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Regulation of "Employee Leasing Companies" under the Fair Share Contribution Requirement of the Massachusetts Health Care Reform Act

A Conundrum for Staffing Firms, PEOs and Other Three-Party Employment Arrangements

The Massachusetts health care reform act—Chapter 58 of the Acts of 2006, *An Act Providing Access to Affordable, Quality, Accountable Health Care*[1] (the "Act")—imposed health-care-related requirements on individuals, providers, insurers and employers. (Click here for a copy of our guide that explains in detail the Act's impact on employers.) The Act's employer mandates include a so-called "fair share contribution" (FSC) requirement, the essence of which is to impose sanctions on employers that fail to provide a prescribed level of employer-subsidized health care coverage to their full-time employees. Two state agencies enforce the Act's FSC requirement—the Division of Health Care Finance and Policy (DHCFP) of the state's Executive Office of Health and Human Services, and the Division of Unemployment Assistance (DUA) of the Executive Office of Labor and Workforce Development.

While the DHCFP and the DUA and other state agencies have done yeoman's work issuing the guidance and establishing the administrative systems and IT infrastructure necessary to implement all of the Act's requirements, certain challenges remain. These challenges include the application of the FSC rules to traditional staffing firms, Professional Employer Organizations (PEOs) and other three-party employment arrangements. This client advisory explains the issues that have arisen in connection with these arrangements.

Background

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The simplest way to understand the core employer mandates of the Act is with three simple rules:

Rule 1. Nothing in the Act requires any employer to provide any health care coverage to anyone.

Rule 2. Employers must make pretax coverage available under a cafeteria plan (this is referred to as the Act's "section 125 cafeteria plan" requirement) to all employees irrespective of whether the underlying coverage is provided by the employer or some other source (*e.g.*, the Connector).

Rule 3. If an employer does not provide subsidized coverage to some or all of its *full-time* employees, it may be required to pay an annual fee of $295 per full-time equivalent employee to a state trust fund designed to increase health coverage in the Commonwealth.

Rule 3 is, of course, the FSC requirement. The Act assigns to DHCFP the power to determine who is and who is not a "contributing employer." Only "non-contributing employers" (and those employers deemed non-contributing under the DUA regulation) must pay the FSC contribution. The Act caps the contribution at $295 per full-time equivalent employee per year. Full-time equivalency is determined for this purpose on the basis of 2,000 payroll hours/year. (These rules are set out in a final DHCFP regulation at 114.5 CMR 16.00.) To DUA, the legislature delegated the power to prescribe rules for assessing and collecting the FSC contribution. (The DUA's rules are at 430 CMR 15.00).

While the DHCFP's regulation does not say so in as many words, the FSC rules can be applied by following four steps:

Step 1. *Threshold Coverage*. Does the employer have 11 or more full-time equivalent employees working at a Massachusetts location? (This step takes into account all of the employer's employees—full-time, part-time, seasonal and temporary.) If the answer is no, then the FSC requirement does not apply. If the answer is yes, then the FSC rules apply.

Step 2. *The Primary Test*. If the employer offers subsidized coverage of any sort (this does not need to rise to the level of "minimum creditable coverage" for purposes of the Act's individual mandate), do at least 25% of the employer's full-time employees accept the employer's offer of coverage? (A "full-time employee" for this purpose generally means an employee who works 35 or more hours per week.) If so, the employer is not subject to the FSC contribution.

Example 1

Employer A has 12 full-time employees and 90 part-time employees. Employer A offers a subsidized mini-med plan to its full-time employees but offers no coverage to part-time employees. Three of Employer A's employees elect to purchase the mini-med coverage. Employer A passes the primary test, and is not required to make an FSC contribution for the year.

Step 3. *The Secondary Test*. Does the employer offer to pay at least 33% of the cost of individual coverage to full-time employees who were employed at least 90 days during the fiscal year from October 1st to September 30th? If so, the employer is not subject to the FSC contribution.

Example 2

Same facts as Example 1, except Employer A offers to pay 33% of the cost of individual coverage under the mini-med plan, but no full-time employee accepts the offer. Employer A passes the secondary test, and is not required to make an FSC contribution for the year.

Step 4. *Payment of Contribution*. If the employer is unable to satisfy either test, it must make an FSC contribution, which is calculated on an full-time equivalent basis taking into account all of the employer's employees—full-time, part-time, seasonal, temporary, etc.

Employee Leasing Companies

Applying the primary and secondary tests described above is relatively straightforward in a traditional two-party employment setting where there is only an employer and its employees. But where there are three parties to the relationship (*i.e.*, employer, staffing company or PEO, and a client company), the following questions arise:

Question 1. When applying the primary and secondary tests, is the worker allocated to (and counted with other employees of) the staffing firm or client company?

Question 2. Who bears the legal responsibility for the payment of any FSC contribution, the staffing firm or the client?

In an effort to address these questions, DHCFP and DUA have introduced the concept of, and provided special rules governing, "Employee Leasing Companies" and "Client Companies." Unfortunately, the DHCFP and DUA definitions are not uniform.

The DHCFP Regulation

The DHCFP final FSC regulation defines the term "Employee Leasing Company" to mean:

> A sole proprietorship, partnership, corporation or other form of business entity whose business consists largely of leasing employees to one or more Client Companies under contractual arrangements that retain for such employee leasing companies a substantial portion of personnel management functions, such as payroll, direction and control of workers, and the right to hire and fire workers provided by the employee leasing company; provided, however, that the leasing arrangement is long term and not an arrangement to provide the client company temporary help services during seasonal or unusual conditions.[2]

The term "Client Company" is, in turn, defined to mean a "person, association, partnership, corporation or other entity *that is a co-employer of workers provided by a Employee Leasing Company* pursuant to a contract" (emphasis added). The DHCFP regulation then establishes a special rule that provides:

> If there is a co-employment arrangement between a Client Company and an Employee Leasing Company, the Employee Leasing Company shall be responsible for *calculating and remitting* the Fair Share Contribution on behalf of the Client Company. (Emphasis added.)[3]

Thus, DHCFP's initial rule addressed only who had the obligation to calculate and remit the FSC contribution; it did not modify the rules respecting which entity counted workers for FSC purposes. In a bulletin issued in January 19, 2007, the DHCFP said that employee leasing companies will be required to perform the fair share contribution tests separately for each client company, but the client company is responsible for any fair share contribution liability. For the reasons explained below, this rule was directed at PEOs and not staffing companies.

In a subsequent bulletin issued September 14, 2007, DHCFP attempted to further clarify the rule saying, "[n]otwithstanding any arrangement between a Client Company and an Employee Leasing Company, the Client Company is the employer for [fair share contribution] purposes." But—and this is critical—this latest guidance did not change the underlying DHCFP definitions of "Employee Leasing Company" and "Client Company."

The DUA Regulation

The DUA's final FSC regulation defines "Employee Leasing Company" as:

> an employing unit that contracts with a client company to supply workers to perform services for the client company; provided, that the term "employee leasing company" does not include private employment agencies that provide workers to employers on a temporary basis or entities such as driver-leasing companies which lease employees to an employing unit to perform a specific service.[4]

Also, importantly, DUA defines "Client Company" as:

> an individual, association, partnership, corporation or other business entity that agrees to lease or is leasing its employees through an employee leasing company on a long term basis.[5]

The DUA's regulation then sets out its own special rule for employee leasing companies, which provides:

> Notwithstanding any arrangement between a Client Company and an Employee Leasing Company, the Client Company is the employer for purposes of M.G.L. c. 149, § 188 and 430 CMR 15.00.

This rule is a stark departure from the DHCFP's initial approach, since it not only assigns responsibility for applying the test, but also determines which entity a worker is assigned for testing purposes. It also means that for general DUA reporting purposes, a staffing company will report workers placed with clients as employees of the staffing firm, but for FSC testing purposes the same workers will be treated as employees of the client.

Applying the Rules

Where a staffing firm or PEO places a worker with a client company on a temporary or short-term basis, the rules governing employee leasing companies don't apply. But the terms "temporary" (under the DUA regulation) and "not long term" (under the DHCFP regulation) are not well defined, and it's not clear whether they are intended to mean the same thing. So other than in the case of "temporary help services during seasonal or unusual conditions" (under the DHCFP regulation) or "driver-leasing companies" (under the DUA regulation), the contours of this exception are not clear.

The DHCFP's definition of "Employee Leasing Company" appears to be limited to PEOs, which aggressively market their role in taking control of all of an employer's personnel management functions. In addition, the DHCFP's reference to "co-employment" in its definition of "Client Company" is telling. While mainstream staffing firms generally treat the workers placed with client companies as their (*i.e.*, the staffing company's) employees and not co-employees, PEOs take the opposite tact. PEOs generally treat the workers placed with clients as "co-employees."[6]

As a consequence, mainstream staffing companies would appear to be required to treat employees placed with client companies as staffing company employees for FSC purposes. PEOs on the other hand would be required to test compliance with the FSC rules at the client level. While apparently intended to do so, the recent DHCFP bulletin does not seem to change this result, since it does not change any of the underlying definitions.

The DUA's regulation reaches the opposite result. Under the DUA rule, *any* staffing company or PEO (*i.e.*, an "employing unit"), that contracts with a client company is an employee leasing company unless it is a "private employment agenc[y] that provide[s] workers to employers on a temporary help basis or entities such as driver-leasing companies which lease employees to an employing unit to perform a specific service." The definition of "Client Company" for this purpose is not limited to co-employment arrangements. This result flows from the provision in the DUA regulation that flatly states: "Notwithstanding any arrangement between a Client Company and an Employee Leasing Company, the *Client Company* is the employer…" (emphasis added).

Example

Employer A has 100 employees in Massachusetts, and it retains an additional 20 employees from Staffing Company B on a basis that is neither "short-term" nor "temporary." Staffing Company B has a self-funded group medical plan for its internal staff (none of whom are located in

Massachusetts), but provides no benefits for its field employees. Under the DHCFP rules, B's field employees are employees of B, so B will be need to include these employees in its FSC testing, and it will be liable for FSC contribution if it fails to pass either the primary or secondary test. Under the DUA rules, however, Employer A will need to include Staffing Company B's employees when testing compliance with the FSC rules. Among other things, this will preclude Employer A from taking advantage of the secondary test, and it will make it marginally more difficult for Employer A to pass the primary test.

Further Implications

The consequences of the discrepancy between the approaches taken by the DHCFP and the DUA principally affect traditional staffing firms that furnish workers to client companies on a long-term or indefinite basis. Are staffing firm workers tested with the staffing company for purposes of complying with the Act's FSC requirements, or are they tested at the level of the client company? PEOs are unaffected because they are treated consistently by both sets of rules. Of course, the issues raised in this advisory are not confined to staffing companies and PEOs; rather they apply as well to other three-party employment arrangements, including:

Temporary Services Agencies

Temporary services agencies are excluded from the definition of "Employee Leasing Company" under both the DUA and DHCFP regulations. Thus, workers employed by these agencies are treated as employees of the agency for FSC purposes. But distinguishing between a staffing firm and a temporary employment agency is not always easy, and many staffing firms provide both types of services, often without careful (or any) delineation.

Per Diem Employees

The phrase "per diem employee" has no separate legal significance; it is, rather, an industry term that is encountered often though not exclusively in the health care sector. Per diem employees hired day-to-day for brief stints will be short-term or temporary, in which case they will be allocated to their "employer" under the general rule. In many instances, however, per diem employees work for extended periods under circumstances that are indistinguishable from at-will employment. Per diem employees can be hired directly or through a staffing firm or agency. In the latter case, all of the issues described above will apply.

IT/Specialty Engineering Staffing

In recent years, a subset of the staffing industry has evolved to focus on specialty workers, typically in information technology and highly specialized engineering applications. For example, a large financial services firm may need a talented Java programmer with very specific skills to implement a proprietary client service platform. The financial institution may turn to an IT staffing agency or firm to locate such a programmer. While the arrangement is sometimes referred to as "staffing," it has more in common with brokerage, and it may well be that the programmer in this case is an independent contractor and not an employee at all. To the extent that it is determined that he or she is an employee, the facts and circumstances will determine whether the staffing organization or the end user is the employer. As a result, it appears that the issues raised above with respect to staffing companies generally apply as well here, unless the arrangement is short-term or temporary.

Business Process Outsourcing

Business Process Outsourcing (BPO) is the contracting of a specific business task, such as payroll, to a third-party. Typical BPO applications include "back-office" outsourcing (*e.g.*, billing or purchasing) or "front office" outsourcing (*e.g.*, marketing, customer service or tech support). It is not at all clear how BPO arrangements will be treated for FSC purposes. Many BPO arrangements have much in common with staffing arrangements, although in most instances it should be possible (depending on the facts and circumstances) to establish a contractor as opposed to an employment relationship between the parties. That the work is almost always performed off-site generally makes it easier to establish that the arrangement is that of a contractor.

Conclusion

It appears that the DUA, in developing its regulation, started with a fundamentally different view of how the FSC rules ought to be applied where employee leasing arrangements are concerned, and DHCFP appears to have been persuaded to adopt the DUA approach. In doing so, however, DHCFP failed to also expand the universe of companies affected. Thus, the rules remain murky.

Some of the most daunting issues raised by the implementation of the Act's FSC requirements arise in the context of the traditional staffing firms—of which there are nearly nine thousand in the United States. How staffing firms ought to be treated for FSC purposes needs to be clarified. Until the regulators take steps to do so, these firms and vendors (and their clients) will have to apply the statute in good faith to the best of their ability. This is an unsettling state of affairs that cries out for a remedy sooner than later.

[1] As amended by Chapter 324 of the Acts of 2006, *An Act Relative to Health Care Access*, and Chapter 450 of the Acts of 2006, *An Act Further Regulating Health Care Access*.

[2] 114.5 CMR § 16.02.

[3] 114.5 CMR § 16.03(2).

[4] 430 CMR 15.03.

[5] 430 CMR 15.03.

[6] While the claim of co-employment advanced by the PEO industry might be accurate for purposes of many federal and state employment laws, among others, it almost certainly fails for most tax and benefits purposes, with respect to which the doctrine of co-employment is generally not recognized.

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If you have any questions concerning the information discussed in this advisory or any other employee benefits topic, please contact one of the attorneys listed below or your primary contact with the firm who can direct you to the right person. We would be delighted to work with you.

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