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Focus on Misclassification: Are Your Association's Workers "Employees," "Volunteers," or "Contractors?"

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agenda

- n What's in a Name: "Employee" vs. "Independent Contractor"
 - Federal rule
 - Varying state law interpretations
 - What about volunteers and interns?
- n Avenues of Enforcement
 - Government
 - Employees and the plaintiffs' bar
- n Consequences of Misclassification
- n Identifying and Remediating Problems



employee vs. independent contractor

- n Varying definitions between common, federal and state law
- n Executive assistant vs. lawn-care company
- n Common theme – ***control***
 - Behavioral
 - Financial



IRS: old 20-factor test

- (1) instructions
- (2) training
- (3) integration into the business
- (4) services rendered personally
- (5) hiring, supervising, and paying assistants,
- (6) continuing relationship
- (7) set hours of work
- (8) full-time required
- (9) doing work on employer's premises
- (10) order or sequence set
- (11) oral or written reports
- (12) payment by hour, week or month
- (13) payment of business or travel expenses
- (14) furnishing significant tools and materials
- (15) significant investment
- (16) realization of profit or loss
- (17) working for more than one entity
- (18) making services available to general public
- (19) right to discharge
- (20) right to terminate



common law or “economic realities” test

- n Behavioral control
 - Instructions
 - **how**, when, or where to do the work?
 - what **tools** or **equipment**?
 - what **personnel** to use?
 - Training – particularly **procedures** and **methods**



common law or “economic realities” test

- n Financial control
 - Compensation
 - Per hour/day/week/month?
 - **Project basis?**
 - Expenses – reimbursed?
 - Investment and opportunity for **profit** or **loss?**



common law or “economic realities” test

- n Relationship of the Parties
 - Provision of **benefits**
 - **Exclusivity** of arrangement
 - **Permanence** of relationship
 - Written **agreements**



the “economic realities” test

- n Degree of **control** exercised over the worker
- n Worker’s opportunities for **profit and loss**
- n Worker’s investment in **equipment** or material, or employment of other workers
- n **Skill** required for the work
- n **Permanence** of the working relationship
- n Whether the worker’s services are an “**integral part**” of the business



varying state tests can apply

- n States **are not** restricted by IRS definition
- n In Maryland employment status is **presumed**
- n Criteria for determining independent contractor status
 - Person is “**free** from the employing unit’s control or direction”
 - Service being provided is “**outside the usual course of business** of the employer”
 - Contractor is “customarily engaged in an independently **established business**”



volunteers and interns

- n Volunteers and interns, like independent contractors, are **not employees**
- n Volunteers typically “serve on a **part-time basis** and **do not displace** paid workers or perform work that would otherwise be performed by employees”
- n May receive a “**nominal fee**”
 - Not tied to number of hours worked/productivity
 - No more than **20% of cost** if employer had to pay wages



volunteers and interns

- n DOL “Fact Sheet 71” six prongs for unpaid internships
 - Similar to training in **educational** environment
 - For **benefit of intern**
 - Intern does not **replace** regular employees
 - No **immediate advantage** to the employer
 - No entitlement to a **job** following internship
 - Understood that no entitlement to **wages**
- n Footnote indicates unpaid internships “**generally** permissible” for “non-profit **charitable** organizations”



avenues of enforcement

- n Current focus of government authorities
- n Employees
- n Plaintiff's bar



priority of federal government

n DOL

- Historic priority of Patty Smith, Solicitor of Labor
- \$46 million in proposed 2012 DOL budget specific to worker misclassification; \$15 million budgeted for Wage-Hour investigations (90 new investigators)

n IRS

- Employment National Tax Research Program – a three-year IRS audit initiative of 6,000 “randomly targeted” audits
- In addition to worker classification, “invasive” audits look at fringe benefits, expense reimbursement, executive compensation and other withholding issues



state enforcement

- n Maryland, Connecticut, New York, Pennsylvania are just some of the states enacting or considering laws to crack down on worker misclassification
- n 37 states have entered into agreements with DOL and IRS to share information related to worker misclassification
 - Tax auditors for each side bundle information and share it with their counterparts



employees

- n SS-8 Determination
 - Many IRS audits are initiated as a result of claims filed **by workers** for **benefits**, or are related to workers' personal tax issues
 - An SS-8 Determination is made by an IRS agent and although not binding on a company may lead to an IRS examination
- n Significant questions regarding what effect an adverse SS-8 determination will have on the employer in a subsequent audit



SS-8 criteria

- n General Information
- n Behavioral Control
- n Financial Control
- n Relationship of the Worker and Firm



so is worker x an “employee” or an “independent contractor”?

- n Wrong answer may result in significant liabilities - back taxes; backpay and overtime payments; related liability under a number of laws and regulations.
- n Answer implicates several areas of law – Federal and state wage-hour law, federal and state tax law, benefits, and related laws and regulations



consequences of misclassification

- n Overtime and backpay under the FLSA; damages
 - Potential for class actions
- n Coverage under Title VII and other EEO laws
- n Benefit eligibility
- n Back taxes:
 - Social Security
 - Medicare
 - Unemployment Insurance Trust
- n Smaller employers and coverage under additional laws due to sudden increase in workforce



potential for relief under IRC section 530

- n Section 530 of the Revenue Act of 1978
- n Permits businesses to treat workers as independent contractors, avoiding the more detailed factors of the 20-point test, as long as the following requirements are met:
 - Reasonable basis
 - Substantive consistency
 - Reporting consistency



requirements of section 530

- n “Reasonable basis”
 - court case, IRS ruling or past audit
 - advice of counsel or accountant
 - Industry practice
- n “Substantive consistency”
 - “similarly situated workers” treated as independent contractors
- n “Reporting consistency”
 - employer has only filed 1099s with respect to the workers in question for all years



section 530 under fire

- n Federal legislation has been introduced in various forms to weaken Section 530 relief
 - FY 2011 budget called for prospective elimination of Section 530
- n Other Federal legislation proposed in the last Congress would require independent contractors to be provided specific notice of their status and impose penalties



identifying and remediating problems

- n Self-audit
- n Independent Contractor Agreements



common problems

- n Retirees performing their old duties
- n Former employees who return to work as “independent contractors”
- n Current employees working in a second capacity
- n “Independent contractors” in a management or supervisory role



cleaning-up

- n No obligation to self-report
- n Modify arrangements at year-end to avoid W-2 and 1099 reports
- n If possible, modify position to provide context for change in arrangement
 - “temp to perm”
 - benefit eligibility
 - additional duties



independent contractor agreements

- n In a perfect world, written contract addressing each of the following:
 - Independent, discrete tasks or project
 - Limited training or instruction required
 - Worker decides when, where, how the work is to be performed
 - Worker provides his/her own tools, equipment, assistants
 - Worker has freedom to contract with others for his services
 - Worker works off-site
 - Compensation should not resemble a salary
 - Termination only for non-performance/breach of contract



independent contractor agreements

- n In real world, written contract addressing each of the following:
 - Define **scope of work** in contract
 - **Limit** training or instruction
 - Worker decides **how** the work is to be performed
 - If worker does not have freedom to contract with others for services, **limit duration** of contract
 - Require **invoicing** and, if practicable, fixed-fee type payments
 - **Limited** termination rights
- n Avoid circumstances where IC position is identical to W-2 employees



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questions?



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