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**Common Knowledge – Determining
Who is a Common Law Employee and
Counting Them Under the Affordable
Care Act**

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Topics for Discussion

- Defining the Issue
- Determining Common Law Employee Status
- DOL Recent Guidance on Independent Contractor Status
- Special Classes of Employees – Leased/Staffing Agency Employees/PEO Employees
- Union Employees/Seasonal Workers
- Orientation/Waiting Period Implications
- How to Count the Worker for Large Employer Status

Defining the Issue

- Up to 30% of employers misclassify workers
 - Independent contractor
 - Someone else's employee
- 3.4 million workers are contractors, when they should be employees

Defining the Issue

- Revenue loss to US Treasury is \$3.4 billion, annually
 - Income tax
 - Social Security
 - Medicare
 - Unemployment Insurance Trust Fund

General Legal Risk of Worker Misclassification

- Employment taxes
 - Past federal payroll taxes (3 years back, or more)
 - State payroll taxes
 - Up to 100% penalty—if willful failure
 - Income tax not withheld
 - Trust fund recovery penalty for responsible persons
- Minimum wage and overtime
 - Minimum wage/over time (up to 6 years)
 - Liquidated damages (100% penalty)
 - Application of damage model to all workers in same job, not just individual worker
 - DOL supervision over payment of wages
 - Attorneys' fees and costs

General Legal Risk of Worker Misclassification

- Unfair labor practices liability (different test than IRS)
- Unions see independent contractors as potential members
- Violation of terms of government contracts as to prevailing wage, etc.
- Employee benefit plan operational failures (Note: No statute of limitations)

More on Health Plan Exposure

- Premium costs
- Lost benefits
- Loss of income tax exclusion for premium costs of highly compensated employee/participants
- Disqualification of cafeteria plans/flexible spending arrangements

More on Benefit Plan Exposure

- Draft **ALL** employee benefit plans so that workers who are inadvertently excluded from plan participation due to misclassification are not permitted an award of past benefits

The ACA and Worker Classification

- The inquiry into whether a business is an “applicable large employer that must “pay or play” requires employers to “count” full-time and full-time equivalent “employees”
- The obligation to make an offer of minimum essential coverage requires the employer to determine who are full-time “employees” under the ACA
- The determination of the nature and amount of exposure to penalties under Code section 4980H thus requires, as a threshold matter, that the business identifies who, among its various workers and service providers, are “employees”

Play or Pay/Employer Shared Responsibility

- Applicable Large Employers (ALEs) that fail to **offer** their full-time employees and their dependents group health plan coverage that is **affordable** and provides **minimum value** are subject to penalties if a full-time employee enrolls in Marketplace coverage and receives a premium tax credit or cost-sharing reduction
- No Offer Penalty = \$2,000 per year for each full-time employee in excess of 30 (80 in 2015)
- Inadequate Coverage Penalty = \$3,000 per year for each full-time employee who enrolls in Marketplace coverage and receives a subsidy

The “Classification Test” Under the ACA

- To classify workers, the ACA Proposed Regulations rely upon the Treasury Regulations promulgated under the specific provisions of the Internal Revenue Code governing payroll taxes
- These Regulations adopt a federal common law analysis to determine who is an “employee”
- The Regulations require a company to focus upon whether the worker or the company controls the nature of the work that must be done and manner in which the work shall be accomplished

The Classification Analysis

Publication 15-A, *Employer's Supplemental Tax Guide* (January 29, 2013) creates three types of workers

- Independent Contractors
- Statutory Employees
 - Drivers who distribute beverages, meat, vegetables, laundry
 - Full-time insurance agents who work primarily for one insurance company
 - At-home “piece work” workers (such as seamstresses)
 - Full-time sales persons of certain wholesale or retail goods
- Common Law Employees
 - Facts showing behavioral control
 - Facts indicating financial control
 - Facts demonstrating the nature of the parties' relationship

Statutory Non-employees

- Licensed Real Estate Agents
 - Real estate sales agents and brokers
 - Real estate appraisers
- Direct Sellers
 - Persons who solicit sales of products from homes or businesses
 - Newspaper distributors to homes
- Companion Sitters
 - Personal attendants to the elderly
 - Nannies who care for children
 - Individuals who provide household care services to the elderly

Common Law Employee Behavioral Control

Analysis examines evidence indicating whether the company provides instruction to the worker as to:

- When and where to work;
- What tools or equipment to use;
- Where to purchase supplies;
- Who, among workers should perform what task;
- Which of many tasks comprising the job should be undertaken in what order; and
- Whether the company trains the worker as to the services performed

Common Law Employee Financial Control

Analysis examines evidence of facts demonstrating whether the worker effectively is operating his or her own business:

- Whether the worker bears the risk of profitability in the relationship;
- Whether the worker incurs costs of operating the business;
- The extent to which the worker makes a significant investment in the place of work and tools of work;
- The degree to which the worker advertises his or her services to other non-related companies; and
- How the worker is paid (regular, guaranteed incremental payments indicate worker is employee)

Common Law Employee Nature of the Relationship

The Analysis examines evidence indicating:

- Whether the relationship between the worker continues indefinitely or exists only for the duration of a specific project;
- Whether the workers' services are an integral aspect of the company's regular business activity;
- Whether the worker's services are key to the company's ability to render services or provide products to customers;
- Whether a written contract for services exists between the parties (Note: the existence of a written contract will be disregarded if other factors indicate a common law employment relationship exists); and
- Whether the worker or the company provides insurance, benefits, vacation pay, etc.

Leased or Temporary Employees

- Under the ACA, a leased worker will be deemed an employee if the worker is an employee under the federal tax common law analysis
- Pension plans (See IRS Pub. 560)
 - Common law analysis is still over-riding consideration
 - General rule is leased worker must be treated as the employee of the company that is the recipient of services if:
 - The worker provides services under an agreement between service recipient and the leasing organization
 - The worker has performed services full-time for at least a year
 - The worker performs services under the recipient company's direction and control
 - But an exception exists
 - If leased workers are not more than 20% of non-highly compensated employees
 - Lease worker is covered under leasing company qualified pension plan
 - Pension plan is money purchase plan that has (a) immediate participation; (b) full and immediate vesting; and (c) employer contribution of at least 10% for each participant

Recent DOL Guidance on Misclassification of Employees as Independent Contractors

- For Fair Labor Standards Act (FLSA) purposes
- FLSA uses an “economic realities” test rather than common law control (ACA uses common law test)
 - A multi-factorial test which focuses on whether the worker is economically dependent on the employer or in business for himself
- Brings more workers into employee status – most workers employees for FLSA purposes
- Proposed special OSHA rule for franchisers and franchisees

Worker Classification Scenarios

- Arrangements with individual
- Arrangements with Third Party Contractors
 - Temporary agency for short-term assignment/possible not common law employee
 - Temporary agency as hiring function/likely common law employee
 - Professional Employer Organization (PEO)/likely common law employee
 - Outsourcing Ancillary Function/good possibility not common law employees

Who is an Applicable Large Employer?

- “ALE” means the employer had an average of 50 or more full-time and **full-time equivalent** employees on business days in prior calendar year
- Employer status is determined on controlled group basis; different EIN does not mean different employer for determining ALE status

ALE Determination

- First – Determine number of full-time employees
 - A full-time employee is an individual who is expected to work at least 30 hours per week or 130 hours per month
- Second – Hours of all other employees must be counted to determine how many “Full-Time Equivalent” employees exist
 - Part-time employees are considered to determine whether an employer is “Large,” part-time employees do not need to be offered coverage to avoid the penalty

ALE Determination

- Fractional employees are counted for determining how many full-time equivalent employees exist
- Calculation of “Full-Time Equivalent” = The aggregate hours of service in a month of all employees who work an average of less than 30 hours per week (up to 120), divided by 120 hours. The result is the number of Full-Time Equivalent employees for that month
- Example
 - 6 workers each work 100 hours per month
 - $600 \div 120 = 5$ Full-Time Equivalent employees

Seasonal Workers for ALE Determination

- Generally **seasonal workers** are included for ALE determination
- Seasonal worker is a worker who performs services on a seasonal basis as defined by DOL, including retail workers used exclusively during holiday seasons
- Distinguish seasonal employee for penalty tax
- Avoid ALE status if
 - Workforce exceeds 50 full-time employees for 120 or fewer days during the calendar year, and
 - The employees in excess of 50 employed during the 120 day period were seasonal workers

Special Rule for Veterans for ALE Determination

- July 2015 legislation
- Do not count veterans for ALE determination if the individual has coverage through the military (e.g., TRICARE) or VA health care programs
- Determined on a monthly basis

What is a “Full-Time Employee” for Penalty Purpose?

- Common law employee definition
- Full-time = employed on average 30 or more hours per week (130 hours per month)
- For salaried employees, can count hours or use equivalencies (8 hours/day; 40 hours/week)
- Can use month-by-month or look back measurement period
- Look-back measurement period can be used for variable, seasonal and part-time employees

Leased Employees/Agency Employees/Staffing Employees

- Determine who is properly considered the common law employer
- Examine leasing contracts for language regarding provision of health plan by leasing organization
- In the event the recipient employer is the common law employer, coverage offered by the leasing organization can satisfy the recipient employer's obligation to offer coverage if part of the fee the recipient employer pays to the leasing organization takes into account the provision of coverage
- Consider requiring indemnification for any ACA penalty in the event the recipient employer is determined to be a common law employer
- Draconian downside – fail to offer to substantially all full-time employees/ALE status

Staffing Firm/PEO Approaches to Employees

- Option 1 – Determine not common law employee/do nothing
 - Assume the risk
- Option 2 – Require staffing firm/PEO to offer coverage using IRS safe harbor
 - Amend contract
 - Still a mandatory reporting issue – who reports
 - If common law employee of recipient organization, recipient organization must report the worker
 - May want contract that staffing firm will comply or provide the necessary information to service recipient
- Option 3 – Manage hours to the 130 hour/month threshold

PEO – ABLE Act

- Beginning in 2016, the ABLE Act will require PEO to be responsible for employment taxes and withholding
- However, not a pass for anything else, e.g., ACA

Specific Exclusions from Common Law Employee Status

- Sole proprietors
- Partners
- 2% S-Corporation shareholders

Non-U.S. Citizen/Foreign Workers

- A non-U.S. citizen residing in the U.S. on a temporary U.S. Visa is an employee for ACA purposes
- Employees working abroad are not counted as employees for ACA purposes – both U.S. citizens and non-U.S. citizens
- Only lawful workers can obtain exchange coverage

Variable and Seasonal Employees

- Variable Hour Employees = impossible to determine whether they will average at least 30 hours a week/good faith determination
- Seasonal Employees = hired into a position for which the customary annual employment is 6 months or less
- If a Variable, Seasonal or Part-Time Employee averages at least 30 hours a week over a “Measurement Period,” he or she is treated as a full-time employee for the following “Stability Period”
- Plan document should specifically exclude seasonal employees if that is the employer’s intent

Special Classes of Employment

- Final regulations addressed certain unique situations:
 - Hours of Service as a “bona fide volunteer” are excluded
 - Special rules for educational organizations and commissioned salespeople
 - No exception for short-term, temporary and high-turnover employees

Union Employees

- No exclusion of employees covered by collective bargaining agreement (CBA)
- Employer can use multiemployer plan offer as employer's offer if the multiemployer plan is offering minimum value, affordable coverage
- Employer enters Line 2E on Line 16, Form 1095-C; Fund sends Form 1095-B to employee for mandatory reporting
- Employer and Fund have to coordinate about when coverage commences
- Effect on CBA negotiation?

Leaves and Rehires

- If there is a Break in Service of less than 13 weeks, the employee:
 - Is treated as an ongoing employee upon return
 - Retains the status he or she had prior to the break
 - Must be offered coverage as soon as administratively practicable after return (by first of month following resumption of service) if he or she was considered full-time prior to the break

Leaves and Rehires

- If an employee has a break of at least 13 weeks or more, the employee:
 - May be treated as a new hire upon return
 - May be subjected to an initial measurement period if part-time, seasonal or variable
 - Employer is entitled to another 3 month limited non-assessment period, provided minimum value coverage is offered after 3 months, i.e., can hold out of plan for 3 months upon rehire

Eligibility Waiting Period/ Orientation Period

- Eligibility Waiting Period - No more than 90 days; applies to all plans
- Orientation Period
 - Up to one month orientation period, in addition to 90 day waiting period, permitted as a condition of eligibility
 - Begins with start date
 - Employers should review handbooks/policies regarding probationary periods
 - Must be bona fide -
 - Parties evaluate whether employment situation is satisfactory
 - Standard orientation and training processes begin
 - May not be a mere passage of time
- Caution – many employers have longer probationary/orientation periods that may need to be revised/evaluated with regard to health plan eligibility



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ANY QUESTIONS?



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