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RANKING MEMBER

Congress of the United States

U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, Subcommittee on Health and Technology
From: Committee Staff
Date: October 7, 2013
RE: Hearing, "The Effects of the Health Law's Definition of Full-Time Employee on Small Businesses."

On October 9, 2013, at 1:00 p.m. in Room 2360 of the Rayburn House Office Building, the Subcommittee on Health and Technology will meet for a hearing entitled: "The Effects of the Health Law's Definition of Full-Time Employee on Small Businesses." The Patient Protection and Affordable Care Act (ACA)[1] defines a full-time employee as one that works 30 hours or more per week. The hearing will examine the potential effects of this definition on employment, especially full-time employment at small businesses.

I. The Health Care Law's Requirements on Businesses

The ACA requires "large" employers to offer full-time employees the opportunity to enroll in an employer-sponsored health care plan or pay a penalty.[2] This provision is colloquially referred to as the employer mandate or the pay-or-play mandate.

The ACA defines a large employer for the purpose of the pay-or-play mandate as one that has at least 50 full-time employees.[3] The Act then delineates a full-time employee as one that in any given month works an average of 30 hours per week.[4] Given the aforementioned definitions, some small businesses, especially those in low profit margin industries, may adjust the composition of their workforces in order to avoid the strictures of the employer mandate.

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[1] Pub. L. No. 111-148, 124 STAT. 199 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010) codified in scattered sections of 20, 25, 26, 29, and 42 U.S.C. [hereinafter "the Affordable Care Act" or "the health care law"]. For ease of reference, this memorandum will cite to the United States Code rather than public law.

[2] 26 U.S.C. § 4980H(a). The type of coverage that must be offered to employees is specified at 26 U.S.C. §5000A(f)(2). Technically, the employer penalty only occurs if an employee enrolls in a plan for which the employee obtains a tax credit or when a cost-sharing reduction is allowed or paid. 26 U.S.C. §4980H(a)(2).

[3] *Id.* at § 4980H(c)(2)(A).

[4] *Id.* at §4980H(c)(4)(A).

While the Act was intended to benefit workers, the parameters of the Act may have unintended adverse consequences on workers, especially those in small businesses. The rest of the memorandum will analyze the unintended consequences of the law.

II. IRS Implementation of the ACA

The ACA requires the Internal Revenue Service (IRS or Service) to collect penalties when a violation of the employer mandate occurs.[5] The IRS issued a proposed rule to implement both the employer mandate[6] and the calculation of penalties.[7] Penalties are calculated on a monthly basis as the product of the number of full-time employees multiplied by $166.67 (1/12 of $2,000).[8] If a firm offers employees health insurance that meets the minimum statutory standards set out in § 5000A(f)(2) of the Internal Revenue Code but at least one employee during the month purchased insurance that qualifies for a tax credit premium or cost-sharing reduction (i.e., the employer-sponsored insurance is not affordable), the monthly penalty is calculated as the product of the number of employees multiplied by $250 (1/12 of $3,000).[9]

As already noted, the employer mandate only affects those businesses with 50 or more full-time employees.[10] There is some concern that businesses with less than 50 full-time employees might not hire new employees if they are then forced to provide affordable qualifying health insurance for their employees or might convert full-time employees to part-time employees to stay below the trigger for the employer mandate.

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[5] *Id.* at § 4980H(b).

[6] The employer mandate was supposed to commence on January 1, 2014, including the imposition of penalties. However, the Service delayed the implementation of the penalties (and associated information collection) for one year. I.R.S. Notice 2013-45, 2013-31 I.R.B. 116, *available at* http://www.irs.gov/pub/irs-irbs/irb13-31.pdf.

[7] Shared Responsibility for Employers Regarding Health Care Coverage, Proposed Rule, 78 Fed. Reg. 218 (Jan. 2, 2013) [hereinafter "Proposed Rule"). The IRS determined that the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA) does not apply to the Proposed Rule. The Service contends that the proposal is not required to be issued pursuant to the notice and comment requirements of the Administrative Procedure Act and does not impose a collection of information on small entities. The latter assertion is simply irrelevant since the condition in the RFA concerning collection of information only applies if the IRS is issuing an interpretative rule and the Proposed Rule cannot be considered "interpretative" as that term is used in the Administrative Procedure Act. An even cursory glance of the Proposed Rule shows that the Service is filling numerous gaps in the statutory definitions of what constitutes a large employer, including rules on how to calculate what a large employer is for firms not subject to aggregation rules in section 414 of the Internal Revenue Code. Thus, there is little doubt that the Proposed Rule must be issued pursuant to the notice and comment procedures of the Administrative Procedure Act and, as a result, the RFA applies.

[8] 26 U.S.C. § 4980H(a)(2); *see also* Proposed Rule, 78 Fed. Reg. at 233. For purposes of the liability calculation under this section, an applicable large employer's number of full-time employees is reduced by 30. *Id.* at 250-51.

[9] 26 U.S.C. § 4980H(b)(1)(B); *see also* Proposed Rule, 78 Fed. Reg. at 235.

[10] In many industries, particularly those associated with manufacturing and wholesaling, a 50-employee firm would be considered small given the size standards developed by the Administrator of the Small Business Administration to implement § 3 of the Small Business Act.

III. Defining the 30-Hour Week

The Service's proposed regulations establish a variety of methods employers may utilize in determining whether an employee is full-time.[11] Many of these methods require employers to retrospectively calculate the employee's status, known as the "look-back" measurement period.[12] If an employee worked an average of more than 30 hours a week in any preceding month, and the employer did not provide health insurance that qualifies and is affordable, the employer could be liable for a penalty for each of those months.

Although the proposed regulation allows employers to utilize multiple measurement periods and provides a measure of flexibility to small businesses to account for their unique circumstances,[13] small firms often lack the administrative capacity of larger businesses and may find it difficult to determine the appropriate method of calculating employee status[14] or understand the various exemptions for certain employees.[15]

IV. Effect of the 30-Hour Work Week Full-Time Employee Definition on Employment with Small Businesses

The extent to which employers may alter the composition of their workforce due to the health care law may depend on a number of factors. According to one study, some of these factors include the type of industry in which a worker is employed; whether firms in the industry typically employ a large number of workers working more than 30 hours per week, but less than 40 hours per week; and the average wages paid to occupations in these industries.[16]

According to a recent survey of small business owners and executives, 27 percent report that they will reduce full-time employees, 24 percent will reduce hiring, and 23 percent intend to replace full-time employees (30 hours per week or more) with part-time workers to avoid triggering the mandate.[17] A similar study by the International Foundation of Employee Benefit Plans found that nearly 20 percent

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[11] *Id.* at 243-249. A complete description of these methods is beyond the scope of this memorandum.
[12] *Id.* at 243. Regardless of the method an employer chooses, the look-back measurement period is to begin no later than July 1, 2013. *Id.* at 237.
[13] Proposed Rule, 78 Fed. Reg. at 242-43.
[14] The proposed rule establishes different measurement methods for different types and classes of employees. For example, ongoing employees are calculated using one method, while new variable and non-variable hour employees are calculated using other methods. *Id.* at 245-246.
[15] For example, certain seasonal workers are exempt. *Id.* at 243.
[16] UNIVERSITY OF CALIFORNIA AT BERKLEY, LABOR CENTER, DATA BRIEF, WHICH WORKERS ARE MOST AT RISK OF REDUCED HOURS UNDER THE AFFORDABLE CARE ACT 3 (February 2013), *available at* http://laborcenter.berkeley.edu/healthcare/reduced_work_hours13.pdf.
[17] UNITED STATES CHAMBER OF COMMERCE, Q2 SMALL BUSINESS OUTLOOK STUDY 3 (July 16, 2013), *available at* http://uschambersmallbusinessnation.com/uploads/Chamber%20Small%20Business%20Survey%20Q2%207%2016%2012.pdf.

of businesses with 50 or fewer workers already have or expect to reduce employee hours over the next twelve months in order to avoid the health law's mandates.[18]

The economists at UC-Berkley estimated that workers in industries with high percentages of employees working slightly over 30 hours per week, such as restaurants, nursing homes, and retailers, are very vulnerable to a reduction in work hours once the employer mandate takes effect.[19] Overall, the study estimates that up to 10 million workers may be at risk of having their work hours reduced in order for employers to avoid the mandates of the health care law.[20]

In addition, the 30-hour work week may reduce the flexibility small employers need to efficiently manage their workforce, especially in industries where consumer demand for products and services is highly variable. Similarly, employees in these industries may experience a reduction in work hours as employers struggle to ensure that the employee's hours do not regularly exceed 30 hours a week.

V. Potential Employer Liabilities in Reducing Employee Hours

While the health law provides a compelling economic incentive for employers to reduce employee work hours, small businesses may be concerned that doing so could result in liabilities under other federal labor laws.[21] Specifically, provisions in the Employee Retirement Income Security Act generally prohibit employers from taking actions against employees to prevent them from being eligible for benefits.[22] An employer who sponsors affordable qualified health coverage could be subject to litigation from employees and civil penalties if the sole reason an employee's hours have been reduced is to prevent them from participating in a benefit plan.

VI. Conclusion

Most policy decisions involve tradeoffs between preferred and unwanted outcomes. At a time when the economy is producing too few well-paying full-time jobs, the health care law's definition of 30 hours per week as full-time employment, may result in a tradeoff between access to health insurance for some who were previously uninsured and reduce employment opportunities for others. As most new jobs are created by small employers, these mandates can be a barrier to new job creation.

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[18] INTERNATIONAL FOUNDATION OF EMPLOYEE BENEFIT PLANS, 2013 EMPLOYER-SPONSORED HEALTH CARE: ACA'S IMPACT, SURVEY RESULTS 17 (March 19, 2013), *available at* http://www.ifebp.org/pdf/research/2103ACAImpactSurvey.pdf.
[19] *Id.*
[20] *Id.*
[21] Allen Smith, *Critics Say PPACA May Encourage Part-Time Society,* SOCIETY OF HUMAN RESOURCE MANAGEMENT, May 22, 2013, *available at* http://www.shrm.org/LegalIssues/FederalResources/Pages/Part-time-society.aspx.
[22] 29 U.S.C. § 1140.

Some of these impacts could be minimized by substituting the law's current definition of full-time employee with a standard more aligned with other federal full-time employee definitions.[23] For example, the President and Congress may consider enacting legislation introduced in the House of Representatives, H.R. 2575, the Save American Workers Act,[24] which would change the health law's definition of full-time employee to 40 hours per week.

[23] For example, under the Fair Labor Standards Act, 5 U.S.C. §550.111, 40-hours per week is the threshold for determining the eligibility of certain classes of workers for overtime pay.
[24] The Save American Workers Act of 2013, H.R. 2575, 113th Cong. (2013)