

## BOOK REVIEW

# Why Every Lawyer Needs the New Edition of Employee vs. Independent Contractor Guidebook

## Review of *Legal Guide to Independent Contractor Status* (5th ed. 2010) by Robert W. Wood

By Jonathan R. Flora\*

A perennial problem for employers (and their advisors) is classifying workers. Every worker must be slotted into one of two fixed categories: employee or independent contractor. And let's face it—there's a lot of incentive for an employer to prefer the fruits of independent contractor status: no income tax withholding, no payroll or employment tax obligations, no worker's compensation—the list goes on and on. The trouble is, the stakes of misclassification are significant. They run the gamut from liability for failure to withhold income taxes and pay employment taxes to potential exposure on pension and employee benefit plans and employment claims.

Given the stakes and the frequency with which this issue arises, one might expect there would be a clear set of guideposts used for classifying a worker. Yet sadly, the opposite is the case. For example, a traditional and longstanding method used to classify a worker is the Service's so-called 20 factor test. This test is perhaps one of the least helpful the Service has provided—not one of the 20 factors is determinative, and to make planning more difficult, each factor is given different weight depending on the facts and circumstances.

It is against this backdrop that the *Legal Guide to Independent Contractor Status* by Robert W. Wood (5th ed. 2010) (the "Legal Guide") sits as an essential treatise for practitioners facing worker classification issues. Guidance is crucial in this area. Mr. Wood recently issued the fifth edition of the Legal Guide (the first edition was published in 1992). The timing could not be better. Classification of workers continues to be a front burner item for the Service—in fact, it has conducted a series of worker classification audits over the last several months.

### Scope of Work

The Legal Guide's comprehensive scope and exhaustive detail make it a resource practitioners will turn to again and again. The treatise is logically organized in a manner that a tax professional would use approaching the subject (Mr. Wood is, in

fact, a prominent tax attorney who practices in San Francisco). First, it addresses the tax treatment of independent contractors and employees. Next, it analyzes how to determine classification. Finally, it lays out the stakes of misclassification. The Legal Guide also includes a chapter on how to draft independent contractor agreements and an appendix of multiple sample documents and checklists.

Worker status turns on the right of control the employer has over the worker, regardless of whether the right is exercised. The right to control is measured through numerous factors. The Service has used the 20 factor test, which looks to training, instructions, hours of work and similar components of the relationship to determine whether there is a sufficient right to control to give rise to employee status. In recent years, the Service has moved away from the 20 factor test to a three factor test (that resembles the 20 factors).

At the crux of the treatise is a chapter devoted to the issue of how to classify a worker. The Legal Guide analyzes the control tests in detail, providing examples and references to applicable rulings. It parses the components of the tests, provides discussions of relevant decisions which have applied them, and posits useful practice tips. In addition, the treatise focuses on specific types of workers to analyze the appropriate

classification of each and to discuss applicable rulings and authority. The treatise, for example, examines workers labeled consultants, corporate directors and officers, employment agencies, construction workers and attorneys.

There is general consensus that the agreement between the company and worker will be a very significant factor in the event the relationship is scrutinized. The intention of the parties is a factor for determining classification, and nowhere is the intent better expressed than in the agreement between the parties. While not by itself determinative, it is nevertheless essential that the agreement consistently represent the desired worker relationship.

It is one thing to understand how to apply the relevant factors to an existing relationship. It is quite another thing to prospectively structure a relationship to successfully cope with the factors to achieve the desired classification. The Legal Guide correctly notes that practitioners rarely spend enough time on the front end structuring the relationship, which makes resolving disputes more difficult on the back end. Recognizing the importance of the agreement, the Legal Guide supplements the chapter on how to classify a worker with a separate chapter dedicated to how to draft independent contractor agreements and includes 17 sample agreements (ranging from consulting to work for hire).

\* Schnader, Harrison, Segal & Lewis L.L.P., Philadelphia, PA.

## Consequences of Misclassification

Proper classification of a worker may be challenged in various ways. For example, in a well known decision, workers sued Microsoft in the 1990s claiming that they were really employees even though Microsoft treated them as independent contractors. See *Vizcaino v. Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996), *modified en banc*, 120 F.3d 1006 (9th Cir. 1997). In that case, the Service in a routine review initially reclassified certain workers as employees, and it required Microsoft to pay withholding taxes and the employer's portion of Social Security and Medicare taxes. Following the reclassification, the workers then sued claiming they should have participated in Microsoft's employee benefit plans.

As noted in the Legal Guide, the decision demonstrates the interaction between tax controversies and other worker status inquiries. It is not uncommon for state taxing authorities also to follow a federal dispute. The stakes are high because employees typically have a

much greater arsenal of substantive rights than independent contractors. There are federal labor and employment laws that apply to and protect employees. Employees also have certain rights with respect to participation in employer-sponsored retirement and employee benefit plans. Also relevant to classification is the fact that employees are generally much more likely to bind the employer with respect to tort and contract claims than an independent contractor. The Legal Guide deftly covers all of these areas in separate chapters.

## Section 530 Safe Harbor

If the Service were to challenge a classification, the employer may be able to rely on a safe harbor introduced as section 530 of the Revenue Act of 1978. When it applies, section 530 may relieve an employer of liability for unpaid taxes, as well as penalties and interest. The safe harbor is different from the traditional 20 factor test—it does not turn on control. Instead, it applies when an employer can show that it (1)

consistently treated the workers as independent contractors, (2) complied with Form 1099 reporting for the tax years at issue, and (3) had a reasonable basis for treating the workers as independent contractors. The third requirement—reasonable basis—can be met through judicial precedents or administrative rulings, a prior audit, industry custom, or a catch all “other” reasonable basis.

The Legal Guide navigates the elements of the section 530 safe harbor, and it illustrates the application of the safe harbor in various cases.

Throughout the years, the Service has focused on worker status and, given the stakes and the often ambiguous nature of worker status, it will surely continue to do so in the future. The Legal Guide will prove a useful tool when confronting the thorny classification issue and its consequences.

Robert W. Wood's book, *Legal Guide to Independent Contractor Status* (5th Ed. 2010), is available at <http://www.taxinstitute.com>. Compression bound, including CD, 1,034 pages, \$399. ■

# 10th Annual Law Student Tax Challenge

The Section of Taxation would like to congratulate all of the J.D. and LL.M. teams who participated in the 10th Annual Law Student Tax Challenge competition. A total of 95 J.D. submissions and 31 LL.M. submissions were received, making this year's Challenge the most competitive to date. The following ten teams were selected to participate in the oral rounds of the competition, which took place on January 21 at the Tax Section's 2011 Midyear Meeting in Boca Raton. The winners' names are available on the Section's website at: <http://www.abanet.org/tax/lstc/>.

## J.D. Semi-Finalists

**Cleveland State University College of Law**  
Caryn Gross and Michael Tangry  
Coach: Deborah A. Geier

**Liberty University School of Law**  
Tim M. Todd, Jr. and Melissa M. Ogden  
Coach: F. Philip Manns, Jr.

**University of Florida Levin College of Law**  
Ben Friedman and Christopher Mikes  
Coach: Charlene Luke

**University of Kentucky College of Law**  
Leah Chalkley and Patrick Kern  
Coach: Jennifer Bird-Pollan

**Samford University School of Law**  
Wes Hill and Sims Rhyne III  
Coach: Brannon Denning

**William and Mary School of Law**  
Peter J. Farrell and Jonathan D. Puvak  
Coach: William M. Richardson

## LL.M. Finalists

**Northwestern University School of Law**  
Judson Bryant and John Goodell  
Coach: Robert R. Wootton

**Temple University School of Law**  
Travis Wheeler and Jeanmarie Dunn-Kane  
Coach: Andrea Monroe

**University of Denver College of Law**  
Jennifer Jewkes and Matthew Wiseman  
Coach: Alicia Buckingham

## University of Missouri-Kansas City School of Law

Nicholas Bracco and Samuel Burnett  
Coach: Judith F. Wiseman

The Law Student Tax Challenge was established in 2001 by the Tax Section's Young Lawyers Forum to provide a unique opportunity for law students to research “real-life” tax planning issues and to demonstrate their acquired tax knowledge through their writing and oratory skills before a panel of seasoned practitioners from private practice, government, and academia.