WINSTON & STRAWN LLP

BLOG

No Relief Under PPACA "Pay or Play" Regulations for Misclassification of Workers

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As you are no doubt aware, the misclassification of workers as something other than employees (such as independent contractors or consultants) can cause major headaches in the world of employee benefits. Independent contractors and other non-employees are typically not permitted to participate in employer-sponsored benefit plans (including retirement and health/welfare plans) otherwise offered to an employer's workforce. Where an employer discovers that it has been incorrectly classifying an individual who should have been treated as employee, the question of how to fix historical non-compliance under applicable employee protection laws and the terms of the employer's own benefit plans is often a thorny one—which is about to get thornier, due to the Treasury Department's recently released final regulations on the "pay or play" mandate of the Affordable Care Act (discussed in a couple of our earlier Blasts, here and here).

The final regulations covered a wide scope of topics, but one issue addressed in more detail was the interplay between the requirement to offer affordable coverage to full-time employees under IRC Section 4980H and an employer's failure to offer that coverage due to employee misclassification. The rules reaffirm the position taken in the proposed regulations that an "employee" is defined by reference to a common law standard—generally interpreted by the IRS to mean an employment relationship where the entity controls how and what the employee does in the scope of his or her provision of services to the employer. This definition excludes individuals who are correctly classified as independent contractors; as such, employers are not required to count independent contractors for purposes of determining whether the coverage mandate applies or which individuals must be offered coverage under the employer's plans.

Following release of the proposed regulations, many commenters expressed concerns about the consequences under IRC 4980H of a reclassification of a worker as an employee—specifically, a worker who had sufficient hours of service for past periods to qualify as a full-time employee during those periods. Such reclassification could impact the determination of whether an employer was a "large employer" subject to the rules, whether the employer offered coverage to a sufficient percentage of employees, and even whether the employer could be subject to penalties if the reclassified worker had received a premium tax credit during a period in which he or she was being treated as a non-employee. Commenters requested relief in a form similar to that provided under Section 530 of the Revenue Act of 1978 (Section 530), which allows employers to cut off liability for failing to properly withhold federal income tax, FICA and FUTA due to misclassification of workers if they can (among other requirements) prove that

they had a reasonable basis for the original classification and that they complied with the Form 1099 reporting requirements.

In response to this request for relief, the Treasury Department stated in the preamble to the final regulations that "the relief requested would serve to increase the potential for worker misclassification by *significantly increasing the benefit of having an employee treated as an independent contractor. Accordingly, the final regulations do not adopt this suggestion*." In other words, there is currently no mechanism—whether in the form of Section 530 relief or otherwise—for mitigating the impact of a misclassification error on compliance with these provisions of the Affordable Care Act. In light of this fact, employers should *carefully* review their contractual arrangements with independent contractors, consultants, and other non-employee workers to ensure that they have been properly classified. This would involve a review not only of the operative documents (consulting and independent contractor agreements) but of the facts and circumstances of how the worker performs his or her services on a day-to-day basis. It may be advisable, particularly for employers with numerous independent contractor relationships, to have in-house or external counsel conduct an audit of those relationships to determine whether there is any risk that the common law employee standard might be triggered.
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