OVERVIEW OF THE CHANGING WORKFORCE IN AMERICA AND HOW TO AVOID PITFALLS ASSOCIATED WITH MISCLASSIFICATION OF CONTINGENT WORKERS AND INDEPENDENT CONTRACTORS

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Today’s presenters and some notes...

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INTRODUCTION TO THE VARIOUS TYPES OF WORKFORCES USED IN AMERICA TODAY

- Various types of workforces (classifications) used:
  - Employee
  - Independent Contractor
  - Subcontractor
  - Consultant
  - Temp (workers hired through temporary employment agencies)
  - On-call workers (i.e., substitute teachers)
OVERVIEW OF WORKER CLASSIFICATION/STATUS TESTS (EMPLOYEE v. INDEPENDENT CONTRACTOR)

- Internal Revenue Service criteria for determining worker status
- Common-law test of master and servant\(^1\) under ADA, ADEA, ERISA, and other statutes that do not provide meaningful definitions of employee
- Employment relationship test under the FLSA
- Test under New Jersey’s Law Against Discrimination and Conscientious Employee Protection Act\(^2\)
- Test under California’s Division of Labor Standards Enforcement\(^3\)
- State Administrative Agency standards, e.g., unemployment contributions
- State statutes: New York, New Jersey and Massachusetts

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\(^1\) Clackamas Gastroenterology Assoc. v. Wells, 538 US 440 (2003)


\(^3\) S. G. Borello & Sons, Inc. Dept. of Industrial Relations, 769 P.2d 399 (Cal. 1989)
INTERNAL REVENUE SERVICE CRITERIA FOR DETERMINING WORKER STATUS

1. Behavioral Control
   - Facts that show whether the employer has the right to direct and control how the worker is hired.

2. Financial Control
   - Facts that show whether the employer has a right to control the business aspects of the worker’s job.

3. Type of Relationship
   - Facts that show the parties’ understanding of the type of relationship.
COMMON LAW TEST OF MASTER AND SERVANT
Clackamas Gastroenterology Assoc. v. Wells

6 factors:

1. Whether the employer can hire or fire the individual or set the rules and regulations of the individual’s work;

2. Whether and, if so, to what extent the employer supervises the individual’s work;

3. Whether the individual reports to someone senior in the organization;

4. Whether and, if so, to what extent the individual is influenced by the employer;

5. Whether the parties intended that the individual be an employee, as expressed in written agreements and contracts, and

6. Whether the individual shares in the profits, losses, and liabilities of the employer.
ECONOMIC REALITY TEST UNDER FAIR LABOR STANDARDS ACT

7 factors:

1. The extent to which the services rendered are an integral part of the principal’s business;
2. The permanency of the relationship;
3. The amount of the alleged contractor’s investment in facilities and equipment;
4. The nature and degree of control by the principal;
5. The alleged contractor’s opportunities for profit or loss;
6. The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor; and
7. The degree of independent business organization and operation.
TEST UNDER NEW JERSEY’S LAW AGAINST DISCRIMINATION AND THE CONSCIENTIOUS EMPLOYEE PROTECTION ACT

Puposky v. Caruso

12 factors:

1. The employer’s right to control the means and manner of the worker’s performance;
2. The kind of occupation – supervised or unsupervised, licensed or unlicensed;
3. Skill;
4. Who furnished the equipment and workplace;
5. The length of time in which the individual has worked;
6. The method of payment;
7. The manner of termination of the work relationship;
8. Whether there is annual leave;
9. Whether the work is an integral part of the business of the "employer";
10. Whether the worker accrues retirement benefits;
11. Whether the employer pays social security taxes; and
12. The intention of the parties.
New Jersey uses a regulatory scheme for unemployment contributions called the “ABC Test”:
1. Freedom from employer control; and
2. Service is outside normal course of business or performed outside place of business; and
3. Individual is engaged in independently established trade, occupation or business.

Other states use the same test: e.g. Massachusetts – But still need to look at each State’s laws.
Rebuttable presumption worker is an “employee”

11 Factors

- Whether the person performing services is engaged in an occupation or business distinct from that of the principal;
- Whether or not the work is part of the regular business of the principal or alleged employer;
- Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;
- The alleged employee’s investment in the equipment or materials required by his or her task or his or her employment helpers;
- Whether the service rendered requires special skill;
- The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
- The alleged employee’s opportunity for profit or loss depending on his or her managerial skill;
- The length of time for which the services are to be performed;
- The degree of permanence of the working relationship;
- The method of payment, whether by time or by the job; and
- Whether or not the parties believe they are creating an employer-employee relationship may have some bearing on the question, but is not determinative.
Even where there is an absence of control over work details, an employer-employee relationship will be found if: (1) the principal retains pervasive control over the operation as a whole; (2) the worker’s duties are an integral part of the operation; and (3) the nature of the work makes detailed control unnecessary.
The use of independent contractors can be beneficial to employers and allow employers to save in areas such as the payment of traditional employee benefits. However, employers need to be cautious when engaging independent contractors and aware of the significant risk that an independent contractor may be considered an “employee” and fall under the protection of workplace employment statutes and employee benefits programs.

A number of states, including New York, New Jersey and Massachusetts have set up task forces or modified laws seeking to eliminate perceived abuses in this area.
## PITFALLS ASSOCIATED WITH MISCLASSIFICATION AND FAILURE TO IMPLEMENT AN APPROPRIATE CLASSIFICATION SYSTEM cont’d

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A 2007 study by the federal government’s General Accounting Office estimates that some 15% of all employers misclassify 3.4 million workers as independent contractors annually and that in inflation-adjusted figures, misclassification annually costs $2.72 billion in social security, unemployment tax, and income tax revenues.
FedEx Ground Package System, Inc. has been battling claims in multiple jurisdictions over its classification of drivers as independent contractors. In federal court, a class of more than 20,000 current and former drivers brought suit under the Employee Retirement Income Security Act seeking benefits under several FedEx plans for which they were not eligible because they were deemed independent contractors.
On November 29, 2007, in a related class action litigation, the California Supreme Court affirmed the appellate court’s decision affirming the trial court’s finding that the FedEx drivers were “employees” under the California Labor Code § 2802(a).

The trial court stressed that FedEx had control over “every exquisite detail” of the driver’s performance, namely:

- FedEx determined the driver’s uniforms;
- The drivers worked exclusively and full time for FedEx;
- The drivers were paid weekly; and
- FedEx provided the drivers with standard employee benefits.
Fed Ex’s drivers have alleged that its “business model” is based on union avoidance (independent contractors can’t join labor unions).

Fed Ex decision has led to Massachusetts AG fining Fed Ex $190,000.

IRS has levied $139 million in back taxes.

On August 9, 2009, 8 State AG’s demanded that Fed Ex change their business model.

Recent Activity: The “National Association of AllState Agents” currently represent more than 11,000 “contract” AllState agents have complained their agents are treated like employees.

Independent Contractor Proper Classification of 2007 (proposes to close Section 530’s safe harbor).

Section 530 of the Code provides a safe harbor for misclassification if:

1) The Company files tax returns and treats individuals as independent contractors; and
2) The Company treats individuals with similar job duties as independent contractors; and
3) The Company has a reasonable belief that the worker is an independent contractor based on:
   a) Judicial precedent, published rulings, technical tax advice or letter rulings; or
   b) A long-standing practice in that segment of the Company’s industry; or
   c) Past IRS tax audit on the issue.

Conn. created a commission on July 1, 2008 to deal with misclassification issues, including recommending imposing civil and criminal remedies.

Like Conn., New York issued an Executive Order on September 2007 creating a “task force” to address this issue.

Numerous states and federal agencies are reviewing the construction industry – New Jersey for example, will prosecute companies that “knowingly” misclassify workers as independent contractors.
Key Details:

- $10,000 fine, per violation, per employee for companies that “repeatedly or willfully” fail to properly classify a worker.

- Companies would have to:
  1. Keep records of employment classifications.
  2. Notify workers of their rights to wage, hour and employee benefits.
  3. Workers would be directed to the Department of Labor if improperly classified.

- Section 530 safe harbor to be closed.
The Taxpayer Responsibility, Accountability and Consistency Act of 2009 (proposed)

- Would eliminate Section 530 safe harbor.
- Future Outlook:  **Likely** that some form of law will be passed in 2010 or 2011 based on:
  1) State and federal need for additional tax revenue;
  2) Health insurance concerns: want to increase individuals covered by health insurance;
  3) Strong backing of labor; and
  4) State AG involvement.
Both the States and the federal government now have technology that can track 1099 forms and target workers who only have one 1099 report and significant income from one source.

This technology can establish separate search criteria and is highly efficient to “catch” companies that are abusing process, e.g., New Jersey.
AVOIDING LITIGATION

- What can companies do?
  - Draft independent contractor agreements that “define” an independent contractor relationship;
  - Make contracts results-oriented as opposed to setting open-ended terms;
  - Provide the contractor with the right to set hours of work and schedules and to determine what tools and materials to use;
  - Do not restrict the contractor’s ability to work on other projects;
  - Provide contractual requirements for:
    - insurance;
    - indemnification; and
    - risk of loss.
  - When possible contract with a corporation or company as opposed to an individual;
  - Do not compensate the contractor as an employee, i.e., weekly or bi-weekly payments;
  - Provide a provision requiring that the contractor must seek reimbursement for expenses.
February 18, 2010

U.S. Cracks Down on ‘Contractors’ as a Tax Dodge

By STEVEN GREENHOUSE

Federal and state officials, many facing record budget deficits, are starting to aggressively pursue companies that try to pass off regular employees as independent contractors.

President Obama’s 2010 budget assumes that the federal crackdown will yield at least $7 billion over 10 years. More than two dozen states also have stepped up enforcement, often by enacting stricter penalties for misclassifying workers.

Many workplace experts say a growing number of companies have maneuvered to cut costs by wrongly classifying regular employees as independent contractors, though they often are given desks, phone lines and assignments just like regular employees. Moreover, the experts say, workers have become more reluctant to challenge such practices, given the tough job market.

Companies that pass off employees as independent contractors avoid paying Social Security, Medicare and unemployment insurance taxes for those workers. Companies do not withhold income taxes from contractors’ paychecks, and several studies have indicated that, on average, misclassified independent workers do not report 30 percent of their income.

One federal study concluded that employers illegally passed off 3.4 million regular workers as contractors, while the Labor Department estimates that up to 30 percent of companies misclassify employees. Ohio’s attorney general estimates that his state has 92,500 misclassified workers, which has cost the state up to $35 million a year in unemployment insurance taxes, up to $103 million in workers’ compensation premiums and up to $223 million in income tax revenue.

“It’s a very significant problem,” said the attorney general, Richard Cordray. “Misclassification is bad for business, government and labor. Law-abiding businesses are in many ways the biggest fans of increased enforcement. Misclassifying can mean a 20 or 30 percent cost difference per worker.”

Employers deny misclassifying workers deliberately. The businesses say the lines are unclear between employee and independent contractor.

Workers are generally considered employees when someone else controls how and when they perform their work. In contrast, independent contractors are generally in business for themselves, obtain customers on their own and control how they perform services.

Many businesses are dismayed about the tougher federal and state scrutiny.

“The goal of raising money is not a proper rationale for reclassifying who falls on what side of the line,” said Randel K. Johnson, senior vice president with the
Teamsters Praise Bill to Close Loophole for Tax Cheats

Hoffa Thanks Sen. Kerry for Supporting Workers


The bill would close a loophole that allows employers to avoid paying Social Security and Medicare taxes, withholding income taxes and contributing to workers' compensation and unemployment insurance.

Companies escape those responsibilities by misclassifying their employees as "independent contractors."

"Misclassification hurts responsible employers who pay their taxes, provide health insurance and respect their workers' right to join a union," Hoffa said. "It lets unscrupulous employers cheat workers out of benefits they're entitled to."

"It's time to level the playing field so companies that play by the rules aren't at a competitive disadvantage to companies that cut corners by misclassifying their employees," Hoffa said. "I'd like to thank Sen. Kerry for sponsoring this important legislation."

As many as 30 percent of all employers misclassify their employees as "independent contractors," according to the U.S. Department of Labor.

In Massachusetts, the rate of misclassification rose to 13.4 percent between 2001 and 2003 from 8.4 percent between 1995 and 1997.

The federal government lost an estimated $34.7 billion in tax revenue between 1996 and 2004.

The bill removes the loophole that allows businesses to bypass the Internal Revenue Service's test of whether a worker is an employee or an independent contractor.

Full Senate bill is available at http://www.govtrack.us/congress/billtext.xpd?bill=s111-2882
Next Webinar

- March 24th, 12 – 1 pm EST
- NLRA and NLRB update
- Mark Goodwin and Clinton Morse
- Invitation to be distributed soon
Thank You.

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