

# ERISA INDUSTRY COMMITTEE

## FOCUSON CONFERENCE CALL: VARIABLE HOUR AND COMMON LAW EMPLOYEES

June 24, 2014

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# Agenda and Overview

- Context—Assessing “full-time” employee status for Code §4980H purposes
- Methods for determining “full-time” employee status
  - The monthly measurement method
  - The look-back measurement method
  - What methods are best suited to which employers?
- Full-time, variable hour, seasonal, and part-time employees
- Transition to “on-going employee” status
- Compliance strategies—compliant and abusive
  - Capping annual hours

## Agenda and Overview

- Compliance strategies—compliant and abusive
  - Capping/tracking annual hours
  - Capping/tracking monthly hours
- Special rule for “offer[s] of coverage on behalf of another entity” (under Treas. Reg. §54.4980H-4(b)(2))
  - The “common law employee” conundrum
  - Contractual solution (for Code §4980H purposes only)
  - Long-term compliance issues
  - Suggested plan amendments (“inoculation language”) for client organization welfare plans

# The Backstory: IRS Notice 2011-36

## **Rational for Variable Hour Classification**

“A determination of full-time employee status on a monthly basis for purposes of calculating an employer’s potential § 4980H liability may cause practical difficulties for employers, employees, and the State Exchanges. These difficulties include uncertainty and inability to predictably identify which employees are considered full-time and, consequently, inability to forecast or avoid potential § 4980H liability. *This issue is particularly acute in circumstances in which employees have varying hours or employment schedules (e.g., employees whose hours vary from month to month or who are employed for a limited period).*” (Emphasis added).

# Full-Time Employees

## ACA Definition

A full-time employee means, with respect to a calendar month, a “common law employee” who averaged 30 or more hours of service per week or, if the employer elects, had 130 or more hours of service in the calendar month

## Common Law Standard

Under common law standard, an individual is an “employee” if 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:

- (i) The result to be achieved by the work, but also
- (ii) The details and means by which the result is achieved

# Measurement Methods

## Monthly Measurement Method

- An employer determines each employee's status as a full-time employee by counting the employee's hours of service for each month
- Coverage need not be offered during the first three full months of employment

## Look-back measurement method

- An employer may determine the status of an employee as a full-time employee during a future period (referred to as the "stability period"), based upon the hours of service of the employee in a prior period (referred to as the "measurement period")
- Does not apply for purposes of determining whether an employer is an applicable large employer

## Measurement Methods (cont'd)

- Measurement methods may be applied by categories:
  - Salaried employees and hourly employees;
  - Employees whose primary places of employment are in different states;
  - Collectively bargained employees and non-collectively bargained employees; and
  - Each group of collectively bargained employees covered by a separate collective bargaining arrangement
- Rules for transitioning from one measurement period to the other in the case of a change in employment status

## Monthly Measurement Method

- Full-time status determined based on hours worked during a calendar month
- Monthly measurement based on weeks per calendar months
  - Period measured for the month must contain either the week that includes the first day of the month or the week that includes the last day of the month
  - Four-week calendar months – 120 hours or more is full-time
  - Five-week calendar months – 150 hours or more is full-time



## Look-Back Measurement Method

- Answers the question, “What if I don’t know if a new hire is going to be full time?”
  - Applies to new variable-hour, new seasonal employees, new part-time employees, and ongoing employees
  - Does not apply to full-time employees
- Hours are tested during the measurement period: If employee works 30 hours per week on average during the measurement period, he or she must be covered during the stability period, irrespective of hours
- Special rule for breaks-in-service and service-spanning rules for certain unpaid leave

## Which Method is Best?

- Answer: It depends
- Monthly measurement method appears best suited for employers with stable employment, who:
  - Tend to offer robust, major medical benefit to the vast majority of their full-time employees
  - E.g., banking and finance, IT, professional services
  - Residual risk of 4980H exposure in some instances
- Look-back measurement method is best suited to employers with large cohorts of variable or contingent workers (e.g., restaurants, franchise, staffing, hospitality, retail, etc.)

## Variable Hour Employees

- An employee is a variable hour employee “if, based on the facts and circumstances at the employee’s start date, the applicable large employer member cannot determine whether the employee is reasonably expected to be employed on average at least 30 hours of service per week during the initial measurement period because the employee’s hours are variable or otherwise uncertain”
- Factors considered in making a variable hour determination include but are not limited to:
  - Whether the employee is replacing an employee who was a full-time employee or a variable hour employee;

## Variable Hour Employees (cont'd)

- The extent to which the hours of service of employees in the *same or comparable positions* have actually varied above and below an average of 30 hours of service per week during recent measurement periods; and
- Whether the job was advertised, or otherwise communicated to the new employee or otherwise documented (for example, through a contract or job description) as requiring hours of service that would average at least 30 hours of service per week, less than 30 hours of service per week, or may vary above and below an average of 30 hours of service per week

## Variable Hour Employees (cont'd)

- Additional factors for employees placed through staffing firms include, but are not limited to, whether:
  - Other employees in the *same* position of employment with the temporary staffing firm, as part of their continuing employment, retain the right to reject temporary placements that the temporary staffing firm offers the employee;
  - The employees typically have periods during which no offer of temporary placement is made;
  - The employees typically are offered temporary placements for differing periods of time; and
  - The employees typically are offered temporary placements that do not extend beyond 13 weeks

# Seasonal and Part-Time Employees

- A seasonal employee means an employee in a position for which the customary annual employment is six months or less (Treas. Reg. §54.4980H-1(a)(38))
- A part-time employee means:
  - A new employee who the applicable large employer member reasonably expects to be employed on average less than 30 hours of service per week during the initial measurement period (Treas. Reg. §54.4980H-1(a)(32))
  - Whether an employer's determination that a new employee is a part-time employee is reasonable is based on the facts and circumstances at the employee's start date.

## Seasonal and Part-Time Employees (cont'd)

- Factors to consider in determining a new employee's full-time employee status are set forth in §54.4980H-3(d)(2)(ii) described above
- Seasonal and part-time employees to be treated under the same rules applicable to variable hour employees

## “Variable Hour” Testing Framework

- Is the newly hired employee, based on the facts as of the date of hire, and disregarding the length of the anticipated assignment full-time?
- If yes, coverage must be offered as of the first day of the 4<sup>th</sup> month of employment
- If no, the employee is either variable hour, seasonal or part-time



## The Testing Framework (cont'd)

- Once the employee's service spans a full standard measurement period, he or she is an "ongoing employee"
  - His or her status as variable hour, seasonal, or part-time (as the case may be) drops away and is subsumed in ongoing employee status
- Employers can be more generous than the rule requires, i.e., employees in a particular class, division, line of business, etc. can be presumed eligible for coverage irrespective of hours *for Code §4980H purposes*
- Whether this works under applicable non-discrimination rules (Code §105(h); PHS Act §2716) is another matter

## Capping Annual or Monthly Hours

- Capping annual hours of variable hour employees in advance at 1560 (or less) will not likely comply with the variable hour rules, since the “factors” that need to be considered are not (considered)
- Capping annual hours of ongoing employees may work under Code § 4980H, but
  - May run afoul of ERISA § 510;
  - Query whether this is problematic if the ongoing employee is scheduled to work full-time hours for, say, nine months
- Capping monthly hours will likely work, but ERISA § 510 will likely play some role

## Offers of Coverage/Unrelated Employers

- An offer of coverage made by a staffing firm on behalf of a client organization under a plan maintained by the staffing firm, is treated as an offer of coverage made by the client, if
  - The fee the client employer would pay to the staffing firm for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay to the staffing firm for the same employee if the employee did not enroll in health coverage under the plan
- While welcome, this rule does not itself address determination of common law employee status, but that determination poses some critical challenges

## Why the “Fee”

- If the staffing firm is not the employer but offers the coverage, then:
  - The employee does not qualify for the exclusion from gross income under Code § 105(b) of the deduction under Code § 106 (see, e.g., Treas. Reg. § 1.5000A-2(c)(1)(ii)—“A self-insured group health plan under which coverage is offered by, or on behalf of, an employer to the employee”); and
  - The employee does not pre-tax contributions under Code § 125
- If the client neither sponsors nor pays for the coverage, the plan is not sponsored by or on the client's behalf
- This is a tacit admission that the plan that is sponsored by the staffing firm is a MEWA

# Common Law Employee Definitions

## **20-Factor Test: Revenue Ruling 87-41**

Instructions; training; integration; services rendered personally; hiring, supervising, and paying assistants; continuing relationship; set hours of work; full time required; doing work on employer's premises; order of sequence set; oral or written reports; payment by hour, week, month; payment of business and/or traveling expenses; furnishing of tools and materials; significant investment; realization of profit or loss; working for more than one firm at a time; making service available to general public; right to discharge; and right to terminate

# Common Law Employee (cont'd)

## **13-Factor Test: National Mutual Insurance Co. v. Darden**

The hiring party's right to control the manner and means by which the particular result is to be accomplished; the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent to which the hired party may decide when and how long to work; the method of payment; the role of the hired party in hiring and paying assistants; whether the work is part of the hiring party's regular business; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party

# Common Law Employee (cont'd)

## IRS Training Guidelines

- Behavioral control, e.g., Instructions the business gives the worker; training the business gives the worker
- Financial control, e.g., The extent to which the worker has unreimbursed business expenses; the extent of the worker's investment; the extent to which the worker can realize a profit or incur a loss.
- Legal control, e.g., written contracts describing the relationship the parties intended to create; whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay

# Common Law Employee (cont'd)

## **Treas. Regs. §31.3401(c)-1(b)**

Generally the relationship of employer and employee exists when the person for whom 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. . . In this connection, it is not necessary that the employer actually director control the manner in which the services are performed; it is sufficient if he has the right to do so. . . .



# Common Law Employee – Limitations

- Why are you asking?
  - To distinguish a common law employee from and independent contractor?
  - To determine from among 2 putative employers which is the common law employer of a individual who is clearly someone's employee (and not an independent contractor)?
- For tax and benefits purposes, there historically has been no such thing as “co-employment” or “joint employment”
- Historically, for employment tax purposes, in three-party staffing arrangements that contemplated the issuance of a W-2 and not a 1099, the potential for abuse was limited
- Code §4980H presents a similar regulatory profile

# Staffing Industry vs. PEOs

- Historic treatment of workers placed with client organizations
  - Staffing firms are the common law employer of workers placed by staffing firms
  - Client organizations are the common law employer of workers placed by PEOs (although at least one recent federal appeals court has held otherwise)
- Rationale: staffing firms traditionally recruited, trained, and generally retained the right to control workers' place with client organizations
- These positions have not been challenged by the regulators to our knowledge

## Staffing Industry vs. PEOs (cont'd)

- IRS Rev. Proc. 2002-21: PEO retirement plans are multiple employer plans—therefore (despite that the notice nowhere mentions common law employer status), the client organization is the common law employer
- March 1, 2006 DOL Information Letter: PEO welfare plan is a MEWA
- **NOTE:** This view is not universally embraced by the PEO industry

## Temporary Staffing Firm vs. Staffing Firm

- Neither term has independent legal significance
- From the preamble to the final Code § 4980H regulations, it appears that the term “temporary staffing firm” means a firm that places variable hour employees in short-term, high turnover assignments—i.e., positions with low job stability
- A “staffing firm” is presumably any staffing firm that does not place temporary workers, i.e., long-term assignments, temp-to-perm, placement services, and pay-rolling
- PEOs and similar arrangements are quite different from temporary staffing firms in two key respects—PEOs generally do not recruit the employees, and the employees are characterized by high job stability

## The MEWA Conundrum

- If the client organization, and not the staffing firm, is the common law employer, then
  - Any tax-qualified retirement (e.g., 401(k)) plan maintained by the staffing firm is a multiple employer plan, and
  - Any group health plan maintained by the staffing firm is a multiple employer welfare arrangement (MEWA)
- MEWAs must file an Form M-1 annually with the Department of Labor
  - A self-funded MEWA is subject to state law (and in most states is an unlicensed insurance company)
  - A fully-insured MEWA can not generally cover small groups

# Common Law Employer/Employee

	Temporary Staffing Firm	Staffing Firm	PEO
Industry View	Temporary staffing firm is the common law employer	Staffing firm is the common law employer	Client organization is the common law employer
(Apparent) IRS View under Code § 4980h Final Regulations	Temporary staffing firm is the common law employer	Client organization is the common law employer	Client organization is the common law employer
Comment(s)	A GHP of the TSF is a single employer plan	A GHP of the Staffing Firm is <i>what?</i>	A GHP of the PEO is a Multiple Employer Welfare Plan

# The “Offer of Coverage” Safe Harbor

- Treas. Reg. §54.4980H-4(b)(2) (Offer of coverage on behalf of another entity)
  - An offer of coverage made to an employee by a staffing firm under its group health plan is treated as being made by the client organization in certain instances
  - The rule applies in cases “in which the staffing firm is not the common law employer”
- The offer qualifies for safe harbor treatment only if “if the fee the client employer would pay to the staffing firm for an employee enrolled in health coverage under the plan is higher than the fee the client employer would pay the staffing firm for the same employee if that employee did not enroll in health coverage under the plan”

## Drafting Best Practices

- Include the following provisions in staffing agreements:
  - Reservation of rights: a recitation that the staffing firm reserves the right to control and direct the individual who performs the services
  - Intent of the parties: a recitation that the parties intend that the employee be the common law employee of the staffing firm and not the client organization
  - Contingent safe harbor: state that, if in the event of audit, investigation, or claim, the client organization and not the staffing firm is determined to be the common law employer, then the parties intend to rely on the Treas. Reg. §54.4980H-4(b)(2) safe harbor
- Inoculation language for client organization
  - Reclassified employee not retroactively eligible to participate



# Indemnity Provisions

- Demands for broad indemnity provisions in staffing contracts are becoming more common, and may be justified where directed at things within the control staffing firm, which include
  - What offers of coverage the staffing firm undertakes to make minimum essential coverage, minimum value, etc., and
  - What events will trigger liability
  - But events within the control of the client organization should not trigger liability on the part of the staffing firm, e.g., the client organization's failure to offer coverage

# Questions & Answers

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