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Counting Employees – Beware the Details!

Until passage of the ACA, most employers thought they knew how many employees they employed. As the ACA is implemented, many employers are finding out that the number of employees for ACA purposes differed from the number that they would have stated.

The concern with employee counting under ACA is that the number of employees determines the extent to which an employer must comply with the Employer Shared Responsibility requirements or “pay or play” provisions of the Act. This issue of Legislative Review discusses two (2) areas of particular concern that employers should consider when counting employees.

Controlled Group

Controlled group rules have been in place for tax purposes as well as retirement plans, and ERISA for many years. Yet, many employers have been lax in determining whether they were part of a controlled group.

Part of the difficulty in assessing controlled group status is easily seen by conducting a simple internet search asking for a definition of “controlled group.” **Most definitions are at least 200 words long with multiple references to other sections of tax code. Each explanation starts out simply saying that a “controlled group is any two or more corporations connected through stock ownership.”** Then the complications ensue regarding the relationship of the ownership interests and the degree of ownership.

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Letter from Karen Knippen

Have you ever been on a diet? I know that I am great at following the rules and restrictions for a week or so. After that, I may fudge a little (pun intended) or relax my diligence. Ultimately, the results of my actions show up – or don’t show up – on the scale.

So it is with employers. Many of them have relaxed their diligence or forgotten some of the labor laws and rules. With the vast myriad of laws that impact Employers, it is more important than ever to make sure they are in compliance with the Affordable Care Act.

As with my diet, it’s a lot easier to lose 5 pounds than it is to lose 15. Similarly, it will be key for Employers to count employees correctly now before facing penalties under the Employer Shared Responsibility requirements.

Sincerely yours,



Karen Knippen, RHU, REBC, CLTC
Senior Vice President

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Further complicating an analysis to determine controlled group status is that a business owner may not consider another business as related. For example, the owner of a manufacturing firm may not consider his spouse's craft sales business as more than a hobby. But, the spouse's "hobby" may be considered part of a controlled group.

Similarly, not-for-profit entities may not relate to rules that address "ownership." Yet, there are "affiliated group rules" that apply in the same way as controlled group.

For those business entities that are clearly applicable large employers (ALEs) for ACA purposes, controlled group rules may have less impact. **However, for firms that would not be an ALE - except for the fact that they are determined to be part of a controlled group - such a determination could have significant compliance implications.**

Determination of controlled group status is complicated and fact specific. **Employers should consider seeking legal advice to determine whether they are part of a controlled group.**

Independent Contractor Status

Employers that utilize the services of independent contractors need to conduct a thorough review of anyone afforded this status. Both the federal and state governments have had ongoing special projects aimed at ensuring that employees are not misclassified as independent contractors. The concern is that a misclassified employee is not afforded the many protections of employees such as minimum wage, overtime payments, unemployment insurance and workers' compensation.

Misclassifying workers can also give an employer an unfair tax advantage over another employer that characterizes workers in similar positions as employees.

The provisions of the ACA, especially the counting of employees, makes the identification of employees central to compliance with the law. As such, misclassification of employees as independent

contractors can undercount the number of employees as well as affect whether a worker is eligible for coverage through the employer.

A July statement issued by the Wage & Hour Division of the Federal Department of Labor labeled an "administrator's interpretation" regarding identification of employees misclassified as independent contractors has given this employment practice even greater urgency. This "administrator's interpretation" offers a much more stringent approach to classifying employees.

Many employers have used the ability to control an employee as their main test of whether a worker is an employee or independent contractor. This analysis relied on a 20 factor list that the IRS had developed in 1987. Some of the 20 factors that would indicate that a worker was an employee include:

- Requirement that worker follow instructions
- Providing training to a worker
- Whether services are rendered personally
- Whether the company for whom services are provided hires, supervises or pay assistants
- Whether the employer sets the hours and place of work.

The administrator's interpretation shifts the focus from who controls the worker to the "economic realities" that determine whether a worker is in business or is an employee. The new interpretation looks at a six (6) factor economic realities test to determine whether there is an employment relationship.

1. Is the Work an Integral Part of the Employer's Business?

The examples given to answer this question make the point. The examples are:

- Cake decorators are integral to the business of selling custom decorated cakes
- A worker answering calls at a call center is integral to operating a call center
- A construction company that frames residential homes would have carpenters as integral to the business.

Who wouldn't be integral is also identified. In the case of the construction company, the notice advises that a software developer for a software program that the construction company uses to track bids or schedule projects is not integral to construction.

2. Does the Worker's Managerial Skill Affect the Worker's Opportunity for Profit or Loss?

A worker in business for himself has the opportunity to make a profit or experience a loss. The decisions that the worker makes determine this. Some of these decisions are whether or not to advertise, hire others, purchase materials and the like.

The amount of hours worked or the amount of work available is not viewed in the same light. The notice states: "The effect on one's earnings of doing one's job well or working more hours is no different for an independent contractor than it is for an employee."

3. How does the Worker's Relative Investment Compare to the Employer's Investment?

The fact that a worker has made an investment should not be considered in isolation. The investment needs to be viewed in comparison to the employer's investment. If the worker's investment is relatively minor, that suggests that the worker may be an employee.

The nature of the investment is also important. If the investment is necessary to perform the specific work for the employer, that may indicate that the worker is an employee.

4. Does the Work Performed Require Special Skill and Initiative?

The worker's skills, judgment and initiative help determine whether the worker is economically independent. Merely being skilled, including specialized skills, is not sufficient to determine independent contractor status.

5. Is the Relationship between the Worker and the Employer Permanent or Indefinite?

To the extent that a worker's relationship with the employer is permanent or indefinite, the relationship suggests that the worker is an employee. The notice

states that an independent contractor "typically works one project for an employer and does not necessarily work continuously or repeatedly for an employer."

The court cases cited reference whether the permanency or length of the relationship results from the worker's own independent business initiative. The notice provides two examples of publishing editors.

One editor edits publications for only one firm using their specifications and software. She is considered an employee. Another editor works over the years for 15 different publishers and negotiates rates for each editing job. She also turns down work for any variety of reasons. This lack of permanence is seen as indicative of an independent contractor status.

6. What is the Nature and Degree of the Employer's Control?

This factor brings back the long held determination of control. But, the notice states that the ultimate determination is whether the worker is "economically dependent" on the employer or "truly an independent businessperson."

The notice continues that the workers must control "meaningful aspects of the work performed." The guidance discusses that flexible working arrangements or schedules are not sufficient to create independent contractor status.

Conclusion

Employers need to take the identification and counting of employees very seriously – now more than ever. The ACA has redefined some of the ways that employer count employees to determine the threshold for compliance. The nuances of controlled groups coupled with the recent independent contractor notice are factors that should be considered as a part of the counting analysis.

At this time, the "administrator's interpretation" is not the final word in classifying of employees. However, employers should be aware that this interpretation could come into play in any audits or disputes regarding ACA compliance.

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