White Paper

The Patient Protectionand Affordable Care Act: AGeneral Summary oftheControlled Group Rules

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The Patient Protection and Affordable Care Act ("ACA") requires employers with 50 or more full-time equivalent employees ("FTE") to offer affordable coverage or pay a monthly, non-deductible tax penalty if any one of their full-time employees (those working on average at least 30 hours per week) obtains coverage in a public exchange and receives a federal subsidy. The annual penalty for those employers who do not offer *any* group health insurance is $2,000 multiplied by every one of the employer's full-time employees (reduced by the first 30). For those employers who offer coverage that is deemed not affordable, the annual, non-deductible penalty is the *lesser of* $3,000 multiplied by the number of full-time employees who receive subsidized coverage on an exchange or $2,000 multiplied by each full-time employee (reduced by the first 30). The penalty tax is assessed on a monthly basis.

Those with limited understanding of ACA's provisions have suggested that an employer might simply break its company into smaller entities, each with its own taxpayer identification number, to avoid the application of the penalty; that is, the suggestion is that an employer with 90 FTE employees could break its company into two separate entities, each with 45 FTE, and avoid application of this provision of ACA. As with a lot of advice that provides an *easy* fix to any concern, this bit of advice is too good to be true. It does not work.

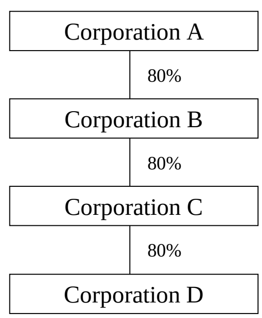
For purposes of determining whether an employer is a large employer, with 50 or more FTE, and for purposes of determination and assessment of the penalty described above, ACA requires employers to count employees on a "controlled group" or an "affiliated service group" basis. In general, this means that employees of businesses with common owners (or, in some cases, that perform services for each other) will need to be aggregated—combined—for purposes of counting.

This article provides a general summary of the controlled group rules. It is not intended to be legal advice and does not purport to address all the issues attendant to a determination of controlled group status. Rather, this article highlights ownership considerations and issues that businesses might consider when attempting to assess whether the employer should be concerned about controlled group issues for purposes of ACA. Those who believe they may need to determine whether they are part of a controlled group are strongly cautioned to consult with an attorney familiar with these rules. These are complex rules and no attempt is made here to provide full instruction on all applicable rules. In a word, assessment of controlled group analysis is simply not something anyone should try at home.

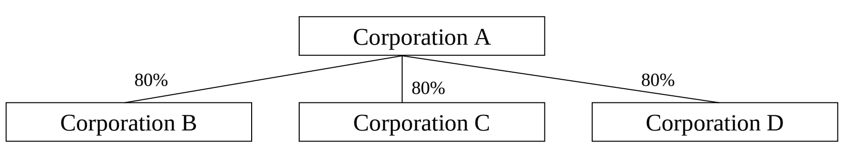
With that caveat in mind, the following is a brief overview of the controlled group and affiliated service group rules. Under federal law (the U.S. Internal Revenue Code), employers with a sufficient degree of *common ownership* are treated as a single employer when certain ownership rules are applied. Under the general scheme of the common ownership rules, two or more business entities are related if they are a "*parent-subsidiary group*" or if they are a "*brother-sister group*".

Parent-Subsidiary Controlled Groups

A parent-subsidiary controlled group exists when one business entity owns a controlling interest in another business entity. For this purpose, a controlling interest is generally an 80% or greater interest. In the case of a corporation, this means ownership of 80% or more of the total combined voting power of all classes of stock of the corporation entitled to vote, or ownership of 80% or more of the total value of all shares of stock of a subsidiary corporation. In a partnership, a controlling interest is ownership of 80% or more of the profits interest or capital interest. A parent-subsidiary controlled group can also consist of a chain of businesses linked by 80% ownership, as for example, when a subsidiary itself owns at least 80% of yet another business. For example, if Corporation A owns 80% or more of Corporation B and Corporation B is an 80% partner in Partnership C which, in turn, owns 80% or more of Corporation D, then Corporation A, Corporation B, Partnership C and Corporation D are a parent-subsidiary controlled group.



Alternatively, common ownership through a parent-subsidiary controlled group can be established by a parent corporation that has a direct 80% or greater ownership interest in any number of businesses.
For example, if Corporation A owns 80% or more of each of Corporation B, Corporation C and Corporation D, then Corporation A, Corporation B, Corporation C and Corporation D are a parent-subsidiary controlled group.



Note: For benefits purposes, sometimes a percentage lower than 80% is used to determine common ownership. Employers should also talk to counsel when applying these rules.

Similar controlled group rules apply to not-for-profit entities, as well. A controlled group exists where one entity has a controlling interest in another not-for-profit entity. This may happen when 80 percent of the trustees or directors are also trustees, directors, agents or employees of the other organization or the other organization has the power to remove a trustee or director.

Brother-Sister Controlled Group

Parent-subsidiary controlled groups may be (but are not always) fairly obvious. Less obvious are ***brother-sister controlled groups***. The can occur even in the case of a number of completely unrelated businesses. The rules: a brother-sister controlled group exists if the *same five or fewer* individuals (or entities) own (directly or indirectly) 80% or more of two or more businesses and also own more than 50% of those businesses when taking into account only the smallest percentage of ownership each individual owner has in each of the businesses.

Consider the following example. Al, Betty and Charles each have an ownership interest in three distinctly different businesses, X-Ray Photo Shop, located in New York City, Yellow Tag Flowers, located in Atlanta, Georgia and Zoom-In Auto Repair, located in Peoria, Illinois.

Their ownership interest in each is as follows:

	Al	**Betty**	**Charles**
X-Ray	20%	30%	25%
Yellow Tag	40%	10%	45%
Zoom-In	20%	40%	25%

To determine whether a controlled group exists, first add up ownership interests to see if the same 5 or fewer people (or entities) own more than 80%. In the above example, Al, Betty, and Charles' combined ownership in X-Ray is less than 80% (it's 75%). You can remove X-Ray from consideration as a controlled group for purposes of ACA because the first hurdle, the 80% hurdle, is not crossed. However, Al, Betty and Charles collectively own a 95% interest in Yellow Tag, and an 85% interest in Zoom-In. So, with the first hurdle crossed, one would consider whether there is a 50% overlapping interest by looking at the smallest percentage ownership that each of Al, Betty and Charles owns. In this case, its 20% (in Zoom-In) for Al, 10% (in Yellow Tag) for Betty and 25% (in Zoom-In) for Charles. Adding 20% to 10% and 25% equals 55%.

Because Al, Betty and Charles own controlling interests in Yellow Tag and Zoom-In of 95%, which is greater than 80%, and an overlapping interest in each of the same entities of 55%, which is greater than 50%, Yellow Tag, a flower shop in Georgia and Zoom-In, an auto repair shop in Illinois, are part of the same controlled group (their combined ownership is in excess of 50%). If Yellow Tag has 10 FTE and Zoom-In has 45 FTE, then the controlled group of Yellow Tag and Zoom-In is considered a large employer for purposes of the pay-or-play mandate under ACA, because combined they have over 50 FTE. This is true even though the individuals running Yellow Tag on a day-to-day basis do not even know that Zoom-In exists, and vice versa.

Assuming that all employees of Yellow Tag and Zoom-In are full-time employees working on average at least 30 hours per week, this means that if Yellow Tag opts out from providing benefits to its employees and their dependents, Yellow Tag's annual penalty may be $2,000 multiplied by 25 full-time employees, 15 more full-time employees than are employed by Yellow Tag. Why? Because the annual penalty, assessed on a controlled group basis if one of Yellow Tag's employees receives subsidized exchange coverage is $2,000, multiplied by all full-time employees (on a controlled group basis), reduced by the first 30.

Affiliated Service Groups

If a company regularly performs specified types of personal services or management functions with or for related entities it may be part of an "affiliated service group" even if the ownership rules for a Parent-Subsidiary or Brother-Sister controlled group are not in play. Affiliated service groups are, in general, a group of businesses working together to provide services to each other or jointly to customers. Affiliated service groups occur in the personal services sectors and are problematic with the following types of entities:

- ✓ Accounting
- ✓ Actuarial science
- ✓ Architecture
- ✓ Consulting
- ✓ Engineering
- ✓ Health (including doctors, dentists, chiropractors, optometrists, podiatrists, psychologists, and veterinarians)
- ✓ Insurance
- ✓ Law
- ✓ Performing arts

Employers in these personal services industries that maintain a management or personal services relationship with another entity—even if there is no significant cross ownership—should always consult with counsel to determine whether they are part of an affiliated service group.

Conclusion

For purposes of determining whether an entity has 50 or more FTE for purposes of "pay or play" mandates, and for purposes of determining whether and how the penalties might apply, entities are "counted" on a controlled or affiliated service group basis.

These rules typically look for a certain percentage of ownership to be present or for the provision of services between certain types of business entities. These rules are complex and the analysis to determine whether an entity is part of a controlled or affiliated service group should always be done by a lawyer or accountant who understands these rules. The regulations include attribution rules for stock ownership and other complex concepts. Those who believe a controlled group might exist should seek assistance in making that determination.

DISCLAIMER*: This information is provided as general guidance by your ProSential broker. It is not intended to be and should not be deemed to be legal advice. It is not intended to be a comprehensive review of the applicable rules and cannot be relied on for that purpose. In addition, regulations specifying how these rules will be applied with respect to ACA have not been released as of the date this guidance piece was drafted (December 2012). It is possible that the regulations may alter the application of these rules with respect to ACA. Always check with qualified benefits counsel for the latest releases.*

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