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A Thorny Issue: Independent Contractors and Group Health Plan Coverage

This column deals with the potential problems of adding independent contractors to a company's medical plan for traditional employees.

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In this time of work-from-home arrangements, furloughs, lay-offs, gig workers, and baby boomers with years of expertise wanting to ease into retirement, employers are changing the way they structure the relationship with their workers. This includes hiring independent contractors. To respond to workers' needs for health coverage, some employers are considering adding independent contractors to their medical coverage. This may seem like a simple solution and great business decision, but as in anything benefits-related, the devil is in the details and it can be a compliance minefield.

What Do the Insurers Have to Say?

For fully-insured plans, the insurer determines who they will cover. Most insurance policies provide for

the coverage of *employees* and their dependents. As a non-employee, an independent contractor may not be covered under the contract with the insurer. This means that if the independent contractor is promised medical coverage as a term of their agreement with the employer, the employer may end up self-insuring the medical expenses of the independent contractor out of its general assets. For self-insured plans, a similar issue can arise with stop-loss insurance. As with fully-insured plans, the employer may end up paying for large medical expenses that would normally be paid by the stop-loss insurer. Before making any offers of medical coverage to an independent contractor, employers should make sure they first review their insurance and stop-loss policies (if applicable).

What Does the Plan Document Say?

Plan documents should be reviewed. Even if the insurer agrees to cover a nonemployee, the plan's governing document (often called a wrap document) may not provide for this. An external document, such as a services contract with an independent contractor, generally will not be treated as an amendment of, or have any effect on, plan provisions on its own. Some language should be established in the plan document that sets out eligibility for any worker participating in the plan. This may require an express amendment to the plan document before the coverage can be offered.

Does This Create an Employer-Employee Relationship?

Whether a worker is designated by the employer as an independent contractor or as an employee is not definitive. Under Revenue Ruling 87-41 [Rev. Rul. 87-41, 1987-1 CB 296] (setting out a 20-factor test), *Nationwide Mutual Insurance Company v. Darden* [112 S. Ct. 1344 (1992)] applying the common law definition of "employee", and as most infamously set forth in *Vizcaino v. Microsoft Corp.*, [290 F.3d 1043, 9th Cir. (Wash.), May 15, 2002] [Note that this issue is also on the radar of state legislatures, such as the recently-enacted California Assembly Bill 5 (2020). AB 5 codifies and expands the California Supreme Court's 2018 ruling in *Dynamex Ops. W. v. Superior Court of Los Angeles*, 4 Cal. 5th 903 (2018), which set a new test for determining the employment status of workers] in spite of an employer's designation to the contrary, or even the terms of the agreement between the parties, a worker designated as an independent contractor can be determined to be, in fact, an employee. Facts and circumstances, such as who has control over how, where and when the workers perform their services, or how they are paid, are examined to determine the employer-worker relationship. The fact that an independent contractor is covered under the health plan established by the employer for its employees could weigh towards the establishment of an employer-employee relationship. This most recently was addressed in final regulations published by the Wage and Hour Division of the Department of Labor on January 6, 2021, which established a new test for employee status for purposes of the Fair Labor Standards Act (FLSA). These regulations indicate that:

> The offering of health, retirement, and other benefits is not necessarily indicative of employment status . . . [h]owever, providing a worker with the same employer-provided health or retirement plans on the terms that a business also gives its own employees may indicate the worker is not an independent contractor but rather an employee. [Independent Contractor Status under the Fair Labor Standards Act, 29 CFR Parts 780, 788, and 795 January 6, 2021, originally effective March 8, 2021, delayed by incoming Biden Administration on January 20, 2021 for 60 days from that date. As of the date of preparation for publication of this article, the Biden Administration has announced it is reviewing these regulations, and the fate of these regulations is unknown]

Misclassification of an employee or an independent contractor could open up a Pandora's box with regards to eligibility for other employee benefits that the employer never intended to extend to the independent contractor, such as retirement plan benefits.

Can the Independent Contractor Pay Premiums on a Pre-Tax Basis?

If the independent contractor is covered under the hiring employer's health plan, they are not able to pay their premiums on a pre-tax basis. In order to pay for premiums on a pre-tax basis, premiums must be paid through a Code Section 125 Plan. [26 U.S. Code § 125 (a)] A Code Section 125 plan may only be made available to employees. [26 U.S. Code § 125 (d)(1)(A)] As a nonemployee worker, the independent contractor is ineligible to participate in a Code Section 125 plan. The independent contractor may be able to deduct the amounts paid for health coverage from their income when filing their income tax depending on their individual tax situation.

Can Any Employer Contribution Towards Health Coverage Be Excluded from the Independent Contractor's Income?

Any contribution the employer makes towards an individual independent contractor's health coverage cannot be excluded from the income of the independent contractor. Like Code Section 125, Code Section 105 permits the exclusion of costs for accident or health costs from the income of an employee. [26 U.S. Code § 105(a)] Further, Code Section 105 expressly says that a self-employed individual is not an employee. [26 U.S. Code § 105(g)] Therefore, as a nonemployee, the individual independent contractor is not eligible for this exclusion. However, the amounts paid by the employer for this as well as other expenses related to the independent contractor generally may be deducted by the employer under Code Section 162(a) as an ordinary and necessary business expense of carrying on a trade or business.

Could Including an Independent Contractor under a Single Employer Health Plan Create a MEWA?

An independent contractor may be a sole proprietor, a corporation, or some other type of business entity. They will, in almost all cases, be unrelated to the employer and the employer's own controlled group. The participation of an unrelated business entity in an employer's group health plan creates a multiple employer welfare arrangement (MEWA). MEWAs have special federal, and in some cases state, filing requirements. Self-insured MEWAs can be subject to (or, as a practical matter, be prohibited by) state insurance laws… and that opens up a can of worms. State rules for MEWAs vary from state-to-state, and MEWAs must satisfy the applicable rules in each state in which it operates, complicating administration to say the least.

What Should an Employer Do?

Because of all of the issues discussed above, it generally is not a good idea to put an independent contractor on an employer's group health plan. There are other ways of compensating independent contractors and ensuring they can get the health coverage they need, in order to attract and retain skilled workers. For example, a company could provide the independent contractor with additional compensation in lieu of medical benefits. The independent contractor could then purchase coverage on an exchange if they so choose. Employers should carefully review its worker classifications, and consult with their legal counsel to determine what option best suits their situation. ■