

Morgan Lewis

Not Our Employee? Minimizing Risks and Maintaining Compliance in Temporary, Contractor, and Joint Employee Relationships

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Purpose of Today's Discussion

- To provide an overview of the criteria for determining whether an individual should be classified and treated as an employee or independent contractor (IC), and review the risks that may arise from improper classification

Why Do These Distinctions Matter?

- **Perils of misclassification**
 - **Liability** for employment-related litigation, including discrimination, harassment, and wage and hour issues
 - **Traditional Labor:** employees, but not independent contractors, can organize for the purpose of establishing a collective bargaining unit
 - **Employee Benefits:** risk of litigation for failing to provide benefits, costs associated with back contributions, and even threat of loss of tax-exempt status for benefit plans

Why Do These Distinctions Matter? – cont'd

- **Perils of misclassification**
 - **Tax:** risk of federal and state liabilities for back taxes, interest, and penalties if workers are subsequently reclassified as employees
 - **Immigration:** status of foreign nationals as lawful permanent residents or non immigrants will determine whether they can qualify as an independent contractor

Why Do These Distinctions Matter? – cont'd

- Opportunities when workers in non-employee status are engaged correctly:
 - Reduced benefit, FICA, and other costs
 - More flexible workforce
 - *Quickly deploy or remove resources to meet business demands*
 - Ability to concentrate on core competencies
 - Reduced liability risks, including IRS, workers' compensation, and EEOC concerns

Why Do These Distinctions Matter? – cont'd

- Concerns when workers in non-employee status are engaged incorrectly:
 - Contingent workers and employees may not be fully integrated, which may decrease productivity, collaboration, and cooperation
 - Contingent workers may experience lower morale due to their non-employee status
 - Employees may experience lower morale if non-employees are paid at a premium relative to employees
 - Contingent workers may have less loyalty to the employer
 - Real or perceived inequities in the treatment of non-employees can harm the employer's reputation

Typical Worker Categories

- **Regular Employee:** A person rendering actual service in any business for an employer, whether gratuitously or for wages
- **Contingent Worker:** A part-time, temporary, seasonal or specialized workers employed for a limited period of time or an identified project (nearly 25% of the nation's workers)
- **Joint Employee:** Workers typically supplied by an employee leasing firm or temporary staffing agency
- **Independent Contractor:** A person who renders services for specified recompense or a specified result under the control of his/her principal as to the result of the work only, and not as to the means by which the result is accomplished

Classification Criteria: Employee or Independent Contractor?

- **Employment Statutes (Title VII, ADEA, ADA)**
 - Courts use the Darden ruling or some combination of the “economic realities” and “right to control” tests for determining employment status
- **FLSA/FMLA - “Economic Realities” Test**
- **NLRA - Independent contractors have no right to unionize**
- **ERISA – Darden**
- **IRS, Tort - “Right to Control” Test (20-Factor Test)**
- **Immigration: Green card holders vs. visa holders**

Factors That May Demonstrate a Joint Employer Relationship

- The exercise of control over the worker's employment, including hiring, firing, discipline, and promotion
- Control of when, where, and how the worker performs the job
- The Company, rather than the worker or staffing agency, furnishes tools, materials, and equipment
- Work is performed on Company premises

Factors That May Demonstrate a Joint Employer Relationship - cont'd

- Continuing relationship between the worker and the Company
- The Company has the right to assign additional projects to the worker
- The Company sets the hours of work and the duration of the job
- The worker is paid by the hour, week, or month rather than for the agreed cost of performing a particular job

Factors That May Demonstrate a Joint Employer Relationship - cont'd

- The worker has a role in hiring and paying assistants
- The work performed by the worker is part of the Company's regular business
- The worker is not engaged in his or her own distinct occupation or business
- The Company provides the worker with benefits such as insurance, leave, or workers' compensation

Factors That May Demonstrate a Joint Employer Relationship - cont'd

- The worker is considered a Company employee for tax purposes
- The Company can discharge the worker
- The Company and the worker believe that they are creating an employer-employee relationship

Risks of Misclassification

- Risks of Joint Employer Status
- Risks Associated with Use of Independent Contractors
- Risks Associated with Leased Employees

Risks of Joint Employer Status

- Potential liability in employment lawsuits brought by worker (e.g. discrimination, harassment)
- Potential liability for outside agency's wrongful acts against employee (e.g. discrimination)
- Potential liability for unpaid overtime, vacation, medical leave, and other unpaid wages

Risks Associated with Use of Independent Contractors

- Misclassification of workers as independent contractors can result in significant tax liability for the employee
- Numerous federal and state statutes to protect the health, safety, and employment rights of workers apply specifically to “employees”
 - Employers could be liable for significant retroactive liability for misclassified independent contractors relating to:
 - Workers’ compensation
 - Unemployment insurance
 - Mandated disability insurance

Risks Associated with Leased Employees

- Leased employees are considered to be common law employees unless specifically excluded from Company benefit and retirement plans

Federal Employment Law

The “Economic Realities” Test

- FLSA; FMLA
- Employer-employee relationship exists if, as a matter of economic reality, the worker is dependent on the recipient of the services for his livelihood

The “Economic Realities” Test

- In applying this test, courts look to a number of factors that can vary somewhat depending on the court. For example, the Fifth Circuit looks at five factors including (1) the degree of control exercised by the employer; (2) the extent of the relative investments by the putative employee and employer; (3) the degree to which the worker’s opportunity for profit and loss is determined by the employer; (4) the skill and initiative required in performing the job; and (5) the permanency of the relationship.

Practical Considerations for Wage and Hour Issues

- Are the workers employed by someone?
- Are they being paid required overtime by someone?
- Who is responsible for complying with wage and hour laws (including breaks and lunch)?
- Do the applicable agreements clearly assign liability for overtime and other wages and benefits (including indemnification)?

Independent Contractor Status Under the National Labor Relations Act

- Independent contractors do not have the right to organize
- Taft-Hartley Amendments to NLRA (1947)
 - Reaction to NLRB decisions - “farfetched meanings” (H.R. Rep. No. 245, 80th Cong., 1st Sess. 18)
- Section 2(3) of NLRA – definition of “employee”
 - Excludes “any individual having the status of an independent contractor”

What Standard Is Applied under the NLRA?

- Common law of agency
- *NLRB v. United Insurance Co. of America*, 390 U.S. 254 (1968)
 - “All of the incidents of the relationship must be assessed and weighed with no one factor being decisive.”
 - Analysis involves “no special administrative expertise”
 - Court deference to chose between “two fairly conflicting views”

Current NLRB Standard

- Restatement (Second) of Agency § 220(2)
- Examination of all factors, not just “right of control.”
Roadway Package System, 326 NLRB 842 (1998); *Dial-A-Mattress*, 326 NLRB 884 (1998)
- Recent focus on “entrepreneurial opportunity for gain or loss.” *Corporate Express Delivery Systems*, 332 NLRB 1522 (2000), *enforced*, 292 F.3d 777 (D.C. Cir. 2002)

What Standard Will Be Applied by an Obama Board?

- Focus on “economic dependence” or “economic realities”
- Member Liebman’s dissent in *St. Joseph News-Press*, 345 NLRB 474 (2005):
 - “[I]t is entirely appropriate to examine the economic relationship ... to determine whether the carriers are economically independent business people, or substantially dependent on the Respondent for their livelihood.”
 - Argues that increasing use of “contract labor” and other “nontraditional” relationships “makes the question of labor law coverage worthy of a fresh evaluation.”

Joint Employer Standard Under NLRA

- Whether two (or more) entities “share or codetermine those matters governing essential terms and conditions of employment”
 - Hiring
 - Firing
 - Discipline
 - Supervision
 - Direction
 - Wages, benefits, working hours, overtime

Joint Employer Issues in Representation Cases

- Units that include both user employees and supplier/contractor employees. *Oakwood Care Center*, 343 NLRB 659 (2004).
 - Considered to be a multi-employer bargaining unit
 - Can be established only by consent
 - Does not apply to unit of supplier/contractor employees only
- Return to *M.B. Sturgis*, 331 NLRB 1298 (2000), by an Obama Board?

Other Consequences of Joint Employer Status Under the NLRA

- **Bargaining obligation**
 - Duty to respond to information requests
 - Duty to comply with collective bargaining agreement
- **Liability for unfair labor practices**
- **Strikes and picketing at any location**
 - Not just location where dispute arises

ERISA - Employee Retirement Income Security Act of 1974

- ERISA does not require that a plan cover ALL employees or all classifications of employees (subject to discriminatory testing under the IRC). Thus, a plan may exclude groups, segments, or certain classes of employees under its terms.
- When a claimant asserts that he or she has been wrongfully excluded from coverage, there is a two step process to assert a claim under ERISA:
 1. Determine whether the party is a common law employee or an independent contractor.
 - It is possible to be an independent contractor for some purposes and not for others. *Hopkins v. Cornerstone Am.*, 545 F.3d 338 (5th Cir. 2008).
 2. If the party is an employee, determine whether the party is covered under the terms of the plan.
 - *Wolf v. Coca-Cola Co.*, 200 F.3d 1337, 1340 (11th Cir. 2000).

Step 1: Apply Common Law Agency Principles

- **The Darden factors:**
 1. the skill required
 2. the source of the instrumentalities and tools
 3. the location of the work
 4. the duration of the relationship between the parties
 5. whether the hiring party has the right to assign additional projects to the hired party
 6. the extent of the hired party's discretion over when and how long to work
 7. the method of payment
 8. the hired party's role in hiring and paying assistants
 9. whether the work is part of the regular business of the hiring party
 10. whether the hiring party is in business
 11. the provision of employee benefits
 12. the tax treatment of the hired party
 - *Nationwide Mutual Ins. Co. v. Darden*, 503 U.S. 318, 323-24 (1992).

Step 2: Examine the Plan

- The definition of “employee” in the plan will frequently determine whether a claimant will receive benefits.
 - See *MacLachlan v. ExxonMobil Corp.*, 350 F.3d 472 (5th Cir. 2003), *abrogated in part by Metro. Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2348 (2008) (reviewing plan that specifically excluded independent contractors, irrespective of employment status under common law principles).
 - See *Wolf v. Coca-Cola Co.*, 200 F.3d 1337, 1342 (11th Cir. 2000) (reviewing plan that specifically excluded temporary and seasonal employees).
 - See *Kolling v. Am. Power Conversion Corp.*, 347 F.3d 11, 14 (1st Cir. 2003) (holding that “it is the language of the Plan, not common law status, that controls).
 - *But see Vizcaino v. Microsoft Corp.*, 120 F.3d 1006, 1013 (9th Cir. 1997) (en banc), *cert. denied* 522 U.S. 1098 (1998) (noting that independent contractors were common law employees and discouraging Microsoft from asserting that the independent contractors were not covered by the plan because they were not on its U.S. payroll).

Review of Plan Administrator's Decision

- On review, the court must determine whether the plan administrator's decision was correct under applicable legal standards. In most cases today, plans give the administrator discretion in interpreting and applying plan terms. This results in a deferential "abuse of discretion" standard of review.
- Generally, courts analyze three factors:
 - (1) whether the administrator has given the plan a uniform construction;
 - (2) whether the interpretation is consistent with a fair reading of the plan; and
 - (3) any unanticipated costs resulting from different interpretations of the plan.
- Such review is subject to a "conflict of interest" standard.

Federal Tax Considerations

TOP 10 FEDERAL TAX LAW CONSIDERATIONS

1. The IRS has renewed its focus on independent contractor issues
2. The IRS replaced the 20-Factor Common Law Test with a Three-Factor Test
 - *Behavioral Control Factors*
 - *Financial Control Factors*
 - *Relationship of the Parties Factors*
3. The IRS has published its IRS Agent training materials
4. Understand the relief provisions
 - *Section 3509*
 - *Section 530 Relief—"off Code" relief*
 - *IRS Classification Settlement Program*
5. Seek consistency for tax, labor and benefits purposes

Federal Tax Considerations

TOP 10 FEDERAL TAX LAW CONSIDERATIONS – cont'd

6. The IRS does not recognize joint or co-employment
7. The IRS begrudgingly recognizes dual status workers
8. The IRS has never met a valid independent contractor relationship—OK, maybe one or two
9. Watch out for Washington—Congress and the Obama Administration may be active in IC matters, including Section 530 repeal/restructuring
10. Understand the financial exposure/consequences from a worker's reclassification

IRS 20 Factor Test of Employee Status

- **Employee-Employer**

- Continuing relationship
- Work on Employer's premises
- Services rendered personally
- Compliance with instructions
- Payment by hour, week, or month
- Right to discharge
- Full time required

- **Independent Contractor**

- Furnishing own tools and materials
- Hiring, supervising and paying assistants
- Working for more than one firm at a time
- Realization of profit or loss
- Payment by job or commission
- Significant investment in facilities used by worker

Simplified Independent Contractor Test

- ***Behavior Control*** – Does the service recipient have the right to control the behavior of the worker
- ***Financial Control*** – Does the service recipient have financial control over the business activities of the worker (e.g., method and frequency of compensation)
- ***Relationship of the Parties*** – Do the parties operate within the typical employer-employee relationship, or is the worker free from any binding relationship with the service recipient

Federal Tax Considerations

Tax Consequences of Worker Reclassifications

Statutory liability equal to at least 40% of payment—

- 25% FITW exposure
- 7.65% Employer FICA
- 7.65% Employee FICA
- FUTA tax exposure
- Information reporting penalties—Failure to file and Failure to furnish
- Negligence—potential 20% penalty
- Failure to deposit
- Interest

Federal Tax Considerations – cont'd

Tax Consequences of Worker Reclassifications

- Proper planning should reduce the worker reclassification exposure to :
 - *\$0 under Section 530*
 - *less than 5% of the payment for the most recent year under audit under the CSP Relief guidelines*

Federal Tax Considerations – cont'd

10 METHODS TO REDUCE RECLASSIFICATION EXPOSURE

1. Undertake Section 530/Independent Contractor/CSP reviews
2. Enhance 530 Position—Identify your reasonable basis
3. Enhance 530 Position—Always issue Forms 1099 to ICs
4. Enhance 530 Position—Do not treat identical or substantially similar workers differently (i.e., some as employees and others as ICs)
5. Obtain services from ICs who have incorporated or who are provided by third parties

Federal Tax Considerations – cont'd

6. Avoid audit red flags - do not issue Forms W-2 and Forms 1099-MISC to the same worker in the same year
7. Ensure ICs remain current on their payroll taxes—also consider obtaining Forms 4669 or similar statements from ICs
8. Watch out (and challenge) Form SS-8 Determinations
9. Adopt and implement standardized IC contract language
10. Neutralize employee benefit risks associated with disgruntled ICs
 - *Use proper IC contractor language*
 - *Add Microsoft language to all plans—qualified plans, nonqualified plans, fringe programs, etc.*
 - *Companies with ESPPS should be especially vigilant*

Immigration-Related Legal Issues Affecting the Use of Foreign National Contractors

- Foreign nationals in the United States fall into one of two categories:
 - Lawful permanent residents (Green Card holders)
 - *May work for or be employed by anyone in the U.S. without prior government approval*
 - Nonimmigrants (H-1B, L-1, TN)
 - *Must receive government approval and may only be employed by employer designated by USCIS under terms approved by USCIS*
 - *Services may be contracted out to another entity*
 - *Will not be Independent Contractors*

Prohibition on Employment of Unauthorized Aliens I

- It is unlawful to hire an alien not authorized to be employed in the United States – INA § 274A(a)(1)
- Form I-9, (Employment Eligibility Verification Form) must be used for all new employees
- Employment eligibility of contractors and outside consultants need not be verified by entity using contract labor – 8 CFR § 274a.1(a)
- BUT: Use of contract, subcontract to obtain the labor of an unauthorized alien known to be unauthorized is prohibited – INA § 274A(a)(4)

Prohibition on Employment of Unauthorized Aliens II

- “Knowing” standard for liability
 - *May be actual or constructive*
(“inferred through notice of certain facts and circumstances”)
- Penalties may be criminal or civil
 - *Criminal: Fine of not more than \$3,000 and/or 6 month prison term*
 - *Civil: Fine of between \$275 and \$16,000 per unauthorized alien*

The H-1B Contractor I

- H-1B visa used extensively by IT consulting companies
- Presence of H-1B worker At worksite will require Posting of labor condition application in two locations
- H-1B worker must be in lawful status in order to work – process governed by employer

The H-1B Contractor II

H-1B Employees of “H-1B Dependent” Employers (20 CFR § 655.736(a)):

- At least 51 FTEs and 15% of Workforce are H-1Bs
- At least 26 FTEs and More than 12 H-1Bs
- 25 or fewer FTEs and More than 7 H-1Bs

“Secondary Displacement” Prohibition for H-1B Dependent Employers (20 CFR §655.738(d)):

- H-1Bs may not displace U.S. workers in “essentially equivalent” jobs
- 90 days before placing H-1B worker and 90 days after
- “Indicia” of employment relationship between H-1B worker and entity receiving H-1B worker’s services
- H-1B employer must inquire about possibility of secondary displacement

Hiring the H-1B Contractor

- Must file H-1B petition as a petitioner
- Must pay prevailing wage and meet all other H-1B requirements
- Must complete Form I-9
- If seeking permanent resident status through labor certification, may not use experience gained working as contractor



Best Practices

Best Practices for Independent Contractors

- Enter into written agreements with independent contractors before work begins
 - Identify individual as an Independent Contractor
 - Set complete list of tasks to be performed
 - Specify results to be obtained
 - AVOID requiring daily or weekly reports, or specifying working hours or work schedule but milestones (dates/production) are acceptable

Best Practices for Avoiding Joint Employer Status

- Assign workers to staffing agency locations if feasible.
- Workers' hours and days of work set by staffing agency.
- Workers should participate in staffing agency benefits plans, if any, rather than the Company benefits plans.
- Provide payment by job with no benefits or expenses.
- Specify that individual is responsible for all taxes.
- Specify a contract-termination term, usually under one year.

Best Practices for Avoiding Joint Employer Status – cont'd

- Workers should receive salary from staffing agency.
- Workers should arrange vacation and other leave through staffing agency. Staffing agency may consult with the Company about leave requests.
- Workers should regularly report to staffing agency manager regarding the status and execution of projects. The off-site staffing agency manager should remain the main contact person for Company management with regard to reporting issues on the project.

Best Practices for Avoiding Joint Employer Status – cont'd

- The Company should never discipline and/or terminate workers, and should rely on the staffing agency manager to handle any investigatory, performance, or disciplinary discussions with, or actions taken against, workers.
- The Company should not grant awards or bonuses to workers. Any recognition of a worker's good performance should be directed to staffing agency management.
 - The Company should not conduct formal or informal performance reviews or have input into compensation for individual workers.

Best Practices for Avoiding Joint Employer Status – cont'd

- Training and development opportunities should be provided by the staffing agency, not the Company
 - Exceptions:
 - *Non-discrimination/Harassment Training*
 - *Confidential information*
 - *Insider trading*
- Workers should not identify themselves as Company employees.

Best Practices for Avoiding Joint Employer Status – cont'd

- Workers should not be treated as Company employees in their terms and conditions of employment
 - no access to Company benefits
 - Should not be provided with Company business cards or employee security badges
 - specify in workers' email footers that they are staffing agency, and not Company, employees
 - prohibit use of Company facilities such as fitness center

Best Practices for Avoiding Joint Employer Status – cont'd

- If feasible, workers should be physically separated from Company staff, such as being given a separate office rather than a cubicle in an open environment working alongside Company employees
 - Workers should also have appropriate restrictions with respect to building access.
- The Company should consider prohibiting, or severely limiting, workers' participation in Company employee events (e.g. holiday parties, training meetings, Company-sponsored social events). If invited at all, these workers should receive a special invitation and not an "employee" invitation.

Best Practices for Avoiding Joint Employer Status – cont'd

- Workers should use, where feasible, equipment and software provided by staffing agency when performing their responsibilities
- To the extent possible, workers should attend training or other staffing agency meetings at staffing agency facilities (away from Company facilities) in order to further solidify the employment relationship between the staffing agency and the workers.
- Building access should be limited to areas necessary for workers to perform their jobs.

Best Practices for Minimizing Risks of Misclassification

- Review definition of “covered employee” in benefit plan documents
 - Benefit plans should exclude leased employees and workers who are not receiving Form W-2 from the plan sponsor
 - Amend plans to add Microsoft language
 - *Microsoft language provides that even if the worker is subsequently reclassified as an employee, such reclassification will not be done on a retroactive basis*
 - Review employee communications, including handbooks and benefits websites, to ensure that documentation accurately describes the categories of individuals who are eligible to receive benefits

Best Practices for Minimizing Risks of Misclassification – cont'd

- Periodically review employee status to determine if worker should be classified as an employee
- Ensure that workers with status of independent contractor can “pass” 20-factor test: they are not providing services under the direction and control of the employer
- Watch the 1,000-hour rule – unless the individual falls under a reasonable classification, e.g. engaged to work on a specific project, individuals with the status of common law employees need to either be eligible for retirement plans after they work 1,000 hours or have limited tenure

Best Practices for Minimizing Risks of Misclassification – cont'd

- Review agreements with vendors providing contingent workers to ensure that the vendors:
 - Are complying with IRS withholding and reporting rules
 - Are providing mandated insurance coverages, e.g., state disability, workers' compensation, and unemployment
 - Indemnify for potential joint employer liability/actions of their employees
 - Include appropriate provisions with respect to data privacy, EEO and related matters