INDEPENDENT CONTRACTOR MISCLASSIFICATION PENALTIES UNDER THE AFFORDABLE CARE ACT

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President Barack Obama signed the Patient Protection and Affordable Care Act ("ACA") into law on March 23, 2010.[1] Today, more than three years later, the ACA remains one of the most politically divisive issues currently facing our nation.[2] It is so divisive in fact that it led to the first federal government shutdown in seventeen years.[3] Moreover, healthcare management disagreements also caused, in part, the 1996 federal government shut down.[4]

The present controversy in Congress is described as follows: The ACA's centerpiece is the creation of an individual responsibility to carry a particular level of medical insurance called minimum essential coverage or pay a financial penalty (the "individual mandate").[5] Conversely, certain employers have a parallel responsibility to offer a particular level of medical insurance, a qualified healthcare plan, to full-time employees or also pay a financial penalty ("the employer mandate").[6] As originally enacted, both the individual and employer mandates were set to begin on January 1, 2014.[7] This changed on

1. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) [hereinafter ACA] (codified as amended in scattered sections of the U.S.C.).

2. *See* Connie Cass, *Government's Work Stacking up a Week Into the Shutdown*, ASSOCIATED PRESS, Oct. 7, 2013, *available at* http://www.bigstory.ap.org/article/governments-work-stacking-week-shutdown (explaining the effects of the government's latest shutdown that was caused by the divisive politics of the ACA); *see also Obama: Shutdown is Result of Ideological Crusade*, ASSOCIATED PRESS, Oct. 1, 2013, *available at* http://www.bigstory.ap.org/article/obama-calls-quick-end-government-shutdown (quoting President Obama's statement that "Republicans have shut down the federal government over an 'ideological crusade'" against the ACA).

3. Lori Montgomery & Paul Kane, *Shutdown Begins: Stalemate Forces First U.S. Government Closure in 17 Years*, WASH. POST (Sept. 30, 2013), http://www.articles.washingtonpost.com/2013-09-30/politics/42513138_1_prison-guards-federal-workers-shutdown.

4. *See* Jennifer Steinhauer, *Last Shutdown a Lesson Lost on Capitol Hill*, N.Y. TIMES (Sept. 28, 2013), http://www.nytimes.com/2013/09/29/us/politics/last-shutdown-a-lesson-lost-on-capitol-hill.html (noting the 1996 government shutdown was ultimately provoked by "a side fight over Medicare premiums").

5. ACA § 1501, 26 U.S.C. § 5000A; *see also* Tom Cohen, *U.S. Government Shuts Down as Congress Can't Agree on Spending Bill*, CNN (Oct. 1, 2013, 12:43 AM), http://www.cnn.com/2013/09/30/politics/shutdown-showdown/ (explaining the controversy over the individual mandate).

6. ACA §§ 1511, 1513 (codified as amended in scattered sections 26, 29 U.S.C.).

7. *See* 26 U.S.C. §§ 5000A, 4980H.

July 2, 2013, when the Obama Administration announced that the employer mandate penalties and reporting requirements would be delayed until January 1, 2015.[8] Republicans also wanted the individual mandate to be delayed until January 1, 2015.[9] This is the controversy in the U.S. Congress that led our nation's federal government to shut down this past fall. While the date by which individuals had to purchase coverage was extended for a few days,[10] the individual mandate nevertheless took effect on January 1, 2014, as scheduled.

The employer mandate delay was received with a sigh of relief by the employer community.[11] Nevertheless, many employers are still not taking the necessary steps to both remain competitive in their particular labor markets, and to avoid government audits, investigations and lawsuits. Every company is unique. No company has the same owners, the same employees, or faces the same challenges with the benefit of the same resources. Notwithstanding these differences, some industry wide guidance is available for energy companies hoping to successfully navigate the ACA and remain competitive for labor.[12]

The media's coverage of the employer mandate has almost exclusively restricted itself to how that mandate will affect low-wage, unskilled labor markets.[13] Such coverage does little to

8. Mark J. Mazur, *Continuing to Implement the ACA in a Careful, Thoughtful Manner*, U.S. DEP'T OF TREASURY BLOG (July 2, 2013), http://www.treasury.gov/connect/blog/pages/continuing-to-implement-the-aca-in-a-careful-thoughtful-manner-.aspx.

9. Jake Sherman, John Bresnahan & Burgess Everett, *Government Shutdown: Congress Sputters on CR*, POLITICO (Sept. 30, 2013, 10:03 AM), http://www.politico.com/story/2013/09/house-senate-government-shutdown-97557.html (last updated Oct. 1, 2013).

10. *See* Guaranteed Availability of Coverage, 45 C.F.R. § 147.104 (2014).

11. *See, e.g.*, Michael Iorfino, *Business Executives, School Administrators Relieved Over Delay in Employer Mandate*, TIMES-TRIBUNE (July 10, 2013), http://www.thetimes-tribune.com/news/business-executives-school-administrators-relieved-over-delay-in-employer-mandate-1.1518415 (discussing the reaction of business executives and school administrators to the delay).

12. *See, e.g.*, Laura L. Roman, *Health Care Reform and Its Impact in 2014 for Oil and Gas Companies*, TAX ADVISOR (Aug. 1, 2013), http://www.aicpa.org/publications/taxadviser/2013/august/pages/tax-clinic-story-06.aspx.

13. *See, e.g.*, John Goodman, *The Cruel Things President Obama is Doing to the Labor Market*, FORBES (Mar. 7, 2013, 8:00 AM), http://www.forbes.com/sites/

aid most energy corridor employers who, for the most part, do not operate out of low-wage, unskilled labor pools.[14] How such employers react to the employer mandate should be completely different from how an employer in the energy industry reacts. An appropriate employer reaction accounts not only for what the law says, but also what labor marketplaces dictate.

Some reports indicate that while overall employment has increased roughly one percent over the last few years, oil and gas employment has increased at a rate of forty percent over the same period.[15] However, the labor supply is not keeping up with employer demand.[16] As it relates to their workforces, oil and gas employers are largely worried about a labor shortage.[17] These employer concerns are evidenced by increased salaries, bonuses, and increases in other fringe benefits offered to employees.[18]

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johngoodman/2013/03/07/the-cruel-things-president-obama-is-doing-to-the-labor-market; Jeffrey Young, *The Biggest Myth About Obamacare*, HUFFINGTON POST (Oct. 10, 2013, 12:18 PM), http://www.huffingtonpost.com/2013/09/23/obamacare-change_n_3975425.html.

14. *See* IDENTIFYING AND ADDRESSING WORKFORCE CHALLENGES IN AMERICA'S ENERGY INDUSTRY, U.S. DEP'T OF LABOR, EMPLOYMENT AND TRAINING ADMINISTRATION 14 (2007) ("Individuals entering the workforce too often lack the foundational math and science skill sets they need to be successful in the energy industry. This creates an insufficient labor pool from which industry is able to recruit new workers."); *see also* THE OIL & GAS GLOBAL SALARY GUIDE 2012, HAYS 20 (2012) [hereinafter HAYS REPORT], *available at* http://www.hays.com/prd_consump/groups/hays_common/@og/@content/documents/digitalasset/hays_724929.pdf (noting the diminished "pool of available talent" in the energy industry in 2012 that has led to companies seeking to employ new talent and retrain current employees).

15. *See, e.g.*, *Oil and Gas Industry Employment Growing Much Faster Than Total Private Sector Employment*, U.S. ENERGY INFO. ADMIN. (Aug. 8, 2013), http://www.eia.gov/todayinenergy/detail.cfm?id=12451.

16. Jeff Brady, *As Workers Age, Oil Industry Braces for Skills Gap*, NPR (Apr. 20, 2012, 3:22 AM), http://www.npr.org/2012/04/20/150871935/as-workers-age-oil-industry-braces-for-skills-gap.

17. HAYS REPORT, *supra* note 14, at 25, 27 (noting that skill shortages is the largest concern in the industry.

18. *See id.* at 7, 11–12 (describing that an increase in benefits reflects the desire of companies to incentivize growth); *see also* Simone Sebastian, *Luring Top Oil Talent Demands Perks*, FUELFIX.COM (Dec. 3, 2012, 7:08 AM), http://www.fuelfix.com/blog/2012/12/03/luring-top-oil-talent-demands-perks/?cmpid=eefl (highlighting the salary hikes, signing bonuses, and non-monetary perks being used in the oil and gas industry to "lure" employees and keep them away from competitors).

While some employers may be taking steps to skirt offering employees healthcare benefits, the same response from an oil and gas employer could be disastrous given the current labor marketplace in which the latter competes for labor. Aside from salary, healthcare is often cited as one of the most important variables in a skilled employee's decision to accept a job offer or remain employed with a particular employer.[19] In a highly competitive market for employees, the question is not whether employers can afford to offer full-time employees coverage, but instead, whether they can afford not to do so.

It is clear that to remain competitive in such a currently fiercely competitive labor market, energy companies are going to have to offer employees robust benefits as they compete with each other for employees.[20] It is also clear that it is far more likely that a worker performing services for a particular energy company may be misclassified by that energy company as an independent contractor, thereby rendering that misclassified worker ineligible for benefits under the ACA.[21] Therefore, independent contractor relationships need to be reviewed with increased vigor during 2014 to ensure that any particular

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19. Paula Andruss, *How to Attract—And Retain—Staff When You Can't Pay Big Bucks*, ENTREPRENEUR (June 27, 2012), http://www.entrepreneur.com/article/223516 (noting that medical insurance "tops the list of employee demands," and highlighting a 2011 study finding ninety percent of employees deem health insurance as the most important benefit).

20. 2012 EMPLOYEE BENEFITS: THE EMPLOYEE BENEFITS LANDSCAPE IN A RECOVERING ECONOMY, SOCIETY FOR HUMAN RESOURCE MANAGEMENT 5 (2012) (advising that organizations that have difficulty finding skilled workers to fill key jobs "should examine their benefits offerings as a way to retain and recruit top talent").

21. *See US Department of Labor Follows the Fissures in the Fracking Industry: Wage and Hour Division Drills to Remedy the Misclassification of Employees as Independent Contractors, Other Wage Violations*, U.S. DEP'T OF LABOR [hereinafter DOL REPORT], *available at* http://www.rmecosha.com/NDAKOTASTANDDOWN/Wage_Hour_Enforcement_Article.pdf (last visited Jan. 7, 2014) (explaining the competitive nature of the fracking industry that has led to widespread misclassification of independent contractors in the oil and gas industries, resulting in numerous FLSA violations). For example Honghua America, an oil and gas equipment manufacturing company based in Houston, Texas, paid over $680,000 in back wages to 133 employees after the Department of Labor found those employees had been misclassified as independent contractors. L.M. Sixel, *133 Workers Win Thousands in OT*, HOUS. CHRON., June 4, 2013, at B6.

company's response to the ACA has been adequately tailored.[22] The goal of this Article is to justify that renewed vigor.

I. Background on Employer Mandate Penalties

The Affordable Care Act's employer mandate requires certain employers to offer certain benefits to its full-time employees or pay a nondeductible penalty to the IRS for noncompliance.[23] Employers that employ more than fifty individuals must undertake some rather arcane calculations to determine if they are required to comply with the employer mandate because of their size.[24] I will assume for this Article's purpose that all employees are full-time employees and dispense with arcane calculations involving full-time equivalents and part-time employees.[25]

The Affordable Care Act refers to an employer that has at least fifty full-time employees or their equivalent as an Applicable Large Employer ("ALE").[26] An ALE must offer all of its full-time employees a qualified healthcare plan, or pay a nondeductible penalty to the IRS.[27] An employer has essentially

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22. With the increased demand for workers in the energy sector, the incentive to classify employees as independent contracts increases. *See, e.g.*, DOL Report, *supra* note 21 ("According to Bureau of Labor Statistics and Bureau of Economic Analysis data, mining, quarrying and oil & gas extraction have seen a dramatic increase in the number of workers not covered by unemployment insurance. In 2005, 67% of this industry's workers were covered by unemployment insurance. By 2010, only 55% remained covered. According to BEA data, during this same time period the industry grew by more than 350,000 jobs. This evidence suggests a major shift in the industry toward classifying workers as independent contractors rather than employees.").

23. 26 U.S.C. § 4980H.

24. *Id.*

25. Part-time energy jobs are rare, especially in a labor market where there are not enough workers to do the work available. *See* Hays Report, *supra* note 14, at 20, 22 (describing a shortage of skilled labor in the oil and gas industry as well as a graph showing that part-time jobs account for less than ten percent of all employment in the industry). Therefore, to account for that reality and to keep things short and simple, we will assume all scenarios are based on full-time employees. For an in-depth analysis and explanation of how full-time equivalents are calculated, see Mario K. Castillo, The Business Owner's Guide to The Employer Mandate 34–35 (2013).

26. 26 U.S.C. § 4980H(c)(2).

27. *Id.* § 4980H(a), (c); *see also* Kosali Simon, *Implications of Health Care Reform for Employers: An Analysis of the Patient Protection and Affordable Care Act*, Ctr. for Am. Progress 6 (2010), *available at* http://www.americanprogress.org/issues/2010/05/

three options once it learns it is an ALE: (1) offer a qualified healthcare plan to all full-time employees, (2) offer some lesser healthcare plan to all full-time employees, or (3) offer nothing to those full-time employees.[28]

If an employer chooses the second or third option, the full-time employee can go to an exchange to obtain coverage.[29] Depending on the employee's income, the employee may qualify for a government subsidy to help defray the cost of buying health insurance coverage without the employer's help.[30] If a full-time employee obtains a subsidy, regulators will audit the employer who employed that full-time employee during the month for which a subsidy was authorized.[31] Regulators will then impose a penalty commensurate with whether the employer elected the second or third option outlined above.

The employer mandate penalty tied to an employer's second option is called the "weak penalty."[32] The employer mandate

pdf/health_employers.pdf.

28. The ACA encourages employers to offer a qualified health plan (the first option) by imposing penalties for those employers who offer a lesser qualified plan (the second option), and for those who do not offer any insurance (the third option). 26 U.S.C. § 4980H(a)–(b); *see also Why Health Law's 'Essential' Coverage Might Mean 'Bare Bones'*, KAISER HEALTH NEWS (Aug. 25, 2013), http://www.kaiserhealthnews.org/Stories/2013/August/26/essential-benefits-bare-bones-health-insurance.aspx (noting that the ACA allows employers to opt to pay lower penalties for offering a "skinny plan" rather than incur the expense of offering an affordable, ACA compliant health plan); Simon, *supra* note 27, at 6–7 (explaining why some employers will opt to pay a penalty rather than incur the expense of offering an ACA compliant health plan).

29. *See* Mary Agnes Carey & Julie Appleby, *FAQ: What You Need to Know About the New Online Marketplaces*, KAISER HEALTH NEWS (Sept. 16, 2013), http://www.kaiserhealthnews.org/stories/2013/september/17/marketplace-faq-insurance-exchange-obamacare-aca.aspx (explaining that people are eligible to purchase coverage through the exchange if they cannot obtain a health plan through their employer or if the employer-based coverage is expensive or inadequate).

30. 26 U.S.C. § 4980H(a); *see also* Carey & Appleby, *supra* note 29 (explaining how an employee may qualify for a government subsidy). For a more in-depth discussion on exchanges under the ACA, see CASTILLO, *supra* note 25, at 85–97.

31. *See* 26 U.S.C. § 4980H(d) (delegating the Secretary of the Department of the Treasury with the authority to administer, regulate, and collect penalties under section 4980H). Conceivably this includes the ability to "audit" employers to determine applicability of penalties assessable under section 1513(c) and (a), which correspond to options two and three, respectively.

32. *See* Avik Roy, *Employers Can Minimize Their Exposure to Obamacare's*

penalty tied to an employer's third option is called the "strong penalty."[33]

The weak penalty gets its name because it is the less severe of the two and is reserved for employers that at least try to comply with the ACA to some extent. An affected ALE has to pay a yearly penalty of $3,000 (or a monthly penalty of $250) for every full-time employee that obtains a government subsidy.[34] The reason this penalty is called the "weak" penalty is because the employer will only have to pay for each full-time employee that actually obtains a subsidy on an exchange.[35] In other words, if only one full-time employee obtains a subsidy, that employer pays $250 for every month that the employer employed that otherwise eligible full-time employee.

The strong penalty gets its name because it is the more severe of the two penalties and is reserved for employers that do nothing. Under this penalty, an affected employer adds all of its full-time employees and then subtracts thirty—then multiplies each remaining full-time employee by a yearly penalty of $2,000 (or $167 a month).[36] For example, if an employer has fifty full-time employees, that employer would subtract thirty employees (leaving twenty), and then multiple that twenty by $2,000, for a total penalty of $40,000. Thus, the penalty is $40,000 if just one full-time employee from that business obtains government help on an exchange. Unlike the weak penalty, with the strong penalty there is a domino effect that determines a penalty based not just on the full-time employee that went to the exchange, but on all full-time employees employed by that

Penalties by Offering Low-Cost 'Skinny' Coverage, FORBES (May 21, 2013, 11:50 AM), http://www.forbes.com/sites/theapothecary/2013/05/21/employers-can-minimize-their-exposure-to-obamacares-health-insurance-mandate-by-offering-low-cost-skinny-coverage/print/ (explaining that a weak penalty will be assessed against employers who fail to offer coverage that meets statutory requirements, and subsequently at least one employee enrolls in an exchange).

33. *See id.* (explaining that a strong penalty will be assessed against employers who do not offer full-time employees the chance to enroll in minimum essential coverage, and subsequently at least one full-time employee enrolls in an exchange).

34. 26 U.S.C. § 4980H(b).

35. *Id.*; *see supra* note 32 and accompanying text.

36. 26 U.S.C. § 4980H(a), (c)(2)(D)(i).

particular employer.[37]

The incentive to offer something, rather than nothing, should be clear. If an employer has fifty full-time employees and one of those employees obtains a subsidy for a full year, the yearly penalty would be $40,000 under the strong penalty, but only $3,000 under the weak penalty. The same employee's action produces a $37,000 difference in employer mandate penalties, depending on which of the three options mentioned earlier the employer ultimately undertakes. Note that this is the smallest possible ALE. As the employer's size grows, so does the gravity for the strong penalty versus its weaker counterpart.

II. Background on Independent Contractor Classification

Employers have always had incentives to blur the lines between employees and independent contractors. Employers have even bigger incentives to misclassify employees after the ACA because independent contractors do not count as employees in gaining ALE status or in the calculation of penalties.[38] Before the ACA, employers had several reasons for misclassifying employees as independent contractors. Examples include avoiding overtime payments, avoiding payroll taxes, etc.[39] The Department of Labor has an entire division dedicated to penalizing employers for misclassifying employees as independent contractors.[40] The penalties can be very steep if the

37. *Id.* § 4980H(a)(2); *see also* Roy, *supra* note 32 (comparing the effects of the strong penalty to the weak penalty).

38. *See* 26 U.S.C. § 4980H(a) (assessing penalties based on the product of the applicable payment amount and the number of individuals employed as full-time employees), 4980H(b) (same), 4980H(c)(2) (defining applicable large employer based on full-time employees); *see also* 26 C.F.R. pts 1, 54, 301 (2013) (providing examples distinguishing between independent contractors and employees).

39. *See, e.g.*, Misclassification of Employees as Independent Contractors: Fact Sheet 2013, Department for Professional Employees, AFL-CIO 1, 3 (2013), *available at* http://www.dpeaflcio.org/wp-content/uploads/Misclassification-of-employees-as-independent-contractors-2013.pdf (listing some of the incentives of misclassifying employees as independent contractors, including not being required to pay Social Security and unemployment insurance taxes for independent contractors and noting the resulting savings of twenty to forty percent in costs for employers).

40. *See Wage and Hour Division*, U.S. Dep't Of Labor, http://www.dol.gov/whd/

misclassification has been ongoing for a long period, especially if overtime wages went unpaid.[41]

The ACA steepens those penalties. Suppose an employer employs twenty full-time employees and contracts with 120 full-time independent contractors to build a well. If those 120 full-time independent contractors are legitimately independent contractors, no ACA liability arises.[42] Suppose instead that a different employer has twenty full-time employees and "contracts" 120 full-time independent contractors. Now suppose that just thirty of those alleged independent contractors turn out to be employees (they were misclassified). First, that employer probably has wage and hour liability independent of ACA. Second, that employer also has to worry about owing employer mandate penalties for violating a law it did not even think applied to its business. Correctly distinguishing between employees and independent contractors is more important than ever.

The ACA does not precisely define employee or employer. Instead, the ACA adopts the common-law definition of both terms that analyzes the level of control the former exerts on the

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workers/Misclassification/index.htm (last visited Jan. 7, 2014) (explaining that the Department of Labor's Misclassification Initiative was launched under Vice President Biden's Middle Class Task Force to address the problem of misclassification of employees).

41. *See generally Press Releases: Employee Misclassification as Independent Contractors*, U.S. DEP'T OF LABOR, http://www.dol.gov/whd/workers/Misclassification/pressrelease.htm (last updated May 9, 2013) (listing recent penalties). *See, e.g.*, *US Department of Labor Recovers More than $1 Million in Back Wages and Damages for 196 Employees Misclassified as Independent Contractors*, U.S. DEP'T OF LABOR (May 9, 2013), http://www.dol.gov/whd/media/press/whdpressVB3.asp?pressdoc=Southeast/20130509.xml (detailing an assessed $1,075,000 fine by the Department of Labor following an investigation into the misclassified employees of a Kentucky company in which the misclassified employees were denied overtime for a long period of time); *US Labor Department Initiative Finds More Than $1.3 Million in Back Wages Due to 478 Underpaid Massachusetts Employees*, U.S. DEP'T OF LABOR (Mar. 29, 2012), http://www.dol.gov/whd/media/press/whdpressVB3.asp?pressdoc=Northeast/20130212_1.xml (detailing an assessed fine of $1,307,808 following an investigation into the misclassification of employees that were misclassified as independent contractors to avoid overtime payments).

42. *See* 26 U.S.C. § 4980H(a), (c)(2)(A), (c)(2)(C) (only applicable to full-time employees).

latter.[43] The more an employer controls a worker, the more likely the worker is likely to be an employee.[44] The less an employer controls a worker, the more likely the worker is going to be considered an independent contractor.[45] Control takes several forms that are best summarized as behavioral, financial, and legal control.[46]

The more an employer controls, the closer the worker will swing toward being that employer's employee instead of an independent contractor.[47] The less the employer controls, the closer the employee will swing toward being an independent contractor.[48] The table below discusses in detail some of the employment characteristics that distinguish independent contractors from employees. If employers have some employees that they are unsure about, below are some of the usual variables employed to determine independent contractor status:

Independent Contractors	Employees
Regularly works for multiple businesses	Regularly works for recipient business
Services are offered to the	Services only offered

43. *See* JULIE M. WHITTAKER, CONG. RESEARCH SERV., R41159, POTENTIAL EMPLOYER PENALTIES UNDER THE PATIENT PROTECTION AND AFFORDABLE CARE ACT (ACA) 5–6 (2013); *see also* Michael Newman, *Who is an Employee and Who is an Independent Contractor Under the Employer Mandate Provisions of the Affordable Care Act?*, JD SUPRA LAW NEWS (Feb. 27, 2013), http://www.jdsupra.com/legalnews/who-is-an-employee-and-who-is-an-indepen-86372/ (noting that the ACA uses the word employer more than 500 times and employee more than 400 times, yet never explicitly defines either word and detailing how the ACA uses the common law definition).

44. *See Independent Contractor (Self-Employed) or Employee*, IRS, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-(Self-Employed)-or-Employee (last updated Sept. 26, 2013) (explaining the common law rules for determining whether a person is an employee or an independent contractor).

45. *Id.*

46. *See id.* (enumerating the three common law rules and describing the different "types of relationships" between employers and employees as they relate to the "legal" aspect of "control"; for example, work contracts, and benefits such as pension plans, insurance, vacation pay, etc.).

47. *See id.* (explaining the factors that distinguish "independence" from "control", and explaining that there is no magic or set number of factors that make the worker an employee and that the key is to look at the entire relationship work relationship).

48. *Id.*

general public	to recipient business
Instructions come from third party	Instructions come from recipient business
Training comes from third party	Training comes from recipient business
Project-based Workers	Perpetual Workers
Third party sets their hours	Recipient business sets their hours
Third party sets their pay sequence	Recipient business sets their pay
Work is not performed at your location	Work is performed at recipient's location
Third party covers their expenses	Recipient business covers their expenses
Third party provides tools and materials	Recipient provides tools materials
Third party retains the right to fire	Recipient has the right to fire workers
Wear third party uniforms	Wear recipient's uniforms

Deciding whether a worker is an independent contractor or an employee is a question of degree. It is a grey-area question because the inquiry is neither black nor white as the above-chart shows. The key is the degree to which the employer controls the worker and his work.

III. Independent Contractors and the Affordable Care Act

Energy companies, especially in the construction sector, utilize independent contractors in large numbers.[49] As discussed in the previous sections, independent contractors do not count as employees for the purposes of determining ALE status.[50] They

49. DOL Report, *supra* note 21 (noting that budgetary pressures lead prime contractors in the fracking industry to contract out their specialized tasks to smaller contractors).

50. *See supra* note 38 and accompanying text.

also do not count as employees for the purposes of determining employer mandate penalties.[51] When these two incentives are coupled with the pre-ACA incentives for misclassifying employees as independent contractors,[52] the incentive is clear for that misclassification. Under either scenario, the misclassification of independent contractors can have serious financial consequences.[53]

A. Independent Contractors and the Initial ALE Determination

If an energy company has well over fifty full-time employees, deciding whether one or two workers are employees or independent contractors is not critical to the ALE determination, given that the company knows it has more than fifty full-time employees. Nevertheless, it can be critical in other circumstances.

Suppose an employer has forty-nine full-time employees (or is very close to that fifty-employee mark). Whether that fiftieth full-time worker is an employee as opposed to an independent contractor will decide whether the ACA's employer mandate applies to that company.[54]

If that company underreports its employees, a subsequent government audit or investigation will unearth those misclassified employees and subject the employer to the employer mandate penalties.[55] Misclassifying employees can be the difference between ALE status and total inapplicability of the employer mandate to a particular employer.

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51. *Id.*; *see also* CASTILLO, *supra* note 25, at 91 (noting that only full-time employees can trigger the penalties under the ACA).

52. *See supra* note 39 and accompanying text.

53. *See supra* note 21 and accompanying text (providing examples of severe financial consequences resulting from the misclassification of independent contractors).

54. 26 U.S.C. § 4980H(b)–(c); *see also* WHITTAKER, *supra* note 43, at 1–5 (describing the fifty full-time employee rule).

55. 26 U.S.C. § 4980H(a)–(b); *cf.* Robert Bloink & William H. Byrnes, *ACA Ups the Ante for Small Business Employee Classification*, NAT'L UNDERWRITER CO. (Oct. 7, 2013), http://www.nationalunderwriteradvancedmarkets.com/articles/fc100113-a.aspx?action=16 (denoting the penalties that arise from an employer's misclassification of employees).

B. Independent Contractors and Complex Corporate Structures

The ACA demands that every ALE count all of its employees.[56] An ALE is not necessarily one legal entity or one business, but can include multiple legal entities.[57] Separate legal entities are not sufficient to create a divide between employers under the ACA if ultimately the same companies or individuals own and control "related" companies.[58] In other words, if one person owns two companies, the two companies will be grouped together for the purposes of an employee accounting under the ACA. The same is true for parent-subsidiary relationships.[59] Energy companies are especially susceptible to these aggregation rules because quite often in structuring projects, the same related individuals or companies create second and tertiary legal entities to limit liability, account for ownership, and spread risk.[60] If those secondary and tertiary vessels are excluded from the calculation,

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56. 26 U.S.C. § 4980H(c)(2)(B), (c)(2)(C), (c)(2)(E), (c)(4) (requiring the aggregation of employees from all related companies when determining a company's number of FTE employees and discussing who must be characterized as an employee and who may be excluded from the count); *see also* WHITTAKER, *supra* note 43, at 1–3 (discussing the two-part calculation for determining which entities are subject to penalties and to which workers within the entity penalties are applied).

57. 26 U.S.C. § 4980H(c)(2)(C) (demanding related entities owned by the same individual be treated as a single employer compelling them to aggregate the total number of employees working at all related businesses); *see also* CASTILLO, *supra* note 25, at 3–5, 7–18 (discussing the different ways that the ACA collects related legal entities and treats them as a single employer).

58. *See* 26 U.S.C. § 4980H(c)(2)(C)(i) (requiring at least fifty full-time employees to constitute an "applicable large employer" and necessitating the aggregation of all persons employed at related companies owned by the same individuals); 26 U.S.C. § 414(b) (employees of controlled group of corporations); 26 U.S.C. § 414(c) (employees which are under common control); 26 U.S.C. § 414(m) (employees of an affiliated service group); *see also* Dean Zerbe, *The Affordable Care Act—DELAYED—What Businesses Need to Know—UPDATE*, FORBES (June 17, 2013, 10:27 AM), http://www.forbes.com/sites/deanzerbe/2013/06/17/the-affordable-care-act-what-businesses-need-to-know (discussing the "controlled group test").

59. 26 U.S.C. §§ 4980H(c)(2)(C), 1563(a)(1) (parent-subsidy controlled group).

60. *See, e.g.*, Jeffrey S. Tenenbaum, *Forming and Operating Subsidiaries and Related Entities: Maximizing the Benefits and Minimizing the Risks*, VENABLE LLP (1999), http://www.venable.com/forming-and-operating-subsidiaries-and-related-entities-maximizing-the-benefits-and-minimizing-the-risks-01-01-1999 (discussing various reasons entities create subsidiaries).

the entire analysis could be erroneous as to the larger entity and the smaller entity.

For example, suppose that Energy Company A desires to drill a well. Company A creates Energy Company B to do the drilling and hire the workers that will drill the well. If Energy Company B has twenty full-time employees, and Energy Company A has thirty-five employees, neither company is an applicable large employer and is thus not subject to the employer mandate. However, because Energy Company B is a subsidiary of Energy Company A, the ACA aggregates the two companies together into one for the purposes of deeming them an applicable large employer. In other words, neither company would be required to offer qualified healthcare plans alone, but together, they are considered a single employer for the purpose of the ACA and must do so or pay a penalty.[61] If Energy Company B hires independent contractors that are really employees, those employees must be counted in determining initial ALE status across all legal entities comprising the ALE.

C. Appropriately Staffing Independent Contractors

While separate legal entities are aggregated for the purposes of determining ALE status, they remain separately responsible for the employer mandate penalties they incur.[62]

For example, suppose that Energy Company A offered fully compliant healthcare benefits to all of its full-time employees. Also suppose that Energy Company B decides not to offer coverage. Eventually, Energy Company B gets audited by the federal government and also gets penalized for $10,000. Energy Company A is not liable to the federal government for any

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61. *See supra* note 58 and accompanying text.

62. *See* 26 U.S.C. § 4980H(c)(2)(D)(ii) (limiting only one thirty-employee reduction in determining the overall limitation on assessable payment for entities under common control that are treated as a single employer for purposes of determining if they qualify as an ALE and providing that the reduction is to be allocated among these persons ratably based on the number for full-time employees employed by each entity); *see also* NAT'L FIN. PARTNERS, EMPLOYER MANDATE: WHAT ARE THE PENALTIES AND WHEN DO THEY APPLY? 1 (2013) ("While commonly controlled entities are aggregated for purposes of determining whether the employer mandate is applicable, there is no aggregation used in determining the penalty itself.").

portion of that $10,000—Energy Company B is on its own when paying the federal government. If Energy Company B wants to compel Energy Company A to help pay for employer mandate penalties, it would probably have to do so via contract because the ACA provides no separate liability for Energy Company A under this scenario. Therefore, if independent contractors must be utilized, they should be contracted by the more risk-tolerant legal entities within a corporate structure.

D. *The Employer Mandate's Strong Penalty and Independent Contractors*

Assume an ALE decides not to offer any minimum essential coverage. This decision may have borne out for several reasons. Perhaps the employer did not realize it was an ALE because it did not account for all related companies, or maybe the employer misclassified employees as independent contractors. Although less likely in the energy sector, perhaps an employer decided not to offer coverage, notwithstanding its knowledge that it was an ALE.

Recall that under this scenario, even if an employer has 1,000 full-time employees and only one full-time employee obtains a subsidy on an exchange, the employer will pay a yearly penalty of $2,000 for 970 employees.[63] It does not matter if those other 969 employees did not go to an exchange and obtain a subsidy; the employer will pay $2,000 for 970 employees—or $1.94 million—instead of the $3,000 penalty the same circumstances would create under the weak penalty structure.

Large amounts of misclassified employees could severely change the sum of penalties in this scenario as well. In fact, misclassifying employees in this scenario is more costly than in the weaker penalty structure because here the misclassified employee does not have to go to a exchange and obtain a subsidy to trigger penalties. Here, once the employer is being audited, misclassified employees will probably count as full-time employees that must be multiplied by the yearly penalty of $2,000.

For example, suppose an employer does not realize it is an

63. *See supra* note 36 and accompanying text.

ALE, and thus, it does not offer any coverage. [64] This employer has, to its knowledge, fifty full-time employees. As far as the employer knew, it was liable for $40,000 in penalties. Once investigators audit its workforce, interview employees and contractors, etc., a different reality is exposed. That employer actually had 200 employees once the misclassified employees are taken into consideration. That employer goes from a $40,000 penalty, under its employee accounting, to a $340,000 penalty under the government's employee accounting.

E. The Employer Mandate's Weak Penalty and Independent Contractors

While the severe penalty will severely penalize an employer that misclassifies employees, the weak penalty also heightens the penalties a misclassifying employer faces.[65] Every full-time employee that obtains a coverage subsidy on an exchange employed by an ALE exposes that ALE to a $250 penalty for every month that employee qualifies for a subsidy.[66] Even employers that offer excellent, fully-ACA-compliant coverage to their employees will likely not offer that coverage to independent contractors. Those independent contractors have a duty to carry minimum essential coverage or pay a penalty themselves under the individual mandate.[67] Unless those independent contractors work for an agency that provides them coverage, those independent contractors are likely to go to an

64. This would be because either the employer misclassified employees, or because it did not take into account related entities.

65. 26 U.S.C. § 4980H(a), (b)(1); *see also* Roy, *supra* note 32 (discussing strong versus weak penalties as mandated by the ACA).

66. 26 U.S.C. § 4980H(b); *see also* EMILY EGAN, HEALTH CARE POLICY TEAM, AM. ACTION FORUM, PRIMER: EMPLOYER MANDATE (2013) (providing key takeaways of the ACA's employer mandate, including discussion of penalties assessed against "employers that offer coverage if any employees choose to receive subsidized coverage on the state exchanges").

67. *See* 26 U.S.C. § 5000A (individual mandate); *see also* ANNIE L. MACH, MANON SCALES & JANEMARIE MULVEY, CONG. RESEARCH SERV., R41331, INDIVIDUAL MANDATE AND RELATED INFORMATION REQUIREMENTS UNDER ACA 1–2 (2013) (discussing individual mandates under the ACA and subsequent penalties for failure to maintain the required minimum essential coverage).

exchange and apply for a subsidy.[68] If later that independent contractor is linked back to an employer that misclassified an employee as an independent contractor, that $3,000 penalty may be assessed against the employer that misclassified that employee.[69]

IV. CONCLUSION

Employers have always had large incentives to blur the lines between employees and independent contractors. Before the ACA, employers sometimes misclassified employees to avoid paying those workers overtime, paying their payroll taxes, and otherwise limit the employer's liability. Employers have even bigger incentives to misclassify employees after the ACA. Because energy companies routinely employ independent contractors, and because the ACA steepens those independent contractor misclassification penalties, energy companies would be well advised to review the relationships they have with their independent contractors.

68. *See* BERNADETTE FERNANDEZ & ANNIE L. MACH, CONG. RESEARCH SERV., R42663, HEALTH INSURANCE EXCHANGES UNDER THE PATIENT PROTECTION AND AFFORDABLE CARE ACT (ACA) 36 (2013) (discussing the ACA's individual mandate component and how nearly all plans offered on the exchange satisfy its minimum essential coverage requirement). The "individual mandate" will assess a penalty to every American who does not carry health insurance, regardless of employment status.

69. 26 U.S.C. § 4980H(b); *see also* Bloink & Byrnes, *supra* note 55.