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Labor Department Offers Guidance To Determine Worker Classification

Misclassification of employees as independent contractors is increasing across the county, a situation that the Labor Department's Wage and Hour Division attributes in part to the restructuring of business organizations in recent years.

The division receives many complaints from workers who claim they were misclassifed as independent contractors. Additionally, many state agencies have recognized the problem and have responded with legislation and misclassification task forces.

Many of the states have entered into programs with the division and the Internal Revenue Service by signing memorandums of understanding. Twenty-five states participate in the Labor Department program, which promotes the sharing of information and the coordination of law enforcement efforts.

The programs were created to increase compliance with employment tax filing and payment regulations, facilitate Form 1099 and Form W-2 filing, increase collection of federal and state employment and unemployment tax debts, reduce the tax gap at the federal and state levels, and ensure competitive busi-

SSA Nears Completion of Processing 2014 Forms W-2

The Social Security Administration has completed processing 245.6 million Forms W-2, Wage and Tax Statement, that were submitted for 2014, which represent 98.9 percent of all 2014 Forms W-2. The number of W-2s that were filed for 2014 is about 10 percent higher than the 226 million W-2s filed for 2011, an SSA representative said Aug. 6 during an IRS payroll industry teleconference. Additionally, the agency's decision in 2014 to adopt stricter standards for rejecting errors in submitted W-2 files did not cause the rate of rejections of electronic W-2 file submissions to significantly increase, the SSA representative said.

IN THIS ISSUE

News Update

The terminal charge portion of the Standard Industry Fare Level formula fell to $42.79 for the second half of 2015 from $45.52 for the first half of 2015, the Transportation Department said Aug. 10. The per-mile rate for the first 500 miles of travel also fell, to 0.2341 cents a mile from 0.2490 cents a mile. The rate for miles 501 to 1,500 fell to 0.1785 cents a mile from 0.1898 cents a mile. The rate for distances of more than 1,500 miles fell to 0.1716 cents a mile from 0.1825 cents a mile.

ness operations by assuring proper payment of employment taxes.

Under the program, state workforce agencies share independently conducted examination results, employment tax training materials and outreach opportunities. IRS and the states try to keep examination results consistent, reducing the chance that IRS classifies the worker as an independent contractor and a state classifies the worker as an employee, or vice versa.

The various agencies recognize that independent contractor relationships can be advantageous for workers and businesses; however, some businesses intentionally misclassify workers in order to cut costs and avoid compliance with labor laws. When this occurs, employees do not receive important workplace protections, such as minimum wage, overtime compensation, unemployment insurance and workers' compensation. Misclassification also results in lower tax revenue for government and places competitors who properly classify workers at a competitive disadvantage.

David Weil, administrator of the Wage and Hour Division, issued Administrator's Interpretation 2015-1 on July 15 regarding the application of the ''suffer or permit to work'' standard of the Fair Labor Standards Act and the economic realities tests to help determine worker classification as either an independent contractor or employee.

The interpretation was the first in more than a year and the fifth since the Labor Department shifted away from issuing opinion letters in 2009. Such interpretations are issued when further clarity regarding the proper interpretation of a statutory or regulatory issue is appropriate. The interpretations are intended to provide meaningful and comprehensive guidance and compliance assistance to the broadest number of employers and employees.

The latest interpretation offers additional guidance to employers on how to apply the standards for determining who is an employee under the FLSA. The aim of the Wage and Hour Division is to curtail misclassification through proper application of the guidelines.

Defining 'Employee' Under the FLSA

The FLSA definition of ''employ'' as ''suffer or permit to work'' is of broader scope than the common-law definition of employment. Supreme Court cases were cited in the interpretation, including *Walling v. Portland Terminal Co.* (1947), *U.S. v. Rosenwasser* (1945), *Nationwide Mutual Insurance Co. v. Darden* (1992) and *Tony and Susan Alamo Foundation v. Secretary of Labor* (1985).

The common-law test analyzes whether a worker is an employee based on the employer's control over the worker and not the broader economic realities of the working relationship. The FLSA statutory definitions of employment, including the ''suffer or permit'' standard broadens the

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scope of employment relationships covered by the FLSA and rejects the common-law control test that was prevalent at the time.

In *Walling* and *Rosenwasser,* the court stated that the ''suffer or permit to work'' definition of employ was intended by Congress to be broadly construed and for purposes of the FLSA, extended the definition of employ beyond the common-law or traditional-agency law definitions.

In *Darden,* the court noted the broadened definition of the FLSA. The Employee Retirement Income Security Act did not contain any provision defining employment similar to that in the FLSA that would define employment as anything other than the definitions under common law or agency law, the court said.

In *Rosenwasser,* the court determined that piece-rate workers in the garment industry were employees and that the FLSA did not require payment on an hourly basis. However, compliance with the minimum wage and overtime standards should be measured by reducing an employee's wage to a regular hourly rate of pay, the court said.

In the Alamo Foundation case, the business used the term associates to refer to its staff, who were mostly former drug addicts, derelicts and criminals reformed by the foundation. The associates were not paid in cash, but were provided with food, clothing, shelter and other benefits.

The court stated that payment in cash was not required. Additionally, because the workers already were receiving noncash benefits, the imposition of the recordkeeping and minimum wage requirements would not significantly affect the economic operations of the employer or the workers.

Because the FLSA only applied to the commercial activities of the group that were undertaken with a business purpose, the recordkeeping requirements would not affect the organization's evangelical activities or individuals engaged in volunteer work for other religious groups.

The ''suffer or permit to work'' language was used prior to enactment of the FLSA in state child labor laws intended to extend liability to businesses that used middlemen illegally to hire and supervise children. The idea was that the employer's opportunity to detect work being performed illegally and the ability to prevent it was sufficient to impose liability on the employer. This expanded the coverage of the child-labor laws beyond those who controlled the child laborer, countered arguments that employers were unaware that children were working and prevented employers from using agents to evade the requirements of the law.

Similarly, the FLSA ''suffer or permit'' standard for employment stretches the meaning of ''employee'' to cover some parties that might not qualify as such under a strict application of traditional agency law principles. The standard was developed to assign responsibility to businesses that did not directly supervise putative employees.

On that basis, an entity suffers or permits an individual to work, as a matter of economic reality, if the individual is dependent upon the entity. A multifactor economic reality test has evolved through the actions of the Supreme Court and Circuit

This Month in Payroll

Sept. 2, 4, 10, 11, 16, 18, 23, 25, 30: Semiweekly depositors—Deposit Social Security, Medicare and withheld federal income taxes.

Sept. 7: Federal holiday—Labor Day

Sept. 10: Tipped employees—Employers are to receive employee reports on tips of at least $20 earned in August.

Sept. 15: Monthly depositors—Deposit payroll-related taxes for August.

Courts of Appeals to determine whether a worker is an employee or an independent contractor under the FLSA.

Typically, the test involves six factors:

- the extent that the work performed is an integral part of the employer's business;
- the worker's opportunity for profit or loss depending on his or her managerial skill;
- the extent of the relative investments of the employer and the worker;
- whether the work performed requires special skills, judgment or initiative;
- the permanency of the relationship and
- the degree of control exercised or retained by the employer.

The number of factors and the wording vary, depending on the court, and judges may consider other factors, depending on the circumstances of the case. No single factor is determinative. In this analysis, each factor is examined and analyzed in relation to the others. For example, the control factor should not be given undue weight.

The factors should be considered in totality and not applied as a checklist. The outcome of whether a worker is an employee or an independent contractor should be determined by a qualitative rather than quantitative analysis.

Based on the latest Administrator's Interpretation, the application of the economic realities tests is to be construed to provide broad coverage for workers as evidenced by the FLSA definition of employment as ''to suffer or permit to work.'' Following is a breakdown of the tests and includes examples listed in the Administrator's Interpretation:

Effect of Work on Employer's Business

Underlying the ''suffer or permit to work'' language was a policy decision to bring into the scope of the employment definition workers who are integrated into an employer's business. If the work performed by a worker is integral to the employer's business, the worker likely is economically dependent on the employer. On the other hand, an independent contractor's work is unlikely to be integral to the employer's business.

The work can be integral even if it is just one component of the business or is performed by many other workers. For example, a worker answering the phone at a call center is performing work that is integral to the call center's business, even though the work is the same as and interchangeable with that or many other workers. Work also may be integral to an employer's business even if performed away from the employer's premises, such as at the worker's home or the premises of customers of the business.

Payroll Practitioner's Calendar

- **Payroll System Tax Tables and Attributes: Your Duties as an End User**, webinar, Sept. 8. Contact: Bloomberg BNA (800-372-1033) or http://www.bna.com/learning.
- **Garnishment Administration Best Practices**, webinar, Sept. 10. Contact: Bloomberg BNA (800-372-1033) or http://www.bna.com/learning.
- **How to Recover Wage Overpayments**, webinar, Sept. 16. Contact: Bloomberg BNA (800-372-1033) or http://www.bna.com/learning.
- **Disaster Recovery and Business-Continuity Planning in Payroll**, webinar, Sept. 29. Contact: Bloomberg BNA (800-372-1033) or http://www.bna.com/learning.

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Example: Carpenters are integral to the employer's business that frames residential homes because the company is in business to frame homes. Carpentry is an integral part of providing that service. In contrast, the same construction company may contract with a software developer to create software that, among other things, assists the company in tracking its bids, scheduling projects and crews, and tracking material orders. The software developer is performing work that is not integral to the construction company's business. This is indicative of an independent contractor.

Worker Opportunity for Profit or Loss

Under this test, the focus is on whether the worker's managerial skill can affect the worker's profit or loss. The worker's managerial skill will often affect the opportunity for profit or loss beyond the current job, such as by leading to additional business from other parties or by reducing the opportunity for future work. Decisions by the worker to hire others, buy materials or equipment, advertise, rent space or manage time tables may indicate the use of managerial skills that affect the opportunity for profit or loss beyond the current job.

In contrast, the worker's ability to work more hours and the amount of work available from the employer do not have anything to do with the worker's managerial skill. That is, employees and independent contractors are likely to earn more by working more hours, take on overtime work, work more jobs than assigned , or, in the case of a piece worker, work more efficiently.

Example: A worker provides cleaning services for corporate clients. The worker performs assignments only as determined by a cleaning company and does not independently schedule assignments, solicit additional work from other clients, advertise his services, or endeavor to reduce costs.

The worker regularly agrees to work additional hours at any time to earn more. The worker does not exercise managerial skill that affects his profit or loss. His earnings may fluctuate based on the work available or his willingness to work more. This lack of managerial skill application indicates an employment relationship between the worker and the cleaning company.

In contrast, a worker provides cleaning services for corporate clients, produces advertising, negotiates contracts, decides which jobs to perform and when to perform them, decides to hire helpers to assist with the work and recruits new clients. This worker exercises managerial skill that affects the opportunity for profit and loss, which is indicative of an independent contractor.

Investments of Employer, Worker

The nature and extent of the relative investments of the employer and the worker are also used in determining whether the worker is an independent contractor or an employee.

An independent contractor often makes some investment, therefore, undertakes at least some risk for a loss. Usually such investments support a business as a business beyond any particular job by, for example, furthering the business's capacity to expand, reducing its cost structure, or extending the reach of the independent contractor's market.

When a worker has made an investment, it should be considered relative to the investments of the employer. When the worker's investment is minor relative to that of the employer, it is indicative that the worker and the employer are not on similar footing, and the worker may be economically dependent upon the employer.

An investment in tools or equipment is not necessarily a business investment or a capital expenditure that indicates a worker is an independent contractor, but may instead represent tools and equipment needed to perform the specific work. The worker's investment must be significant in nature and magnitude relative to the employer's investment in the overall business to indicate the worker is an independent business person.

The interpretation provides several examples from court cases. The Tenth Circuit determined that rig welders' investments in equipped trucks costing $35,000 to $40,000 did not indicate that the rig welders were independent contractors when compared to the employer's investment in its business of hundreds of thousands of dollars of equipment at each worksite.

The Second Circuit compared the cake decorator's $400 tool investment with the employer's business investments, including paying for rent, advertising, operating expenses such as labor in addition to supplies and decorating equipment. The court also compared workers providing their own gloves while the employer provided land, farm equipment, seed, fertilizer, living quarters and strawberry growers' investment in light equipment, including hoes, shovels and carts, to the employer's investment in land and heavy machinery. In these cases, the worker's investment was considered minimal by comparison.

To reach an appropriate determination, the worker's investment, even if substantial, must be compared to the employer's investment. Furthermore, the comparison must not be limited to the employer's investment in the piece of the business related to the particular job performed by the worker, but to the total business of the employer.

Example: A worker providing cleaning services for a cleaning company is issued a Form 1099-MISC each year and signs a contract stating that she is an independent contractor. The company provides insurance, a vehicle to use and all equipment and supplies for the worker. The company invests in advertising and finding clients. The worker occasionally brings her own preferred cleaning supplies to certain jobs. In this scenario, the relative investment of the worker as compared to the employer's investment is indicative of an employment relationship between the worker and the cleaning company. The worker's investment in cleaning supplies does little to further a business beyond that particular job.

A worker providing cleaning services receives referrals and sometimes works for a local cleaning company. The worker invests in a vehicle that is not suitable for personal use and uses it to travel to various work sites. The worker rents her own space to store the vehicle and materials. The worker also advertises and markets her services and hires a helper for larger jobs. She regularly, as opposed to on a job-by-job basis, purchases material and equipment to provide cleaning services and brings her own equipment (vacuum, mop, broom, etc.) and cleaning supplies to each worksite. Her level of investment is similar to the investments of the local cleaning company for whom she sometimes works. These types of investments may be indicative of an independent contractor.

Skill, Judgment, Initiative Requirements

Under this rule, the worker's business skills, judgment and initiative are considered, rather than technical skills, to determine whether the worker is economically independent. Technical skills or even specialized skills do not indicate that workers are independent contractors, particularly if those skills are technical and used to perform the work.

For example, the technical skills of carpenters, construction workers and electricians are not necessarily indicative of independent contractor status because they overlook whether the worker exercises business skills, judgment or initiative. To exemplify independent contractor status, skills should be used in an way that indicates the worker is operating an independent business, rather than being economically dependent upon the employer.

Example: A highly skilled carpenter provides carpentry services for a construction firm; however, such skills are not exercised in an independent manner. The carpenter does not make any independent judgments at the job site beyond the work that she is doing for that job; she does not determine the sequence of work, order additional materials, or think about bidding the next job, but rather is told what work to perform where. In this scenario, the carpenter, although highly-skilled technically, is not demonstrating the skills and initiative of an independent contractor, such as managerial and business skills. She is simply providing her skilled labor.

In contrast, a highly skilled carpenter who provides a specialized service for a variety of area construction companies, for example, custom, handcrafted cabinets that are made-to-order, may be demonstrating the skill, judgment and initiative of an independent contractor, if the carpenter markets her services, determines when to order materials and the quantity and quality of materials to order and which orders to fill.

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Relationship Permanency

Permanency or indefiniteness of the relationship between a worker and an employer suggests the worker is an employee. Generally, a worker who truly is in business would want to retain economic independence rather than have a permanent relationship with a single employer.

Even if a working relationship lasts just weeks or months instead of years, there often is some permanence or indefiniteness to the relationship as compared with the independent contractor who typically works on one project for an employer and generally does not work continuously or repeatedly for an employer.

However, a lack of permanence or indefiniteness does not automatically suggest an independent contractor relationship. The reason for that lack should be carefully reviewed to determine whether it is indicative of the worker's running an independent business. The worker is not transformed into an independent contractor simply by working for other employers or not placing reliance on the employer as the primary source of income.

The key is whether the lack of permanence or indefiniteness stems from the worker's initiative or from the operational characteristics intrinsic to the industry, as might be the case when employers hire part-time workers or use staffing agencies.

For example, nurses working for a staffing agency who had a degree of flexibility not shared by many others in the workforce, had an enhanced ability to moonlight by working for more than one staffing agency at a time and had some flexibility in choosing when and where to make themselves available for work, were still employees of the agency when working on assignment for the agency. The court concluded that the fact that the nurses were a transient workforce reflected the nature of their profession, rather than their success in marketing their skills independently.

Example: An editor has worked for an established publishing house for several years. His edits are completed in accordance with the publishing house's specifications, using its software. He only edits books provided by the publishing house. This scenario indicates a permanence to the relationship between the editor and the publishing house that is indicative of an employment relationship.

Another editor has worked intermittently with fifteen different publishing houses over the past several years. He markets his services to numerous publishing houses. He negotiates rates for each editing job and turns down work for any reason, including because he is too busy with other editing jobs. This lack of permanence with one publishing house is indicative of an independent contractor relationship.

Degree of Employer's Control

The employer's control should be analyzed in light of the ultimate determination whether the worker is economically dependent on the employer or truly an independent businessperson. The worker must control meaningful aspects of the work performed, such that it is possible to view the worker as a person conducting his or her own business. Control is only significant when it shows an individual has such control over a meaningful part of the business that the worker stands as a separate economic entity. The worker must actually exercise the control.

The employer's lack of control over workers is not particularly informative when the workers work from home or off-site. For example, workers who work from home typically can control the hours during which they work and are subject to little direct supervision, so those facts are relatively insignificant in determining worker status.

Administrator's Interpretation 2015-1 notes that technological advances and enhanced monitoring mechanisms may encourage companies to engage workers as nonemployees, but still maintain stringent control over aspects of the workers' jobs, such as their schedules, the way that they dress and the tasks that they carry out.

Some employers claim that the control that they exercise over workers is because of the nature of their business, regulatory requirements, or the desire to ensure that their customers are satisfied. However, control exercised over a worker, even for any or all of those reasons, still indicates that the worker is an employee. When the nature of a business requires a company to exert significant control over workers then the workers may be employees rather than independent contractors.

The control factor should not play an oversized role in the analysis of whether a worker is an employee or an independent contractor. All possibly relevant factors should be considered cases must not be evaluated based on the control factor alone. The FLSA covers workers of an employer even if the employer does not exercise the requisite control over the workers, assuming the workers are economically dependent on the employer. The control factor should be analyzed conjunction with the other factors in the context of ultimately determining whether the worker is economically dependent on the employer or an independent business.

Example: A registered nurse who provides skilled nursing care in nursing homes is listed with Beta Nurse Registry to be matched with clients. The registry interviewed the nurse before she joined and required the nurse to undergo a multi-day training presented by Beta.

The business sent the nurse a listing each week with potential clients and required the nurse to fill out a form with Beta before contacting any clients. Beta also required that the nurse adhere to a certain wage range and prohibited her from providing care during weekend hours. The nurse had to inform Beta if she was hired by a client and contact Beta if she were to miss scheduled work with any client. In this scenario, the degree of control exercised by the registry is indicative of an employment relationship.

Another registered nurse who provided skilled nursing care in nursing homes was listed with Jones Nurse Registry to be matched with clients. The registry sent the nurse a listing each week with potential clients. The nurse was free to call as many or as few potential clients as she wished and to work for as many or as few as she wished. The nurse also negotiated her own wage rate and schedule with the client. In this scenario, the degree of control exercised by the registry was not indicative of an employment relationship.

A recent case illustrates the application of the economic dependence rules under California labor law. Uber Technologies Inc. is a $50 billion company that matches riders with drivers through the use of electronic mobile devices. In June, the California Labor Commission determined that an Uber driver was an employee and entitled to expense reimbursement under California labor law. (See related story, Page 13)

Uber claimed that the company exercised little control over drivers, which was the reason it treated them as independent contractors. The commission was not persuaded by the claim that the work required relatively little skill.

The commission also said the drivers were an integral part of Uber's business and the company exercised the requisite control over the operation as a whole; by obtaining customers in need of the service and providing drivers to provide the service. The service of the drivers was integral to Uber's business, the commission said, because Uber would not have a business without the drivers.

The requirement that the drivers invest in a suitable vehicle did not represent a significant investment when compared to the investment in technology and other resources made by Uber, the commission said. Technology was essential to the operation of the business and was not otherwise available to the drivers, so they could not operate independently of Uber, it said.

Uber also exercised control through mandatory ratings of drivers and riders, standards as to the type and condition of the driver's vehicle, security and safety controls for drivers and riders, the determination of compensation rates and whether the driver received cancellation or no-show fees when riders did not show for rides. On that basis, the driver did not have any managerial control over profit or loss, the commission said.

The relationship was permanent or indefinite in nature, the commission said in ruling that the driver was an employee under California law.

By Patrick Haggerty

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