Navigating the Muddy Waters of the Affordable Care Act in Franchising

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The Patient Protection and Affordable Care Act (PPACA) became the law of the land on March 23, 2010.1 Despite numerous challenges to the law since its enactment, PPACA seems to be here to stay.2 At its most fundamental level, PPACA’s purpose is to require most Americans to have health insurance. It accomplishes this in a number of ways. PPACA provides a mechanism through which individuals can purchase coverage through health insurance exchanges.3 It also creates separate exchanges through which small businesses can purchase health coverage.4 And, most significantly, it requires large employers to offer affordable health coverage to certain employees or pay penalties.5

PPACA impacts everyone from health care providers and insurance companies to government agencies, employers, and individuals. While the law itself is gargantuan (over 900 pages), the regulations issued under PPACA dwarf it in volume and continue to grow. Government agencies, such as the Department of Labor (DOL), the Department of the Treasury (Treasury), and the Internal Revenue Service (IRS), have issued extensive guidance to clarify various provisions and resolve concerns that have arisen since the law’s passage. Even though Treasury and IRS issued final regulations on February 12, 2014,6 some of PPACA’s provisions are not slated to take

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4. Id.
5. 26 U.S.C. § 4980H.

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effect for several more years, while others are delayed pending further regulatory guidance. This has led to considerable uncertainty and planning challenges.

Businesses remain unsure of how PPACA will impact their bottom lines. What is the actual cost of compliance? What unforeseen penalties might they be subject to? Are they exposing themselves to liability in other areas through their health care actions? This article explores these issues for franchisors and franchisees and provides guidance for navigating the still largely unknown world of PPACA compliance.

To do that, this article focuses on the employer mandate (also known as the employer shared responsibility provision or the play or pay requirement), which is arguably the most important provision of PPACA for franchisors and franchisees alike. The provision requires applicable large employers to offer health coverage that is affordable and provides minimum essential benefits at a minimum value to a substantially all of their full-time employees. If these employers do not comply, they will be required to pay an excise tax called an “assessable penalty.” It seems simple enough, but each of the italicized terms is the subject of extensive regulation and imposes rigorous requirements for compliance.

Whether the employer mandate applies to a business is a matter of counting and categorizing employees of that business and its affiliates, but the rules for counting and categorizing employees are not intuitive. Employers in franchising can face unique challenges in determining whether the employer mandate applies to them because of their variable workforces and complex organizational structures. Although the employer mandate is not effective until January 1, 2015, for employers with at least 100 full-time employees and January 1, 2016, for employers with at least fifty, but fewer than 100, full-time employees, the number and type of employees currently employed will determine whether the employer mandate will apply in many circumstances. As such, it is essential that employers consider their options now and prepare for whether they will “play or pay” come January 2015 or 2016.

Part I of this article educates franchisees and franchisors about the rules for aggregating entities and counting full-time employees under PPACA so that they may determine whether the employer mandate applies to them. Part II describes the penalties applicable large employers may face under PPACA. Part III identifies compliance pitfalls and ways to avoid them. Finally, Part IV concludes by analyzing the decision to play or pay for franchised businesses in light of their business needs and goals.

7. See 26 U.S.C. § 4980H.
9. See infra Part I.D. for a detailed discussion of timing of the employer mandate.
I. The Employer Mandate: 50 is the Magic Number

The employer mandate does not require all employers to offer health insurance to all of their employees. Rather, in any given calendar year, a business will be subject to the mandate only if it is an “applicable large employer,” meaning one with at least a total of fifty full-time (including full-time equivalent) employees. As such, franchisors and franchisees must properly count their employees to determine if they are above or below the fifty-employee threshold. Counting can be a challenge for franchised businesses because of entity aggregation rules, hours of service rules, and special categories of employees. Each topic is discussed in turn.

A. Aggregation of Employees of Affiliated Entities

In order to determine whether a franchisee or franchisor is an applicable large employer subject to the mandate, all entities that are part of the same controlled group or affiliated service group are treated as a single employer. Under PPACA, a business entity determines if it is part of a “controlled group” or “affiliated service group” using the same rules for determining controlled group and affiliated service group status for qualified retirement plan purposes. Importantly, if a controlled group or affiliated service group is an applicable large employer for a calendar year, the employer mandate applies separately to each member of the group. While large employer status is determined on an aggregate basis, each member of the controlled group is liable for its own tax penalties under the employer mandate and not for the penalties of any other group member.

Aggregating entities could have a huge impact on franchisees and franchisors. For example, a multi-unit operator whose individual franchised units are all part of the same control group will need to take into account all employees of all of the individual units to determine whether the group members are large employers. Each separate franchise cannot be counted separately even if they are distinct companies or even distinct franchised brands. This sort of aggregation provides both obstacles and planning opportunities. Because of PPACA, franchisors and multi-unit developers may want to consider the number and type of employees and the corresponding health care costs when determining the number of units, timing, and schedule of their development agreements. A franchisor attempting to grow through multi-unit development might push a developer to front load its development schedule and quickly develop four or five locations. However, because

10. 26 C.F.R. § 54.4980H-1(a)(4) (2012). In the case of a new entity, it will be deemed a large employer during its first year or partial year of existence if it reasonably expects to employ and actually employs an average of at least fifty full-time employees (taking into account full-time equivalent employees) during that calendar year. Id. § 54.4980H-2(b)(3).
12. See 26 U.S.C. § 4980H(c)(2)(C); see also 26 U.S.C. § 414(b), (c), (m), (o).
of PPACA, this number of units may not be optimal as staying below the fifty-employee threshold could be key to early success. For example, four units that require a total of sixty full-time employees may not make financial sense because of the associated health care costs, while three units and forty-five full-time employees does. Franchisors and multi-unit developers should naturally strive to grow to a place where the associated health care costs are not limiting development, but the early stages of growth and number of locations should be planned carefully.

The aggregation rules also provide a planning opportunity because the employer mandate penalties apply separately to each related employer in the controlled group. Thus, a controlled group could substantially reduce its aggregate penalty payments by assigning employees who are offered coverage to different subsidiaries than those who are not offered coverage. Before engaging in any restructuring designed to limited penalty payments, however, employers will want to evaluate the implications under PPACA.

B. Identification of Full-Time Employees

Because the employer mandate applies only to employers exceeding the fifty full-time employee threshold, it is imperative to understand who is an “employee” and how to count employees. The final regulations define an “employee” as “an individual who is an employee under the common-law standard” and excludes leased employees, sole proprietors, partners in a partnership, 2 percent S corporation shareholders, real estate agents, and direct sellers. Under the common law test, an employment relationship generally exists if the person contracting for services has “the right to control” not only the results of the services, but also the means by which that result is accomplished. IRS has enumerated twenty factors that can indicate such requisite control, including having direct control over the way work is performed, not just the outcome; requiring that work be performed at a specific location and during specified hours; providing training, tools, and materials; a continuing working relationship; and the worker providing services that are integral to the business. No one factor is determinative, and each situation must be examined on a case-by-case basis.

Using its employees’ hours of service, an employer must calculate its number of “full-time” and “full-time equivalent” (FTE) employees, which are then added together to determine if it is above the fifty-employee threshold. The final regulations provide two methods of calculating whether an

15. Id. at 8566.
19. Id.
20. See id.
employee has sufficient hours of service to be full-time—the monthly measurement method and the look-back measurement method—but only the monthly measurement method matters for determining whether PPACA’s employer mandate applies to a business.\textsuperscript{22}

Under the monthly measurement method, the critical factor is counting the employee’s hours of service for each month.\textsuperscript{23} Employers often make the mistake of counting only the hours an employee is physically at work, but PPACA requires a more robust calculation. An hour of service is each hour the employee is paid, or entitled to payment, for the performance of duties for the employer.\textsuperscript{24} This includes hours employees are not at work but entitled to be paid, such as vacation, holiday, illness, disability, layoff, jury duty, and leave of absence.\textsuperscript{25}

Full-time employees are counted based upon actual hours of service worked in the preceding calendar year (a shorter six-month period is allowed for 2015).\textsuperscript{26} For each month, the number of full-time employees equals the number of employees that worked at least 130 hours of service in that month—the monthly equivalent of thirty hours per week.\textsuperscript{27} FTE employees (e.g., part-time or variable hour employees) are also counted month-by-month.\textsuperscript{28} From this pool, the employer aggregates those employees’ hours of service per month (not counting more than 120 hours for any one employee) and then divides the total hours by 120.\textsuperscript{29} The result is the number of FTE employees for the month.\textsuperscript{30} The final step is to determine the average number of full-time and FTE employees in a calendar year by taking the totals for each month, adding them together and dividing by twelve.\textsuperscript{31} If the result is less than fifty, then the entity (or group) will not be an applicable large

\textsuperscript{22} 26 C.F.R. § 54.4980H-3(a). The look-back measurement method for identifying full-time employees is available only for purposes of determining and computing liability for payment of penalties under the employer mandate, and not for determining if the employer is an applicable large employer. \textit{Id.} See infra Part II.B. for a discussion of the look-back measurement method.

\textsuperscript{23} 26 C.F.R. § 54.4980H-3(c).

\textsuperscript{24} 26 C.F.R. § 54.4980H-1(a)(24).

\textsuperscript{25} Id.

\textsuperscript{26} Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. at 8573; \textit{see also} 26 U.S.C. § 4980H(c)(4). For calendar year 2015, an employer may determine its status as a large employer by determining whether it employed an average of at least fifty full-time employees during any consecutive six calendar month period of 2014. In 2016, the calculus will permanently change, and employers will need to average the total number of full-time employees for each of the twelve months of the preceding calendar year to determine if they are large employers. Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. at 8573.

\textsuperscript{27} 26 C.F.R. § 54.4980H-1(21); \textit{see also} 26 U.S.C. § 4980H(c)(4)(A). On April 3, 2014, the U.S. House of Representatives voted 248–179 to approve H.R. 2575, the Save American Workers Act, which would repeal PPACA’s definition of full-time employee status as thirty hours of service per week and replace it with forty hours of service per week. Save American Workers Act, H.R. 2575, 113th Cong. (2014). Further legislative action is expected.

\textsuperscript{28} See 26 C.F.R. § 54.4980H-2(c)(2).

\textsuperscript{29} Id.

\textsuperscript{30} Id.

\textsuperscript{31} 26 C.F.R. § 54.4980H-2(b).
employer, but if it is fifty or more, the entity (or group) will be a large employer subject to the mandate.\textsuperscript{32}

The hours of service of some types of employees are difficult to identify and track, and Treasury and IRS continue to consider additional rules for these challenging categories of employees. Until further guidance is issued, employers are required to use a reasonable method of crediting hours of service that is consistent with PPACA’s purpose.\textsuperscript{33}

C. Counting Special Categories of Employees

Several special rules for counting full-time and FTE employees are of particular interest to franchised businesses that use seasonal, temporary, or leased workers.

1. Seasonal Workers

Seasonal workers, while counted for purposes of the fifty-employee threshold, are allowed a special exemption that could prevent companies relying heavily on this type of labor from being large employers simply because of increased staffing during a few months of the year.\textsuperscript{34} Under the exemption, an employer will not be deemed a large employer subject to PPACA, even if it averages fifty or more full-time and FTE employees, if (1) the sum of its workforce exceeds fifty such employees for a period of 120 days (four calendar months)\textsuperscript{35} or less and (2) the employees in excess of fifty were solely seasonal workers.\textsuperscript{36}

A “seasonal worker” is one who works in retail “exclusively during holiday seasons” or “who performs labor or services on a seasonal basis”\textsuperscript{37} as defined by the Secretary of Labor[].\textsuperscript{38} The regulations do not specify which events or periods of time count as “seasonal.” Although the retail industry, which employs a large number of workers solely for holiday seasons, asked IRS to clarify what counted as a holiday season when it issued its final regulations, IRS declined to do so because what is a holiday season will differ from employer to

\textsuperscript{32}. Id.


\textsuperscript{34}. See 26 U.S.C. § 4980H(c)(2)(B).

\textsuperscript{35}. 26 U.S.C. § 4980H(c)(2)(B)(i); 26 C.F.R. § 54.4980H-2(b)(2). This 120-day measurement period need not be consecutive. 26 C.F.R. § 54.4980H-2(b)(2).

\textsuperscript{36}. New employers may also take advantage of the seasonal worker exemption as long as they reasonably expect to meet these requirements. 26 C.F.R. § 54.4980H-2(b)(2).

\textsuperscript{37}. “Seasonal basis” means “where, ordinarily, the employment pertains to or is of the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year.” 29 C.F.R. § 500.20(s)(1).

\textsuperscript{38}. 26 C.F.R. § 54.4980H-1(a)(39) (citing 29 C.F.R. § 500.20(s)(1)).
employer.\textsuperscript{39} Consistent with this approach, the regulations leave discretion to the employer to “apply a reasonable, good faith interpretation of the term \textit{seasonal worker} and a reasonable good faith interpretation of [\textit{seasonal basis}].\textsuperscript{40} Under this guidance, therefore, an employer may be able to apply the seasonal worker exemption to retail workers who are employed only during holiday seasons, such as between Thanksgiving and New Year’s Day, and to employees who perform labor or services for specific seasons or periods of the year, such as food kiosk, lawn care, and snow or ice removal workers.\textsuperscript{41}

2. Temporary or Leased Employees

Employers might look to leasing employees from a temporary staffing agency as a way to stay beneath the fifty-employee threshold and avoid the employer mandate, but it may not be a worthwhile alternative. If the worksite employer qualifies as the common law employer under the IRS twenty-factor test, the leased employees may still be deemed its employees for all PPACA purposes.\textsuperscript{42}

Worksite employers can minimize these risks by specifying in their contracts with a staffing agency that the staffing agency is the leased employees’ sole employer, but they should keep in mind that courts and government agencies like IRS and DOL will look beyond the contract and scrutinize the overall relationship for evidence of control over the employee.\textsuperscript{43} In addition, worksite employers can minimize risks by leasing employees from a reputable staffing agency that should itself be an “applicable large employer” providing appropriate health coverage.\textsuperscript{44} Even so, such a staffing agency, faced with increased health care costs due to PPACA, may simply pass those costs on to the worksite employer. The final regulations provide a safe harbor precisely for this situation under which a non-employer staffing agency can offer health coverage to the leased employees on behalf of the “client employer,” and that offer can satisfy the client employer’s obligations


\textsuperscript{40} 26 C.F.R. § 54.4980H-1(a)(39) (citing 29 C.F.R. § 500.20(s)(1)).

\textsuperscript{41} For instance, a lawn care employee may be seasonal in one geographic location where lawn care is needed for the summertime only, but not in another geographic location where lawn care is needed all year.


\textsuperscript{43} E.g., United States v. Garami, 184 B.R. 834, 836–38 (M.D. Fla. 1995) (applying the IRS twenty-factor test and holding that the worksite employer, not the leasing company, was the “employer” despite contractual agreement assigning employment responsibility to leasing company).

\textsuperscript{44} The final regulations do not adopt a general presumption that employees of temporary staffing agencies should be counted as variable hour or full-time employees. See 26 C.F.R. § 54.4980H-1(a)(49)(ii). Rather, they provide factors a temporary staffing agency can use to determine whether a new hire is a variable hour or full-time employee of the staffing agency. 26 C.F.R. § 54.4980H-1(a)(49)(ii)(B). Given the current landscape with respect to leased employees, IRS expects to issue additional guidance clarifying the employer mandate’s application to temporary staffing firms. Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. at 8557.
under the employer mandate. For this safe harbor to apply, the client employer must pay a higher fee to the staffing agency for employees enrolled in health coverage than it would pay for the same employees if they were not enrolled.

IRS also recognizes special rules for home care workers since there are circumstances when a home care worker who is paid by a home care staffing agency is truly an employee of the service recipient under the common law test. IRS’s reasoning stems from the fact that the service recipient often has “the right to direct and control the home care provider as to how they perform the services, including the ability to choose the home care provider, select the services to be performed, and set the hours of the home care provider[].” Because a service recipient often employs only a few home care workers, it will rarely meet the required fifty-employee threshold to be subject to the employer mandate. This means that home care franchises may well escape the employer mandate regardless of size.

D. Timing and Implementation

To assist employers in transitioning into compliance with PPACA, the federal government has provided transition relief for certain employers. Mid-sized employers—those with fifty to ninety-nine full-time and FTE employees—have until January 1, 2016, to comply with the employer mandate or risk paying a penalty. To be eligible for this transition relief, the employer must meet and certify that it complies with certain requirements. The employer must employ on average at least fifty but fewer than 100 full-time and FTE employees on business days during 2014, not reduce its workforce or hours of service solely for purposes of becoming eligible for the transition relief and continue offering to employees any health coverage that was in place as of February 9, 2014. Offering coverage on substantially the same terms requires the employer, among other things, to not reduce or narrow the class of employees (and dependents) who are eligible for coverage.

Employers must then certify their eligibility for the transition relief in the transmittal form they are required to file with IRS for year 2015,

45. See 26 C.F.R. § 54.4980H-4(b)(2).
46. 26 C.F.R. § 54.4980H-4(b)(2).
48. Id.
49. Id.
50. See id. at 8574–75.
51. Id. at 8574.
52. The workforce size determination is made according to the same rules used for determining applicable large employer status. Id. at 8574 n.14; see, e.g., 26 C.F.R. § 54.4980H-1(a)(16) (aggregation); 26 C.F.R. § 54.4980H-2(b)(2) (seasonal workers).
54. See id.
which is not due until early 2016. IRS is still finalizing the form and instructions.56

II. You’ve Hit the Big 5-0: Predicting Potential Penalties

A. PPACA Imposes Monetary Penalties

Applicable large employers are potentially subject to two penalties under PPACA. One is based on the failure to offer coverage and the other based on offering inadequate coverage. To avoid PPACA’s “no offer” penalty, a large employer must offer minimum essential coverage to at least a required percentage of its full-time employees (70 percent for 2015 and 95 percent for 2016 and later years) and their dependents.57 If it does not and even one full-time employee receives a market subsidy, the employer must pay a $2,000 penalty per full-time employee.58 When calculating the total penalty owed, employers can automatically exclude thirty full-time employees, but only thirty.59 There is no exception for full-time employees who are properly offered coverage.60

An applicable large employer can also be subject to PPACA’s “inadequate coverage” penalty if it offers minimum essential coverage to at least 95 percent (or 70 percent for 2015) of its full-time employees and their dependents, but does not offer coverage that is “affordable” and provides “minimum value,” and at least one full-time employee receives a market

55. Id. Under section 6056 regulations, all employers with at least fifty employees remain subject to annual information reporting requirements, even if they are not subject to the employer mandate in 2015. Id. at 8572. Employers are still required to file this report for the entire 2015 calendar year because the information reported is needed by employees to show that they qualify for the premium tax credits and by IRS to administer the premium tax credit in the exchanges. Id.


57. 26 U.S.C. § 4980H(a); 26 C.F.R. § 54.4980H–4(a); Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. at 8575. The 95 percent threshold does not begin until the 2016 plan year. Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. at 8575–76. Employers in controlled or affiliated groups share these “free employees” pro rata; however, as discussed earlier, employers in affiliated groups pay their own penalties on their own employees. 26 U.S.C. § 4980H(c)(2)(D)(ii); 26 C.F.R. § 54.4980H–4(e); see supra Part I.A.


subsidy.\textsuperscript{61} Coverage is affordable if the employee’s share of the premium is no more than 9.5 percent of that employee’s annual household income.\textsuperscript{62} A plan provides “minimum value” if it covers at least 60 percent of the total allowed cost of benefits that are expected to be incurred under the plan.\textsuperscript{63} The “inadequate coverage” penalty is $3,000 per year for each full-time employee receiving the subsidy; unlike the “no offer” penalty, the first thirty full-time employees are included in the calculation.\textsuperscript{64}

B. Avoiding PPACA’s Penalties

To avoid paying either penalty, employers must offer coverage when employees become eligible.\textsuperscript{65} Generally, coverage must be offered immediately after the end of a three-month period that begins when the employee meets the plan’s eligibility requirements (other than a waiting period).\textsuperscript{66} For full-time employees, this will often be the first day of the fourth month of employment.

Also essential to avoiding PPACA’s penalties is offering coverage to the appropriate “full-time employees” because penalties will not be assessed for part-time employees who are not offered coverage or whose coverage is not affordable. In this context, an employer may use either the monthly measurement method or the look-back measurement method to determine an employee’s “full-time” status. Picking the correct method of calculation is key.

The monthly measurement method provides a comfortable means of determining full-time status for franchised businesses with predictable workforces as it accurately determines which employees need to be offered coverage (or for whom penalties are due) with less record keeping.\textsuperscript{67} But, because

\textsuperscript{62} 26 C.F.R. § 54.4980H-5(e)(2)(ii)–(iv). As employers generally will not know household incomes of their employees, they can take advantage of one or more of the three affordability safe harbors set forth in the final regulations that are based on information they will have available—the employee’s Form W-2 wages, employee’s rate of pay, or federal poverty line. See id. If an employer meets the requirements of any of these safe harbors and applies them consistently, the offer of coverage will be deemed affordable for purposes of the employer mandate. 26 C.F.R. § 54.4980H-5(e)(2)(i).
\textsuperscript{64} 26 U.S.C. § 4980H(b)(1), (c)(2)(D)(i); 29 C.F.R. § 54.4980H-1(a)(42). The “inadequate coverage” penalty is calculated as follows: (number of full-time employees receiving subsidy for month) x 1/12 x $3,000.
\textsuperscript{65} 26 U.S.C. § 4980H(a), (b)(1).
\textsuperscript{66} 26 C.F.R. § 54.4980H-3(d)(2)(iii), (d)(3)(iii).
PPACA’s penalties are determined on a month-by-month basis, it is not possible to know whether coverage must be offered to a particular employee until the end of the month, when full-time status is known. This places franchisors and franchisees with variable workforces in a tricky position as they may owe a substantial penalty simply because they miscalculated their short-term business needs, such as overtime. The look-back measurement method provides a solution for these employers as it allows them to “look-back” at actual hours worked when determining full-time status.68

In addition, franchisees and franchisors relying on seasonal and variable hour employees should take note of the special considerations afforded to them by PPACA.69 Employers do not have to offer coverage to these employees within three months (when employees typically become eligible), but can instead track their hours of service during an initial measurement period to determine if they are in fact “full-time.”70 Even if it is ultimately determined that the employee is full-time, no penalty will be due during this initial period, provided various conditions are met.71

III. Compliance Pitfalls Faced by Employers in Franchising

In light of PPACA’s onerous requirements on applicable large employers, businesses subject to the employer mandate are looking for ways to reduce or restructure their workforces to qualify for the transition relief or avoid the mandate altogether.

A 2013 study released by the U.S. Chamber of Commerce and the International Franchise Association found that a significant number of businesses favor reducing, and some even have already reduced, employee hours below

68. Under the look-back measurement method, an employee’s full-time status for a future period known as the “stability period” is determined based upon the employee’s hours of service in a prior period referred to as the “measurement period” that can range from three to twelve months. See 26 C.F.R. §§ 54.4980H-1(25), (45)-(46), 54.4980H-3(d)(1). Each ongoing employee who works an average of thirty hours per week during the standard measurement period is a “full-time” employee during the subsequent stability period and must be offered health coverage to avoid PPACA’s penalties. 26 C.F.R. § 54.4980H-3(d)(1)(i), (d)(1)(ii). An employer may use different standard measurement periods and stability periods, so long as they are consistent for all employees in the same category. 26 C.F.R. § 54.4980H-3(d)(1)(i), (d)(1)(iv).

69. 26 C.F.R. § 54.4980H-3(d)(3). Variable hour employees are those in positions for which the employer cannot reasonably anticipate at their start date whether their hours will be above or below thirty per week. 26 C.F.R. § 54.4980H-1(a)(49). Seasonal employees are those “hired into a position for which the customary annual employment is six months or less” and whose position begins about the same time each year. 26 C.F.R. §§ 54.4980H-1(38), 54.4980H-2(b)(2); see also U.S. Treasury Dep’t, Fact Sheet: Final Regulations Implementing Shared Responsibility Under the Affordable Care Act (ACA) for 2015, at 2 (2014), http://www.treasury.gov/press-center/press-releases/Documents/Fact percent20Sheet percent2020021014.pdf.


thirty hours as a cost control measure to deal with PPACA’s increased health care costs.\footnote{72} The survey asked 208 decision-makers in franchise-owned businesses and 206 decision-makers in non-franchise businesses with forty to fifty employees about the impact of PPACA on their businesses.\footnote{73} Together, franchise-owned and non-franchise-owned businesses of this size account for over 42 million jobs or over 25 percent of all employed Americans.\footnote{74} Overall, the decision-makers reported that PPACA has already resulted in higher costs and fewer full-time positions.\footnote{75} Some highlights reported in the study include that:

- 64\% of franchise and 53\% non-franchise businesses believe PPACA will have a negative impact on their businesses.
- To cope with increasing health care costs, 31\% of franchise and 12\% of non-franchise businesses have already reduced worker hours and 15\% of franchise and 12\% of non-franchise businesses have already reduced the number of workers.
- Additionally, 27\% of franchise and 12\% of non-franchise businesses have already replaced full-time workers with part-time employees.
- Among businesses with forty to seventy employees (23\% of all franchise and 10\% of all non-franchise businesses surveyed), 59\% of franchise and 52\% of non-franchise businesses planned to make personnel changes to stay below the fifty-employee threshold. Cost control methods cited by survey participants included cutting full-time staff and hours, hiring only temporary or part-time employees, and cutting benefits and bonuses.
- 60\% of franchise and 37\% of non-franchise businesses say the employer mandate will mean they will not provide health care coverage and opt instead to pay a penalty.\footnote{76}

These findings highlight that employers in franchising are looking for options to ease or avoid compliance with the employer mandate. Indeed, one case in the franchising context is already making its way through the U.S. District Court for the Middle District of Florida in which an employee has jointly sued the franchisee and franchisor, alleging that they required


73. McInturff & Roberts, supra note 72, at 2.

74. Id.

75. Id.

76. Id. at 3, 8, 10–11.
him to work under two different names to avoid compliance with the employer mandate.  

Put simply, any decision to reduce the workforce size, cut an employee’s hours, or otherwise curtail properly crediting an employee for all hours of service cannot be taken lightly considering the wide range of protections PPACA has put in place to shield employees from such employment actions.

A. Workforce Reductions Must be for Legitimate Business Reasons

To qualify for the transition relief available to medium-sized employers, any reduction in workforce size or employees’ hours must be for “bona fide business reasons.” Acceptable “bona fide business reasons” exist where the decrease in employees or hours is attributable to a “business activity,” such as “the sale of a division, changes in the economic marketplace in which the employer operates, terminations for poor performance, or other similar changes unrelated to eligibility for the transition relief[.]” However, given the fact that the final regulations providing for this transition relief have been recently issued, it is unclear how IRS and courts will apply the bona fide business reasons standard. One possibility is that the standard will be expanded beyond transition relief workforce reductions. For now, since it is clear that employers must certify to IRS under penalty of perjury that no workforce size or hours reduction occurred merely to qualify for the transition relief, employers must exercise caution and good business judgment in making any decisions that impact their workforces’ size or hours.

B. Far Reach of PPACA’s Whistleblowing Protections

In addition to the above considerations, an employer must keep in mind that PPACA’s protections for employees extend beyond workforce reductions. In fact, effective February 2014, PPACA § 1558 amended the Fair Labor Standards Act (FLSA) to add § 18C, commonly known as the “PPACA whistleblower provision.” FLSA § 18C prohibits employers from discharging or discriminating against an employee regarding compensation, terms, conditions, or other privileges of employment because he or she (1) received a premium tax credit or a cost sharing reduction for enrolling in a qualified health plan or (2) provided information related to a PPACA violation, testified in a proceeding concerning a PPACA violation, assisted or participated in such a proceeding, or objected to or refused to participate in any activity that the employee reasonably believed to be in violation of PPACA. Employees who receive a market subsidy because the employer

79. Id.
failed to offer coverage are specifically included to prevent their employer from retaliating against them because the failure to offer coverage might expose the employer to a tax penalty.  

The protection afforded is extensive. Employees are protected from retaliation not only by their own employers, but also by any other employer that provides their health insurance coverage, such as their spouse’s employer. In addition, § 18C protects current employees, former employees, and job applicants alike. Further, retaliation is broadly defined to include, among other employment actions, firing or laying off, reducing pay or hours, blacklisting, demoting, denying overtime or promotion, disciplining, denying benefits, failing to hire or rehire, intimidation, threats, and reassignment.

Moreover, the procedures applicable to PPACA whistleblowing complaints are lenient toward employees. To pursue a complaint, employees must file with the Secretary of Labor within 180 days after the alleged retaliation occurred, and the employee has wide latitude in styling the complaint, which can be in any form. Problematically, employees need only reasonably believe that they have been retaliated against in violation of § 18C to be protected; there need be no actual violation of the law. Within twenty days of receiving notice that a complaint was filed, both the employee and employer can submit a written response and evidence. The filing of a complaint will generally trigger investigation by the Secretary unless (1) the employee fails to make a prima facie showing of the facts alleged in the complaint or (2) the employer rebuts that showing by presenting clear and convincing evidence that it would have taken the same unfavorable personnel action in the absence of the protected activity claimed. Timing is an employee’s best friend here. There is a presumption that employees can meet their burden simply by showing that “the adverse action took place shortly after the protected activity,” thus creating the inference that it was a contributing factor in the adverse action.

Within sixty days of the filing of the complaint, the Secretary will issue a determination as to whether there is reasonable cause to believe that retal-
tion occurred. If the Secretary finds reasonable cause exists, it can issue a preliminary order awarding a wide array of temporary remedies to the employee, including reinstatement with benefits and compensation (with back pay and interest) and payment of compensatory damages and attorney fees. The preliminary order will become effective thirty days after the employer receives it, except where reinstatement is ordered, in which case reinstatement becomes effective immediately upon the employer’s receipt. It is important that the employer comply with the order or timely object and request a hearing because the Secretary has authority to file a civil action in the appropriate U.S. district court to enforce the relief awarded to the employee.

A dissatisfied party may file objections and request a hearing with an administrative law judge within thirty days of receipt of the preliminary order; otherwise the order becomes final and not subject to judicial review. The PPACA whistleblower provision also provides for a second level of administrative review before an administrative review board. It additionally permits an employee to seek de novo review of the complaint by a federal district court (1) within ninety days after receiving a written determination or (2) if the Secretary does not issue a final decision within 210 days after the complaint is filed. Moreover, an employee can appeal final orders of the administrative law judge or administrative review board to the appropriate federal appellate court.

In short, § 18C is employee-friendly in every respect. The myriad of protected whistleblowing activity, the presumptions and burdens of proof, the levels of agency and judicial review, and the robust remedies allowed all favor the employee. For an employer, having to prove by “clear and convincing evidence” that its employment actions were not retaliatory is highly burdensome. This is particularly true because under § 18C an employee can be wrong about the alleged PPACA violation but still have an actionable retaliation claim.

Although it generally is a good idea for employers to document their reasons for taking employment actions and to ensure that their employment actions can be supported by legitimate business reasons, the PPACA whistleblower provision highlights why it is crucial in a post-PPACA world for franchised business owners to follow these fundamental steps.

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91. 29 C.F.R. § 1984.105(a). However, prior to issuing a reasonable cause determination, the Secretary will give the employer a limited opportunity to submit evidence and arguments to demonstrate no violation occurred. 29 C.F.R. § 1984.104(f).
92. 29 C.F.R. § 1984.105(a)(1), (c).
94. 29 C.F.R. § 1984.113. To the extent the preliminary order required the employee’s reinstatement, the reinstatement remains in place regardless of any objections to the order. 29 C.F.R. §§ 1984.105(c), 1984.106(b).
96. 29 C.F.R. § 1984.110(a). A final decision should be issued within 120 days of the hearing before the administrative review board. 29 C.F.R. § 1984.110(c).
97. 29 C.F.R. § 1984.114(a)(1)–(2).
98. 29 C.F.R. § 1984.112(a), (c). The petition for review must be filed within sixty days after such final order is issued. 29 C.F.R. § 1984.112(a).
C. Misclassifying and Miscounting Employees

1. Independent Contractors

To avoid the employer mandate, some employers in franchising might use or contemplate using independent contractors or consultants in lieu of employees. Depending on the nature of the business, this could include fitness instructors, hair stylists, nail technicians, massage therapists, plumbers, and landscapers. After all, the benefits of treating a worker as an independent contractor versus an employee are many. Among other things, employers are not required to provide health benefits to independent contractors, do not incur payroll taxes on these workers, can avoid workers’ compensation obligations and overtime liability, and can avoid an increase in unemployment rating when these workers are terminated.\(^9\) But while independent contractors may provide a greater return on investment than hiring new employees in some cases, misclassification of workers is extremely costly.\(^{10}\)

Worker misclassification is front and center in state and federal legislation, including PPACA, enforcement actions by federal and state agencies, DOL and IRS audits, and wage and hour litigation. For example, DOL launched a misclassification initiative in 2010 through which it coordinates and shares information regarding worker misclassification with over a dozen states and with IRS.\(^10\) Ten states have also enacted laws, some even targeting particular industries, which curtail the use of independent contractors or increase penalties for misclassification.\(^{12}\)

Not surprisingly, following release of PPACA’s proposed regulations, businesses expressed concerns to IRS about the consequences that reclassifying a worker as an employee could have on their businesses under the employer mandate.\(^{13}\) Specifically, businesses voiced concerns that if a worker who had sufficient hours of service for past periods to qualify as a full-time employee during those periods, was not treated as such, and was later reclassified as an employee, the reclassification could impact (1) the determination of whether the employer was a “large employer” subject to the employer mandate, (2) whether the employer offered coverage to a sufficient percentage of employees, and (3) even whether the employer could be subject to penalties if the reclassified worker had received a premium tax credit during a period in which he or she was not treated as an

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100. E.g., Vizcaino v. Microsoft Corp., 142 F. Supp. 2d 1299, 1301 (W.D. Wash. 2001) (settlement of $97 million for misclassified independent “freelancers” hired under independent contractor written agreements), aff’d, 290 F.3d 1043 (9th Cir. 2002).


employee. Businesses requested relief from liability for not properly withholding federal income tax due to worker misclassification if they could demonstrate that they had a reasonable basis for the original classification. Treasury and IRS declined to grant this relief, finding that “the relief requested would serve to increase the potential for worker misclassification by significantly increasing the benefit of having an employee treated as an independent contractor.”

The implications of this decision are far-reaching for employers because it leaves them without a mechanism to mitigate the impact of a misclassification error associated with PPACA’s employer mandate. Therefore, employers must exercise great care when making initial worker classification decisions based on the common law employment standard to avoid the risks of reclassification down the road. This will require businesses to not only review their contractual agreements with independent contractors, consultants, and other types of non-employee workers, but also scrutinize how the worker performs work on a day-to-day basis and the extent of control the business exercises or has the right to exercise over the worker.

2. Short-Term and High-Turnover Employees

Franchised businesses in some industries such as restaurant, retail, and health care know employee turnover far too well, but will nonetheless have to keep track of those employees’ hours for purposes of PPACA compliance. This can be particularly daunting when dealing with short-term and high-turnover employees because Treasury and IRS, citing the potential for abuse, have refused to adopt any special rules or exceptions for them. According to the agencies, any such exception will only incentivize employers to terminate employees to ensure that a position remains short-term or high-turnover.

Although the agencies did not adopt any special exceptions for counting these types of employees, they did address two categories of potentially high-turnover employees in the final regulations. First, failure to offer coverage to full-time employees who do not continue in employment through the first day of the fourth month following the start date will not result in a penalty if coverage would have been offered by the first day of the fourth

104. Id. at 8567.
105. Id. at 8567–68.
106. Id. at 8568 (emphasis added).
107. Short-term employees for purposes of PPACA are those who are reasonably expected to average at least thirty hours of service per week for less than twelve months but are not doing seasonal work expected to recur on an annual basis. Id. at 8561–62.
108. High-turnover employees are those in positions in which a significant percentage of employees can be expected to terminate employment over a reasonably short period of time (for example, over a six-month period). Id. at 8562.
109. See id.
110. Id.
month of employment.\textsuperscript{111} Second, failure to offer coverage to variable hour employees generally will not result in a penalty to an employer who uses the look-back measurement method until after the end of the first month beginning on or after an employee’s first anniversary of employment.\textsuperscript{112}

This leaves at issue positions in which employees are reasonably expected to average thirty hours of service or more per week and in which a significant portion of new hires are expected to continue working only slightly beyond three months.\textsuperscript{113} Some employers may want to classify short-term and high-turnover employees as seasonal employees to avoid having to count them for purposes of PPACA compliance, but the temptation to misclassify them should be avoided. As discussed earlier, the final regulations foreclose special exceptions for high-turnover positions because of concerns with employer manipulation, and the penalties for worker misclassification are steep.\textsuperscript{114}

Employers with a short-term or high-turnover workforce must therefore properly count such workers for purposes of ensuring compliance with the employer mandate.

\textbf{IV. To Play or Not to Play?}

Large employers that are subject to the employer mandate must determine whether to offer coverage to full-time employees or pay assessable penalties. There are costs and benefits associated with both playing and paying, and business needs and goals, as well as risks of noncompliance, are key considerations in the decision to play or pay.

While the business expense of providing health benefits or paying tax penalties will affect the bottom line of any business, certain franchised industries, such as fast-food or other service-based businesses, are expected to be particularly hard hit by the employer mandate. These high-turnover businesses have traditionally not felt the need to offer health coverage to attract employees, so regardless of playing or paying, their expenses are expected to rise. Moreover, the margins of these businesses are often quite narrow, meaning a 10 percent increase in health care costs could turn a profitable unit into an unprofitable one. Indeed, PPACA may well give mom-and-pop shops or single-unit franchisees a competitive advantage over multi-unit developers and franchisor-owned chains as the large businesses will be bound by the law while the smaller businesses will not meet the fifty-employee threshold. One thing is certain: the decision to play or pay will change the economics of these businesses.

Simply paying the penalties may appeal to some employers that think by paying they can save on health care costs and escape the hassle of providing

\textsuperscript{111} \textit{Id.} (citing 26 C.F.R. § 54.4980H-3(c)(2), (d)(2)(iii)).
\textsuperscript{112} \textit{Id.} (citing 26 C.F.R. § 54.4980H-3(d)(3)(iii)).
\textsuperscript{113} \textit{Id.}
\textsuperscript{114} \textit{See supra} notes 100–02 and accompanying text.
insurance and tracking employee hours. But all large employers face tracking and reporting costs since even the penalties are based on employee hours. On the other hand, no one knows how PPACA will affect costs going forward. Should health care costs rise substantially over the coming years, the incentives for dropping employee coverage and paying the penalties will increase.

While the costs of providing health coverage to full-time employees can be substantial, there are some cost-saving measures associated with playing. First, the employer’s costs of providing health coverage to employees will be tax deductible. Penalties, on the other hand, receive no such favorable tax treatment. Second, health care costs may not be as high as an employer anticipates once the demographics and health care needs of its workforce are taken into account.

One thing is clear: not complying with PPACA or attempting to skirt the employer mandate can result in negative repercussions for employers beyond the financial costs. Cutting employees’ hours, reducing workforce size, or misclassifying employees to circumvent the employer mandate can have serious ramifications on a franchised business. Employees who are not offered health coverage or who are subjected to any of these employment actions to avoid offering them coverage will often have no vested interest in seeing the business thrive, resulting in poor operations and potential lower profits. Taking adverse employment actions to avoid the employer mandate can also expose the franchised business to liability for a myriad of employment claims, including wrongful reduction of hours, retaliation, and worker misclassification.

Unfortunately, for now, the decision to play or pay must be made in the face of uncertainty. The legal challenges to PPACA persist as the agencies continue to muddy the waters with additional regulation. Against this backdrop, it is more important than ever for employers not to lose sight of their business needs and goals. Offering health benefits to employees can be valuable to franchised businesses. This benefit could be essential to retaining top talent, creating an optimal culture, and shaping an enjoyable environment for employees and customers patronizing the business. In franchising where brand integrity is paramount, employers cannot afford to let PPACA run the business.