HINSHAW

Who is an employee and who is an independent contractor under the employer mandate provisions of the Affordable Care Act (ObamaCare)?

4 min read
Feb 27, 2013

As we have written in this space in the past, whether a worker is an employee or an independent contractor can have many consequences. The classification can determine whether the principal is liable for the negligent acts of the worker, whether the worker may sue for wrongful termination or discrimination, is entitled to workers' compensation insurance, is subject to tax treatment as an employee, and a lot more.

Now, the Affordable Care Act (aka ObamaCare) has added still more consequences. Among other things, as reported in the *Wall Street Journal*, the Affordable Care Act requires firms with 50 or more "full-time equivalent workers" to offer health plans to employees who work the requisite number of hours per week, or else pay a $2,000 penalty for each uncovered worker beyond 30 employees. The *Wall Street Journal* reports that many businesses have been moving full-time employees to part-time positions in an effort to avoid the mandate.

Businesses might also be tempted to re-classify employees as independent contractors, since only employees fall within the mandate. But this option might be fraught with peril, since it inevitably leads to the thorny question of who is an employee and who is an independent contractor for purposes of the employer mandate provisions of the Affordable Care Act. Furthermore, government agencies, including the IRS, have long been aware of this temptation, and have increasingly cracked down on what they deem to be misclassification of employees.

The Affordable Care Act, which uses the word "employer" more than 500 times, and employee more than 400 times, never explicitly defines either term in any overarching way. However, for anyone willing to follow us down the rabbit hole, here is what we have found:

- The employer mandate provisions of the Affordable Care Act are found in Title I of the law
- Section 1551 provides that "[u]nless specifically provided for otherwise, the definitions contained in section 2791 of the Public Health Service Act (42 U.S.C. 300gg-91) shall apply with respect to this title [Title I].

- So, following the trail, we come to section 300gg-91, which provides the following definitions of the terms "employee" and "employer":
  (5) Employee. The term "employee" has the meaning given such term under section 3(6) of the Employee Retirement Income Security Act of 1974 [29 USCS § 1002(6)].
  (6) Employer. The term "employer" has the meaning given such term under section 3(5) of the Employee Retirement Income Security Act of 1974 [29 USCS § 1002(5)], except that such term shall include only employers of two or more employees.
- And this, at long last, leads us to sections 3(6) and 3(5) of the Employee Retirement Income Security Act of 1974 (ERISA) [29 USCS § 1002(5), (6)], which provide the following definitive answers:
  (5) The term "employer" means any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity.
  (6) The term "employee" means any individual employed by an employer.

So now we know. An employer is someone acting as an employer or in the interest of an employer — while an employee . . . well, that's an individual employed by an employer. Everyone got that?

In *Nationwide v. Darden* the U.S. Supreme Court was asked to determine the distinction between an employee and an independent contractor under ERISA, and arriving at the second of these two "definitions," the Justices were not amused. Justice Souter wrote on behalf of a unanimous Court:

> "ERISA's nominal definition of 'employee' as 'any individual employed by an employer,' 29 U. S. C. § 1002(6), is completely circular and explains nothing."

The Supreme Court, therefore, adopted the following federal common law definition of employee for the purposes of ERISA:

> "In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party."

As Justice Souter went on to explain, "no shorthand formula or magic phrase that can be applied to find the answer, . . . all of the incidents of the relationship must be assessed and weighed with no one factor being decisive." Various Circuit and district courts have added their own interpretive spin to this standard in the last twenty years.

Since the definition of an employee in Title I of the Affordable Care Act appears to be the same as that used in ERISA cases, it is reasonable to conclude that, in determining what constitutes an employee under the employer mandate provisions of the Affordable Care Act, Courts will likewise use the common law definition provided in *Darden*.

This standard, incidentally, is similar to the common law definition of employee in many states, including California. However, as a predictive tool, it is of limited use. Under many circumstances, it is far from easy to determine with any certainty whether a judge, jury, or administrative body would find a particular worker to be an independent contractor or employee. As always, no one will penalize you for classifying your workers as employees, but the Affordable Care Act adds yet another reason why businesses may look for ways to avoid such classification.

Finally, we offer a caveat: We believe that the above analysis is a viable reading of the law. But the Affordable Care Act is a complex statute, not to mention a new law. To our knowledge no court or regulator has addressed the issues discussed above. So it is conceivable that courts and/or regulators will ultimately adopt some analysis different from ours above. We will continue to follow the development of this law on this page.

For further discussion on this topic, please contact Michael Newman.

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