

Worker Misclassification and Unemployment Insurance

An Update From Constitution Ave

NAUIAP Conference
June 2015

Topics

- Introduction
- Definition of an Employee
- Worker Misclassification Issues
- Overview of Actions to Prevent/Detect Worker Misclassification

Introduction

- Worker misclassification occurs when an employer incorrectly classifies an employee as a non-employee (e.g., as an independent contractor)
- When the Social Security Act was enacted in 1935 it did not include an express definition of “employee”
- Estimates based on numerous state studies suggest that between 10 – 20 percent of employers misclassify at least one worker - Economic Policy Institute – Briefing Paper #403, June 8 2015

Significant Cases; Congressional Resolution

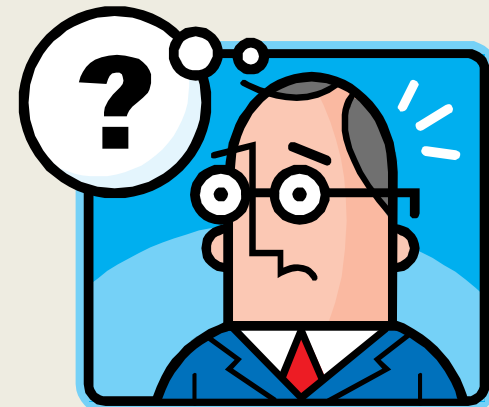
- United States v. Silk
- Bartels v Birmingham
- Gearhart Resolution passed by Congress

Defining an Employee

How Do Agencies/Employers Determine Who is an Employee?

- “Employee” is defined in section 3306(i) FUTA by reference to section 3121(d) of the Internal Revenue Code
- IRS → Common Law
 - 20 Factor Test
 - 3 Test Categories:
 - Behavioral Control
 - Financial Control
 - Type of Relationship

IRS Form SS-8



Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

Name of firm (or person) for whom the worker performed services

Worker's name

Part I General Information

- 1 This form is being completed by: Firm Worker; for services performed _____ to _____.
(beginning date) (ending date)
- 2 Explain your reason(s) for filing this form (for example, you received a bill from the IRS, you believe you erroneously received a Form 1099 or Form W-2, you are unable to get worker's compensation benefits, or you were audited or are being audited by the IRS). _____

- 3 Total number of workers who performed or are performing the same or similar services: _____.
- 4 How did the worker obtain the job? Application Bid Employment Agency Other (specify) _____
- 5 **Attach copies of all supporting documentation (for example, contracts, invoices, memos, Forms W-2 or Forms 1099-MISC issued or received, IRS closing agreements or IRS rulings).** In addition, please inform us of any current or past litigation concerning the worker's status. If no income reporting forms (Form 1099-MISC or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue \$ _____.
If both Form W-2 and Form 1099-MISC were issued or received, explain why. _____

- 6 Describe the firm's business. _____

Part II Behavioral Control (Provide names and titles of specific individuals, if applicable.)

1 What specific training and/or instruction is the worker given by the firm?

2 How does the worker receive work assignments?

3 Who determines the methods by which the assignments are performed?

4 Who is the worker required to contact if problems or complaints arise and who is responsible for their resolution?

5 What types of reports are required from the worker? Attach examples.

6 Describe the worker's daily routine such as his or her schedule or hours.

7 At what location(s) does the worker perform services (for example, firm's premises, own shop or office, home, customer's location)? Indicate the appropriate percentage of time the worker spends in each location, if more than one.

8 Describe any meetings the worker is required to attend and any penalties for not attending (for example, sales meetings, monthly meetings, staff meetings).

9 Is the worker required to provide the services personally? Yes No

10 If substitutes or helpers are needed, who hires them?

11 If the worker hires the substitutes or helpers, is approval required? Yes No

12 If "y

13 Is th
if "y

- Behavioral Control - whether the business has a right to direct and control how the worker does the task for which the worker is hired
 - Instructions that the business gives to the worker
 - Training that the business gives to the worker

Part III Financial Control (Provide names and titles of specific individuals, if applicable.)

1 List the supplies, equipment, materials, and property provided by each party:

The firm:

The worker:

Other party:

2 Does the worker lease equipment, space, or a facility? Yes No

If "Yes," what are the terms of the lease? (Attach a copy or explanatory statement.)

3 What expenses are incurred by the worker in the performance of services for the firm?

4 Specify which, if any, expenses are reimbursed by:

The firm:

Other party:

5 Type of pay the worker receives:

Lump Sum

If type of pay is:

6 Is the worker a business owner?

If "Yes," how is the worker paid?

Specify any relevant details:

7 Whom does the worker report to?

If worker, does the worker:

8 Does the firm own the equipment, materials, or property used by the worker?

9 What economic risk does the worker bear?

(Specify any relevant details.)

10 Does the worker have the right to control the business aspects of the worker's job?

If "No," who does?

- Financial Control - Does the business have the right to control the business aspects of the worker's job?
 - Does the worker risk profit/loss?
 - Unreimbursed business expenses
 - Is the worker free to market his/her services?
 - How is the worker paid?

Part IV Relationship of the Worker and Firm

1 Please check the benefits available to the worker: Paid vacations Sick pay Paid holidays
 Personal days Pensions Insurance benefits Bonuses
 Other (specify) _____

2 Can the relationship be terminated by either party without incurring liability or penalty? Yes No
If "No," explain your answer. _____

3 Did the worker perform similar services for others during the time period entered in Part I, line 1? Yes No
If "Yes," is the worker required to get approval from the firm? Yes No

4 Describe any agreements prohibiting competition between the worker and the firm while the worker is performing services or during any later period. Attach any available documentation. _____

5 Is the worker a member of a union? Yes No

6 What type of advertising, if any, does the worker do (for example, a business listing in a directory or business cards)? Provide copies, if applicable. _____

7 If the worker assembles, manufactures, or repairs goods, does the worker have any special skills or training? _____

8 What does the worker do? _____

9 How does the firm represent the worker? Does the firm use the worker's business name? _____

10 If the worker no longer works for the firm, when did the contract end, firm name? _____

- Type of relationship - Do the facts support a worker/employer relationship?
 - Are there written contracts?
 - Does the worker have employee-type benefits?
 - Is the relationship time-bound?
 - Does the work perform similar services for others?

Internal Revenue Service (IRS)

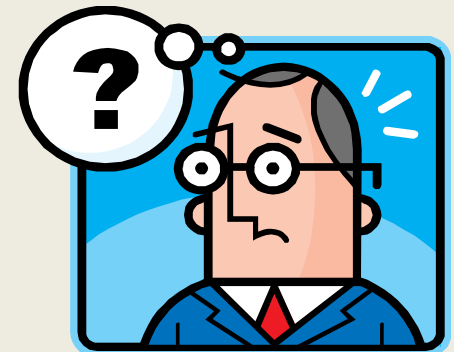
Section 530 (Safe Harbor)

- When an employer erroneously classifies employees or a group of employees as independent contractors, the employer will generally be held harmless for past **and future** Federal employment tax obligations if s/he relied on:
 - Past rulings or judicial precedent
 - Industry practice
 - Past IRS audit practice
 - Any other “reasonable” basis
- Rule applies to IRS & FUTA; it is not binding on states for UI.
- In general, filing of timely IRS Form 1099(s) is one precondition for section 530 safe harbor to apply.

State UI Agency Determinations

States use:

- ABC Test: In general, the worker is:
 - A: Free from direction and control
 - B: Performing service(s) that is outside the usual course of the business
 - C: Customarily engaged in an independent trade, occupation, profession or business.
- Variations of the ABC test
- Common law rules
- Other unique rules



MANUAL OF
STATE EMPLOYMENT SECURITY
LEGISLATION

Revised September 1950

(5) Service performed by an individual shall be deemed to be employment subject to this Act irrespective of whether the common-law relationship of master and servant exists, unless and until it is shown to the satisfaction of the commissioner that--

(A) such individual has been and will continue to be free from control and direction in connection with the performance of such service, both under his contract for the performance of service and in fact; and

(B) such service is performed either outside the usual course of the business for which the service is performed or is performed outside of all the places of business of the enterprise for which the service is performed; and

Section 2(k)(5)(C)

(C) such individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.

Worker Misclassification Issues

Worker Misclassification Issues

- Adverse effects on worker and ability to receive:
 - Unemployment Insurance
 - Workers' Compensation
 - Health Insurance Coverage
 - Retirement Coverage
 - Protection under the Fair Labor Standards Act
- Reduced tax revenues
 - UI taxes underpaid
 - Other employment taxes underpaid
- Unfair competition among employer population

Causes of Worker Misclassification

- Differences in Federal and State laws
- Competition – Locally, Regionally, Nationally & Globally
- Limited regulatory oversight
- Regulatory and taxation reporting
- Costs above labor rates
 - Employment taxes (FICA & UI)
 - Withholding taxes (Federal/State/Local)
 - Health Care
 - Workers' Compensation
- New types of jobs and employment relationships

Overview of Employee Misclassification Prevention Efforts

Ongoing Initiatives

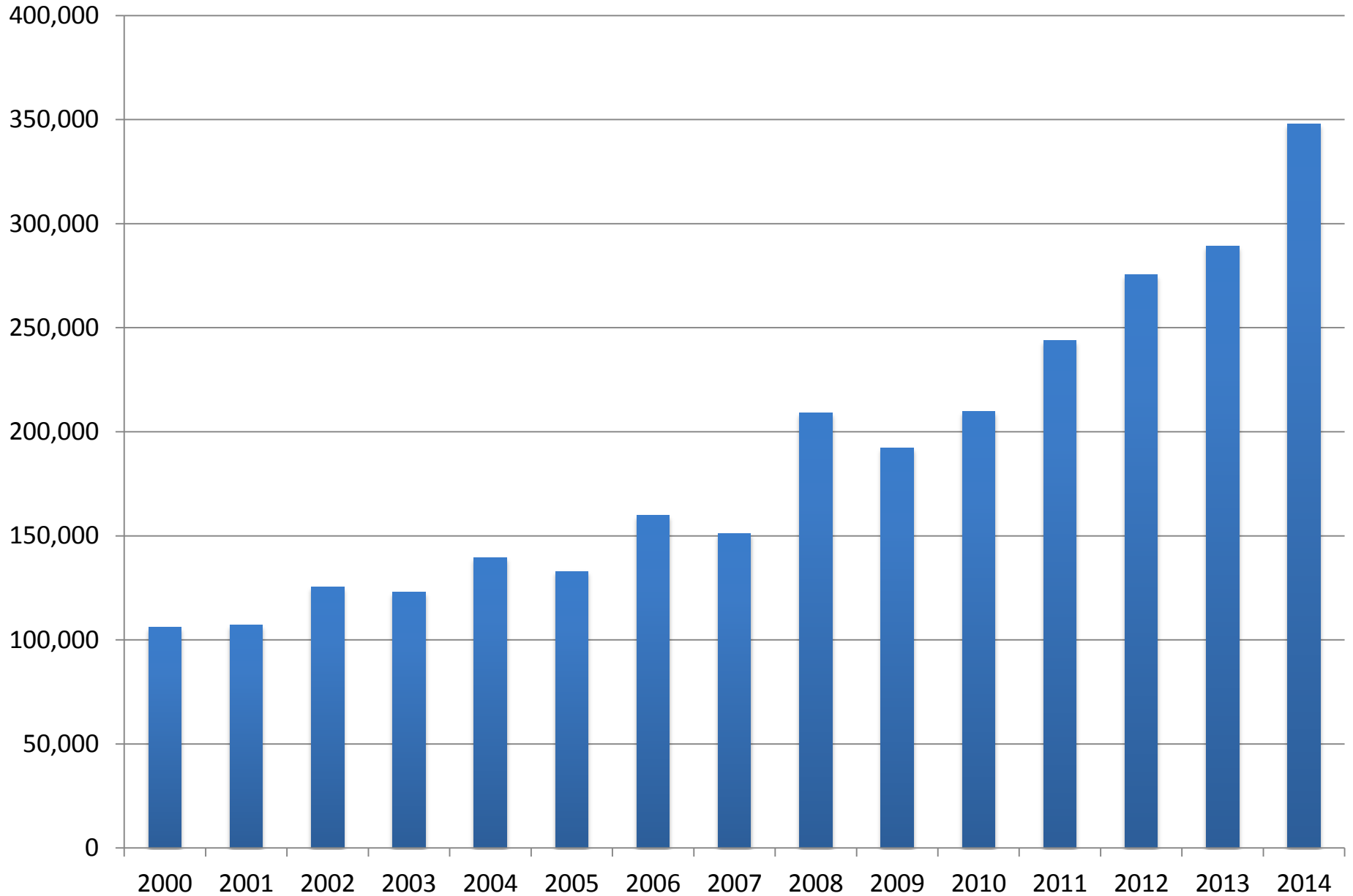
- ETA - Effective Audit Measure
- Data Sharing
 - Questionable Employment Tax Practices (QETP) – 42 state MOUs
 - Governmental Liaison Data Exchange Program - 1099 MISC Extract
 - Information Return Analysis System (IRAS) for State Agencies (pilot testing with 3 states)
- ETA Funding Opportunities
 - Data Sharing
 - Education/Outreach
 - Automation
 - State Task Forces



Effective Audit Measure

- Unemployment Insurance Program Letter (UIPL) No. 30-10 and UIPL No. 30-11.
- Reporting Began on March 31, 2011
- Significant changes:
 - Reduces required percentage of contributory employer audits from 2% to 1%, annually
 - Four Audit Factors combine for Pass / Fail
 - Percent of contributory employers audited
 - Percentage of total wage change from audit
 - Percentage of wages audited
 - Average number of misclassifications detected per audit

Total # of Misclassified Employees Discovered



Data Sharing Efforts

- Questionable Employer Tax Practices (QETP)
- Governmental Liaison Data Exchange Program (GLDEP)
 - IRS 1099-MISC Extract
- Information Return Analysis System (IRAS)
 - Three states are testing

Annual IRS 1099-MISC Extract

- An extract of Federal tax data that makes up the Governmental Liaison Data Exchange Program (GLDEP).
- Criteria for participation in the GLDEP:
 - Must have a Basic Agreement to exchange data with IRS
 - Must satisfy requirements of IRC §6103(d); must be responsible for tax administration and demonstrate a need and use for the data
 - Must have an approved Safeguard Procedures Report on file with IRS
 - Must complete an Annual GLDEP Enrollment Agreement
- States may use the data in their audit selection process to discover potential unreported wages reported as non-employee compensation.

FY 2014 Funding for State UI Agencies

\$10 million was made available to states

- \$8 million in competitive grants were awarded to 19 states to increase their capacity for detecting misclassification and enforcing their state UI laws and policies
- \$2 million was awarded to 4 states as high performance awards

Funding Opportunity in FY 2015

- \$10 Million is available to states to:
 - Improve systems that will enable enhanced data sharing with Federal and state agencies.
 - Implement targeted audit strategies to focus on industries that may be more likely to have misclassified workers;
 - Establish a statewide task forces to address misclassification ; and
 - Develop education and outreach programs for employers and workers to help prevent misclassification; and
 - Develop other innovative approaches designed to prevent and detect misclassified workers.

Questions?

