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2010 - TIME TO RE-ASSESS INDEPENDENT CONTRACTOR STATUS

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Why the Renewed Emphasis?

In this recessionary economy, federal and state governments are interested in recouping billions of dollars in lost employer taxes when workers are misclassified as independent contractors; workers want those protections offered by being an employee rather than an independent contractor; even labor unions argue that independent contractor relationships are being used as a management strategy to avoid organizing or to diminish bargaining units. The result in 2010 is a well publicized, well financed federal and state “misclassification initiative” which targets increased scrutiny by federal and state regulatory agencies of workers, including healthcare professionals, treated as “independent contractors.”

What Are the Consequences?

Consequences of misclassification include liability for a panoply of employer-owned taxes for its employees, from FICA to state unemployment taxes and corresponding interest; overtime pay; employee benefits; resulting attorneys’ fees and costs; possible regulatory penalties; and any associated claims filed by the worker or governmental agency. Agencies often share information about identified misclassifications. In Washington, after pursuing repayment (with interest) of employer unemployment taxes owed as a result of an independent contractor misclassification, that information is routinely turned over to the state Department of Labor and Industries to address failure to pay corresponding employer worker’s compensation taxes (and interest).

Legal Tests that Determine Independent Contractor Status

There are many different legal tests for determining whether a viable independent contractor relationship exists. The tests vary depending on the reason for the inquiry.



For example:

- The Internal Revenue Service (IRS) utilizes its test to determine employee status for purposes of an employer's tax obligations.
- A test under the Fair Labor Standards Act (FLSA) determines employee status for purposes of an employer's minimum wage and overtime obligations.
- The U.S. Citizenship and Immigration Services (CIS) utilizes its test for purposes of determining legality of employment under the Immigration Reform and Control Act (IRCA).
- The Equal Employment Opportunity Commission (EEOC) employs a set of guiding factors regarding application of the non-discrimination statutes (Title VII, ADEA, ADA, Equal Pay Act) to contingent workers.
- The National Labor Relations Board (NLRB) uses an approach similar to the EEOC in determining whether a worker is a covered employee or a non-covered independent contractor under the National Labor Relations Act.
- Individual states, including Washington, have adopted their own tests arising out of common law principles. These states also have multiple tests for different purposes. For example, the test for unemployment purposes may be different from the test for state tax purposes. **The Washington State test for some purposes, such as the paying of unemployment taxes, is tougher to satisfy than the federal test. Hence, it is important to start with the Washington State tests. (A summary outline of the guidelines the IRS and the Washington State Employment Security Department and Department of Revenue use to assess independent contractor status is included on the last page.)**

Healthcare Focus

Back in the mid-nineties the IRS surprised the healthcare industry when it issued two technical advice memorandums finding physicians in various contractual relationships with hospitals to be employees rather than independent contractors. The IRS appeared to be placing more emphasis on the degree to which physicians' activities were integrated into a hospital's operations rather than on the amount of control the hospital maintained over physicians' decision making and analysis, which has traditionally supported the independent contractor status.

In 2008, the Second Circuit Court of Appeals found that a physician who had clinical privileges at a hospital (and at other hospitals), who was free to set her own hours and workload and determine which patients to see and treat was nonetheless an employee and not an independent contractor. As an employee, the Court ruled that the physician could bring a Title VII claim (involving sexual harassment) against the hospital. As the IRS

had done, this Court focused on the integration of the physician with the hospital, emphasizing the hospital's right to control "the manner and means" by which physician services were accomplished as a pivotal factor in finding the physician an employee.

With hospitals' increasing desire to exercise control over physicians who deliver in patient services, coupled with the new federal misclassification initiative, 2010 portends a greater risk that independent contractor physicians may be considered as employees under federal and state law.

SUMMARY OUTLINE

WASHINGTON STATE TESTS

A. Employment Security (Unemployment) Department Tests

There are several tests used in Washington State to determine Independent Contractor vs. Employee Status. See Appendix A. One of the toughest state tests is used by the Employment Security Department if unemployment taxes (and benefits) are required. Hence this is a good place to start in determining proper classification. The Employment Security Department uses alternative tests to determine Independent Contractor status:

▶ Test One

A worker is an independent contractor if all three of the following criteria are true:

1. He or she is completely free from all direction and control by the employer.
2. He or she performs services that are different from those usually offered by the business that is contracting for services OR the services are not performed at the business' physical location.
3. He or she is independently established in his/her own trade, occupation or business.

▶ Test Two

If a worker fails the first test, he or she must meet all six of the following criteria to be considered an independent contractor:

1. He or she is completely free from all direction and control by the employer.
2. He or she performs services that are outside of the usual course of business or are performed off-site OR he or she covers the costs of the site where the service is performed.
3. He or she is independently established in his/her own trade, occupation or business OR his or her principal place of business is eligible for a federal income tax deduction.
4. He or she files a schedule of expenses for the service to the Internal Revenue Service.
5. He or she has a Unified Business Identifier (UBI) number and is registered to pay business taxes to the State of Washington.
6. He or she maintains a set of bookkeeping records separate from the employer.

B. Department of Revenue Tests

Independent Contractor Test

The Department of Revenue taxes “independent contractors,” but not those individuals deemed employees. The Department has acknowledged that while no one factor determines that status, it looks to the right to control an employee as the most important. Such control is not limited to controlling the result of the work to be accomplished, but includes controlling the details and means by which the work is accomplished.

Complying with the following conditions will indicate to the Department that an individual is an independent contractor (and thus engaged in business and subject to taxation as such) as opposed to an employee. If a person is:

1. Holding oneself out to the public as engaging in business with respect to dealings in real or personal property, or in respect to the rendition of services;
2. Entitled to receive the gross income of the business or any part thereof;
3. Liable for business losses or the expense of conducting a business, even though such expenses may ultimately be reimbursed by a principal;
4. Controlling and supervising others, and being personally liable for their payroll, as a part of engaging in business;
5. Employing others to carry out duties and responsibilities related to the engaging in business and being personally liable for their pay;

6. Filing a statement of business income and expenses (Schedule C) for federal income tax purposes;
7. A party to a written contract, the intent of which establishes the person to be an independent contractor;
8. Paid a gross amount for the work without deductions for employment taxes (such as Federal Insurance Contributions Act, Federal Unemployment Tax Act, and similar state taxes).

Employee Test

Alternatively, in order to be considered an employee rather than an independent contractor, the Department of Revenue looks to the following factors for its determination. If a person:

1. Receives compensation, which is fixed at a certain rate per day, week, month or year, or at a certain percentage of business obtained, payable in all events;
2. Is employed to perform services in the affairs of another, subject to the other's control or right to control;
3. Has no liability for the expenses of maintaining an office or other place of business, or any other overhead expenses or for compensation of employees;
4. Has no liability for losses or indebtedness incurred in the conduct of the business;
5. Is generally entitled to fringe benefits normally associated with an employer-employee relationship, *e.g.*, paid vacation, sick leave, insurance, and pension benefits;
6. Is treated as an employee for federal tax purposes;
7. Is paid a net amount after deductions for employment taxes, such as those identified in subsection (3)(h) of this section.

FEDERAL TESTS

There are several federal tests used to determine Independent Contractor vs. Employee status. The most well known of these tests is the test used by the Internal Revenue Service.

IRS Tests

The IRS utilizes a three-pronged analysis to incorporate the myriad of factors most agencies and courts examine when applying their tests. The three prongs establish a helpful framework for guiding you through each of the questions you should consider in determining whether a worker is an employee or an independent contractor:

1. Behavioral control by the company:

- Controlling the details of the worker's performance
- Providing the tools or equipment for the worker
- Requiring the work to be performed on premises
- Setting the individual's hours of work
- Requiring work to be performed by a specific individual

2. Financial control by the company:

- How the worker is paid
- Payment of business and travel expenses
- Extent to which the worker can realize a profit or loss

3. Relationship of the parties:

- Whether the worker's services are part of core business
- Continuing or temporary relationship
- Whether the individual works for other companies
- Whether the relationship is terminable without liability



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