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Employee Benefits & Executive Compensation ADVISORY ■

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The Impact of Staffing Firm Employees and Contingent Workers on the Employer Shared Responsibility Requirement Under IRC 4980H

The Employer Shared Responsibility requirement under Section 4980H of the Internal Revenue Code (the "Code") (referred to hereafter as the "Employer Mandate") generally require applicable large employers (i.e., those with 50 or more full time employees counting full time equivalencies) to offer group health plan coverage to their full-time employees or face possible excise taxes.

This requirement applies to all common law employees of the employer. Whether an individual is the common law employee of an employer is determined using the IRS' 20-factor test.[1] The IRS has summarized the test for employers as follows:

> Under common-law rules, anyone who performs services for you is your employee i***f you can control what will be done and how it will be done***. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.[2]

If an individual is determined to be the common law employee of an employer, the employer must satisfy the Employer Mandate requirements with respect to that employee, even if the individual is employed through a staffing firm or is short-term (*i.e.*, a temporary employee).

This Article will describe how the Employer Mandate applies to each of various types of "contingent worker" employees and will provide practical advice for complying with the Employer Mandate.

Staffing Firm Employees

We assume, for purposes of this article, that all reasonable steps have been taken to ensure that the individuals assigned by a staffing firm to the employer ("Assigned Employees") will be considered to be common law employees of the staffing firm. However, as is often the case, an entity's status as the common law employer may be unclear. Thus, we discuss below approaches for assessing and minimizing the risk under 4980H if the Assigned Employees are considered to be common law employees of the entity receiving their services (the Contracting Entity). Briefly stated these are:

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1 *See* www.irs.gov/pub/irs-utl/x-26-07.pdf

2 http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Employee-Common-Law-Employee

Option 1: Ensure the Assigned Employees are NOT the Contracting Entity's common law employees under IRS common law analysis (and/or if they are common law employees, that the number is small enough as to not trigger the significant 4980H(a) penalty for any month);

Option 2: Assume that the Assigned Employees will be considered as the Contracting Entity's employees and take advantage of the IRS safe harbor[3] by requiring the staffing firm to provide coverage under terms that would satisfy the Employer Mandate if they were employees of the Contracting Entity; or

Option 3: Assume the Assigned Employees are the Contracting Entity's employees and manage Assigned Employee hours to ensure they work no more than 130 hours in any month for the Contracting Entity.

Option #1: Do Nothing

Under this option, a Contracting Entity would continue to assume that the Assigned Employees are not its employees--and assume the risk that the IRS might reclassify the Assigned Employees as the Contracting Entity's common law employees and subsequently assess excise tax liability each month with respect to each such Assigned Employee who was a full-time employee and also received a subsidy in the exchange that month. The excise tax for which the Contracting Entity might be liable in a month depends on the following:

- Would the reclassification of the Assigned Employees as common law employees cause the Contracting Entity to fail the "substantially all" test that month?

  Example: assume a Contracting Entity has 1000 regular full-time employees in a given month to which it offers coverage to 98% (i.e. 980). However, the Contracting Entity also has 100 Assigned Employees who have full-time hours of service in a month. The Contracting Entity does not offer nor is it deemed to offer coverage to any of the 100.

  Net result: the Contracting Entity would only offer coverage to 89% of full-time employees in that month (for 2015, the Contracting Entity would pass the substantially all test due to the transitional 70% threshold, but not in 2016).

If the Contracting Entity fails the substantially all test, then it would pay the 4980H(a) tax with respect to all full-time employees if just one full-time employee received a subsidy in the exchange.

- If the Contracting Entity does not fail the substantially all test, then the only excise tax that would apply is the 4980H(b) tax with respect to any employee (including Assigned Employees who are re-characterized as the Contracting Entity's common law employees) who received a subsidy in an exchange for that month. The (b) tax is $250 per month for each full-time employee who received a subsidy in the exchange.

Option #2: Require the Staffing Firm or PEO to Offer Coverage

Under this approach, the Contracting Entity would require the staffing firm or PEO to offer affordable, minimum value coverage to each Assigned Employee who is a full-time employee *while working for the Contracting Entity*.

In this option #2 (also called the safe harbor), you are assuming worst case scenario – i.e., the Assigned Employees are your employees. Consequently, you must use the same full-time employee identification method that you use for all other similarly situated employees employed by the same subsidiary.

A Contracting Entity choosing this option will need to amend its contract with the staffing firm or PEO to meet the safe harbor requirements. See Staffing Firm and PEO contracts later in this advisory for details.

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3 *See* Treas. Reg. § 54.4980H-4(b)(2)

Option #3: Manage Hours Worked

Under this option, the Contracting Entity assumes that the Assigned Employees are its employees but does not require the staffing firm or PEO to offer coverage. Instead, the Contracting Entity manages hours down (or requires the staffing firm or PEO to contractually manage hours down) to less than 130 hours in a month so that Assigned Employees are not full-time in any given month.

This option is valid provided that the Contracting Entity can manage hours down successfully enough such that any Assigned Employees who actually have 130 hours in a month (i.e. those that slip through the cracks) do not cause the Contracting Entity to fail the substantially all test. If you are successful enough, then the only tax you might pay, if at all, would be the 4980H(b) tax ($250 per month) with respect each Assigned Employee who is considered to be a common law employee who receives a subsidy in the exchange.

> **Example:** Assume Company X has 1000 full-time regular employees in a month to which Company X offers coverage to 98% (980). Company X also has 100 Assigned Employees in a month. Company X is able to successfully limit 90 of those 100 Assigned Employees to less than 130 hours of service in a month. In that case, Company X would still offer coverage to 97% of its full-time employees, which means it would satisfy the substantially all test in 2015 (where the threshold is 70%) and also 2016 (when the threshold is 95%).
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> Assume further that all 10 of the Assigned Employees who were full-time in a month received a subsidy in the exchange (because they weren't also offered coverage by the staffing firm or PEO that was affordable and provided minimum value). In that case, Company X's excise tax for the month would be a mere $2500. Next steps with respect to this option: the Contracting Entity must determine how many Assigned Employees have historically had 130 hours of service in any given month and then:

(i) determine whether failure to offer coverage to these Assigned Employees who have 130 hours of service will cause the Contracting Entity to fail the substantially all test;

(ii) if it will cause the Contracting Entity to fail the substantially all test, determine whether the Contracting Entity can effectively manage the hours down for enough Assigned Employees so that it passes the test; and

(iii) if it doesn't cause the Contracting Entity to fail the substantially all test, determine whether the Contracting Entity is comfortable paying the potential (b) tax if all Assigned Employees who are still full-time receive a subsidy in the exchange.

Practice Pointer: Even if hours are managed down to avoid the Employer Mandate, the Contracting Entity should check the terms of its plan to ensure the employees provided by the staffing firm or PEO are excluded.

Staffing Firm and PEO Contracts

If a Contracting Entity wants to satisfy the regulatory safe harbor for staffing firms, it would be well advised to amend its contract with the staffing firm or PEO to address the Employer Mandate. The regulations deem a Contracting Entity to have made an offer of coverage if an offer is made by the staffing firm.[4] To gain this protection, the staffing firm's or PEO's offer of coverage must meet all the requirements that would apply if the Contracting Entity were offering coverage directly to the Assigned Employees. That means that the coverage offered must provide minimum value

4 Treas. Reg. § 54.4980H-4(b)(2)

and must be affordable. In addition, the offered coverage must extend to dependent children through the end of the month in which the child attains age 26.

The Contracting Entity should also address the newly issued 6055 and 6056 reporting requirements. Unlike the 4980H regulations, the regulations issued for the reporting requirements and the instructions for the applicable IRS forms (*e.g.*, 1094-C and 1095-C) do not specifically address staffing firms. The common law employer of an employee must file Form 1095-C if the employee is full-time or is enrolled in coverage under a self-insured plan. Therefore, the Contracting Entity will need to specifically address whether it or the staffing firm or PEO is the employer of the Assigned Employees after applying the IRS' 20-factor common law employee analysis. As you know, that is a facts and circumstances test, so the Contracting Entity will need to make a good faith determination regarding whose employees they are.

- *If the staffing firm or PEO is the employer* – the staffing firm or PEO will file a Form 1095-C for the employee and include the employee in its Form 1094-C count.
- *If the staffing firm's* client (the Contracting Entity) *is the common law employer* – the Contracting Entity must file the Form 1095-C for the employee and include them in its Form 1094-C employee count. The staffing firm will need to provide all the information necessary to complete the Form 1095-C for the Assigned Employee, such as the months in which an offer of coverage was made, when the employee was in a limited non-assessment period, the cost associated with the least expensive employee-only coverage, etc.

The Contracting Entity may want to specify in the contract that the staffing firm or PEO will complete the filings or that they will produce the information above in a timely manner so the filings can be completed by January 31st.

Finally, the Contracting Entity may want to include indemnification language in the contract in case the staffing firm fails to offer compliant coverage and/or fails to provide the necessary information to allow the employer to meet its 6055 and 6056 reporting requirements.

The ABLE Act

Recent legislation, known as the ABLE Act, that takes effect in 2016 will require certified professional employer organizations ("PEOs") to be responsible for a customer-employer's employment taxes and withholding obligations.[5] A PEO is a certified PEO if the PEO posts a bond, complies with reporting obligations, and submits audited financial statements.

Although a PEO will be treated as an employer in the sense that it is responsible for paying employment taxes, the ABLE Act specifies that the Act "shall not be construed to create any inference with respect to the determination of who is an employee or employer"[6] for Federal tax purposes or for any other purposes. This means that employers utilizing a PEO will **not** be able to automatically exclude PEO employees for 4980H purposes.

Practice Pointer: The ABLE Act will not affect application of the Employer Mandate to employees obtained through PEOs or staffing firms.

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5 26 U.S.C. § 3511

6 26 U.S.C. § 7705(h)

Temporary employees

The Employer Mandate does not differentiate between permanent and temporary employees. If a temporary employee is reasonably expected to work at least 30 hours a week, the employer must offer the employee health coverage at the end of the waiting period, which is generally the first day of the employee's fourth month of employment. If the employer fails to make an offer of coverage, the employer risks incurring an excise tax. If a temporary employee is not reasonably expected to work at least 30 hours a week, the employer does not need to make an offer of coverage to the employee until the end of the 1-year look-back measurement period (assuming he/she averages 30+ hours/week during that period).

Practice Pointer: Employers will want to check their plan documents to ensure temporary employees are not excluded. Or if exclusion is intended, employers will want to ensure that the excluded temporary employees do not cause the plan to fail the substantially all test.

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If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Members of Alston & Bird's Employee Benefits & Executive Compensation Group

Robert A. Bauman
202.239.3366
bob.bauman@alston.com

Saul Ben-Meyer
212.210.9545
saul.ben-meyer@alston.com

Stacy C. Clark
404.881.7897
stacy.clark@alston.com

Emily Seymour Costin
202.239.3695
emily.costin@alston.com

Patrick C. DiCarlo
404.881.4512
pat.dicarlo@alston.com

Meredith Gage
404.881.7953
meredith.gage@alston.com

Ashley Gillihan
404.881.7390
ashley.gillihan@alston.com

David R. Godofsky
202.239.3392
david.godofsky@alston.com

John R. Hickman
404.881.7885
john.hickman@alston.com

H. Douglas Hinson
404.881.7590
doug.hinson@alston.com

Emily C. Hootkins
404.881.4601
emily.hootkins@alston.com

James S. Hutchinson
212.210.9552
jamie.hutchinson@alston.com

Johann Lee
202.239.3574
johann.lee@alston.com

Blake Calvin MacKay
404.881.4982
blake.mackay@alston.com

Emily W. Mao
202.239.3374
emily.mao@alston.com

Steven Mindy
202.239.3816
steven.mindy@alston.com

Craig R. Pett
404.881.7469
craig.pett@alston.com

Earl Pomeroy
202.239.3835
earl.pomeroy@alston.com

Jonathan G. Rose
202.239.3693
jonathan.rose@alston.com

Syed Fahad Saghir
202.239.3220
fahad.saghir@alston.com

Thomas G. Schendt
202.239.3330
thomas.schendt@alston.com

John B. Shannon
404.881.7466
john.shannon@alston.com

Richard S. Siegel
202.239.3696
richard.siegel@alston.com

Carolyn E. Smith
202.239.3566
carolyn.smith@alston.com

Michael L. Stevens
404.881.7970
mike.stevens@alston.com

Jahnisa P. Tate
202.239.3670
jahnisa.tate@alston.com

Daniel G. Taylor
404.881.7567
dan.taylor@alston.com

Elizabeth Vaughan
404.881.4965
beth.vaughan@alston.com

Kerry T. Wenzel
404.881.4983
kerry.wenzel@alston.com

Kyle R. Woods
404.881.7525
kyle.woods@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ▪ 18th Floor ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ▪ Suite 400 ▪ Durham, North Carolina, USA, 27703-85802 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ▪ 5th Floor ▪ East Palo Alto, California, USA, 94303-2282 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.756.3300 ▪ Fax: 202.756.3333