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Buyer Beware! Potential Risks With Employee Health Plans, EOR Services, and Online Platforms

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Employer of Record?

- **Definitions vary:**
 - A third-party organization that becomes the full legal employer of your workforce and assumes all employer-related responsibilities and tasks on behalf of your company
 - Takes on a company's human resource responsibilities and onboards, pays, and manages your supported employees while you maintain and control the day-to-day operations



Functions of an Employer of Record

- EORs assume the following tasks or roles:
 - Legal responsibility to pay employees, including payroll taxes, Forms W-2 and Forms 941
 - Benefits and insurance
 - Human resource operations
 - Visa/sponsor applications for clients employing foreign workers



Intended Relationship

Goal of the EOR relationship:

- As name suggests, an EOR seeks employer of record status for client's workers
- As employer, the EOR can ensure the client complies with tax and labor laws
- As employer, the EOR can provide retirement benefits
- As employer, the EOR can provide insurance benefits



Why Hire an EOR?

- Businesses hire EORs to simplify worker and work site relationships
- Reduce complications and headaches associated with
 - Human resource operations
 - Market access/participation
 - Managing



Are EORs and PEOs the Same?

EOR vs. Professional Employer Organization (PEO)

- Many similarities exist, most notably payroll functions and benefits
- However, distinct rationale for providing payroll and offering employee benefits
 - “Employer” of record as single employer, co-employer, common law employer or simply new status as “employer of record”
- Most EORs (and likely PEOs) would assert the differences

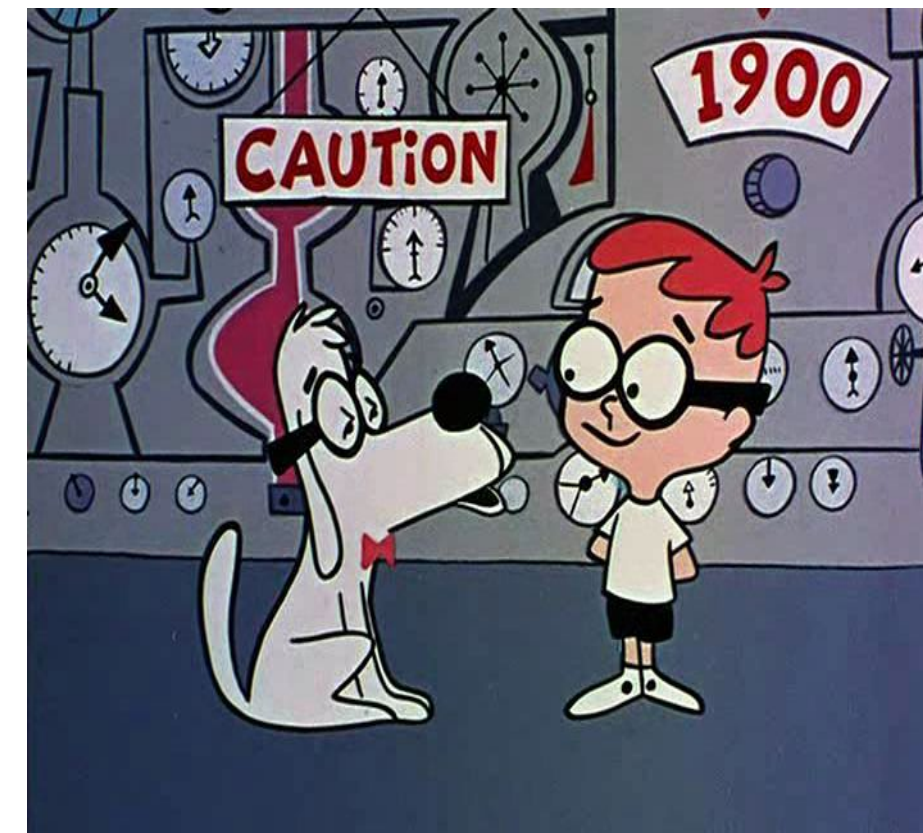
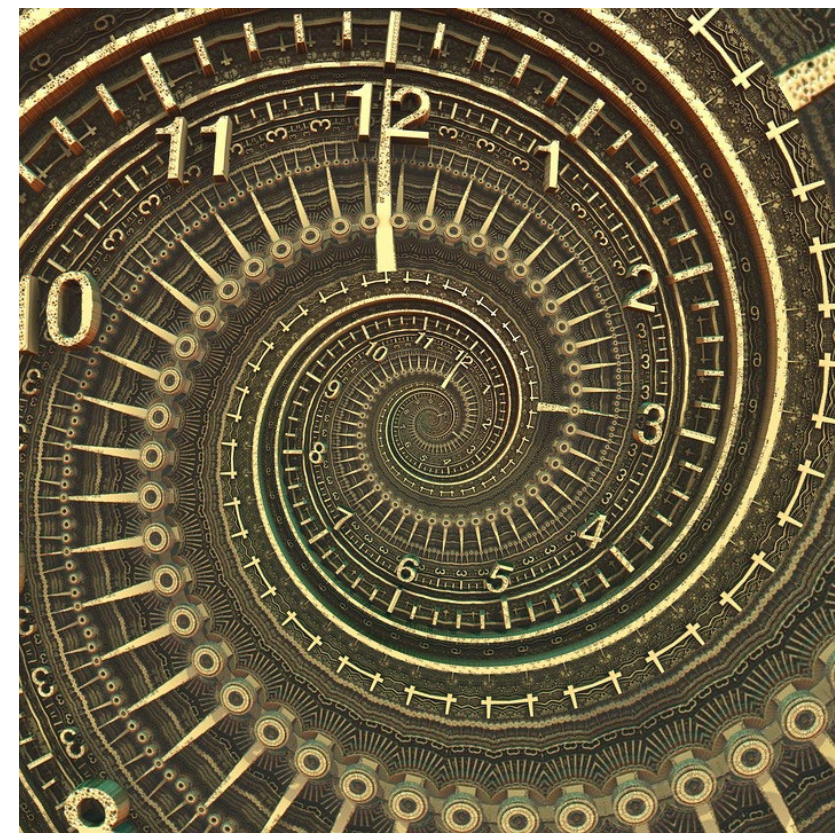


Payroll Functions: The Backbone of EOR Status

- For all their differences, payroll is the critical similarity
- Key payroll questions:
 - What status supports payroll functions?
 - Does employer status for payroll support employer status for retirement and fringe benefits?
 - Does employer status for payroll support employer status for insurance (health, life, workers' compensation, and unemployment)?
 - Does employer status for payroll support employer status for employment law purposes?

IRS Perspective of EOR Payroll Functions

- To find these answers and the perspective of the U.S. Internal Revenue Service, we travel through time using the Wayback Machine





IRS Perspective of EOR Payroll Functions

- To perform payroll functions using name and employer identification number as a more generalized employer of record, an entity must have one of the following statuses:
 - Common law employer
 - Statutory employer
 - Authorized payroll agent
 - Certified professional employer organization





Common Law Employer

- The focus is on the right to direct and control workers
- Heavy focus on actual exercise of direction/control
- Three-part common law test (replaces IRS 20-factor test):
 - Behavioral control
 - Financial control
 - Relationship control/intent of the parties





Statutory Employer

- Derives its name from U.S. Code Section 3401(d)(1)
- Entity is solely liable for payroll taxes, information reporting, filing, etc.
- Focus is on the control of the payment of wages
- It is determined by the facts
 - Not elective
 - Either are or are not a statutory employer under the facts
- Has been extended to FICA and FUTA by the courts





Statutory Employer (cont'd)

- IRS challenges
- Recent court challenges:
 - *Paychex Business Solutions*
 - *TriNet*
- Legislative activity
 - Biden administration tax proposal





Authorized Payroll Agent

- Code Section 3504
- An election by the common law employer and *any* third party to assign payroll functions to the third party
- Election using Form 2678
- Creates joint and several liability
- Commonly used by the federal government...
 - And IRS tries to pigeonhole taxpayers into 3504 status





Certified Professional Employer Organization

- Code Section 7705 defines CPEOs to provide payroll
- Section 3511—a CPEO “shall be treated as the employer” for specified federal tax purposes
- As name implies, must become certified under IRS program
- Sole liability for payroll taxes under Subtitle C
- Once certified, may also provide certain types of benefits to the work site employees based upon CPEO status





IRS View of EOR Status

- It depends—as with early stages of PEO industry, it is love/hate relationship
- Love:
 - Report workers as employees
 - Provide benefits
 - Enhance payroll tax collection
- Hate:
 - Blurring of employer lines from technical legal basis
 - Single vs. multiple employer plans
 - Some bad actors that defraud U.S. Treasury of payroll taxes





IRS View of EOR Status (cont'd)

- How does the EOR perform payroll?
 - Statutory employer
 - Authorized pay agent
 - Common law employer
- Does payroll status support employee benefit functions?
- Does payroll status support insurance functions?
- Caveat: IRS still challenges payroll functions of some PEOs





IRS View of EOR Status (cont'd)

- How does the EOR provide employee benefits?
 - Single-employer plan
 - Multiple-employer plans
 - Licensed as PEO
 - Disclosure to the insurers/parties providing/administering the benefits





IRS Risks and Exposures With *Some* EORs

- Joint and several payroll tax responsibility:
 - If EOR fails to pay taxes, goes after client
- Disqualification of single-employer plans
- Recharacterization of favorable tax benefits
- Reallocation of tax credits
- Penalties and interest
- Interaction with state taxing authorities





How to Choose an EOR

- Determine authority to provide payroll
- Review tax compliance/audit history and periodic review of IRS transcripts
- Publicly traded and/or adequately funded
- How are employee benefits provided and who are the carriers/providers
- Track record/client testimonials
- Recharacterize workers as independent contractors
- Use common sense



Double Dipping 3.0: Hospital/Fixed Indemnity Schemes Promising Big Payroll Tax Savings



The Basics

<i>Code Section 104(a)(3)</i>	<i>Code Section 105(b)</i>	<i>Code Section 106(a)</i>	<i>Code Section 125</i>	<i>Code Sections 3101, 3111, 3121(a), 3306(b), (c), 3401(a)</i>
Gross income does not include amounts received through an individual accident or health insurance plan for personal injuries or sickness, if paid by the employee <i>after tax</i>	Payments or reimbursements of qualified medical expenses received are excludable from employees' gross income and not subject to payroll tax	Gross income does not include the value of employer-provided coverage under an accident or health insurance plan	Employee contributions to group health insurance plans and accident and health insurance plans are allowed to be made	Collectively, these are the provisions of the tax code governing payroll taxes—the tax is on “wages,” which is broadly defined but does not include medical expense



Treas. Reg. §1.105-2 and Rev. Rul. 69-154

- Treas. Reg. §1.105-2: Section 105(b) is not applicable to the extent that amounts reimbursed exceed the amount of the actual expenses for such medical care
- Payments under health policies are excludable from income only up to the amount of unreimbursed medical care expenses incurred; the excess (referred to as the “excess reimbursement”) is includible in income
- In Revenue Ruling 69-154, an employee received indemnity from an employer-provided supplemental medical insurance policy that was greater than the amount of unreimbursed medical care expenses that he incurred
- The supplemental indemnity was “reimbursement” for the medical care expenses and was excludable up to the amount of the otherwise unreimbursed portion of the medical care expenses incurred pursuant to Code §105(b); the excess amounts were taxable



Double Dipping 1.0: Rev. Rul. 2002-3

The Plan	The Problem
<ul style="list-style-type: none">• Employers reimbursed employees, purportedly tax free, for health insurance premiums paid by the employees• Employees paid for coverage pretax, thus reducing the employee's taxable income and the employer's payroll tax liability• Employer reimbursed the employee for the premium expenses deducted from salary, claiming the reimbursements as an employer expense that were not taxable income to the employee	<ul style="list-style-type: none">• For an employee to be reimbursed on a nontaxable basis for the insurance premiums, the employee must first incur the expense• Because the employee paid the premium with pretax dollars, and because the law treats the portion of the premium reimbursed as an expense paid by the <i>employer</i> and not the employee, the employer was effectively taking the deduction twice, hence the "double dip"• Reimbursed amounts must be included in the employees' income, and they are also subject to payroll taxes



Double Dipping 2.0

GCM 201622031, April 14, 2016	GCM 201703013, Dec. 12, 2016	GCM 201719025, April 24, 2017
<ul style="list-style-type: none">• This memorandum involved an arrangement that excludes from income cash rewards paid to an employee for participating in a wellness program• The IRS held that the cash payment and premium reimbursements could not be excluded from the taxable income• Payments/reimbursements are subject to income and payroll taxes	<ul style="list-style-type: none">• When a fixed indemnity health insurance plan is employer-paid or purchased on a pretax basis, favorable tax-free treatment is not available because the amount paid is not a reimbursement of medical care• Amounts paid under the fixed indemnity health insurance plan are taxable	<ul style="list-style-type: none">• The memo addresses a wellness program that makes after-tax contributions to a self-insured health insurance plan and provides fixed cash payments for no-cost activities such as attending a health seminar or calling a telephone number and hearing health information• That the program was self-funded was determined to be fatal



Double Dipping 3.0

Hospital/Fixed Indemnity Policies Licensed Under State Law

Integrated arrangements

- In an integrated arrangement, all the program benefits are provided under a single hospital/fixed indemnity policy

Bifurcated arrangements

- Bifurcated arrangements, as the name suggests, separate out the hospital/fixed indemnity segment from a separate wellness feature
- The wellness feature is sometimes structured as a policy rider

In addition to hospital/indemnity and wellness features, some programs include a “direct primary care” benefit, a “minimum essential coverage” or “MEC” (i.e., preventative-services only) feature, dental coverage, prescription drug discount, or telehealth benefits, among others



The Promoters' Core Claim

- Reimbursements are not compensation for services; they are rather a benefit payment—some or all of which might be a taxable, excess benefit that is not subject to payroll taxes
- But if a covered individual forgoes, say, \$1,000 in compensation in return for a benefit of \$1,000 in benefits, where is the substance?
- The claimed net result is that payroll taxes are eliminated to the full extent of the benefit payment, despite that income tax likely is owed on most or all of the same benefit payment



Issues

Definition of Hospital/Fixed Indemnity insurance	Application of Applicable Tax Rules	“Green Book”
<ul style="list-style-type: none">• These programs conflate and confuse federal and state law• This implicates:<ul style="list-style-type: none">• Health Insurance Portability and Accountability Act—portability, privacy, and security• Affordable Care Act wellness and insurance market reforms• Americans With Disabilities Act• Genetic Information Nondiscrimination Act• Consolidated Omnibus Budget Reconciliation Act• Employee Retirement Income Security Act	<p>The programs generally misapply the relevant tax principles and corresponding Internal Revenue Code provisions on which medical benefits may be excluded from income</p>	<p>Promoter claims that the Green Book legislative proposals targeting the provisions of the tax code on which their programs rely for the efficacy of their programs are misplaced</p>



The Bottom Line: ASA Views

- If the Green Book's proposals on the subject were adopted, the tax benefits claimed by the proposals would be unambiguously eliminated
- At present, in the absence of a clarification by Congress or the IRS, there is at least some ambiguity under current law
- It is simplistic and unhelpful to ask whether the programs comply with, or fail to comply with, applicable law
- Casting the issue in binary terms obscures the better questions: How much risk exactly? And is that level of risk acceptable?
- ASA is urging members to consider these questions before adopting these programs



Worker Misclassification



Health Care Worker Classification

- Some online job platforms classify nurses and nurse aides as “1099 workers,” avoiding payroll taxes and other costs
- Creates unlevel competitive playing field and puts clients and workers at risk
 - Client payroll tax liability; employee FICA tax liability
 - Unpaid overtime
 - No coverage for workplace injuries
 - No professional liability insurance



ASA Steps to Combat Misclassification

- Education
 - ASA issue paper describing risks sent to staffing firms, health care facilities, trade groups, media, and regulators
- Enforcement action
 - ASA met with top U.S. Department of Labor officials urging stepped-up enforcement against misclassification
 - ASA participated in Washington conference hosted by former Sen. Majority Leader Tom Daschle to spotlight the issues



Legal Status of Platforms

- Platforms operating on Uber/Lyft model may be using independent contractors, but clients may be liable based on control
 - Arizona, Florida, Iowa, Kentucky, Tennessee, and Utah have laws deeming workers on “marketplace platforms” independent contractors, and not employees of the platform, if certain criteria are met; but client status not addressed
 - Trump DOL opinion letter supported independent contractor status of platforms and platform workers, but letter was withdrawn by Biden DOL
 - ASA has sent letter to Treasury seeking clarification of client status