



## Focus on Misclassification: Are Your Nonprofit's Workers "Employees" or "Independent Contractors?"

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## agenda

- What's in a Name: “Employee” vs. “Independent Contractor”
  - Federal rule
  - Varying state law interpretations
- Avenues of Enforcement
  - Government
  - Employees and the plaintiffs’ bar
- Consequences of Misclassification
- Identifying and Remediating Problems



## employee vs. independent contractor

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



## IRS: old 20-factor test

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



## common law or “economic realities” test

- 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

- 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

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



## the “economic realities” test

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





## varying state tests can apply

- States **are not** restricted by IRS definition
- In Maryland employment status is **presumed**
- 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**”



## avenues of enforcement

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



## priority of federal government

### ■ 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)

### ■ 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

- Maryland, Connecticut, New York, Pennsylvania are just some of the states enacting or considering laws to crack down on worker misclassification
- 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



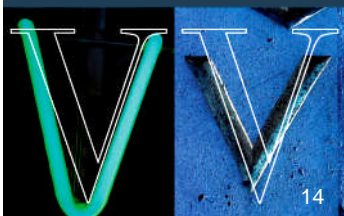
## employees

- 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
- Significant questions regarding what effect an adverse SS-8 determination will have on the employer in a subsequent audit



## SS-8 criteria

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



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

- Wrong answer may result in significant liabilities - back taxes; backpay and overtime payments; related liability under a number of laws and regulations.
- 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

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





## potential for relief under IRC section 530

- Section 530 of the Revenue Act of 1978
- 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

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



## section 530 under fire

- Federal legislation has been introduced in various forms to weaken Section 530 relief
  - FY 2011 budget called for prospective elimination of Section 530
- 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

- Self-audit
- Independent Contractor Agreements



## common problems

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



## cleaning-up

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



# independent contractor agreements

- 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



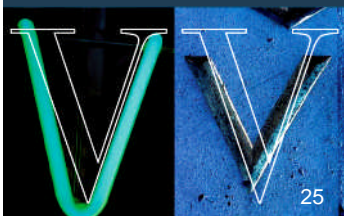
# independent contractor agreements

- 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
- Avoid circumstances where IC position is identical to W-2 employees

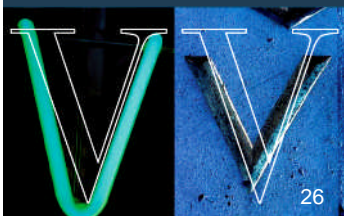




hypos



questions?



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