Independent Contractor or Employee? Avoiding Worker Misclassification Confusion

Wednesday, October 7, 2015
11:30 a.m. – 12:15 p.m. CDT
Bruce Ely, John Hargrove, Summer Austin Davis
Agenda

- Three-part program today
- BABC tax partner Bruce Ely will review current tax issues relating to independent contractors and provide practical pointers
- BABC labor and employment partner John Hargrove will review employment and employer-liability issues involving independent contractors
- BABC labor and employment attorney Summer Davis will discuss best practices as relates to employee classifications
Tax Issues

- Bruce Ely, presenting
Tax Issue Overview

- IRS’s early 20-factor test, the Revenue Act of 1978’s “safe harbor,” and the IRS’s latest Voluntary Compliance Settlement Program

- IRS’s coordinated efforts with state tax and labor agencies

- Federal concerns for the employer, including Title VII (and related acts), the FLSA, the Affordable Care Act, benefit plans, and the new paid sick leave mandate

- State concerns for the employer, including Workers’ Compensation, Unemployment Insurance, State Anti-Discrimination Laws, and more...
Federal and State Priorities

- USDOL (Congress) and IRS made worker misclassification issues a high priority/target several years ago
- States also realized money being lost to misclassification – became a priority
- Point: It is now a priority at multiple levels!!!
Employee v. Independent Contractor

- **Common law test**
  - Variety of factors
  - Key Issue: Control
  - Who controls method and result?

- **Can differ in different settings**
  - Each federal agency
  - Each federal circuit court of appeals
  - Each state/state agency

- **IRS Independent Contractor Test**
  - Key element still is control
  - Historical test - the 20 factors
  - The new test
Employee vs. Independent Contractor

- Importance of Proper Worker Classification
  - Federal Tax Ramifications
  - State Tax Ramifications
  - Potential Class Actions
  - A Few Recent War Stories
  - Possible State Legislative Efforts
Employee vs. Independent Contractor

- Employment Tax Issues
  - Withholding
  - Internal Revenue Code Definition
  - Regulatory Definition
Employee vs. Independent Contractor: What’s the Test for Tax Purposes?

- Testing Worker Classification – Four Tests
  - The Common Law Test
  - The Newer IRS Test
  - State Statutes
IRS 20-Factors

- Instructions
- Hiring, supervising, and paying assistants
- Continuing relationship
- Set hours of work
- Full-time required

- Training
- Doing work on a hiring party’s premises
- Order or sequence set
- Oral or written reports
- Payment by the hour, week, or month
IRS 20-Factors – continued

- Payment of business or travel expenses
- Furnishing of tools and materials
- Significant investment
- Realization of profit and loss
- Working for more than one firm at a time
- Services available to public
- Right to discharge
- Hired party has right to terminate
- Integration
- Services rendered personally
Employee vs. Independent Contractor: What’s the Test for Tax Purposes?

- **Key:** "Right to Control"

- **Dual Status Individuals**
  - Insurance Agents
  - General Rule

- **Automatic Employees**
  - Corporate Officers
IRS Simplified Test – 3 Areas

- **Behavioral Control**
  - Instructions from business to worker
  - Training business provides to worker

- **Financial Control**
  - Reimbursement of business expenses
  - Worker’s investment
  - Services available to relevant market
  - How worker is paid
  - Realization of profit or loss

- **Type of Relationship**
  - Written contract
  - Benefits provided
  - Permanency of relationship
  - Services are key aspect of business
Employee vs. Independent Contractor: What’s the Test for Tax Purposes?

- **Form SS-8**
  - Review vs. audit
  - Beware the use of this form as a weapon by former/unhappy contractor(s).
  - Guess how often the applicant is “found” to be an employee?
Section 530 Relief

- Statutory Rules
- Additional Rules
- Exceptions
- No Alabama Equivalent
How Does the Affordable Care Act (ACA) Affect Worker Classification?

- Section 4980H Excise Tax Penalties - Punitive

- Does section 530 relief apply to ACA penalties?

- So what if my company was exonerated because of Section 530, not based on the Common Law Factors?
Voluntary Classification Settlement Program ("VCSP")

- **In General**

- **Eligibility**
  - Consistent Treatment
  - Not Under Audit
  - New Wrinkle – Disclosure of the Names and SSN’s of the Target Group Members
Voluntary Classification Settlement Program (\textquotedblleft VCSP\textquotedblright)

- VCSP Agreements
- Application
- Waiting on Alabama DOL and DOR to Follow Suit
Recommended Action

- Convince your clients/company to review their existing contractor relationships, including the paperwork (hint, their independent contractor agreement must be consistent, internally and externally) – TODAY

- Visit with experienced counsel to look at options (remember attorney-client privilege)

- If at risk, consider VCSP with IRS

- Working on ADOR and ADOL VCSP
Labor, Employment, and Employer-Liability Issues

- John Hargrove, presenting
Significance of Worker Classification

So how can worker classification impact an employer?

• Status determines employee’s rights and employer’s obligations

• Status impacts rights of third parties
Economic Realities Test

  Identified 5 factors
  - The degree of control exercised by the alleged employer
  - The degree to which the "employee's" opportunity for profit or loss is determined by the employer
  - The extent of the relative investments of the putative employee and employer
  - The permanency of the relationship, and
  - The skill and initiative required in performing the job

- Some courts add 6th factor:
  - Whether the service rendered is an integral part of the alleged employer's business
Empolyment Issue Overview

- Federal Discrimination Law
- Federal Wage and Hour Law
- State Workers’ Compensation Law
- Third-party Liability
- Miscellaneous Issues
- General employee coverage issues
Worker Is Harassed
Federal Antidiscrimination Laws – Claim Issues

- **Ramifications if employee**
  - Federal (or state) EEOC charge
  - Subsequent federal court lawsuit
  - Damage caps (usually)
  - Discrimination reporting policy defenses

- **Ramifications if not employee**
  - Negligent hiring or retention
  - Defenses based upon notice and reasonable care
Other Federal Employment Laws – Claim Issues (wage and hour)

- **Ramifications if employee**
  - Pay for all hours worked
  - Time and a half for overtime
  - Tax and SS withholdings
  - Huge attorney fee awards

- **Ramifications if not employee**
  - Pay according to agreement
  - None of the typical withholdings
Workers’ Compensation

- Legislative “contract” between employee and employer
  - Coverage regardless of employee “fault”
  - Rule of exclusivity

- Historically can be traced to 2050 B.C.
  - Law of Ur-Nammu, King of city-state of Ur
  - Code of Hammurabi around 1750 B.C.
  - Prussia and Europe had it
  - Originally lobbied for by employers in US
  - Wisconsin had it first

- Bottom line: If employee, cannot sue in tort
Workers’ Compensation

- Alabama uses “reserved right of control test”:
  - The reserved right to control the “how” of the work and not just the “what”;
  - Actual control of the “how”;
  - The method of payment;
  - The furnishing of tools and equipment; and
  - The right of termination.

- One single factor does not control
Worker Seeks Workers’ Comp
Workers’ Compensation

- Ramifications if employee
  - Covered by the Act
  - Payment of medicals, TTD, PPD, PTD

- Ramifications if not employee
  - No coverage for accident
  - If no negligence, then no recovery at all except against third parties
Worker Avoids Workers’ Comp
Workers’ Compensation

- Ramifications if employee
  - Cannot sue in tort for negligence
  - No “failure to maintain a safe workplace”
  - Can sue a “co-employee”
  - Can sue third parties like outside parties in the accident or product manufacturers

- Ramifications if not employee
  - Can sue in tort
  - Pain and suffering
  - Punitive damages
Worker Injures Third Party
Typical Third-party Issues

- Ramifications if employee
  - Agency or respondeat superior liability
  - Line and scope issues
  - Company’s insurance!

- Ramifications if not employee
  - Not direct liability for the wrongdoer
  - Independent wrong like premises liability
  - Independent contractor’s insurance!
Miscellaneous issues

- **Unemployment Compensation**
  - Business must pay the tax
  - Liability for benefits

- **Covenants Not to Compete**
  - Do not apply to independent contractors in Alabama
  - Must be during employment relationship
Federal Employment laws - Coverage Issues

- Title VI 15 employees
- ADA 15 employees
- ADEA 20 employees
- FLSA 1 employee
- FMLA 50 employees
- WARN Act 100 employees
Benefits or No Benefits

- ACA
- ERISA benefits are determined by plan definitions
- Definitions generally describe eligibility in reference to hours worked (or something similar) per week
  - If worker ≠ employee = not eligible
  - If worker = employee = eligible

- Contract issues:
  - Severance
  - Sick pay
  - STD
  - Vacation
Best Practices

- Summer Davis, presenting
Advantages to Employee Relationship

- Clarity as to legal obligations
- Least likelihood of legal challenge
- Right to control is accepted and understood
- Control of training
- Exclusivity protection under workers’ compensation laws
Advantages to Contractor Relationship

- No liability for third-party injuries (probably)
- No federal or state tax withholdings
- No liability for:
  - Title VII and other employment laws
  - ADA obligations
  - FLSA compliance
  - Federal Paid Sick Leave requirements
  - FMLA obligations
  - NLRA protections
  - Workers’ Compensation coverage
  - Unemployment Compensation coverage
- Affordability, Adaptability, Flexibility, and Experience/Expertise
Increased Scrutiny of “Contractor” Relationships

- NLRB redefined its standard for determining joint-employer status.
- Federal DOL opined that thousands of workers misclassified as independent contractors under FLSA.
- OSHA directed inspectors to consider whether principal employers might be at fault for the safety violations of their subcontractors.
- Uber, Lyft, Fedex lawsuits
How to Manage Risk?

- Examine the relationship based on the IRS factors
- Every factor
- Change what you can to make sure the factors available are weighted towards contractor status
- Who really has control?
- Is there another employer out there other than you???
How to Manage Risk?

- Always first consider using a corporation or legal business entity!
- Written agreements:
  - Memorialization of the contractor relationship
  - Clear statement of tax obligations
  - Company’s obligation to send form 1099
  - No benefits like employees receive
  - Standard contract termination provisions
  - Consider dispute resolution provisions
  - Indemnity, indemnity, indemnity
- Perhaps consider staffing company or employee leasing arrangement
- Live by the agreement(s), and do not start acting like an employer
Control vs. Distance

- Businesses can no longer have their cake and eat it too.
- To legitimize contractor relationships, increase distance between parties to the contract.
- If the relationship is an employer/employee relationship, minimize risk by exerting control.
Common-sense Cautions

- Don’t make some workers employees and others independent contractors doing the same job
- Don’t convert employee to independent contractor doing same thing he/she did before
- Don’t pay by the hour
- Don’t require uniforms and a little badge that says “Mike”
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