

Worker Misclassification

- the Game Changes and Consequences

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Why Worker Misclassification Now?

- Various state laws and at least three federal laws—the Fair Labor Standards Act (FLSA), the Internal Revenue Code (the Code), and the National Labor Relations Act (NLRA)—with different purposes, different standards, but similar terminology
- Similar terms used in different definitions: consider impact of your answer under each applicable law
- Common concern: “fissured” workplaces
- DoL desires a common definition of “employee”
- DoL’s Wage and Hour Division (WHD) renewed its FLSA enforcement efforts
 - Fissured workplace enforcement efforts resulted in \$4M in penalties in f/y 2015, a \$1M increase over the prior year

3 Laws With Separate Enforcement

- FLSA- to protect the worker's compensation, leave, health, safety, and benefits; DoL's WHD Admin. Interp. 2015-1, *Nationwide Mut. Ins. v. Darden*, and WHD Admin. Interp. 2016-1 related to the "economic reality test" and horizontal and vertical joint employment
- Code- to collect FICA and income taxes, ensure that employee benefits are provided in a nondiscriminatory manner, and ACA compliance and enforcement; common law test
- NLRA- to facilitate worker representation by CBUs to negotiate for wages and terms and conditions of employment; NLRB, courts, and several CBUs, e.g., AFL-CIO website

Increased Collaboration

- States and WHD sharing identities and employee statements, internal opinions, policy statements, and records, including those that would not otherwise be subject to disclosure: attorney-client and work-product privilege protected information, confidential business information, and trade secrets
 - WHD signed agreements with 14 states in 2014-15, for a total of 27 states with agreements at last check

Increased Collaboration

- DoL and IRS also agreed to share information on investigations into worker misclassification
- States, the DoL's WHD, and the IRS all can investigate at the same time on worker misclassification
- An agency can share your responses to an investigation involving one law with other agencies administering different laws—laws which use similar terms but have different focuses and standards

Employer Quandry

- An answer to one agency which is shared with another may have unintentional consequences
- Answer investigation questions carefully understanding the different focuses of the different agencies and that your response may be shared and reviewed in the light used by an agency enforcing a different law
 - FLSA disputes increased from 6,761 cases in 2010 to 8,066 in 2014 and to 8,954 cases in 2015, and are expected to continue to increase in number

Employer Quandry

- The good news is the NLRB has its own analysis of who it considers to be an employee, but it is not sharing information with the IRS, other than thru its published decisions/opinions

Worker Status

- Employee v. Independent Contractor?
- In three-party arrangements (staffing industry, Professional Employer Organizations) who is the employer?
 - Joint employment (e.g., ADA, discrimination, retaliation, whistle blowing)
 - Co-concurrent employment (e.g., 26 C.F.R. § 31.3121(s) common paymaster)
 - Co-employment (e.g., relationship between a PEO and a client in which both have actual or potential legal rights and duties)
- Outsourced departments and fissured industry focus means that agreements for outsourcing should be reviewed for employment tax and employer shared responsibility tax implications

WHD's Joint Employer Standards

- WHD Admin. Interp. (AI) 2016-1 focuses on fissured workplaces by establishing new standards for determining joint employment and applying the “economic realities” test for evaluating employment relationships
 - Purpose of the AI is to expand statutory coverage of the FLSA to small businesses and collect back wages and penalties from larger businesses
 - WHD Administrator Weil claimed that the impact of supply-chain, branding, franchising, third-party management, and subcontracting relationships “all have important implications for patterns of compliance in an industry and for strategies that WHD can take to affect employer behavior.”
 - AI specifically targets the construction, agricultural, janitorial, warehouse and logistics, staffing, and hospitality industries

WHD's Joint Employer Standards

“Economic realities” factors:

- Is the work an integral part of the employer’s business?
- Does the worker’s management skill affect the worker’s opportunity for profit or loss?
- How does the worker’s relative investment compare to the employer’s investment?
- Does the work performed require special skill and initiative?
- Is the relationship between the worker and employer permanent or indefinite?
- What is the nature and degree of the employer’s control?

ERISA Standards

- Who is an employee?
 - ERISA does not have a statutory definition of an employee
 - *Nationwide Mutual Insurance Company v. Darden*, 503 US 318 (1992), applies common law principles
- Is the employee an eligible employee according to the language of the plan?

ERISA Standards

- Rev. Rul. 87-41, 1987-1 C.B. 296
- Control is a matter of degree, and the factors must be weighed to determine the extent, if any, of the business's right to direct and control the worker's performance of services
- The factors in Rev. Rul. 87-41 are the considerations for employment tax withholding, which are also used for employee status determination for the employer shared responsibility tax under the Affordable Care Act

Common Law “Employee”

Rev. Rul. 87-41:

- 20 “factors or elements” used in determining whether there is an employer/employee relationship
- Instructions; training; integration; services rendered personally; hiring, supervising, and paying assistants; continuing relationship; set hours of work; full time required; doing work on employer’s premises; order or sequence set; oral or written reports; payment by hour, week, month; payment of business and/or traveling expenses; furnishing of tools and materials; significant investment; realization of profit or loss; working for more than one firm at a time; making service available to general public; right to discharge; and right to terminate

Common Law “Employee”

National Mutual Insurance Co. v. Darden:

- 13-factor test
- The hiring party's right to control the manner and means by which the particular result is to be accomplished; the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent to which the hired party may decide when and how long to work; the method of payment; the role of the hired party in hiring and paying assistants; whether the work is part of the hiring party's regular business; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party

Common Law “Employee”

IRS Training Guidelines:

- Behavioral control, e.g., instructions the business gives the worker; training the business gives the worker
- Financial control, e.g., the extent to which the worker has unreimbursed business expenses, the extent of the worker’s investment; the extent to which the worker can realize a profit or incur a loss
- Legal control, e.g., written contracts describing the relationship the parties intended to create; whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay or sick pay

Common Law “Employee”

Treas. Regs. § 31.3401(c)-1(b):

- Required to treat as employee for withholding employment taxes and as employee for the employer shared responsibility tax
- Generally, the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished...In this connection, it is not necessary that the employer actually directs or controls the manner in which the services are performed; it is sufficient if he has the right to do so

Common Law “Employee” - Limitations

- Why are you asking?
 - To distinguish a common law employee from an independent contractor?
 - To determine from among 2 putative employers which is the common law employer of an individual who is clearly someone’s employee (and not an independent contractor)?
- For tax and benefit purposes, there historically has been no such thing as “co-employment” or “joint employment”
- Historically, for employment tax purposes, in three-party staffing arrangements that contemplated the issuance of a W-2 and not a 1099, the potential for abuse was limited
- For NLRB purposes and for employment law purposes...

INDEPENDENT CONTRACTOR V. EMPLOYEE

IRS	DOL	NLRB
<ul style="list-style-type: none"> Integration- Is the worker performing a service that is a key aspect of the regular business of the company? Work on employer's premises 	<p>Factors:</p> <ul style="list-style-type: none"> (A) The extent to which the work performed is integral part of the entity's business: Integrated unit of production? Integral part of business? 	<ul style="list-style-type: none"> Whether the work is part of the regular business of the employer Whether the entity is or is not in the business in which services are being provided Concerns regarding staffing companies and subcontracting areas of the business and doing regular business of the company
<p>Financial Control</p> <ul style="list-style-type: none"> How business expenses handled / unreimbursed employee business expenses No managerial skills required Can work more hours to get profit Multiple service recipients How the worker is paid hourly v. project v. per time period Extent worker can earn a profit or loss 	<ul style="list-style-type: none"> (B) Worker's opportunity for profit or loss depending on his managerial skill Not just more hours worked Other business skills – managing purchases tools, materials, staffing projects, work scheduling, advertise, rent space Others to whom service provided 	

INDEPENDENT CONTRACTOR V. EMPLOYEE CONT.

IRS cont.	DOL cont.	NLRB cont.
<ul style="list-style-type: none">• Order or sequence of work set• Hours of work set• Hire, fire, discipline, and set rules of workplace		<p>(A) Premises share or codetermine: (i) requires evidence of (ability to direct and control) of direct and immediate control over employees, (2) looking to the actual practice of the parties and to the contractual rights to control, and (3) requiring an employer's control to be substantial and not limited or routine</p> <p>(B) New definition Post <i>Browning-Ferris</i>: the extent of control the master may exercise over the work, if both parties are employers within the common law meaning and if they share or codetermine those matters governing the essential terms and conditions of employment</p>

INDEPENDENT CONTRACTOR V. EMPLOYEE CONT.

IRS cont.	DOL cont.	NLRB cont.
<ul style="list-style-type: none">• Training the business provides the worker• Extent of worker's investment in facilities or tools	<p>(C) Extent of <i>relative investment</i> of the employer and worker</p> <ul style="list-style-type: none">• Investment furthers business capacity, reduce cost structure• Relative investment worker v. service recipient – what is the significant nature and magnitude of investment of the worker as compared to the service recipient's investment?	<ul style="list-style-type: none">• Whether the employer or individual supplies the instrumentalities, tools and place of work• Training and orientation provided by company• Safety instruction by company
<ul style="list-style-type: none">• Services rendered personally• Making service available to the general public	<p>(D) Whether the work performed requires special skills and initiatives</p> <ul style="list-style-type: none">• Use of skills independently and as a way of demonstrating businesslike initiative	<ul style="list-style-type: none">• Whether the individual is engaged in a distinct occupation or business• Skill required in the occupation

INDEPENDENT CONTRACTOR V. EMPLOYEE CONT.

IRS cont.	DOL cont.	NLRB cont.
<ul style="list-style-type: none">• Whether a contract exists• Provision of employee-type benefits• Permanency of the relationship<ul style="list-style-type: none">• Indefinite duration• Making service available to general public	<p>(E) The permanency of the relationship or indefinite nature of relationship</p> <ul style="list-style-type: none">• 1 source of work or multiple sources of work	<ul style="list-style-type: none">• Length of time for which the individual is employed• Whether the parties believe they are creating an independent-contractor relationship• Whether the evidence shows the individual is rendering services as an independent contractor
<p>Right to control what will be done and how it will be done – Pub. 15-A</p> <p>Behavior control</p> <ul style="list-style-type: none">• Which tools to use• When and where• Who to hire or assist• Order or sequence to follow	<p>(F) Degree of control exercised or retained by the service recipient / employer</p> <ul style="list-style-type: none">• Who controls meaningful aspects of the individual's business and the individual must not just have the right to control but must exercise the control (e.g., deciding what job or project to take)• Individual is separate economic entity (a viable one)• Control exercised even if it is merely control to comply with regulation	<p>Method of payment</p> <ul style="list-style-type: none">• Extent of control of employer• Who sets hours worked• Subject to discipline• Freedom to choose to work or not on a particular day• Who dictates where work is performed• Control of pay rate• Control of which tasks to be done• Limited duration of work• Common law concept of control• Supervision <p>Whether the work is usually done under the direction of the employer or by a specialist without supervision</p> <p>Location of workers and management</p>

INDEPENDENT CONTRACTOR V. EMPLOYEE CONT.

IRS cont.	DOL cont.	NLRB cont.
No single factor controls	No single factor controls, but if worker is to be independent contractor, the worker must have economic independence from operating a business of their own.	Burden of proof on recipient of services to prove the service provider is an independent contractor, considering all of the factors



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Reclassification Considerations

- Back wages, minimum wages, and overtime
- State unemployment taxes or insurance
- Workers compensation coverage and benefits
- Federal Unemployment owed
- FICA owed for the employer and employee share
- Medicare tax withholding
- Ability to organize with a union and may change representation elections

Reclassification Considerations

- Retroactive reinstatement in retirement plan benefits (401(k) , DB, other DC)
 - Cost of benefits
 - Cost of administration of correction calculation
 - Impact on testing:
 - ADP/ACP
 - 410(b)
 - 401(a)(26)



Reclassification Considerations

- Retroactive reinstatement in health and welfare benefits may result in self-insuring where an insured benefit was contemplated (e.g., LTD, life, dental, vision, dependent day care, etc.)
- Cafeteria/Flex/125 plan nondiscrimination and coverage Code § 125 (e) and (g)

Reclassification Considerations

- Employee stock purchase plan implications under Code section 423
- Equity grants made to a broad group of employees which would include reclassified person
 - Watch grant date, FMV at date of grant, and related 409A implications

Reclassification Considerations

- Equity grants made pursuant to a collective bargaining agreement
 - Watch CBA mandates re grants and Code § 409A (regulatory requirement that, for grant to be exempt, it must be made at fair market value as of the date of the grant) since corrective grants may be required to have a different grant date after the worker is determined to be an employee; CBA may also set exercise price
 - Watch CBA requirements because failure to comply with the CBA may cause the employer to face litigation related to a violation of the CBA under 301 of the LMRA or an ULP charge

Reclassification Considerations

- Issues under state insurance law when policy terms require coverage be offered to a set % or policy availability limited to certain size employers
- Impact on Code § 4980H
 - Suddenly an ALE with no preparation to plan for tax or reporting when reclassified for a prior year
 - 95% safe harbor for 4980H(a)
 - 98% rule for reporting might no longer be available
 - Did the service agreement meet the Treas. Reg. 54.4980H-4(b)(2) standards?

Reclassification Considerations

- Back Federal Income Tax withholding on wages
- Back State Income Tax withholding on wages
- COBRA notices for both initial coverage and qualifying event past due and related penalties
- ACA notices and SBCs late and related penalties
- ERISA Notices and SPDs not delivered timely and related penalties
- Impact on VEBA of inclusion of individual not previously employees

Reclassification Considerations

- If reinstated in coverage, what happens to wellness opportunities missed?
- Privacy notices missed
- What about prior year Health Savings Account seed money and the opportunities lost to contribute on a tax-deductible basis for prior calendar years?
 - No current program that permits you to correct and make contributions for prior years, so all would be applied to current tax year and may need to be grossed up for taxes

Reclassification Considerations

- State law benefit mandates missed
- State leave laws
- State payday laws related to last paychecks, paycheck deductions, and timing of payment issues
- Local benefit law mandates
 - Health
 - Commuter/Transit benefits



Reclassification Considerations

- Class Actions: Wal-Mart heightened “commonality” requirements for Rule 23(a)(7) and Comcast tightened the predominance factors for 23(b), but expect to see more of these—because even the settlements are big numbers
- ERISA class action settlements 2014 \$1.31B and in 2015 \$926.5M



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Worker Classification – IRS, WHD, and NLRB Perspectives

- Different reasons behind each statute and different results if reclassified, but a common administration initiative: fissured workplaces
- DOL in fiscal year ended 9/30/15 collected \$246M in back wages, which was \$6M more than the previous year
- Since early 2009, DOL collected \$1.246B in back wages for 250,000 workers
- The initiative is not likely to slow or stop

Top Ten Lessons

1. While the different agencies use similar terminology, each has its own focus and its own tests and definitions; be careful when responding to inquiries.
2. Many states (including Texas) are sharing information with the U.S. Department of Labor, and DoL is sharing it with the IRS; be careful how you respond.
3. There can be significant financial consequences to a company if an individual is reclassified as an employee.

Top Ten Lessons

4. Review all independent contractor agreements re language and ACA compliance.
5. Review all outsourcing agreements re language and ACA compliance.
6. Establish company procedures regarding contracting for services from independent contractors and staffing firms.
7. Establish company procedures regarding rehiring retired workers.

Top Ten Lessons

8. Be sure to answer the inquiring agency using the standards used by that agency, and recognizing that the DoL has agreed to share your information with the IRS.
9. Be sure to answer state labor and related regulatory agencies carefully, because 27 states share information with the DoL.
10. When outsourcing areas, be careful not only of the labor and employment implications but also the Employer Shared Responsibility Tax language you need to protect the company.

Thank you for your time and attention.

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