

Independent Contractors

February 2025

Organizations enter into a variety of different staffing arrangements to handle special projects, meet varying capacity needs, and fill temporary employment gaps. When entering into such arrangements, it's important for organizations to properly categorize such individuals as independent contractors or employees and to ensure that benefits are handled accordingly. Determining employment status is critical for several purposes beyond that of handling benefits, but this summary focuses specifically on benefit considerations.

Employment Status

Employers cannot simply designate an individual worker as an independent contractor. The individual must satisfy the criteria necessary to qualify for that status. If employees are misclassified as independent contractors, the employer may owe back wages, tax penalties, and fines under the Fair Labor Standards Act (FLSA), the tax code, state worker's compensation laws, etc.

Various laws at the federal level define who can be classified as an independent contractor. In addition, states have enacted legislation that further defines who is considered an independent contractor for various state law purposes. While these tests are all different, they usually have a similar structure requiring a totality of the circumstances analysis of multiple factors with many of the factors being the same or similar from one test to the next. Because distinguishing between "employees" and "independent contractors" often requires a complicated legal analysis and can have significant consequences if the classification is wrong, organizations should work with an employment law attorney if there is any question as to the employment status of workers.

Benefit Considerations

Organizations are not obligated to offer benefits to independent contractors, so typically, independent contractors are not eligible for employee benefits. At the same time, offering benefits is a useful talent attraction strategy. Therefore, organizations may have an interest in offering benefits to independent contractors, but there are several important considerations that organizations should consider before deciding to extend benefits to independent contractors.

Independent Contractor Status

Offering benefits is one of the factors used to determine independent contractor status in the first place - generally employees are offered benefits, while independent contractors are not. Because of the multifactor nature of the independent contractor test, offering benefits is not necessarily fatal to a worker's classification as an independent contractor but it can tip the scale if the classification is already borderline. Because of the potentially significant consequences of misclassifying an employee as an independent contractor, the organization should consult with

legal counsel on whether offering its independent contractors benefits will affect their employment status before deciding to extend benefits to those workers.

Eligibility

Odds are the organization's existing benefit plan documents only extend coverage to employees. Therefore, before extending coverage to independent contractors, the organization must first obtain permission from any insurance carriers and stop-loss vendors to include independent contractors as eligible individuals. In addition, plan documents should be amended accordingly to allow independent contractors to participate.

Taxation

Tax-free benefits are only available to employees; any benefits provided to independent contractors will be taxable. That means independent contractors are not eligible to participate in the organization's cafeteria plan and any amounts they are required to pay to enroll in benefits are paid after-tax. Further, contributions made by the organization for an independent contractor's benefits are additional compensation and must be included on the independent contractor's Form 1099.

Because independent contractors cannot be provided tax-free benefits, independent contractors cannot participate in HRAs, health FSAs, or DCAPs. While an independent contractor can contribute to an HSA, they must do so on an after-tax basis and claim a deduction on their tax return at the end of the year. Likewise, any HSA contributions made by the organization are taxable income that must be reported on Form 1099, for which the contractor can then claim a deduction on their tax return.

MEWA

Covering a non-employee under an organization's benefit plan forms a multiple employer welfare arrangement (MEWA). Upon creation of a MEWA, ERISA plan documents need to be updated. In addition, the plan sponsor may need to file a Form M-1 annually along with a Form 5500. Form M-1 Instructions indicate that a MEWA can avoid a Form M-1 filing obligation so long as the percentage of independent contractors is less than 1% of the employees and former employees covered by the plan. Most significantly, while a fully-insured MEWA is generally okay so long as the carrier agrees to the arrangement, self-funded MEWAs are subject to a variety of licensing, financing, and reporting requirements under state law, and in some states are even prohibited.

Compliance Considerations

If the organization decides to extend benefits to independent contractors, they must recognize that many of the compliance rules that normally apply may or may not extend to independent contractors. Below is a list of some common compliance considerations and whether they apply to independent contractors. The list is not comprehensive and whenever faced with a compliance issue not addressed here, the organization should verify whether that particular rule applies to independent contractors.

- **COBRA.** Independent contractors and their dependents are not entitled to federal COBRA continuation rights unless specifically provided for in the plan documents. State continuation may or may not apply to independent contractors – check the state law and insurance certificate for details.
- **HIPAA Special Enrollment.** Independent contractors and their dependents are not entitled to HIPAA special enrollment rights unless specifically provided for in the plan documents.

- **ERISA.** Independent contractors are included in the participant counts reported on Form 5500. Independent contractors are not entitled to automatic distribution of summary plan descriptions (SPDs) but can make an ERISA document request for the SPD and other plan documents.
- **ACA / Employer Shared Responsibility Penalties (ESRP).** Independent contractors do not have to be counted when determining applicable large employer (ALE) status. ALEs are only required to offer coverage to full-time employees, so ALEs are not required to offer medical coverage to independent contractors; and if choosing to do so, they are not required to make an affordable offer of coverage. ALEs do not need to report §6056 offer of coverage information in Part II of the Form 1095-C for independent contractors, however, independent contractors enrolled in a level-funded or self-funded plan are subject to §6055 coverage reporting on Form 1095-B or Part III of Form 1095-C.
- **PCORI Fees.** Independent contractors are included when counting covered lives to determine the amount of PCORI fees owed by a self-funded plan.
- **§105(h) Non-Discrimination.** Independent contractors are not included when performing §105(h) nondiscrimination testing on a self-funded plan.
- **Medicare Secondary Payer (MSP).** Independent contractors are not subject to MSP rules. Medicare should always be the primary payer over a group health plan with respect to an independent contractor. This can be a significant issue if the plan includes a so-called Medicare estimation clause, whereby the plan will always pay secondary where Medicare is primary even if the participant is not enrolled in Medicare. Also, group health plan coverage will not count for purposes of the Part B late enrollment penalty for an independent contractor because the coverage is not due to current employment status.

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