The Affordable Care Act Creates A Trap For The Unwary-- Worker Misclassification

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Introduction

As many employers have painfully learned, misclassifying employees as independent contractors can be an expensive mistake. Worker misclassification may become even more costly in 2014, when a new potential trap for the unwary will exist. If a non-complying employer gets caught in this new trap, it could be faced with significant monetary penalties.

Beginning in 2014, as a result of the Patient Protection and Affordable Care Act, employers who misclassify employees as independent contractors may be subject to an additional penalty regime. Section 4980H(a) of the Internal Revenue Code (the "Code") imposes a penalty on "large employers" who fail to offer full-time employees health insurance with a minimum level of coverage. Because employers generally do not provide health care coverage to independent contractors, reclassification of an independent contractor to a full-time employee could trigger this penalty.

Large Employers and Full-Time Employees

The new penalty applies only to "large employers." Whether an employer is a large employer is not always a simple determination. In general, a large employer is any employer with fifty or more full-time employees.

A full-time employee is an individual who works at least thirty

hours per week. Currently, the Internal Revenue Service ("IRS" or "Service") proposes the term "employee" include an individual who is an employee under the "common-law standard." Prop. Treas. Reg. § 54.4980H–1(a)(13). A determination under the common law standard hinges on whether the employer has the right to control the individual who performs the services. Whether or not the "employer" exerts actual control is irrelevant. In determining whether the employer has the right to control, the Service analyzes numerous factors. Due to the large number of factors, the Service's determination of whether an employer has the right to control a worker is highly subjective and its determinations are not always consistent.

The Penalty

Beginning in 2014, an employer may be subject to a penalty attributable to each month when:

1. It is a "large employer" (because of reclassification or otherwise);

2. It fails to offer all of its full-time employees (and dependants) the opportunity to enroll in "minimal essential coverage" under an "eligible employer-sponsored plan"; and

3. At least one full-time employee is certified to the employer as having, for that month, enrolled in a qualified health plan with respect to which an "applicable premium tax credit or cost-sharing reduction" is allowed or paid.

IRC § 4980H(a). For each month the employer is noncompliant, the penalty is equal to:

• The applicable payment amount per month (currently 1/12 of $2,000 or $166.67, adjusted for inflation after 2014), multiplied by

• The number of full-time employees during any month (reduced by 30).

The penalty can be surprisingly high. Consider the following example:

Example. For all of 2014, an employer reports it has forty-five full-time employees and thirty-five independent contractors. On audit, it is determined the independent contractors are actually full-time employees and, therefore, the employer is a "large employer." If one reclassified employee receives a tax credit, the employer becomes subject to the 4980H(a) penalty because it fails to offer minimum essential coverage and has eighty full-time employees.

$100,000 Penalty. For 2014, (for eighty employees) the penalty would be (80 – 30) × $2,000, or $100,000. In other words, for each employee over the thirty-employee threshold, the

employer owes $2,000 ($166.67 × 12 months), for a total penalty of $100,000 ($2,000 × 50 (that is, 80 - 30)).

Section 4980H(a) of the Code imposes the penalty on large employers who fail to offer their full-time employees health insurance meeting a minimum level of coverage and where at least one employee receives a tax credit or cost sharing reduction. This penalty could be triggered by an unsuspecting, otherwise compliant employer, if the government reclassifies one or more of its independent contractors as employees. In such cases, the employer could easily face a huge additional penalty.

Conclusion

Incorrectly classifying workers could become very costly with the addition of this new penalty to the government's arsenal. As exemplified above, some employers could face penalties in excess of $100,000 per year. Thus, it is very important employers evaluate whether their independent contractors are at risk of being reclassified as employees.
For more information about worker classification or this new penalty regime, please contact Larry J. Brant (lbrant@gsblaw.com or (503) 553-3114) or Karl Kaufman (kkaufman@gsblaw.com or (503) 553-3126). The GSB Tax and Benefits Group has significant experience on worker classification issues.

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