Raising the Stakes of Worker Misclassification Yet Again

Article By:
Labor & Employment Practice

New requirements under the Patient Protection and Affordable Care Act are set to intensify state and federal governments' crackdown on worker misclassification.

Most employers are aware by now that state and federal governments are cracking down on worker misclassification. Audits, enforcement actions, and lawsuits focused on the misclassification of workers as independent contractors have become commonplace, and the potential costs of misclassification—back wages, tax liabilities, retroactive exposure for employee benefits, unpaid unemployment insurance contributions, fines, and penalties—can be steep. Those stakes are set to rise again in 2014 as new requirements under the Patient Protection and Affordable Care Act (ACA) go into effect.

Starting in 2014, the ACA will impose penalties on large employers (those with at least 50 full-time employees or full-time equivalent employees) that misclassify workers and consequently fail to offer certain full-time employees a minimum level of health insurance coverage. An employer with fewer than 50 full-time employees may be deemed a "large employer" for ACA purposes if the Internal Revenue Service (IRS) determines that existing independent contractors have been misclassified and if those misclassified workers bring the employer over the 50-employee threshold.

So just who is considered an "employee" under the ACA? The proposed regulations issued by the IRS suggest that the "common law" test for employment status will be used to determine whether workers qualify as "employees." The common law test (which is used to determine employment status under the Employee Retirement Income Security Act) hinges on whether the employer has the right to control the worker. That right of control is determined by evaluating numerous factors, none of which is individually determinative.

Despite the efforts of several industry groups to receive clarification of the terms "employee" and "employer," and to exclude employees who are statutorily treated as independent contractors under a section 530 safe harbor arrangement, it is doubtful that there will be any significant changes in the final regulations with regard to how "employee" and "employer" are defined or with regard to the availability of misclassification relief. This is especially true given the Department of Labor's ongoing Misclassification Initiative, its recent statements concerning its enhanced focused on worker misclassification, and the IRS's enhanced misclassification enforcement activities.

This all means that, beginning in 2014, employers may be subject to significant penalties for
independent contractor misclassification under the ACA. Specifically, misclassification may give rise to the following penalties:

- "Failure to Offer" penalties of $2,000 per year times the total number of full-time employees (minus the first 30 full-time employees) if misclassification results in a failure to offer coverage to 95% of those deemed to be the company's full-time employees and just one such individual obtains subsidized exchange coverage.

- "Insufficient Coverage" penalties of $3,000 per year for each misclassified full-time worker[4] who actually obtains subsidized exchange coverage because the employer coverage is either unaffordable or does not provide minimum value (capped at the maximum "Failure to Offer" penalty).

With this additional misclassification liability looming on the horizon, employers on the cusp of the 50-employee threshold that engage independent contractors and large employers that still maintain borderline independent contractor engagements should take time now to reevaluate such engagements.

[1]. For more information on the ACA, view our recent webinars and commentary here.

2. Because full-time equivalents of part-time employees count toward the 50-employee threshold, misclassified part-time independent contractors could also give rise to "large employer" status under the ACA.

3. Section 530 of the Revenue Act of 1978 generally allows a company to treat a worker as an independent contractor for employment tax purposes (regardless of the worker's status under the common law test) provided that the company has a reasonable basis for this treatment and applies it consistently.

4. For purposes of assessing penalties, the IRS will determine part-time versus full-time status based upon how much the part-time employees actually worked measured over an extended period.

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