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Temporary-to-Permanent Hiring Arrangements Under the Affordable Care Act

"Temporary-to-permanent" employment arrangements pose unique challenges to staffing firms in their efforts to comply with the Affordable Care Act's employer shared responsibility rules.[1] Individuals hired under such arrangements are similar in many respects to traditional temporary and contract workers. But there are material differences with regard to ACA compliance. This paper addresses these challenges and differences, with a particular emphasis on assessing whether and under what circumstances employees assigned on a temporary-to-permanent basis can be classified as variable-hour employees and, if they are, how the employees should be reported to the U.S. Internal Revenue Service.

Background

Under a temporary-to-permanent arrangement, a staffing firm assigns an individual to a client company for a trial period, during or at the end of which the client may decide to hire the employee on a permanent basis.[2] During the trial, or temporary, period, the client has the opportunity to evaluate the temporary employee's job performance. Temporary-to-permanent arrangements may be ad hoc (i.e., a client determines that a temporary employee on a regular temporary assignment is well suited for permanent employment) or formal (i.e., the client's explicit purpose at the outset is to screen individuals for permanent employment).

Employer Shared Responsibility

The ACA's employer shared responsibility rules impose on "applicable large employers" (i.e., those with 50 or more full-time and full-time equivalent employees on business days during the preceding calendar year) the obligation to offer group health insurance coverage to substantially all their full-time employees or potentially be liable for a nondeductible excise tax—"assessable payment" in the parlance of the law.[3] Liability for assessable payments is determined month by month. Determining which employees are full-time employees, and whether the staffing firm or the client is the employer of those employees, is critically important to employers as they navigate the ACA's employer shared responsibly rules.

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1. These are the rules that are found in §1311 of the ACA and that are codified in §4980H of the Internal Revenue Code. Unless otherwise specified, references to section numbers in this article are to the Internal Revenue Code of 1986, as amended.
2. These arrangements are sometimes also referred to as "temporary-to-direct," "temporary-to-hire," or "try-before-hire."
3. See ACA §1513, establishing rule governing Shared Responsibility for Employers, codified at §4980H. Final Treasury Regulations implementing §4980H were issued Feb. 12, 2014 (79 *Fed. Reg.* p. 8544, et seq., *Shared Responsibility for Employers Regarding Health Coverage; Final Rule*)—the "Final Regulations".

The ACA defines full-time employee, with respect to a calendar month, as "an employee who is employed an average of at least 30 hours of service per week with an employer."[4] For convenience, the final regulations issued by the IRS provide that "130 hours of service in a calendar month is treated as the equivalent of at least 30 hours of service per week."[5]

Whether an entity is an employer under the ACA is determined under the "common law employee" standard,[6] as spelled out in Treas. Reg. §31.3401(c)–1(b):

> Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.

In the typical temporary-to-permanent arrangement, employees in the temporary phase of the arrangement will be the common law employees of the staffing firm. The staffing firm recruits, onboards, trains, and places the employees, and the employees are subject to the staffing firm's employment policies and procedures. If and when the employees are hired permanently by the client company, all ties to the staffing firm are severed and the employees become the common law employees of the client.

Because temporary-to-permanent employees are the common law employees of the staffing firm during the temporary phase, staffing firms will need to take them into account for purposes of complying with the ACA's employer share responsibility rules.

Determining Full-Time Employee Status

The final employer regulations issued by the IRS establish two methods under which an employer may determine if an employee is a full-time employee: the monthly measurement method and the look-back measurement method. Under the monthly measurement method, an employee generally is treated as a full-time employee for any calendar month in which the employee averages 30 or more hours of service per week or 130 hours for the month.[7] Coverage need not be offered, however, until the first day of

4. *Treas. Reg.* §54.4980H-1(a)(21)(i).
5. Ibid. §54.4980H-1(a)(21)(ii).
6. Ibid. §§54.4980H-1(a)(15) and (16). See also Bianchi and Lenz, *The Final Code §4980H Regulations; Common Law Employees; And Offers of Coverage by Unrelated Employers*, Tax Management Memorandum (Sept. 8, 2014).
7. See *Treas. Reg.* §54.4980H-3(c)(1).

the month following three full months of employment (irrespective of the hours worked during that period as long as the employee was employed in each month of the period).[8]

Under the look-back measurement method, employees are classified on their start date as full-time, part-time, seasonal, or variable hour. Full-time employees are treated in a manner similar to employees under the monthly measurement method until they have worked through a "standard measurement period." Thereafter, they are treated as "ongoing" employees whose status as full time is generally determined year to year.

In contrast, part-time, seasonal, and variable-hour employees' status is determined based on an "initial measurement period" of up to 12 months based on each employee's start date, during which coverage need not be offered and no penalties are imposed for failing to do so. These employees are treated as full-time (or not) during the immediately following stability period, depending on whether they averaged 30 or more hours of service per week during the immediately preceding measurement period (1,560 hours in the case of a 12-month period).[9]

When assessing a staffing firm's compliance with these rules, the first question should always be: what method is the employer using to assess an employee's status? It appears that most staffing firms have elected to use the look-back measurement method, and many have also concluded that most of their temporary and contract employees qualify as variable-hour employees. A variable-hour employee is defined in the ACA final regulations at §54.4980H-1(a)(49)(i):

> An employee if, based on the facts and circumstances at the employee's start date, the applicable large employer member cannot determine whether the employee is reasonably expected to be employed on average at least 30 hours of service per week during the initial measurement period because the employee's hours are variable or otherwise uncertain.[10]

Temporary-to perm employees in the vast majority of cases work full-time schedules, i.e., they are assigned to a client to work an average of at least 30 hours of service per week. Whether these employees are full-time employees for ACA purposes, and when and whether they must be offered coverage by the staffing firm during the temporary phase of the arrangement, depends on which measurement method the employer selects and how that method is applied. A staffing firm that elects to determine full-time status under the monthly measurement method will make offers of coverage to temporary-to-permanent employees in the same manner as any other employee. If the employees generally work full-time hours, as most do, coverage would be offered after a waiting period of not more than 90 days.[11] If, however, the staffing firm chooses to apply the look-back measurement method, the question is when, *if ever*, must coverage be offered to those employees?

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8. Ibid. §54.4980H-3(c)(2).
9. Ibid. §54.4980H-3(d)(1).
10. Ibid. §54.4980H-1(a)(49)(i).
11. Compare *Treas. Reg*. §54.4980H-3(c)(1) (requiring an offer of coverage by the first day of the month following three full months of employment) with Public Health Service Act §2708 (imposing a ban on waiting periods in excess of 90 days). See also *Treas. Reg*. §54.9815-2708(c)(3)(iii) (allowing employers to use an orientation period of up to 30 days).

Variable-Hour Factors

The final regulations set out list of general factors to be considered when employers determine variable-hour status. These include, but are not limited to

- Whether the employee is replacing an employee who was a full-time employee or a variable-hour employee
- The extent to which the hours of service of employees in the same or comparable positions have actually varied above and below an average of 30 hours of service per week during recent measurement periods
- Whether the job was advertised, or otherwise communicated to the new employee or otherwise documented (for example, through a contract or job description), as requiring hours of service that would average at least 30 hours of service per week, less than 30 hours of service per week, or vary above and below an average of 30 hours of service per week

The rules state that "these factors are only relevant for a particular new employee if the employer has no reason to anticipate that the facts and circumstances related to that new employee will be different."[12] No single factor is determinative, and an employer may not take into account the likelihood that the employee will terminate employment before the end of the initial measurement period.[13]

Where "an employee [is] hired by an employer for temporary placement at an unrelated entity" (e.g., by a temporary staffing firm), the final regulations prescribe the following additional factors:[14]

- Whether employees, as part of their continuing employment with the temporary staffing firm, retain the right to reject assignments
- Whether other employees in the same position of employment with the temporary staffing firm typically have periods during which no offer of temporary placement is made
- Whether other employees in the same position of employment with the temporary staffing firm typically are offered temporary placements for differing periods of time
- Whether other employees in the same position of employment with the temporary staffing firm typically are offered temporary placements that do not extend beyond 13 weeks

Applying the Factors to Temporary-to-Permanent Employees

Whether a temporary-to-permanent employee may be treated as variable hour requires an application of the factors set out in the final regulations. This table lists the factors and compares the treatment of temporary and contract employees with the treatment of employees hired under temporary-to-permanent arrangements.

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12. Treas. Reg. §54.4980H-1(a)(49)(ii)(A).
13. Ibid.
14. Ibid. Here and elsewhere in the final regulations, the regulators appear to distinguish between "staffing firms" and "temporary staffing firms" without explaining the distinction (see, e.g. 79 *Fed. Reg.* pp. 8,556-7 discussing abusive arrangements by temporary staffing firms. In the industry's view, it is a distinction without a difference.

General Factors Under *Treas. Reg.* §54.4980H-1(a)(49)(ii)(A)		
Factor	*Temporary and contract employees*	*Temporary-to-permanent employees*
Whether the employee is replacing an employee who was a full-time employee or a variable-hour employee	In many if not most instances, temporary and contract employees are not hired to replace full-time employees but to supplement the client's full-time workforce, fill high turnover positions, or provide short-term replacements for full-time employees who are temporarily absent. Thus, this factor generally should not weigh against variable-hour status.	Temporary-to-permanent employees generally are assigned for the purpose of allowing clients to determine the employees' suitability for permanent employment—either to replace employees who have been terminated or have quit, or as net additions to the client's workforce. In neither case should this weigh against variable-hour status.
The extent to which the hours of service of employees in the same or comparable positions have actually varied above and below an average of 30 hours of service per week during recent measurement periods	Most positions exceed 30 hours per week.	Most positions exceed 30 hours per week.
Whether the job was advertised, or otherwise communicated to the new employee or otherwise documented (for example, through a contract or job description), as requiring hours of service that would average at least 30 hours of service per week, less than 30 hours of service per week, or vary above and below an average of 30 hours of service per week	Most positions are advertised as exceeding 30 hours per week.	Most positions are advertised as exceeding 30 hours per week.

Staffing Firm-Specific Factors Under *Treas. Reg.* §54.4980H-1(A)(49)(Ii)(B)		
Factor	*Temporary and contract employees*	*Temporary-to-permanent employees*
Whether employees, as part of their continuing employment with the temporary staffing firm, retain the right to reject assignments	Temporary and contract employees generally retain the right to reject assignments.	Temporary-to-permanent employees generally retain the right to reject assignments.
Whether other employees in the same position of employment with the temporary staffing firm typically have periods during which no offer of temporary placement is made	This factor is applied to temporary and contract employees by assignment, although it's not clear in all cases what is meant by "the same position." But, however defined, temporary and contract employees generally satisfy this condition.	This factor could apply to a staffing firm's new temporary-to-permanent employee, if, historically, such employees typically go on multiple assignments before landing a permanent job.
Whether other employees in the same position of employment with the temporary staffing firm typically are offered temporary placements for differing periods of time	Temporary and contract employees are generally offered temporary placements for differing periods of time.	This factor could apply to a staffing firm's new temporary-to-permanent employee, if, historically, such employees typically go on multiple assignments before landing a permanent job.
Whether other employees in the same position of employment with the temporary staffing firm typically are offered temporary placements that do not extend beyond 13 weeks	Because most temporary and contract employees satisfy the previous three factors in the vast majority of cases, staffing firms may be able to meet the variable-hour criteria even though a significant number of assignments exceed 13 weeks (but in no case more than six months).	Temporary-to-permanent assignments typically do not extend beyond 13 weeks but, as with regular temporary or contract employees, this factor could be met even if a significant number of assignments exceed 13 weeks (but in no case more than six months).

The following example may help explain how the factors might apply to a temporary-permanent situation.

Staffing firm X is a large, regional staffing firm, with several lines of business, among which is a temporary-to-permanent segment. X has many defense industry clients that use temporary-to-permanent assignments to recruit employees for permanent positions. X maintains a strict policy under which no temporary-to-permanent assignment can last more than 90 days. X's clients tend to be highly selective, and employees assigned to them on a temporary-to-permanent basis typically do not secure permanent jobs on the first try. Many X employees go on multiple assignments with different clients before being offered a permanent job. The temporary phases of the assignments often vary in length, and the time between assignments also varies. Many employees never land a permanent job. As a result, X generally cannot determine on a new temporary-to-permanent employee's start date whether the employee will work full-time during the initial measurement period, because employees' hours are unpredictable and uncertain.

In the authors' view, if a staffing firm's temporary-to-permanent arrangements resemble the pattern described in this example, a reasonable argument can be made that new employees assigned to the same position as former temporary employees can be classified as variable hour.

A remaining question, of course, is what does "same position" mean in this context? Does it refer to employees assigned on a temporary-to-permanent basis in the same job category (e.g., information technology, finance, administrative, or industrial)? Or does the unique nature of the temporary-to-permanent arrangement, in and of itself, qualify as a type of position irrespective of the specific job for which the employee is auditioning? And why, from a policy standpoint, should that matter in the context of variable-hour analysis? The authors think a reasonable argument can be made that temporary-to-permanent is itself a unique type of position, but regulators may disagree, in which case the variable-hour factors would have to be applied to particular job categories.

Reporting Consequences

Beginning in 2016, for the 2015 calendar year, staffing firms will need to comply with the ACA reporting requirements by filing IRS Forms 1094-C and 1095-C. A staffing firm that has elected the look-back measurement period,[15] and has temporary-to-permanent employees who are properly classified as variable hour, will enter Code 2D on Line 16 of Form 1095-C, Part II, indicating that those employees were in a "§4980H(b) limited nonassessment period." As a consequence, the staffing firm will not be subject to assessable payments under §4980H(b) with respect to those employees, nor will the employees count as full time for purposes of the generally more onerous penalties under §4980H(a) while they are in their initial measurement periods.

15. For an in-depth discussion of the ACA reporting rules, see Mintz Blog (*employmentmattersblog.com/tag/affordable-care-act-2/*).

For the first reporting year, the IRS has announced a good faith compliance standard. Under this rule, carriers and issuers that file reports containing errors or omissions will not be subject to penalties so long as they can show a "good faith effort" to comply with the requirements.[16] This relief does not apply to late filers. If errors are later discovered in a report, correction is required in the form of an amended submission. As a result, even if the IRS determines that a staffing firm incorrectly treats its temporary-to-permanent employees as variable hour, the firm will have an opportunity to reconsider the decision and make changes where appropriate, provided that the initial position was arrived at in good faith.

Conclusion

In the authors' experience, the work patterns of employees on temporary-to-permanent assignments tend not to be as sporadic, intermittent, or unpredictable as those of regular temporary and contract employees, and thus it may be marginally more difficult to classify the employees on temporary-to-permanent assignments as variable hour. However, if historically the variable-hour factors can be demonstrated, as in the example of Staffing Firm X, it may be reasonable to classify new employees assigned to those positions as variable hour.

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16. See Questions and Answers on Reporting of Offers of Health Insurance Coverage by Employers (Section 6056), Q&A 3, *irs.gov/affordable-care-act/employers/questions-and-answers-on-reporting-of-offers-of-health-insurance-coverage-by-employers-section-6056* (establishing the good faith compliance standard).