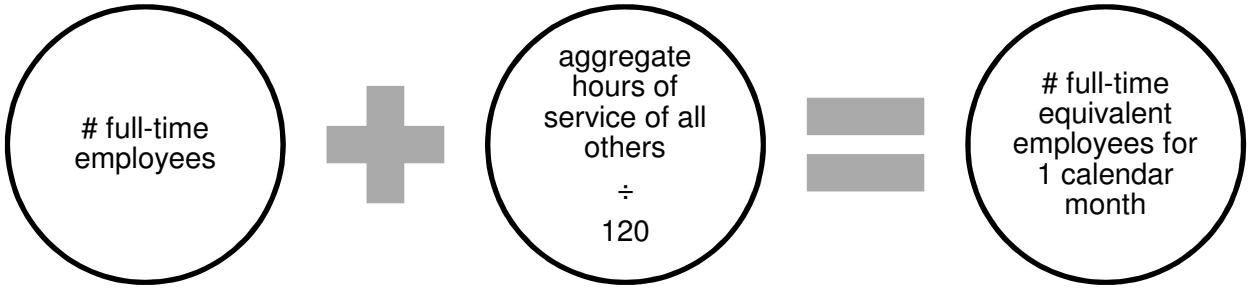
Smaller restaurant and foodservice operators need clarification on when such employers must offer coverage in future years. Will small businesses just reaching the applicable large employer threshold on December 31, 2015, for example, be able to offer coverage a day later on January 1, 2016? Currently, the law does not allow any time to shop for coverage or conduct open enrollment once a small employer determines they are now a large employer. Congress should allow small businesses an administrative period between determining large employer status and offer of coverage, before it creates further confusion, especially in the second year of implementation and beyond.

The applicable large employer determination is complicated. Employers must determine all employees' hours of service each calendar month, calculate the number of FTEs per month, and finally average each month over a full calendar year to determine the employer's status for the following year. The calculation is as follows:

1. An employer must first look at the number of *full-time employees* employed each calendar month, defined as 30 hours a week on average or 130 hours of service per calendar month.
2. The employer must then consider the hours of service *for all other employees*, including part-time and seasonal, counting no more than 120 hours of service per

person. The hours of service for all others are aggregated for that calendar month and divided by 120.

3. This second step is added to the number of full-time employees *for a total full-time equivalent employee* calculation for one calendar month.



4. An employer must complete the same calculation for the remaining 11 calendar months and average the number over 12 calendar months to determine their status for the following calendar year.

This annual determination is administratively burdensome, especially for those employers just above or below the 50 FTE threshold who must most closely monitor their status – most likely smaller businesses. Many restaurant operators rely on third-party vendors to develop technology or solutions to help them comply with these types of requirements but, in addition to the added costs and time this requires, vendors are backlogged and solutions are not easily accessible at this time.

Congress should simplify this calculation and help small businesses more easily determine their status under the law. A more workable definition of large employer is needed as the current calculation stifles smaller employers' ability to manage their workforces, plan to expand their businesses, and prepare to offer health coverage if they are not already doing so.

OFFERING COVERAGE TO FULL-TIME EMPLOYEES

The health care law requires employers subject to the Shared Responsibility for Employers provision to offer a certain level of coverage to their full-time employees and their dependents, or face potential penalties. The statute defines a full-time employee as someone who averages 30 hours a week in any given month.

This 30-hour threshold is not based on existing laws or traditional business practices. In fact, the Fair Labor Standards Act does not define full-time employment. It simply requires employers to pay overtime when nonexempt employees work more than a 40-hour workweek. As a result, 40 hours per week is generally considered full-time in many U.S. industries. In the restaurant and foodservice industry, operators have traditionally used a 40-hour definition of full-time. Adopting such a definition in this law would also provide employers the flexibility to comply with the law in a way that best fits their workforce and business models.

Compliance based on a 30-hour a week definition is further complicated by the fact that, for restaurant and foodservice operators who are applicable large employers, it is not easy to predict which hourly staff might work 30 hours a week on average and which will not. Hourly employees are scheduled for more or less hours depending on several factors, including customer traffic flows.

One reason so many Americans are drawn to restaurant jobs is the flexibility to change your hours to suit your own personal needs. However, under this law, for the first time, the federal government has drawn a bright line as to who is considered full-time and who is considered part-time. As a result, employers with variable workforces and flexible scheduling must alter their practices and be very deliberate about scheduling hours. The reason being that the law imposes a greater financial impact than before in the form of potential liability for employer penalties if employees who work full-time hours are not offered coverage. If the definition is not changed to align with workforce patterns, the flexibility so many employees value will no longer be as widely available in the industry. This could result in significant structural changes to our labor market.

The National Restaurant Association supports efforts, such as Senators Susan Collins' and Joe Donnelly's bipartisan bill S. 1188, Congressman Todd Young's bill H.R. 2575, and Congressman Dan Lipinski's bipartisan bill H.R. 2988, that would define a full-time employee under the Affordable Care Act as someone working 40 hours or more a week.

We appreciate that the Treasury Department, in its January 2, 2013 proposed rule on the Employer Shared Responsibility, recognized that it may be difficult for applicable large employers to determine employees' status as full-time or part-time on a monthly basis, causing employee churn between employer coverage and the exchange or other programs. Such coverage instability is not in our employees' best interests. We are pleased that the Lookback Measurement Method is an option that applicable large employers may use.

While the Lookback Measurement Method's implementing rules are complex, it could be helpful for both employers and employees. Employers will be better able to predict costs and accurately offer coverage to employees as required. Employees whose hours fluctuate (variable hour and seasonal employees) have the peace of mind of knowing that if their hours do decrease from one month to the next, coverage will not be cut short before the end of their stability period.

CHALLENGES FOR APPLICABLE LARGE EMPLOYERS OFFERING COVERAGE TO THEIR FULL-TIME EMPLOYEES AND THEIR DEPENDENTS

Once an applicable large employer has determined to whom coverage must be offered, he or she must make sure that the coverage is of 60 percent minimum value and considered affordable to the employee, or face potential employer penalties.

Minimum value is generally understood to be a 60 percent actuarial test; a measure of the richness of the plan's offered benefits. This is a critical test for employers especially relating to what the employer's group health plan covers and hence what the premium cost will be in 2014. Business owners strive for certainty, and that means the ability to plan for their future costs.

Employers are eager to know what their premium costs will be under the new law. Minimum value is necessary to determining that information.

On February 25, 2013 the Health and Human Services Department included the Minimum Value Calculator, one of the acceptable methods to determine a plan's value, in its Final Rule: Standards Related to Essential Health Benefits, Actuarial Value, and Accreditation. Minimum value can now be determined using this calculator or other options, but it is still difficult to anticipate premium costs this far in advance.

Why? Rates are not usually available until a few months before the employer's plan year begins because insurance companies provide quotes based on the most current data with the greatest amount of claims history. This gives operators a short timeframe to budget and make business decisions in advance of the new plan year. Restaurant operators are eager to see premiums for 2014 and better evaluate the impact and costs associated with the employer requirements for voluntary compliance, and then full implementation in 2015.

Applicable Large Employers must also ensure at least one of their plans is affordable to their full-time employees or face potential penalties. A full-time employee's contribution toward the cost of the premium for single-only coverage cannot be more than 9.5 percent of their household income to be considered affordable. Employers will not know household income – which the statute specifies as the general standard – nor do they want to know this information for privacy reasons. Hence, employers needed a way to estimate before a plan is offered if it will be affordable to employees or potentially trigger an employer penalty.

What employers do know are the wages they pay their employees. Almost always, employees' wages will be a stricter test than household income. Employers are begrudgingly willing to accept a stricter test in the form of wages so that they know they are complying with the law and are provided protection from penalty under a safe harbor. The Treasury Department's proposed rule allows employers to use one of three Affordability Safe Harbors based on Form W-2 wages, Rate of Pay or Federal Poverty Line. The option of utilizing these methods will be helpful to employers as they determine at what level to set contribution rates and their ability to continue to offer coverage to their employees.

We encourage policymakers to address the cost of coverage so that the employer-sponsored system of health care coverage will be maintained, and businesses aren't forced to choose between plans they cannot afford and penalties they cannot afford.

NONDISCRIMINATION RULES NOW WILL APPLY TO FULLY-INSURED PLANS

The health care law applies the nondiscrimination rules that currently apply to self-funded plans to fully-insured plans in the future. These rules state that a plan cannot offer benefits in favor of their highly-compensated individuals over other employees. This rule is not in effect as the Treasury Department has put implementation on hold until further guidance has been issued in this complex area. Under the law, these rules apply to all insured plans, regardless of whether they are offered by an applicable large employer or a small business. I am watching this rule closely as it could impact our future plan offerings and compliance with the law.

Current group health plan participation rules often force operators to carve out the group of employees who will participate in the plan.[10] However, in many restaurateurs' experience, these are almost always a group that would be considered in the top 25 percent based on compensation.

Management carve-outs are not just for upper level executives who may receive richer benefit plans than the rest of the employees. In the restaurant and foodservice industry, management-only plans are sometimes the only option that operators have to provide health care coverage to those employees who want to buy it and pass participation requirements at the same time. As a result, these plans are quite common in the industry.

The rules the Treasury Department writes to apply non-discrimination testing to fully-insured plans could have an impact on our industry. Regardless of how they are written, restaurant and foodservice operators will need sufficient transition time to apply these rules as it could create upheaval for plans and employers alike.

APPLICABLE LARGE EMPLOYER REPORTING REQUIREMENTS

The employer reporting requirements are a key area of implementation for employers: the required information reporting under Tax Code §6055 and §6056 from the Internal Revenue Service and the Treasury Department. These employer reporting requirements are a critical link in the chain of the law's implementation. They represent what could be a significant employer administrative burden and compliance cost.

The Administration's July 2nd announcement and subsequent July 9th IRS Notice 2013-45 provides transition relief and voluntary compliance in 2014 for the Employer Reporting requirements under Tax Code Sections 6055 and 6056, and hence the Employer Shared Responsibility requirements under Tax Code Section 4980H.

The restaurant and foodservice industry welcomes this transition relief after asking the Administration and Congress for more time to receive, understand, and comply with the complex implementing regulations for Employer Reporting under Sections 6055 and 6056. As early as October 2011, the National Restaurant Association, as part of the E-Flex coalition, submitted comments to the Administration requesting transition relief and time to implement the reporting requirements under Tax Code Sections 6055 and 6056 once the rules were issued. The proposed rule from the Treasury Department concerning Tax Code Section 4980H was published in the *Federal Register* on January 2, 2013 to implement the employer mandate, and employers finally

[10] The participation rate requirement cannot be applied for plans beginning on or after January 1, 2014 as guaranteed issue and guaranteed renewability apply in the individual, small group and large group markets. See Department of Health and Human Services Final Rule: Patient Protection and Affordable Care Act; Program Integrity; Exchange, Premium Stabilization Programs, and Market Standards; Amendments to the HHS Notice of Benefit and Payment Parameters for 2014, *Federal Register,* October 30, 2013.

received the critical proposed rules on Tax Code Sections 6055 and 6056 in early September 2013.

Employers need the rules for these reporting requirements to set up the systems that will track data on each full-time employee and their dependents to then report this data to the IRS annually. While the first report was not originally required to be submitted to the IRS until January 31, 2015, six months (July-Dec 2013) was too short a time frame for employers to receive the rule, set up systems or engage vendors to develop information technology systems that would begin tracking the necessary data as of January 1, 2014. We welcome the transition relief[11] that will allow restaurant operator to understand the rules and then implement the law.

On September 9, 2013, the IRS published the Proposed Rules on Information Reporting by Applicable Large Employers on Health Insurance Coverage Offered Under Employer-Sponsored Plans (IRC §6056) and Information Reporting of Minimum Essential Coverage (IRC §6055). The proposed rule on IRC §6056 suggests a general reporting method, which asks applicable large employers to tabulate and track offers of coverage by employee and dependent tax identification number, by calendar month. This will only add to the administrative burden of compliance with the law for applicable large employers, especially for smaller operators. While simplified methods are suggested in the proposed rule, it is not likely restaurant operators will be able to utilize these on a large scale due the characteristics of our workforce.

CONCLUSION

Since enactment of the law, the industry has worked to constructively shape the implementing regulations of the health care law. Nevertheless, there are limits to what can be achieved through the regulatory process alone. Ultimately, the law cannot stand as it is today given the challenges restaurant and foodservice operators face in implementing it.

We ask you to simplify the applicable large employer determination and remove the unnecessary burdens on small businesses, who must closely track their status from year-to-year. This includes a close look at how the aggregation rules apply to small businesses such as mine. The effect of the aggregation rules, and hence our status as an applicable large employer, is that the cost of doing business for each of my small businesses will increase.

Congress must address key definitions in the law: The law should more accurately reflect restaurant and foodservice operators' needs – and our employees' desire for flexible hours.

Consider the impact the administrative burden of the law will have on small businesses like mine as we work to implement the law. The Reporting of Employer Health Insurance Coverage under IRC §6056 will certainly add to the cost of compliance as well.

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[11] "Continuing to Implement the ACA in a Careful, Thoughtful Manner," Mark Mazur, Treasury Notes Blog, July 2, 2013: http://www.treasury.gov/connect/blog/Pages/Continuing-to-Implement-the-ACA-in-a-Careful-Thoughtful-Manner-.aspx

While I did not discuss it in detail in my testimony today, we ask you to also eliminate the duplicative automatic enrollment provision for larger employers with 200 or more full-time employees. It has the potential to confuse and financially harm employees while burdening employers, without increasing employee's access to coverage.

Thank you again for the opportunity to testify before you today regarding the health care law and the effects of the business aggregation rules on small businesses like mine.

We are both proud and grateful for the responsibility of serving America's communities – creating jobs, boosting the economy, and serving our customers. We are committed to working with Congress to find solutions that foster job growth and truly benefit the communities we serve.