A Littler Mendelson Report

InSight

An Analysis of Recent Developments & Trends

In This Issue:

October 2010

This article focuses on how the major healthcare reform legislation enacted in early 2010 may impact staffing firms and explores options available to such businesses under the new law.

Healthcare Reform to Raise Costs, Add Administrative Burden: How Staffing Firms Should Handle It

By George Reardon

The information outlined below is based on an interpretation of the Patient Protection and Affordable Care Act (the "Act") as amended by the Health Care and Education Reconciliation Act of 2010 and clarified by the report of the Joint Committee on Taxation, before comprehensive regulations are published. This article assumes that the Act will not be repealed, materially changed by pending litigation, or materially altered through legislative amendments before significant portions of the law take effect in 2014. This article focuses specifically on the staff augmentation aspect of the staffing business and not on direct placements, PEO operations, or other business lines in which staffing firms may be engaged.

"Play or Pay"

The most significant impact of the Act on the staffing industry is likely to be the new so-called "play or pay" costs scheduled to take effect in 2014. The Act defines these costs as "assessable payments" under the "Shared Responsibility for Employers" section. Whether these costs are essentially taxes or penalties may become issues in litigation challenging the Act. To avoid the cumbersome statutory term and to avoid implying conclusions on these issues, this article refers to these new costs as "fees."

In the United States, most commercial staffing firms offer and subsidize the cost of health insurance for their staff employees (*e.g.*, those employees working in the staffing business itself). Most firms also make limited health insurance coverage available for optional purchase by assigned employees (temporary employees, consultants, and other billable people who work on assignments to customers), but the firms do not subsidize the cost of this coverage. Some firms that place higher-skilled personnel may offer – and subsidize – comprehensive health insurance coverage, but only when specific customers request it. Still other staffing firms offer and subsidize coverage for all employees all the time, and this analysis of "play or pay" fees would not apply to them.

Worst-case Scenario Under "Play or Pay"

This worst-case scenario is possible for those staffing firms who offer coverage for

permanent employees but not for assigned employees. Such firms will be determined to be employers who do not offer qualifying employer coverage to all full-time employees[1] if, for such firms, even a single full-time employee receives a federal subsidy to purchase heath insurance through the newly created health insurance exchanges.[2] Under such circumstances, the Act imposes a $2,000 annual fee, prorated to $166.67 per month, on the staffing firm for each of its full-time employees in excess of 30,[3] with the definition of full-time employee subject to further clarification.

Definition of Full-Time Employee

For purposes of the fees, the Act defines a *full-time employee* as one "who, with respect to a month, is employed on average at least 30 hours of service per week." By this definition, in most staffing firms, virtually all staff employees are full-time. The number of a firm's assigned employees who will be deemed full-time will depend on assignment patterns; day labor assignments are typically very short and intermittent, while clerical and professional assignments tend to be longer, with some continuing for years. Unlike earlier legislative proposals, which would have swept all assigned workers' hours together and then divided by 1,560 or 2,080 to produce the number of "full-time equivalents," the Act's fee calculation looks at each assigned worker's full-time status separately.

The fee calculation also depends on further (forthcoming) clarifications of how the definition of "full-time employee" applies to months in which assigned employees are hired, fired, or placed on or taken off assignment in the middle of the month.[4]

Notably, the fee is imposed for all full-time staff or assigned employees, regardless of any coverage they might be receiving from the staffing firm or from other sources (such as a spouse's plan).

Strategy A for Minimizing Costs: Meet Minimum Affordability

Potentially less expensive calculation of "play or pay" fees

The Act provides a different fee calculation for employers who do offer qualifying employer coverage to all of their full-time employees ("full-time" as defined by the Act). In that situation, a fee of $3,000 per year (tested and prorated monthly) is charged only for those full-time employees who choose to receive government healthcare assistance, which requires that they have low income (varying by family size) and that the employee cost of the company-offered coverage exceeds 9.5% of their family income or that the employer coverage does not provide a minimum value.[5] The total fees generated by this calculation method might be lower than the worst-case method described above, but they cannot be higher, since they are capped at the amount of the worst-case method.

Theoretical basis for minimizing costs

A staffing firm might offer coverage to all of its full-time staff and assigned employees and pay for just enough of the cost of that coverage to make it "affordable" to most of its lower-paid employees, so that they would not qualify for the government health coverage assistance that triggers the $3,000 fees. The Act requires that offered coverage satisfy certain criteria, but there is no minimum percentage of employer cost contribution required for an offer of coverage. "What the plan must pay in benefits" and "who must pay for the plan" are very different concepts.

This alternative gives rise to a financial balancing act. The degree to which a staffing firm subsidizes its offered coverage will affect the affordability of that coverage and thus will affect the number of the staffing firm's employees who could qualify for tax credits or cost-sharing reductions. The greater the staffing firm's premium contribution, the fewer of its employees could qualify for the tax credits or cost-sharing reductions and the fewer $3,000 fees the staffing firm would have to pay.

So, the question is: Can a staffing firm fashion a health plan for all of its full-time employees that is generous enough in its benefits to satisfy the government's coverage requirements and still be inexpensive enough (after any premium contributions by the staffing firm)[6] to prevent too many of the staffing firm's employees from qualifying for the "unaffordability" tax credits that trigger the $3,000 per year per employee fee?

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The financial comparison should be simple:

Cost of additional staffing firm premium contributions to the offered coverage

\+ Administrative expense of tracking the insurance and the tax credit status of employees

\+ Cost of $3,000 fee for each full-time employee who qualifies for a tax credit

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Total cost of alternative "play or pay" fee calculation

Compared to:

$2,000 per year fee for all of the staffing firm's full-time employees (minus 30)

The actual "play or pay" fee would be the lesser of the two results shown above. The only problem with this idea is that typical staffing firms cannot precisely predict which of these will be lower, since they do not collect data on the family size and household incomes of their employees and also cannot predict how many employees who qualify for tax credits or cost-sharing reductions will actually go through the administrative process of qualifying. Whether this strategy would be practical would depend on the degree to which these factors could reasonably be estimated and whether they would be stable over time. The staffing industry may lobby to obtain changes that would make this alternative more promising by relaxing the requirements for offered coverage.

Strategy B for Minimizing Costs: The 29-Hour Work Week

An obvious technique for minimizing the cost of the new law would be a practice of limiting assigned workers to a 29-hour work week or monitoring their monthly hours to achieve a sub-30-hour-per-week monthly average.

For purposes of the fees, the Act defines a *full-time employee* as one "who, with respect to a month, is employed on average at least 30 hours of service per week." Therefore, fees will not apply for those assigned employees working fewer than 30 hours on average, because they are not statutory full-time employees.

These workers will nonetheless be expected to either acquire coverage or pay a fee by 2014. It is possible that, long term, these costs will eventually also be shifted to the employer, but for now, it presents a unique opportunity for placement growth of part-time workers.

This technique would seem more workable for assigned employees than for a staffing firm's full-time employees, and the current level of unemployment would seem to make it achievable by giving more people shorter assignments without reducing the total amount of employment provided.

Fees Not Tax-Deductible

No matter how these variables and contingencies turn out, these fees are likely to be very expensive. What will make these fees even more expensive is that the law makes them non-tax-deductible (unlike other direct labor costs that are tax-deductible "above the line," such as FICA and workers' compensation premiums). That means that, if the staffing firm is in tax-paying status, additional before-tax gross margin even greater than the $2,000 or $3,000 a year fee for each full-time (or tax-credit-qualified) assigned employee must be generated for the staffing firm to pay the fees without suffering loss of profitability on its assigned employee.

Finally, the basic fee amount will increase every year at the rate that insurance premiums increase. As staffing firms weigh the cost of providing health care coverage against the "play or pay" fees that become effective in 2014, they must also consider the impact and costs associated with the Act's new insurance market reforms.

Effects on Staffing Firm Sales, Bill Rates and Margins

For those companies who retain staffing firms and use assigned employees and already provide health insurance coverage to most or all of their employees, the Act may not increase their labor costs or may even decrease them. The labor costs of staffing firms, however, are sure to increase drastically.

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There are only three ways that this extra labor cost can be absorbed – by staffing customers through higher bill rates, by staffing firms through lower operating margins, or by the assigned employees through lower wages.

Staffing Industry Analysts has estimated that, on average, the cost advantage to a staffing customer from using an assigned employee instead of using its own direct employee is in the range of 10% to 20%.

To the extent that staffing customers absorb these costs as higher bill rates, that cost advantage would shrink, staffing customers might accordingly decrease their usage of assigned employees, and aggregate demand for staffing services might drop. To the extent that these costs are imposed on assigned employees through lower wages, recruiting efforts and assigned employee quality might suffer. To the extent that staffing firms absorb these costs, the staffing industry's profitability going forward will be significantly burdened.

Contractual and Administrative Challenges Caused by the Fees

Many staffing firms have agreements in place with their customers permitting the staffing firms to pass through to the customers any newly imposed or increased governmental fees, taxes, contributions, or premiums that are directly related to the labor of the assigned employees.

Although the terms of such contractual provisions may vary, such provisions may allow the staffing firm to send a special "no markup" billing to the customer for the new costs until the new costs can be integrated into the customer's contractual billing rates at contract renewal. Therefore, the imposition of "play or pay" fees raises contractual and administrative issues for staffing firms and their customers.

Many assigned employees work irregular schedules, at different rates, for multiple customers. This pattern can raise issues, such as: whether a customer is liable for any portion of the fees when its usage of a full-time employee was less than 30 hours; how the monthly fees should be allocated to multiple customers when the employee is clearly full-time; how to allocate such costs when the pay and bill rates of the various assignments are different; and how customers can audit the allocation of these fees.

Other issues might include: whether the actual cost of the fee to the staffing firm is the before-tax cost or the after-tax cost; how to account to customers for a before-tax cost; making contractual provision for the increases in the basic fee amount after 2014; and, perhaps most daunting in light of the staffing industry's dominant weekly billing cycle, the monthly lag in determining whether each assigned employee qualified as full-time for the previous month. Separate and delayed billings for these fees would increase and complicate the billing, collection, and accounting functions of staffing firms and their customers.

It would be possible to estimate these costs at an annual staffing-firm-wide level and simply bill customers a flat, prorated fee amount or percentage for each hour worked by assigned employees. That would be administratively convenient, but it might be a disadvantageously blunt instrument for purposes of competition and purchasing efficiency. The per-employee fee amounts to approximately $1.00 per hour, and staffing firms compete over much smaller amounts of hourly cost.

Since many staffing contracts are for terms of three or more years, many contracts now in force or being negotiated will still be in force when the law takes effect. Staffing firms and staffing customers should already be thinking about and talking with each other about how to address these contingencies and calculations to avoid disputes from arising when the "pay or play" fees take effect on January 1, 2014.

Proper planning is all the more important to the extent that fees charged to the staffing firms for staff employees are not directly passable to customers since they are not direct labor costs of the assigned employees.

Non-discrimination Rules

A portion of the new law that has not generated much discussion but which may have a significant impact on the staffing industry is a section that will require qualified insured group health plans, and the insurance companies providing them, to offer coverage only on a basis that does not discriminate in favor of highly compensated employees (defined as the highest-paid 25% of all employees). That

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could mean that, even if a limited value plan could be offered to assigned workers at a cost that would save on the staffing firm's "play or pay" fees, the entire coverage scheme might fail to qualify unless the staff employees are required to have the same low-value plan that is offered to the assigned employees.

It is likely that the top 25% of the most highly compensated employees of staffing firms will cover most or all of the firm's internal employees. Such plans may have difficulty showing that they are not discriminatory in favor of the highly compensated under this new law. If plans are found to be discriminatory, the statutory penalties are very heavy – $100 per day of discrimination for each person against whom the plan discriminates.

If staffing firms are self-insured for health coverage, they are not directly affected by this new provision, because they are expressly excluded from it and because they already have to comply with the non-discrimination requirements for tax purposes. However, this provision may draw new attention to the enforcement of the non-discrimination rules that the Act borrows from Internal Revenue Code section 105(h), which imposes adverse tax treatment in connection with self-insured plans that discriminate in favor of the 25% who are the highest compensated employees.

For the indefinite future, the Act's nondiscrimination provision will not apply to "grandfathered" health plans, but the catch is that grandfathered status is expected to be extremely difficult for insured health plans to maintain for very long, even assuming that insurance companies continue to make such obsolescent plans available.

Silver Linings

There are also two possible upsides to the legislation.

Increased Health Care, IT, and Administrative Employment

The prospect of millions of additional Americans seeking healthcare might suggest a surge in demand for healthcare workers of all kinds, including those provided by staffing firms.

However, very few Americans have actually been going without healthcare. As a matter of policy, ethics, and sometimes law, hospitals and other providers have treated the poor and uninsured without regard for their ability to pay and have passed those costs on to the paying institutions and individuals.

This Act expands insurance options and changes the distribution of costs, but it does not directly expand health care itself. Perhaps people who are newly insured will consume more services in an atmosphere of entitlement than they were receiving on a charity basis, but even this increase in services might be offset by limitations on services under the new system.

It may be that the heavy new administrative burdens placed on employers and others will create new demand for IT services, clerical services, and consulting services.

Transfers of Staffing Customers' Uninsured Employees to Staffing Firms

Some staffing customers may have components of their workforces to whom they do not offer health coverage. In order to become employers deemed to offer coverage to all of their full-time employees, such customers might want to transfer these employees to staffing firms. The customers would still be indirectly paying the fees for the transferred employees, but they would be relieved of paying the fees for all of their remaining full-time employees.

Some Recommended Actions for Staffing Firms

- Determine the "grandfathered" status of your present health plans.
- Determine (with your insurance company, if you use one) what changes to health coverage need to be made between now and 2014.

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- Learn the various new notice and reporting requirements.
- Estimate the "play or pay" fees for your mix of employees and gross them up for your marginal tax rate, to determine how much additional gross margin would be required to cover this extra cost starting in 2014.
- Have your health plans tested for discrimination under the rules of Internal Revenue Code section 105(h).
- Develop an overall long-term strategy of health coverage for staff and assigned employees.
- Identify the extent to which existing timecards, purchase orders, and contracts with your customers enable you to pass on the cost of "play or pay" fees to those customers.
- Decide upon a strategy for adjusting to "play or pay" costs (*e.g.*, socialize them in company-wide bill rate levels; pass on to customers the costs of their assigned employees; absorb the fees with adjustments to specific pay rates, bill rates, and margins, etc.)
- Develop model language to include in new or renegotiated contracts that would clarify who has the burden of "play or pay" fees and provide calculation, billing, and audit procedures for when they are passed on to customers.
- Identify potential opportunities for customers to transfer uninsured employee groups to your employ (if that continues to be a viable option).

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[1] The Act uses the phrase "offer to its full-time employees" to distinguish two categories of fee-paying employers (those who do offer coverage and those who don't), but it does not expressly require the offer to be made to "all" such employees, leaving open the possibility that offering coverage to just some employees, as staffing firms do, would be sufficient for them to qualify as employers offering coverage. However, the report of the joint tax committee, which is the most formal legislative history available at this time, does use the word "all" when explaining this distinction.

[2] The "play or pay" fees apply to "applicable large employers" – those employing more than 50 full-time employees. Solely for the purpose of determining whether an employer is an applicable large employer, the hours of part-time workers are included in calculating whether the employer exceeds this threshold. The number of full-time equivalents is determined by dividing the aggregate number of hours of service of part-time employees for the month by 120.

[3] The Act allows companies to deduct 30 employees from the total number of employees taken into account for purposes of calculating this fee. Since employing large numbers of people is the business of staffing firms, that deductible will not be much relief to most staffing firms.

[4] For example, assume that a temporary employee is hired and assigned on February 16, 2015, to work 40 hours per week. One view is that his 80 hours for the last two weeks of the month would be averaged over all of February's four weeks, yielding a 20-hour-per-week average that falls below the average-30-hour-per-week threshold for full-time. However, another view is that the definition refers to the average weekly hours for the time that the person "is employed;" our sample employee was not employed during the first two weeks of February, and if his 80 hours are averaged only over the two weeks during which he was employed, his 40-hour-per-week average would qualify him as full-time. The same issue occurs when assignments end in the middle of months.

[5] To provide *minimum value*, the employer-sponsored plan's share of the total allowed costs of benefits provided under the plan must be at least 60% of such costs.

[6] The cost of comprehensive health care coverage is usually several times greater than the $2,000 or $3,000 annual fee rates.

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