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Congress's Challenges to the Use of Independent Contractors

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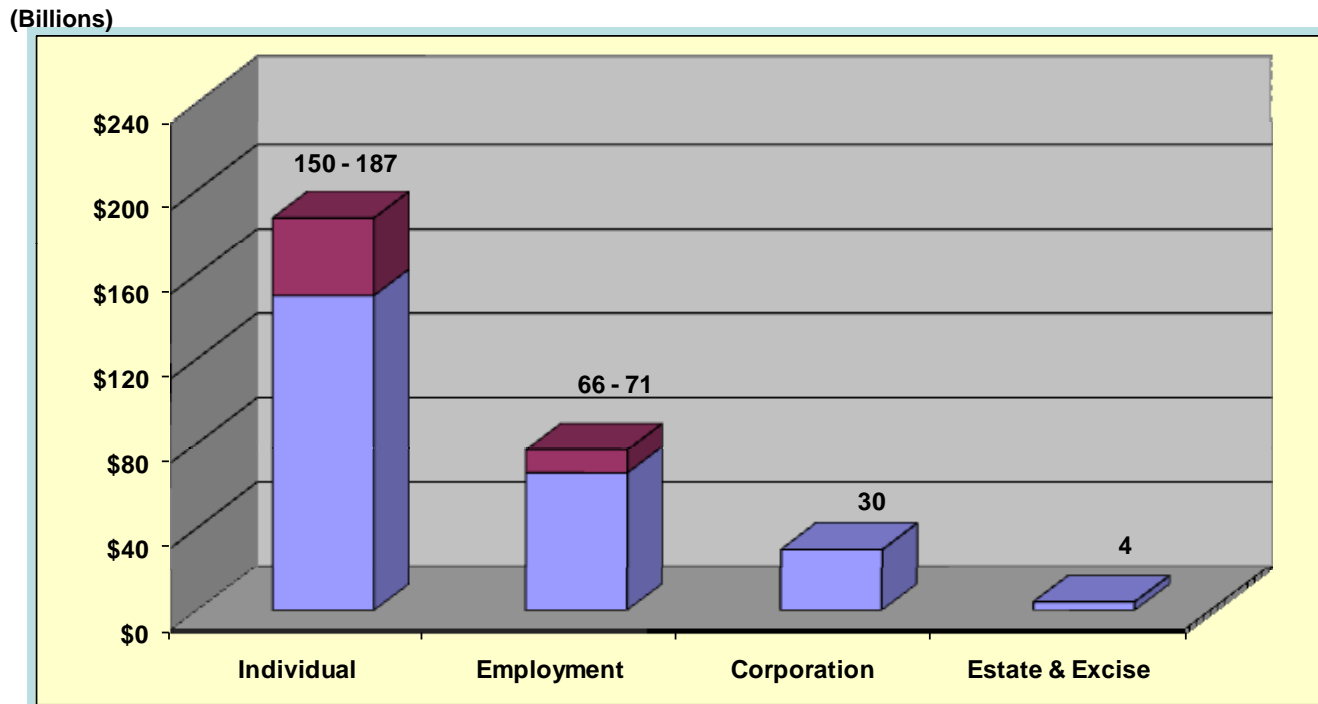
Agenda

- Who Are Independent Contractors?
- What Are the Financial Stakes?
- The Relief Provisions
- Who Are the Stakeholders?
- Government Accountability Office—the Legislative Background
- Legislative Developments

Employee or Independent Contractor?

- Common Law Employee
- Independent Contractor
- Joint Employment/Coemployment Worker
- Dual-Status Worker
- Corporate Officer and Other “Statutory Employees”
- “Statutory Nonemployee”
- Section 218 Agreement Employee
- Leased Employee
- Terminated/Rehired Worker

Why Does It Matter? Payroll Taxes and the Tax Gap



\$5 billion associated with FICA/FUTA

\$51 billion–\$56 billion associated with SECA

Other estimates place the annual “Employment Tax Gap” at \$15 billion (IRS, in introduction of NRP program), \$54 billion (Treasury study issued 9/26/06), or up to \$78 billion.

Federal Payroll Tax Relief: Section 530 Relief

- “Off-Code” relief provision
- IRS bears burden of proof
- Under attack by Congress, Administration, and the IRS
- If applicable, reduces the employer’s federal employment tax exposure to zero for all past and future years
- If applicable, businesses can continue to treat their workers as independent contractors for payroll tax purposes
- Must have reasonable basis for that independent-contractor treatment

Federal Payroll Tax Relief: Section 530 Relief

Statutory Relief: Section 530

- Provides employer-only relief
- Provides complete relief both retroactively and prospectively
- Three Tests
 - Reporting Consistency
 - Substantive Consistency
 - Reasonable Basis (prior audit, industry practice, “judicial” precedent, or any other reasonable basis)

IRS Payroll Tax Audits: Example of Tax Exposure and Tax Relief

The annual “full rate” federal tax exposure for 60 misclassified independent contractors earning \$50,000 each is approximately \$1,250,000.

Relief provisions can reduce the four-year full-rate exposure of approximately \$5 million as follows:

<u>Relief Provision</u>	<u>One-Year Exposure</u>	<u>Total Four-Year Exposure</u>
Statutory relief	320,400	1,281,600
100% CSP Offer	320,400	320,400
25% CSP Offer	80,100	80,100
VCSP Offer	32,000	32,000
Section 530 “Off-Code” Relief	0	0

*Calculations do not include FUTA, SUTA, and SITW liabilities

Employee Misclassification: Governmental Stakeholders

Federal and State Agencies Affected by Employee Misclassification

Agency	Areas potentially affected by employee misclassification
IRS	<ul style="list-style-type: none"> Federal income and employment (payroll) taxes
DOL	<ul style="list-style-type: none"> Minimum wage, overtime, and child labor provisions Job protection and unpaid leave Safety and health protections Immigration/Form I-9 issues
IRS, DOL, and PBGC	<ul style="list-style-type: none"> Pension, health, and other employee benefit plans
Department of Health and Human Services	<ul style="list-style-type: none"> Medicare benefit payments
EEOC	<ul style="list-style-type: none"> Prohibitions of employment discrimination based on factors such as race, gender, disability, and age
NLRB	<ul style="list-style-type: none"> The right to organize and bargain collectively
SSA	<ul style="list-style-type: none"> Retirement and disability coverage and payments
State Agencies	<ul style="list-style-type: none"> Unemployment insurance benefit payments State income and employment taxes Workers' compensation benefit payments

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Employee Misclassification: Improved Outreach Could Help Ensure Proper Worker Classification

- Contingent workers constitute about 30% of the workforce
- Employed in a wide range of industries/occupations such as services industry, construction, and retail trade
- Fewer contingent workers have
 - Health insurance
 - Pension benefits
 - Pay equality
 - Protections to safe, healthy, and nondiscriminatory workplaces

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Improved Outreach (cont'd)

- DOL's enforcement is limited
- DOL detects misclassification only through
 - Responses to FLSA minimum wage/overtime pay complaints
 - FLSA posters that do not contain information on misclassification
 - FLSA posters that do not provide contact information when misclassification occurs
- DOL procedures require it to share information with other federal and state agencies when possible violations arise
- DOL district offices vary regarding sharing information about possible violations

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Improved Outreach (cont'd)

- What does the GAO recommend?
- To enhance DOL enforcement, the GAO recommends that:
 - DOL provide additional contact information to facilitate reporting possible misclassification complaints
 - DOL evaluate and improve the extent to which FLSA misclassification cases are referred to other agencies
- DOL concurred with both recommendations
- A recommendation that DOL should alert employers when misclassification cases are referred to other agencies was deleted

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Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention

- National extent of misclassification is significant, but unknown
- Old IRS studies (to be updated in 2013) indicate:
 - 3.4 million misclassified workers
 - Loss of \$1.6 billion in 1984 dollars
- DOL study found that 10% to 30% of audited firms misclassified at least some of their employees
- Misclassification is not per se a violation of law, but is often associated with labor and tax law violations

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Improved Coordination (cont'd)

- IRS enforces worker classification primarily through audits
- IRS provides extensive information through
 - Publications
 - Fact sheets
 - Outreach efforts to tax/payroll professionals (but not generally directly to workers)
- IRS faces challenges with compliance efforts due to (i) limited resources and (ii) limits that tax laws place on IRS's reclassification enforcement and education efforts (i.e., Section 530)

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Employee Misclassification (cont'd)

- DOL and IRS do not typically exchange the information that they collect relating to misclassification
- DOL does not share information with state labor departments
- IRS and approximately 35 states share information on misclassification-related audits
- Some states share information among each other
- The GAO surveyed various stakeholders regarding methods to address misclassification

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GAO Recommendations to IRS and DOL

Six methods to prevent and respond to employee misclassification:

1. DOL should increase focus on misclassification during targeted investigations
2. Information on DOL misclassification cases should be shared with IRS and referred to the states
3. DOL and IRS should establish a joint interagency effort with other federal and state agencies
4. DOL and IRS should offer education and outreach to workers on classification rules and implications and related tax obligations
5. DOL and IRS should create a forum for regularly collaborating with participating states to identify and address data-sharing issues
6. IRS should extend the CSP to include employers that volunteer to prospectively reclassify their misclassified employees

Worker Classification Legislation

111th Congress

- Taxpayer Responsibility, Accountability and Consistency Act
 - H.R. 3408 (McDermott)
 - S. 2882 (Kerry)
- Fair Playing Field Act
 - H.R. 6128 (McDermott)
 - S. 3786 (Kerry)

Worker Classification Legislation

111th Congress

- Employee Misclassification Prevention Act
- H.R. 5107 (Woolsey)
- S. 3254 (Brown)

Worker Classification Legislation

- The Payroll Fraud Prevention Act (S. 770), introduced on April 8, 2011 by Sens. Brown (D-OH), Harkin (D-IA), and Blumenthal (D-CT)
- Similar to the Employee Misclassification Prevention Act of 2010
- The Payroll Fraud Prevention Act is a labor bill that:
 - Increases penalties on employers that misclassify employees and are found to have violated employees' overtime or minimum wage rights; fines of \$1,100 per employee for first-time violators and up to \$5,000 per employee for repeat violators
 - Requires employers to notify workers of their classification as employees or nonemployees (long before W-2/1099 forms are distributed)
 - Directs states to strengthen penalties for worker misclassification
 - Permits DOL and IRS to refer to one another incidents of worker misclassification
 - Directs DOL to perform targeted audits focusing on employers in industries that frequently misclassify employees

Worker Classification Legislation

- The Employee Misclassification Prevention Act of 2011 (H.R. 3178), introduced by Reps. Lynn Woolsey (D-CA), George Miller (D-CA), and Rob Andrews (D-NJ)
 - Ensures that businesses keep records reflecting the “accurate” status of each worker as an employee or nonemployee
 - Clarifies that employers violate the FLSA when they misclassify workers
 - Increases penalties for misclassification
 - Requires businesses to notify workers of their classification status
 - Creates an “employee rights website” to inform workers about their wage and hour rights
 - Provides protections to workers who seek to be “accurately” classified
 - Mandates state audits to identify employers that misclassify workers
 - Directs states to strengthen worker misclassification penalties
 - Permits DOL and IRS to refer incidents of misclassification to one another

Obama Administration

FY '12 Budget Proposal

- Increase certainty with respect to worker classification (Repeal Section 530)
- \$46 million to DOL to combat misclassification
- \$25 million in grants to states to identify misclassification
- \$15 million for Wage and Hour personnel to investigate misclassification

Recommendations to the “Super” Committee

Letter from Education and Workforce Committee Democrats

- “Tens of thousands of workers are illegally misclassified.”
- “Misclassification deprives federal and state governments of unemployment insurance contributions, workers’ compensation premiums, and other employment taxes.”

Recommendations to the “Super” Committee

Education and Workforce Committee Democrats

- “It gives law-breakers an unfair advantage over employers who follow the law.”
- “The Employee Misclassification Prevention Act is one approach to tightening enforcement, **resulting in significant revenue savings.**”
- “For example, in 2010, the Treasury Inspector General for Tax Administration estimated the federal tax gap for employment underreporting to be **\$54 billion.**”

Other Initiatives

H.R. 572

The Clean Ports Act of 2011

- Overturns a Ninth Circuit decision concerning the Port of LA's "Clean Truck Program"
- That program would permit only company employee truck drivers to serve the port, thus banning the use of independent owner-operators
- 57 House Cosponsors

DOL's "Plan/Prevent/Protect" Initiative

- Provide each independent contractor with whom a company does business with a written analysis explaining the legal basis for classifying the individual as an independent contractor
- Provide each company employee treated as exempt from the FLSA's overtime and/or minimum wage requirements with a written analysis explaining the legal basis for classifying the individual as exempt

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