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ARE YOUR ICS REALLY EES? A LOOK WHO'S WHO ON AN EMPLOYEE BENEFIT PLAN

The glory of self-funding is the flexibility an employer has to create a benefit plan that truly suits the individual employer. Employers with ERISA-governed self-funded plans have the opportunity to craft benefits and exclusions that align with the needs of their employee population, while implementing various cost containment solutions to assist the employer in offering a robust benefit plan, and, perhaps even more importantly, controlling the costs for the employees and the employer.

But where does that flexibility stop?

Flexibility can begin to taper off when it comes to determining which individuals are eligible for employer-sponsored coverage. In short, the relevant regulations mandate that only employees of the employer sponsoring the health plan should be eligible to participate.

So the logical next question is: who qualifies as an employee?

In general, individuals that are issued a 1099 instead of a W-2 are independent contractors ("ICs") and are accordingly not employees ("EEs"), and thus should not be offered employee benefits; to that end, the Internal Revenue Service ("IRS") provides various resources to assist employers in appropriately classifying workers.

The IRS looks at three areas of the relationship: (1) the behavioral control the employer has on the individual, (2) the level of financial control, and (3) the type or nature of the relationship.

Interestingly, the IRS specifically lists "benefits" under the "type of relationship" category as a consideration for classifying a worker.

While the considerations are a sliding scale rather than a hard-and-fast rule (as in, simply offering benefits does not necessarily make the individual an employee), it is certainly a factor.

There is also a 20-factor (yes – 20) test found in Revenue Ruling 87-41 (1987-1 C.B. 296), but the IRS is aware that certain factors may not apply to every situation.

Ultimately, misclassifying individuals may jeopardize the IC's "IC" status, which leads to various complications for the employer, the IC, and the health plan.

As states continue to develop employment-related laws to address various aspects that either directly relate to or at least tangentially effect employee benefits, one such development is of specific interest.

New Jersey in particular has issued several new laws that took effect immediately in late 2019, related to independent contractor status and worker misclassifications.

The New Jersey Department of Labor and Workforce Development now has the authority to issue monetary penalties for misclassification. If a labor contractor is involved, the employer and the labor contractor have *joint* liability for any violations and penalties.

In April 2020, New Jersey employers will also be required to post a notice regarding worker misclassification. The poster will include information about the prohibition on misclassification of workers, information on the differences between ICs and EEs, the benefits and protections employees are entitled to under state law, the remedies available to misclassified workers, and contact information for complaints or notification of alleged violations.

These laws are the result of Governor Murphy issue Executive Order No. 25 in May of 2018 that established the Task Force on Employee Misclassification, making it a top priority to put guidelines in place to diminish work misclassification, which is believed to be widespread problem.

If the State of New Jersey determines that individuals are being identified as ICs when they really are EEs (and vice versa), the State may issue specific penalties and even stop-work orders, in addition to other remedies or penalties found in other applicable law.

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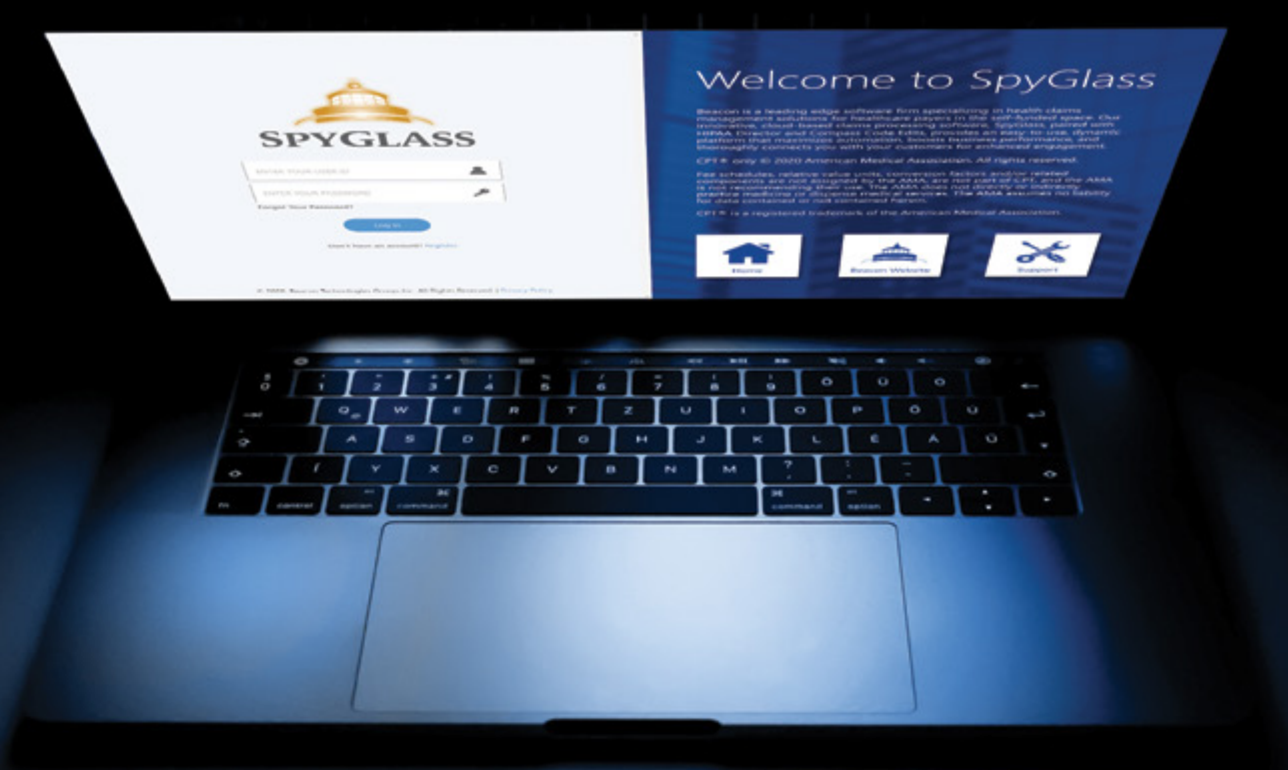

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There are two penalties that can be imposed.

The first is an administrative penalty for misclassifying an employee. For the first violation, the administrative penalty is $250 per misclassified employee. Subsequent violations may increase the penalty up to a maximum of $1,000 per misclassified employee.

The second penalty is structured a bit differently and the monetary amount is to be no more than 5% of the worker's gross earnings over the past 12 months.

The limitation applies to the earnings from the employer that actually misclassified the individual – meaning a new employer that has contracted to work with the IC cannot be held accountable for the prior employer's mistake.

The State may dictate that the penalty is paid directly to the misclassified workers, or the employer may be required to pay into a trust account for any applicable workers. Employers are to be provided with notice and given the opportunity to appeal by requesting a hearing with the Commissioner of Labor and Workforce Development.

As with most laws, there is a good faith factor worked into the analysis. Ultimately the State must look to a variety of factors when applying penalties, including any previous violations by the employer, the seriousness of the violation, the employer size, and the good faith of the employer.

You're probably thinking: why does this matter to me?

Over the last few years there has been an uptick in the number of self-funded plans that appear to want to include ICs as eligible, so if you're a claims administrator, a consultant, or a broker, one of the plans you work with is likely impacted. Aside from specific state law penalties, there are a variety of considerations.

Plan language is a major consideration (as it so often is). This may seem like the easiest piece of the puzzle, but as we dig in a bit, it becomes clear that it's not so simple.

Clear eligibility language is crucial to ensure compliance with ERISA Summary Plan Description requirements, so the first step is to modify the eligibility provisions of the document, including how a covered person or participant is defined.

Again, determining when to offer coverage is usually simple, but the length of coverage and termination of coverage get a bit trickier.

How long will the IC be eligible?

Are ICS only covered when working on a project?

Would the IC be terminated immediately when a project is over?

Would an IC be interested in such coverage if only offered for a limited period of time?

Benefits are usually offered when there is a permanency of the relationship between the employer and individual; generally, true employment relationships do not have defined end dates, while IC relationships usually have a more definite timeframe. That defined timeframe can make crafting the plan language offering coverage to ICs into a tedious process and could be difficult for a TPA to administer!

Employers also need to consider whether they are inadvertently creating a MEWA – a multiple employer welfare arrangement. The offer of coverage to non-employees (i.e., the ICs) likely creates a MEWA.

Generally speaking, a MEWA is created when one benefit plan is offered to two or more unrelated entities. Because each IC is a separate entity, it could create a de facto MEWA by including even one IC in the plan benefits.

As the MEWA and Association Health Plan ("AHP") space is another area of developing law, the company would need to properly form the MEWA or AHP first before modifying plan eligibility provisions, and an employer that forms a MEWA loses many of the coveted protections afforded by ERISA.

If the employer still wants to continue down this path, the next consideration is tax consequences for both the employer and the IC.

By classifying an individual as an IC, an employer avoids paying employment taxes; however, the IC is likely to be taxed on the benefits provided by the employer, since pre-tax protections generally do not apply.

Certain employers may be eligible for the IRS' Voluntary Classification Settlement Program ("VCSP"), which allows employers to reclassify workers and receive some relief from federal employment taxes that the employer was not paying.

Employers can also seek a proactive determination from the IRS regarding the proper classification of workers (although it's not easy to estimate how long that might take to receive). Last, but not least, there are resources for individuals to calculate unreported taxes and report an apparent misclassification to the IRS.

In addition to the above, stop loss is also a consideration; in order to ensure that these individuals' claims will be covered under the stop loss policy, it need to be underwritten accordingly and the policy must be written to include coverage for ICs. It generally goes without saying, but the stop loss carrier will need to sign off on the plan language modifications as well (generally before the changes go into place).

With that said, will other states follow New Jersey's lead?

The answer to that question is unclear; however, since the passage of the Affordable Care Act in 2010, the United States Department of Labor is continuing to audit self-funded ERISA-governed plans on a regular basis, looking at a variety of things. Some audits are truly randomized, while others begin due to a complaint from a plan beneficiary. Employers should take a proactive approach to review their benefit offerings and assess whether the health plan's actual eligibility exactly matches what is stated in the Plan Document, Summary Plan Description, and employee handbook, and update the documents accordingly (or correct any EE or IC statuses accordingly).

In summary, it's natural for an employer to want to offer benefits, including a robust health plan, to the individuals working for the benefit of the employer; however, if those individuals are not actual employees, things can go sideways quickly. Employers should proceed with caution when deciding to offer employer benefits to independent contractors.

In this ever-changing industry, states are continuing to develop new rules for employers that bleed into the employee benefit space and can impact their self-funded health plan offerings.

These new state laws, combined with existing federal guidelines, can be difficult to navigate, but with some careful planning, employers are given the tools they need to figure it all out!

Kelly E. Dempsey is an attorney with The Phia Group, LLC. As the Vice President of Phia Group Consulting, Kelly's specialization is an interesting mix of compliance matters impacting self-funded plans (such as issues relating to ERISA, ACA, COBRA, FMLA, MHPAEA, and MSP) and "outside-the-box thinking," finding creative and innovative ways to help plans, brokers, and TPAs achieve their various self-funding goals. Kelly is admitted to the Bar of the State of Ohio and the United States District Court, Northern District of Ohio.