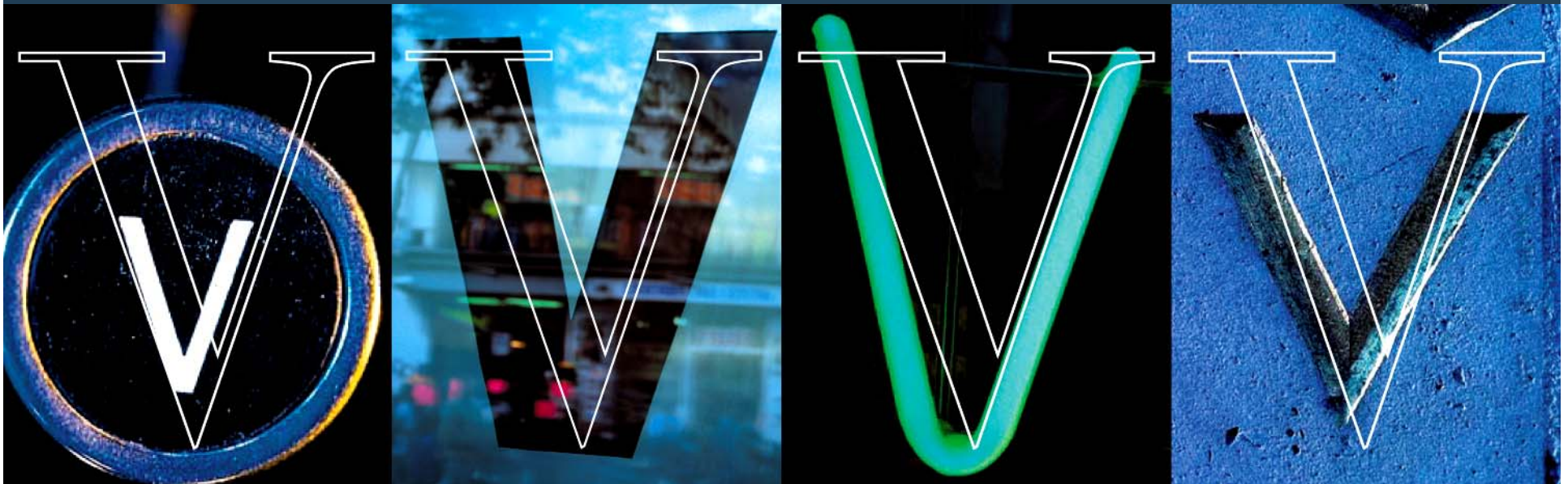


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Focus on Misclassification: “Employee” Versus “Independent Contractor”

FEBRUARY 17, 2011



agenda

- Introduction
- The Government's Focus on Enforcement
- "Employee" vs. "Independent Contractor"
- The Consequences of Misclassification
- Section 530 of the Revenue Act
- Action Plan



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Is Worker X and “employee” or an “independent contractor?”

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



Focus on Enforcement

- \$46 million in president's proposed 2012 budget to help DOL fight worker misclassification. \$15 million budgeted for Wage-Hour investigations.
- 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.



SS-8 Determinations

- 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.
- There are significant questions regarding what effect an adverse SS-8 determination will have on the employer in a subsequent audit.



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.



Common Law Employee Test

- Basic Tenet of Common Law Test: Who has the right to control how the work is accomplished? It is the right to control, not whether that right is exercised, that governs whether there is an employer–employee relationship.



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



IRS: 20-Factor Test

- The factors are (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.



Watch for:

- 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



Consequences of Misclassification

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



Section 530 of the Revenue Act of 1978

- Provision allows 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



Reasonable Basis

- Reliance on court case, IRS ruling or past IRS audit
- Advice of counsel or accountant
- Industry Practice



Substantive Consistency

- The taxpayer has consistently treated the workers in question and other “similarly situated workers” as independent contractors. The term “similarly situated” means persons who perform the same duties as the workers whose classification is in question and have a similar relationship with the taxpayer as the workers in question under the 20-factor test.



Reporting Consistency

- The taxpayer has only filed Form 1099s with respect to the workers in question for all years.
- Relief is not available for any year and any worker for whom the company did not file the required returns.



Legislative Action

- Federal legislation has been introduced in various forms to weaken Section 530 relief. Obama 2011 Budget called for prospective elimination of Section 530.
- Other Federal legislation proposed in the last Congress would require employers to provide workers classified as independent contractors with notice of their status and impose penalties.



Steps To Take

- Self-Audit
- Independent Contractor Agreements



Independent Contractor Agreements

1. Written contract addressing each of the following:
2. Independent, discrete tasks or project
3. Limited training or instruction required
4. Worker decides when, where, how the work is to be performed
5. Worker provides his/her own tools, equipment, assistants
6. Worker has freedom to contract with others for his services
7. Worker ideally works off-site
8. Compensation should not resemble a salary
9. Termination only for non-performance/breach of contract



QUESTIONS?

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