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The Affordable Care Act Independent Contractor vs. Full Time Employee

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An important step in determining the extent a company will be affected by the Affordable Care Act (ACA) is by determining its number of employees. Under the ACA, beginning on January 1, 2015, employers with 50 or more full time equivalents are required to offer their employees' health care coverage (the "play or pay rule"). Many issues affect the number of employees working for a specific employer, such as:

1. Independent Contractors

It is important to analyze whether the employer retains **the right to control the manner or means of performing the work**, which is the chief test under Ohio Law. There are 20 factors used by the IRS to determine whether you have enough control over a worker to be an employer (see page 3). These rules are intended only as a guide, as the importance of each factor depends on the individual circumstances. Employers should perform this analysis and make sure agreements are put in place to acknowledge this classification.

Common Law Rules

The IRS also relies on common law in making this determination. The IRS guidance provides three categories of control factors to determine the degree or extent of the employer's right to control and the worker's independence:

- (1) Behavioral**, which focuses on the right to control and how the worker completes his or her job;
- (2) Financial**, which focuses on whether or not the business aspects of the worker's job are controlled by the employer (three example questions: how is the worker paid, how are the expenses reimbursed; and who provides the tools and supplies);
- (3) Type of Relationship**, which analyzes the written contracts with the worker and the types of additional benefits received by the worker, such as vacation pay, medical insurance, and retirement accounts.

IRS guidance recommends looking at the entire relationship, considering all of the relevant foregoing factors, and documenting each of the factors used in coming up with the determination.

2. Controlled Groups

Under the ACA, a controlled group of employers is considered one employer for the purpose of the “play or pay rule”. Therefore, it is important to analyze whether or not your company is part of a controlled group. Generally, there are three types of controlled groups: (1) Parent-Subsidiary Group, (2) Brother-Sister Group, and (3) Combined Groups.

3. Temporary or Leased Employees

The treasury regulation promulgated under the ACA suggest that an applicable large employer (one with 50 or more employees) may be subject to the ACA penalties for any worker who is a “common law” employee, as determined under the Internal Revenue Code. If you hire workers through temporary and leasing agencies, you may be considered co-employers with the agencies and, thus jointly and severally liable with the agencies for ACA penalties. These temporary and leased employees’ contract should be examined to ensure the agencies burden the responsibility for ACA compliance and that you are indemnified from ACA penalties.

4. Full-Time Equivalents

In order to determine whether an employer is a large employer for purposes of the ACA, both full-time and part-time employees are used to determine the 50 full-time equivalent (FTE) thresholds. In summary, you will count each employees working over 30 hours as 1 FTE and then add the hours of all part-time employees and divide by 2,080 to determine how many FTEs the part-time employees make up.

5 Red Flags to Avoid

The following situations may raise suspicions about how you have classified your workers and could lead to an IRS audit.

1. Reclassifying employees as independent contractors, especially issuing the same worker both a W-2 and a 1099-MISC;
2. Laying off employees and making them independent contractors so that they can finish up work that needs to be done;
3. Providing most of the supplies that workers need to perform their duties (e.g., laptops, phones, office supplies) and classifying them as independent contractors;
4. Being the only client or source of income for an independent contractor;
5. Making regular, indefinite payments to an independent contractor over multiple years.

After examining each of the preceding issues, you may or may not decide to begin providing health care coverage for your employees, even if over the 50 FTE requirement. Providing coverage may still be substantially more costly than paying the penalty. This is a strategic analysis that must be performed once you know whether your company meets the “play or pay” requirements.

Twenty Factor Checklist to Determine Independent Contractor vs. Employee Status

Rev. Rul. 87-41 (1987-1 CB 296)

As an aid to determining whether an individual is an employee under the common law rules, twenty factors or elements have been identified as indicating whether sufficient control is present to establish an employer-employee relationship. The twenty factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. The twenty factors are designed only as guides for determining whether an individual is an employee.

Answer "YES" to all of the first four questions
– your worker is probably an independent contractor.



1. Instructions – A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the right to require compliance with instructions. See, for example, Rev. Rul. 68-598, 1968-2 C.B. 464, and Rev. Rul. 66-381, 1966-2 C.B. 449.



2. Training – Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner. See Rev. Rul. 70-630, 1970-2 C.B. 229.



3. Integration – Integration of the worker's services into the business operation generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business. See *United States v. Silk*, 331 U.S. 704 (1947), 1947-2 C.B. 167.



4. Services Rendered Personally – If the services must be rendered personally presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the result. See Rev. Rul. 55-695, 1955-2 C.B.H. 410

Answer “YES” to any of questions 5-20
– your worker is probably an employee.



5. Hiring, Supervising, and Paying Assistants – If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hired supervises and pays the other assistant pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status. Compare Rev. Rul 63-115, 1963-1 C.B. 178, with Rev. Rul. 55-593, 1955-2 C.B. 610.



6. Continuing Relationship – A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. See United States V. Silk.





7. Set Hours of Work – The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control. See Rev. Rul. 73-591, 1973-2 C.B. 337.







8. Full Time Required – If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses. See Rev. Rul. 56-694, 1956-2 C.B. 694.







9. Doing Work on Employer's Premises – If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Rev. Rul. 56-660, 1956-2 C.B. 693. Work done off the premises of the person or persons receiving the services, such as the office worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route to canvass a territory within a certain time, or to work at specific places as required. See Rev. Rul. 56-694.



  **10. Order or Sequence Set** – If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are being performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so. See Rev. Rul 56-694.



  **11. Oral or Written Reports** – A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control. See Rev. Rul 70-309, 1970-1 C.B. 199, and Rev. Rul. 68-248, 1968-1 C.B. 431.



  **12. Payment by Hour, Week, Month** – Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor. See Rev. Rul. 74-389, 1974-2 C.B. 330.



  **13. Payment of Business and/or Traveling Expenses** – If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities. See Rev. Rul. 55-144, 1955-1 C.B. 483.



  **14. Furnishing of Tools and Materials** – The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship. See Rev. Rul 71-524, 1971-2 C.B. 346.



  **15. Significant Investment** – If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. See Rev. Rul. 71-524. Special scrutiny is required with respect to certain types of facilities, such as home offices.

  **16. Realization of Profit or Loss** – A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. See Rev. Rul. 70-309. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

  **17. Working for More Than One Firm at a Time** – If a worker performs more than a minimal services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. See Rev. Rul. 70-572, 1970-2 C.B. 221. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

  **18. Making Service Available to General Public** – The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship. See Rev. Rul. 56-660.

  **19. Right to Discharge** – The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications. See Rev. Rul. 75-41, 1975-1 C.B. 323.

  **20. Right to Terminate** – If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship. See Rev. Rul. 70-309.

This checklist adapted from:

<http://smallbusiness.findlaw.com/business-forms-contracts/business-forms-contracts-a-to-z/form1-21%281%29.html>
<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Independent-Contractor-Self-Employed-or-Employee>