Employee/Independent Contractor Worker Classification

August 6, 2015
Increased federal agency compliance requirements:

- Department of Labor “Misclassification Initiative” – combat employee misclassification and restore rights denied to workers
- Various agencies/divisions involved – DOL Wage and Hour Division, Employee Benefits Security Administration (EBSA), Occupational Safety and Health Administration (OSHA), Office of the Solicitor
- Labor commissioners from 14 states (so far) are participating through MOU’s with DOL
- Employee entitlements – retirement and medical benefits, family and medical leave, overtime, minimum wage, unemployment insurance, workers compensation
- Fair Labor Standards Act (FLSA) – defines requirements for minimum wage, overtime, employer time and pay record keeping; new guidance issued July 2015 aims to classify most workers as employees
- Affordable Care Act – required essential health care coverage for eligible employees
Background – External, cont’d

- **Increased IRS activity:**
  - Recent court cases involving worker classification
  - Increased audits of colleges and universities
  - IRS Voluntary Compliance Program
  - Development of factors to assist in worker classification determination

- **New DOL guidance:**
  - Most workers would be employees under the FLSA’s broad definitions, per Administrator’s Interpretation issued July 15, 2015
  - DOL is responding to numerous complaints from workers alleging misclassification
Background – Penn

- **Procurement and payment for independent contractor services:**
  - “P2P” initiative to convert I/C’s from PDA forms to Purchase Orders
  - Development of “template” contract for I/C’s
  - Payment and tax reporting for travel and business expenses of I/C’s

- **Existing University policies and procedures:**
  - Policy 2319 – Payments to Individuals for Honoraria, Consulting Fees, Human Subject Fees and Other Services
  - Form C-12 – Independent Contractor Determination and Certification
  - H/R, Payroll and Tax policies related to employees
Challenges

- **Determination and classification as employee vs. independent contractor:**
  - Not a single criterion – numerous factors guide determination
  - Factors relevant in one situation may not be relevant in another
  - Requires input from service provider and Penn employer/purchaser
  - No hard and fast formula – requires judgement

- **Timing:**
  - Should be done **prior** to engaging/employing services
  - Current process allows determination to be done at time of payment

- **Current Policy and guidance**
  - No standard contract tailored to independent contractors
  - Various ways to engage and pay I/C’s
IRS Determination Factors

- IRS list of 20 “Common Law” factors

- Organized into 3 major categories of evidence:
  - **Behavioral Control**
    - Who controls how the work is done
  - **Financial Control**
    - Who controls the business aspects of the worker’s assignment
      - Payment for service
      - Reimbursement of expenses
      - Investment in tools, equipment
      - Worker’s service availability to the marketplace
      - Worker’s profit and loss
  - **Relationship of Parties**
    - Worker’s and employer’s/purchaser’s type of relationship
      - Type of contract
      - Entitlement to benefits
      - Permanency of the relationship and termination
      - Services part of employer’s/purchaser’s regular ongoing business activities
Behavioral Control Test

- Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired.

<table>
<thead>
<tr>
<th>BEHAVIORAL CONTROLS</th>
<th>EMPLOYEE</th>
<th>INDEPENDENT CONTRACTOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instructions</td>
<td>An employer has the right to give an employee instructions regarding how, when and where the work is performed</td>
<td>The client has a right to the parameters of the deliverables; not the details of how, when and where the work is performed</td>
</tr>
<tr>
<td>Training</td>
<td>Employees are often trained to do their jobs</td>
<td>Independent Contractors are hired for their expertise and should receive no internal training</td>
</tr>
</tbody>
</table>
Financial Control Test

- Economic aspects of the relationship between the parties are frequently analyzed in determining worker status.

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<tbody>
<tr>
<td>Significant Investment</td>
<td>Employers provide the tools and equipment necessary for their employees</td>
<td>Independent Contractors provide their own tools and equipment</td>
</tr>
<tr>
<td>Unreimbursed Expenses</td>
<td>Employees are reimbursed for any out-of-pocket business expenses they might incur</td>
<td>Independent Contractors pay their own business expenses</td>
</tr>
<tr>
<td>Marketing</td>
<td>Employees do not market their services to public</td>
<td>Independent Contractors market their services to the public</td>
</tr>
<tr>
<td>Method of Payment</td>
<td>Employees are paid based upon the passage of time – guaranteed return for his/her labor</td>
<td>Independent Contractors are generally to be paid upon the completion of specific deliverables</td>
</tr>
<tr>
<td>Opportunity for Profit/Loss</td>
<td>Employees generally have no opportunity for suffering a loss</td>
<td>Make business decisions which allow them to not only make a profit but also have the opportunity to suffer a loss</td>
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### Relationship of Parties

- **Facts that show the parties’ type of relationship reflecting both parties intent**

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<td><strong>Intent of Parties</strong></td>
<td>Expressed via employment contract; extent of direction and control the employer requires over the employee</td>
<td>Expressed in a contract between the two parties; Independent Contractor expresses his/her intent by fulfilling local and state requirements for business (i.e. securing business license etc.)</td>
</tr>
<tr>
<td><strong>Employee Benefits</strong></td>
<td>Employees are entitled to benefits such as vacation or sick time, health care benefits and ability to attend company sponsored events</td>
<td>Independent Contractor provides their own benefits</td>
</tr>
<tr>
<td><strong>Termination</strong></td>
<td>Within the confines of legal or contractual requirements employees can be discharged at will by the employer</td>
<td>Contracts can only be terminated according to the specifications of the contract. Non-performance on the part of the contractor or client can lead to legal recourse</td>
</tr>
<tr>
<td><strong>Permanency of Relationship</strong></td>
<td>Employer engages for indefinite period of time</td>
<td>Specific services are for limited period of time</td>
</tr>
<tr>
<td><strong>Regular Business Activity</strong></td>
<td>Employees perform services which are key aspects of employer’s regular business activities</td>
<td>Independent Contractors perform services which do not affect client’s bottom line. (limited exceptions)</td>
</tr>
</tbody>
</table>
DOL Economic Realities Factors

- Goal is to determine whether a worker is economically dependent on the employer or is really in business for him/herself

- Six factors to consider
  - Whether the work is an integral part of the employer’s business
    - The DOL considers this factor “compelling”
  - Whether a worker’s managerial skill affects the opportunity for profit or loss
    - Examples of managerial skill:
      - The decision to hire others
      - Purchasing materials and equipment
      - Advertising
      - Renting space
      - Managing time tables
DOL Economic Realities Factors

- **Whether the work performed requires special skill and initiative**
  - The DOL looks only at workers exhibiting business skills, business judgment and business initiative as favorable to a determination of independent contractor status

- **Comparing the relative investment of a worker and employer**
  - The worker’s investment must be significant in nature and magnitude relative to the employer’s investment in its overall business to indicate that the worker is an independent businessperson
  - Investing in tools and equipment is not necessarily a business investment that indicates that a worker is an independent contractor

- **Whether a working relationship is permanent or indefinite**
  - Permanency or indefiniteness suggests the worker is an employee

- **The nature and degree of the employer’s control**
  - The worker must control meaningful aspects of the work performed – must conduct his or her own business
A full-time engineer worked as an adjunct faculty member for two universities:

• He was paid on a course-by-course basis over several years
• He taught on campus but otherwise worked from home communicating with students on email
• He maintained a website devoted to his teaching activities
• The universities treated him as an employee but he challenged his status in Tax Court
The Tax Court concluded the faculty member was an employee of both universities:

- Services as an adjunct professor were part of the regular business of the universities
- He bore no risk of loss from under enrollment
- He had worked for both universities continuously for several years
- His contracts treated him as an employee

*Beitel v. Commissioner, T.C. Summary Opinion (2001)*
A university hired a physician to provide medical care to students:

• The physician had her own private practice
• She worked on-call for the university clinic
• The physician received an hourly wage but no benefits
• There was no written contract between the physician and the university, which treated her as an employee
ANSWER

Example 2: Physician

The IRS ruled the physician was an employee:

• The physician’s services were integral to the clinic’s functions
• The services were preformed on the university’s premises and subject to clinic protocols
• There was a continuing relationship even though the physician worked on-call
• The university had treated the physician as an employee

PLR 9326015
A firm hired a law student to provide part-time legal research and litigation support:

- The student set his own hours and decided where to work – the firm, school, at home
- He was paid by the hour and received no benefits except for parking reimbursements
- The firm reviewed his work and signed all court filings he drafted
- The student did not have a contract with the firm
Example 3: Law Student

The IRS ruled that the student was an employee:

- His services were integral to the firm
- The student had no capital investment in an independent business or risk of loss
- The firm supplied the student with a computer and other office resources
- The firm had the right to direct and control the work
- There was no contract establishing the student’s status
- The firm reimbursed the student’s parking expenses
Open Issues

- **Advisory Group**
  - Final Adjustments to forms and policy language

- **Human Resources**
  - Develop training for HR representatives/business administrators in departments, schools and centers
  - New employee type - “Professional Service Provider”
  - Contract Terms with Personnel Employment Organizations
    - Address Co-employment

- **Purchasing**
  - Submit contract templates to OGC for review
  - Determine alternative for processing NRA Independent Contractors through Purchasing when withholding is necessary

- **IT/ISC**
  - Develop electronic Work Flow
Goals / Next Steps

- Begin Pilot program to review draft policy, procedures and forms
  - PSOM, SAS and Wharton

- Incorporate feedback from Pilot Program into policies, procedures and templates as appropriate

- Develop Communication and Training Plan to University Community
  - Identify resource for Communications

- Present final policy, procedures, templates, communication and training plan to Senior Sponsors

- Execute Communication and Training to University Community for January 1, 2016 implementation