

Audits – Are you ready?

Jeffrey Ment, Esq.
Silver Golub & Teitell
jment@sgtlaw.com

What's the big deal?

- According to a 2012 list of state audits compiled by the National Employment Law Project, by extrapolating from audit data of misclassified workers to account for employers in the entire state there were an estimated 368,685 misclassified workers in Illinois, between 125,725 and 248,206 in Massachusetts, 704,785 in New York, between 54,000 and 459,000 in Ohio, 580,000 in Pennsylvania, and 214,000 in Virginia.
- The DOL commissioned a study in 2000 to determine the extent of misclassification in the unemployment insurance system. The study found that up to 30 percent of audited firms had employees misclassified as independent contractors.
- Misclassification occurs in nearly all major industries, including in the delivery, trucking, building maintenance, janitorial, agricultural, home health care, and childcare industries. Misclassification rates are especially high in construction. In 2007, the Fiscal Policy Institute released a study on misclassified construction workers in New York City, estimating that 50,000 (one in four) workers were misclassified as independent contractors or employed by construction companies completely off the books.

Lost Revenue – what it's about.

- Using an IRS estimate from 1984, the U.S. Government Accountability Office estimated that employer misclassification cost the federal government \$2.72 billion in 2006. Nearly 60 percent of lost revenue was attributable to misclassified individuals failing to pay income taxes. The remaining losses stemmed from the failure of employers and misclassified workers to pay taxes for Social Security and Medicare and the failure of employers to pay federal unemployment taxes.
- A 2000 study commissioned by the DOL found nearly \$200 million in lost UI tax revenue per year through the 1990s due to misclassification. The study also found that misclassifying employees as independent contractors resulted in lost UI benefits for roughly 80,000 workers annually

The Government fights back!

- The DOL launched the “Misclassification Initiative” in 2010 as part of Vice President Biden’s Middle Class Task Force. This initiative seeks to combat misclassification and FLSA violations through the DOL’s Wage and Hour Division.
- While the IRS is responsible for auditing employers, the DOL, under the Obama Administration, has taken steps to increase employer accountability. In September 2011, former Secretary of Labor Hilda Solis announced the signing of a Memorandum of Understanding (MOU) between the DOL and IRS. Under the agreement, the agencies will work together and share information to reduce the misclassification of employees, to reduce the tax gap, and to improve compliance with federal labor laws.
- In September of 2014, Labor Secretary Thomas Perez announced that the U.S. Department of Labor awarded \$10.2 million in grants to 19 states to assist in their efforts to combat employee misclassification.
- President Obama’s 2017 budget request included \$10 million in funding to revive a DOL grant program to help states combat worker misclassification. This program was first introduced in 2014 but was cut in 2016 in the face of industry opposition.

EDD Audit

The Employment Development Department (EDD) has the right to conduct audits to determine employee/independent contractor relationship.

Once notified, you must cooperate. EDD will ask for the following types of documents:

Documents

- Forms 1099
- Forms 1065
- P/L Statement
- Trial Balance Report
- List of Independent Contractors
- Check register
- Contracts, Agreements, Proposals
- Tour Documents (advertising)
- Payroll Records
- Description of I/C

What happens next...

Letters and phone calls are made by the EDD to your I/C requesting cooperation.

Telephone interviews are conducted with your I/C.

Decide level of company cooperation

The Audit

The process is slow and you have little control over it.

I/C opinions – do they matter? What can happen if an I/C turns into an Employee?

- Wage and Hour law issues

- Workers' compensation concerns

- Tax consequences (State, Fed. and SS)

- More likely to face discrimination claims

Common Law Test Factors

1. Control the manner and means of accomplishing a desired result;
2. Is the person engaged in a separately established occupation or business;
3. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of a principal without supervision;

Common Law Factors

4. What skill is required;
5. Does the principal or the person providing the services supply the instrumentalities, tools, and place of work for the person doing the work;
6. Length of time of the assignment (i.e. isolated or continuous);
7. Method of payment (time, piece, job);

More Common Law Factors

8. Is the work part of the regular business of the Principal;
9. What do the parties believe;
10. Extent of actual control by Principal over manner and means of performing services; and
11. Whether the Principal is or is not engaged in a business enterprise.

EDD finds against Employer

- Operator set itinerary and means of transportation were provided by Operator;
- No modifications without Operator approval;
- Operator set cost of trip and any “perks” offered to parents;
- Educational and promotional materials provided at no cost;
- Insurance provided at no cost to person

Why not an I/C

- Operator determined ratio of chaperones to students;
- Operator provided escorts/guides;
- Time of services dictated by Operator;
- Operator collects money;
- I/C only worked for one Operator;
- Right to quit/discharge without notice;
- **Services were an integral part of the employer's business operation and continuous in nature.**

Now what?

- Pay the fine.
 - Pay the fine and take an Appeal.
 - Take an Appeal.
-
- Appeals: slow and steady. Penalties continue to accrue. First level review at EDD and then a trial to an Administrative Law Judge. After that, appeal to the Superior Court.

Another California Decision finding Employee not I/C

- The principal furnished a manual for the tour guides to establish procedures or rules for dealing with various situations when performing services on a tour.
- The tour guides had very little investment in time and money and no investment in the principal's business.
- The principal reserved the right to reassign the tour guides if there were unsatisfactory evaluations.
- The tour guides/directors did not operate their own business. The work performed was a direct and essential part of the principal's business.

A different result – I/C Affirmed

- The tour directors exhibited the special skill of fluency in a foreign language and maintained their own library of specialized books on the regions in which they provided tour services.
- The tour directors had essentially no supervision and could modify the tour or travel arrangements without prior approval from the principal.
- The tour directors were free to provide services for others without informing the principal.
- The tour directors arranged for their own substitutes, if they were unable to complete their tour.

CA Courts

“most important factor is the right to control the manner and means of accomplishing the result desired. If the employer has the authority to exercise complete control, whether or not that right is exercised with respect to all details, an employer-employee relationship exists. Strong evidence in support of an employment relationship is the right to discharge at will, without cause.”

How does the Court distinguish?

“An ‘independent contractor’ ” is generally defined as a person who is employed by another person to perform work; who pursues an ‘independent employment or occupation’ in performing it; and who performs the employer’s desires only as to the results of the work, and not as to the means whereby it is to be accomplished. “If control may be exercised only as to the results of the work and not the means by which it is accomplished, an independent contractor relationship is established.” (Millsap v. Federal Express Corp. (1991) 227 Cal.App.3d 425, 431.)

Section 621, subdivision (b) of the Unemployment Insurance Code defines an employee as: “Any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of employee.” An independent contractor does not come within the scope of this provision.

From West Coast to East Coast

The Massachusetts Attorney General enforces the Massachusetts Independent Contractor Law. In December 2004 the Attorney General issued an “advisory” which declared that the MICL, as amended, “excludes far more workers from independent contractor status than are disqualified under the IRS common law test.” The Attorney General noted that, while the twenty factors considered by the IRS are considered flexible and can be adjusted to the circumstances of the work arrangement, **Massachusetts law establishes a rigid, three-part test that must be met to overcome the law’s presumption of an employment relationship**

Massachusetts Test

- The individual must be free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact;
- The service must be performed outside the usual course of the business of the employer; and
- The individual must be customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.

What about New York?

- While the tour operator may specify the point of departure and destination, the tour guide may select or alter the itinerary without prior approval of the tour operator.
- The tour guide sets or negotiates the rate of pay received from the tour operator.
- The tour guide is not required to maintain a log or submit reports.
- The tour guide is not restricted from setting up a private unscheduled side excursion/tour/event with customers without prior approval of the tour operator. The tour guide handles arrangements and collection of money for side trips.
- The tour guide is free to accept or reject an assignment.
- The tour guide is free to accept assignments from other tour operators.
- The tour guide provides maps, videos, journals, and periodicals.
- The tour operator may require a neat appearance but does not dictate attire.
- The tour guide has private business cards and is not restricted from distributing them to the tour operator's clients.

Employee in New York

- The tour guide is prohibited from accepting assignments from other tour operators.
- The tour guide is paid at a rate established by the tour operator.
- The tour guide must accept an assignment from the tour operator.
- The tour guide is required to follow a point-to-point itinerary established by the tour operator, or must obtain approval for any variation from an established itinerary.
- The tour guide is provided with sick leave, vacation, and health insurance.
- The tour guide is required to submit written logs, reports, or check in at regularly established intervals.
- The tour guide is required to wear a uniform or other standardized attire.
- The tour guide is prohibited from forming private side excursions/tours/events without approval of the tour guide operator.
- The tour operator provides maps, videos, journals, or periodicals.

Ideas?

- Have a written Agreement that states some of the following:
 - Worker is responsible for his/her own taxes;
 - No benefits;
 - Care about results – no say in the method, manner or means of performance;
 - Invoices on workers' letterhead;
 - Worker has a business card;
 - Worker can work on projects for others;
 - Term is fixed and not open-ended.

Real Outcomes – Be Careful!

- In April 2016, Uber decided to settle a class action lawsuit for brought against it by drivers in California and Massachusetts for \$100 million. Because the case did not go to trial, the independent contractor dispute question has not yet been resolved.
- In April 2015, DOL announced that it recovered \$700,000 in back wages, damages, and penalties for over 1,000 misclassified construction industry workers in Utah and Arizona.
- In September 2014, a Sacramento Superior Court in California ruled that The Sacramento Bee misclassified over 5,100 newspaper carriers as independent contractors.
- In May 2013, the DOL helped 196 employees at a Kentucky based cable installer recover over \$1 million in retroactive overtime pay and other benefits.
- In 2012 and 2013, after having hired 300 additional investigators, the DOL collected more than \$18.2 million in back wages on behalf of 19,000 employees who had been misclassified



SYTA SUMMIT

JANUARY 17-21, 2018
SAN JOSE, COSTA RICA

#SYTASummit

Teach&Travel
The Official Publication of SYTA

 **SYTA**
The Voice of Student & Youth Travel®

 **syta youth foundation**
Travel Changes Young Lives for Good