## EMPLOYEES V. INDEPENDENT CONTRACTORS: EMPLOYMENT & TAX LAW ISSUES

First Run Broadcast: June 27, 2013
1:00 p.m. E.T./12:00 p.m. C.T./11:00 a.m. M.T./10:00 a.m. P.T. **(60 minutes)**

As employers seek to outsource a greater share of their work to independent contractors or other firms, they hope to avoid certain tax, health care and employment law obligations. If a worker is properly classified as an independent contractor for tax law purposes, an employer is relieved of certain employment tax liability and may not, under the new health care law, have to provide certain health care benefits. Similarly, if a worker is properly classified as an independent contractor for employment law purposes, employers may not have the same measure of liability for contractor violations of EEO and other laws as for employees. However, the benefits under tax and employment law are not as categorical as widely believed. This program will discuss how federal tax and employment law classify workers as employees or independent contractors and the practical implications of that classification for tax obligations, health care benefits, and EEO violations.

- Understanding tax liability and employment law liability of characterizing workers as contractors versus employees
- Tax factors to determine whether a worker is a contractor v. an employee
- Tax liability and withholding obligations of employers depending on the classification
- New health care law and fringe benefit obligations for employees and contractors
- Employment law factors to determine a worker is a contractor v. employee
- Employer liability for EEO and discrimination violations committed by contractors

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**EMPLOYEES V. INDEPENDENT CONTRACTORS: EMPLOYMENT & TAX LAW ISSUES**

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# WORKER CLASSIFICATION
# EMPLOYEE OR INDEPENDENT CONTRACTOR
# INCOME, EMPLOYMENT, & BENEFITS TAX ISSUES

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## I. RELEVANCE OF EMPLOYER-EMPLOYEE RELATIONSHIP.

If the IRS ascertains that you have incorrectly classified a worker as an independent contractor instead of an employee, you could be responsible for payroll taxes including the FICA (Medicare and Social Security) and FUTA (unemployment taxes), FIT (income tax), plus interest and penalties. If the IRS can show you are a "responsible person" for a business's payment of withholding taxes, you could personally owe a trust fund recovery penalty, which is 100% of the taxes owed plus interest. In addition, improper classification can result in potential imposition of the healthcare reform employer mandate penalties in 2014 and thereafter.

### A. IRS National Research Program.

The IRS in 2009 initiated its National Research Program (NRP) study (the first one in 25 years) that is focused on employment tax compliance. This project randomly examined or audited 2,000 businesses each year for 3 years with a focus on worker classification, fringe benefits, executive compensation, expense reimbursement, and other payroll related issues. The IRS believes that businesses may attempt to save up to 30% on costs by improperly classifying employees as independent contractors. This study is to help the IRS find the percentage of businesses with tax issues in these areas. By understanding compliance percentages in each payroll area of interest, the IRS can improve their audit selection procedures and standards.

The IRS started NRPs in 2001 to measure the "tax gap." The "tax gap" is the difference between the amount of income that taxpayers voluntarily report and pay tax on, versus the amount of tax that the IRS perceives is actually due. An NRP assesses the effectiveness of the existing compliance programs so that taxpayers will report and pay tax on the full amount of taxpayer income (since the IRS' stated goal is to promote voluntary taxpayer compliance). The IRS will use the data gathered from this audit to improve the IRS' programs promoting voluntary compliance with regard to employment taxes.

This NRP focuses on four employment tax issues.

1. Worker Classification.

This is a perennial IRS issue. If a worker is an employee, then the employer is obliged to collect and remit all employment taxes, namely, income tax withholding, FUTA - unemployment, and both the employer's and the employee's portion of social security (FICA) taxes. However, if a worker is an independent contractor, then the employer does not have to collect employment taxes, and the worker is responsible for self-reporting and self-remitting the employment taxes to the IRS. The IRS prefers classifying workers as employees, since then the burden of collecting and remitting employment taxes falls on the employer. The IRS would rather collect employment from one employer for all its employees than having to try to collect employment taxes from each individual worker. Additionally, if an employer fails to collect and remit employment taxes, then the employer's "responsible persons" may have personal liability for uncollected taxes, thus giving the IRS a secondary source to collect employment taxes.

A worker will be classified as an employee versus an independent contractor based on a twenty-factor test developed by the IRS in Revenue Ruling 87-41. Many of the factors relate to the extent of control that the employer has over the worker, for example, control over hours worked, manner of accomplishing the work, etc.

As part of the NRP, we anticipate that the IRS will closely examine all workers whom the employer classifies as non-employees using the twenty-factor test from Revenue Ruling 87-41, and if the IRS concludes that a worker is improperly classified, the IRS likely will assess taxes. As mentioned above, the IRS can assess taxes against the employer, as well as personally against the employer's responsible persons.

2. Fringe Benefits.

Under the Internal Revenue Code, various fringe benefits can be provided to employees on a tax-free basis (certain insurance benefits, dependent care benefits, etc.). However, an employer can provide these benefits on a tax free basis only to employees, not to independent contractors, and in some cases not to self-employed individuals, such as sole proprietors, partners in partnerships (and members in LLCs taxed as partnerships or proprietorships) and more than 2% owners in S corporations. Thus, the IRS focus on fringe benefits likely will be a subset of the worker classification issue discussed above, namely that the IRS will closely examine how an employer classifies workers as employees (eligible for tax free fringe benefits) versus independent contractors.

Concerning fringe benefits, the IRS has been soliciting comments to simplify the record keeping requirements applicable to employer-provided cell phones and other electronic communication devices. Under the Code, an employer-provided cell phone is a taxable fringe benefit to the extent that the employee uses the phone for personal use. The difficulty arises in trying to document personal versus business use. It is possible that the IRS will use the NRP to gather information relating to how employers currently handle personal versus business use of employer-provided cell phones and other electronic communication devices.

3. Officers' Compensation.

There are positions that an employer and its owners can jointly take that will reduce the amount of taxes for both, depending on what type of entity the employer is. For example, if the employer is a C corporation and the owner is an executive who actively works for the company, the owner would want to pay net business profits in the form of deductible compensation, so that the C corporation can recognize a deduction for the compensation paid, and the business profits will only be subject to a single level of tax in the owner's hands.

Alternatively, if the employer is an S corporation, the owner-executive will want to pay himself or herself a low salary, since salary is subject to FICA and FUTA, while distributions of net business profits as dividends are not subject to those employment taxes. Thus, the IRS likely will audit C corporations to make sure that they are not paying too much compensation, and audit S corporations to ensure that they are paying enough compensation.

In the event that the IRS concludes, as part of the NRP, that an employer has underpaid either its corporate income taxes or its employment taxes, an assessment of the underpaid taxes will likely result. As mentioned above, in the instance of employment taxes, the responsible persons of the employer may face personal liability for allegedly underpaid taxes.

4. Reimbursed Expenses.

The last audit issue under the NRP relates to an employer's reimbursement policy for business expenses that its employees incur. Typically, when an employee pays a business expense (whether picking up the tab for a client lunch, purchasing an airline ticket for a business trip, or buying office supplies), the employee will submit the receipt and simply be reimbursed. The intention of the employer and employee is generally that the employer should be entitled to report the business deduction and the employee should not have any tax from paying an employer's business expense and being reimbursed.

However, unless the company has a written business expense reimbursement plan ("BERP") that meets certain requirements in the Internal Revenue Code, employee reimbursements are treated as though the employer paid additional compensation to the employee (subject to withholding and employment taxes) and the employee has income that has to be reported as taxable income on the employee's W-2. On the employee's side, the expense is often non-deductible due to the miscellaneous itemized deduction rules.

The only way to avoid the adverse tax consequences is for the employer to have a written reimbursement policy that meets the requirements of the Internal Revenue Code. The requirement that an employer have a written reimbursement policy is a trap for the unwary. If the employer does not have a written reimbursement policy, the IRS can impose taxes on both the employees and the employer. On the employee side, the IRS assesses income tax on the underreported income (which for a typical employer affects the sales staff and business executives disproportionately, since those are the categories of employees who most likely incur business expenses). On the employer side, the IRS will assess the employer and the responsible persons individually for the income tax withholding and employment taxes on the business reimbursements.

## B. Healthcare Reform Implications.

1. Employee Defined.

Code § 4980H contains the provisions for the employer mandate (or shared responsibility or play or pay) penalty. Code § 4980H(c)(2) defines an applicable large employer with respect to a calendar year as an employer that employed an average of at least 50 full-time employees (taking into account full-time equivalent employees or FTEs) on business days during the preceding calendar year. The proposed regulations adopt the position outlined in Notice 2011-

36 that an employee is an individual who is an employee under the common law standard, and an employer is the person that is the employer under the common law standard. The common law standard provides that an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. Under the common law standard, an employment relationship exists if an employee is subject to the will and control of the employer as to not only what shall be done but also how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so. See Reg. § 31.3121(d)-1(c), 31.3231(b)-1(a)(2), 31.3306(i)-1(b), and 31.3401(c)-1(b).

a. Self-Employed Not "Employees."

A sole proprietor, a partner in a partnership, or a 2-percent or more S corporation shareholder is not an employee. Thus, LLPs, LLCs (taxed as partnerships), and partnerships can design eligibility, coverage and premium obligations for their members/partners however the LLC/partnership desires. An individual who provides services as both an employee and a non-employee (such as an individual serving as both an employee and a director) is an employee for hours of service as an employee.

b. Leased Employees Not Employees.

The regulations provide that a leased employee as defined under § 414(n) is not an employee for these rules.[1] However, those rules will seldom be met. Additionally, in many if not most cases, the IRS views leased employees as common law employees of the firm that uses their services (the service recipient), not the business that pays them, if the service recipient has the right to control their working conditions.

c. Independent Contractors Not Employees.

Bona fide independent contractors, as opposed to employees that an employer treats as independent contractors, are not employees for this purpose.

2. Employer Mandate Penalties Overview.

Commencing in 2014, the healthcare reform employer mandate (a/k/a/ shared responsibility or play-or-pay rules) applies to employers with 50 or more full-time and full-time equivalent employees. These employers are "applicable large employers." An applicable large employer is subject to a nondeductible excise tax (a/k/a an "assessable payment") under Code § 4980H in either of two cases:

- The No Coverage Penalty. This penalty applies if the employer fails to offer any health coverage and at least one employee purchases insurance on an exchange and qualifies for a subsidy, which requires that the employee or family income (depending on type of coverage purchased) is below 400% of federal poverty level. This penalty also applies

[1] Prop. Treas. Reg. § 54.4980H-1(a)(13).

if an employer offers coverage but fails to offer to at least 95% (or all but 5, if less) of its full-time employees and their dependents (spouse coverage is not required to be offered) the opportunity to enroll in group health plan coverage and any one or more full-time employee obtains subsidized coverage from a public health insurance exchange. The employer must pay an annual nondeductible tax of $2,000 for each full-time employee (less 30), if at least one full-time employee obtains federally subsidized coverage through an exchange. Thus, if an employer has 55 full-time and full time equivalent employees and 40 full-time employees, the penalty is $2000 x [40 – 30 = 10] or $20,000.

- The Unaffordable Or Inadequate Coverage Penalty. The employer offers to at least 95% (or all but 5, if less) of its full-time employees and their dependents the opportunity to enroll in group health plan coverage but that plan is either "unaffordable" or fails to provide "minimum value," and one or more full-time employees obtains subsidized coverage from a public health insurance exchange. If at least one full-time employee obtains federally subsidized coverage through an exchange, the employer must pay an annual tax of the lesser of: (1) $3,000 per subsidized full-time employee or (2) $2,000 for each full-time employee minus 30. Thus, this second penalty can never exceed the no coverage penalty.

Subsidized coverage is available on the state and other public exchanges in 2014 and thereafter for persons whose income is below 400% of the federal poverty level. HHS publishes the federal poverty level in the Federal Register in January of each year for that calendar year.[2] For example for 2013, 400% of FPL in the continental states and District of Columbia is $45,960 for an individual and $94,200 for a family of four. The amounts are greater in Alaska and Hawaii.

A full-time employee for this purpose means an employee who works on average 30 or more hours per week or 130 hours per month. A temporary employee who works 30 hours per week (or 130 hours per month) is still a full-time employee. To calculate the number of full-time equivalent employees, calculate the aggregate number of monthly hours of service (but not more than 120 hours of service for any employee) for all employees who are not full-time employees (those employed on average less than 30 hours of service per week or less than 130 for that month) and divide the total hours of service for all part-timers by 120. This is the number of FTEs for the calendar month. If there is a fraction, round down. Add the 12 monthly calculations in and divide by 12. This is the average number of full-time employees. This is calculated in the prior year to determine if the employer is an applicable large employer for the current year, i.e., calendar year 2013 for calendar year 2014. An exception allows six or more consecutive months in 2013 to be used for 2014. Seasonal employee exception: if an employer's workforce is 50 or more full-time plus 50 FTEs for 120 days or fewer during a calendar year, and the employees in excess of 49 who were employed during that period of no more than 120 days were seasonal workers, the employer is not an applicable large employer.

Coverage is affordable if the cost to the employee for self-only coverage does not exceed 9.5%

[2] The 2013 federal poverty level is at http://aspe.hhs.gov/poverty/13poverty.cfm. The FPL is the same numbers in the contiguous 48 states and the District of Columbia and higher in Alaska and Hawaii.

of household income or one of 3 safe harbors looking solely to the employee's income. The employer safe harbors seemingly do not apply to an employee's eligibility for an exchange subsidy. Thus, some individuals will be deemed to have "affordable" employer coverage for purposes of the employer penalty yet have unaffordable coverage for exchange subsidy purposes. For these employees, the employer will not owe the penalty tax. However, those same employees may still qualify for an exchange subsidy. Minimum value is an actuarial measure of the plan's generosity, i.e., the plan's share of the cost of benefits must be least 60%. According to the regulators, for a plan to provide minimum value, benefits must include at least catastrophic, major medical coverage with physician and mid-level practitioner care, hospital and emergency room services, pharmacy benefits, and laboratory and imaging services. The plan must also contain specified limits on out-of-pocket expenses.

The employer mandate penalties are also called 4980H(a) penalties and 4980H(b) penalties, respectively. Both are determined monthly but are discussed here as annual amounts for simplicity. The annual 4980H(a) penalty (i.e., the penalty for failing to offer any coverage) is determined by multiplying the number of all the employer's full-time employees, less 30, by $2,000. If an employer has 30 or fewer full-time employees, even if there are more than 50 full-time equivalent employees, there would be no penalty. The annual 4980H(b) penalty for offering coverage that is either unaffordable or fails to provide minimum value is determined by multiplying the number of the employer's full-time employees who qualify for a premium tax credit or cost-sharing reduction by $3,000. However, this second penalty can never exceed the 4980H(a) penalty. Where an employer timely makes an offer of coverage to at least 95% (or all but 5, if less) full-time employees and their dependents that is both affordable and provides minimum value, there is no penalty, regardless of whether employees select that coverage.

## II. <u>Federal Employment Taxes.</u>

Federal Employment taxes include FICA (social security and Medicare), FUTA (unemployment), FIT (income tax)) (Code §§ 3101 et seq., 3301 et seq., 3401 et seq. and 3501 et seq.). In general, there is an obligation on an "employer" who is a service recipient to pay employment taxes for "wages" paid by the service recipient to an "employee" who provides services to the service recipient as part of "employment." (Note: This outline does not discuss railroad employees, which are specially covered by Code §§ 3201 et seq. and 3321 et seq.)

Employers are motivated to misclassify workers as independent contractors in an effort to avoid paying their share of Federal Insurance Contributions Act (FICA) taxes, unemployment taxes, and workers compensation premiums on covered employees. In addition, employers are at less risk for employee discrimination and other claims. Workers sometimes prefer being classified as employees and prefer to be treated as independent contractors in order to be eligible to deduct their business expenses from their gross business incomes.

The guidance on worker classification includes a combination of legislation, case law, IRS rulings, and audit guidelines. The common theme is that the determination of whether a worker should be regarded as an employee or an independent contractor for federal tax purposes should be guided by common law standards. However, the lack of specific guidance for applying those standards has at times led to inconsistent results.

## A. Employee Benefits.

### 1. "Employee" Status.

For income tax purposes, certain types of fringe benefits, such as group term life insurance, employer-provided eating facilities, qualified tuition reduction plans and no-additional-cost services, are subject to nondiscrimination requirements that require that all employees of the employer be considered. See Code sections 79, 132(e)(2), 117(d)(3), and 132(j). The exclusion of any group of employees could result in the loss of the tax-favored status of certain benefits under the plan. See Code §401 et seq. regarding retirement plans and Code § 125 regarding cafeteria plans. In some, only common law employees are eligible. In others, self-employed individuals (sole proprietors, partners, and more than 2% shareholders in S corporations) are also eligible.

#### a. Leased Status v. Common Law Employment.

If a worker is determined to be a common law employee of the recipient organization, the leased employee rules do not apply. A leased employee by definition is a common law employee of the leasing/staffing firm, not the recipient organization. Notice 84-11, Q&A 1 and 3.

A Professional Employer Organization ("PEO") is a third-party employee leasing agency that, in essence, becomes the "worksite employer's" human resources department, e.g., pays the workers' wages, pays employment taxes with respect to these wages and retains authority for hiring and firing. A PEO arrangement is often established by the common law employer (i.e., the worksite employer) that wants to "source" its own employees to the PEO. After the employees are transferred to the "employ" of the PEO, they continue to perform the same duties for the worksite employer. The PEO is typically paid based on a percentage of the worksite employer's payroll. The percentage usually is based on the number of service features and employee benefits packages that the worksite employer chooses for the PEO to provide to the workers.

The implementation of a leasing/staffing arrangement can have significant consequences to both the leasing/staffing firm and the recipient organization with respect to employment taxes and employee benefits, as well as under labor and employment law. Some of these consequences may not be those intended under the terms of the leasing/staffing arrangement since the treatment of a worker under employment tax and employee benefit law is statutorily based, not contractually based. For example, the labeling of a worker as a "leased employee" under a leasing/staffing arrangement does not mean that the worker will be defined as a "leased employee" under Code section 414(n) for employee benefit plan purposes. If not, then if the PEO has a retirement plan, for the leased workers to participate, the recipient entity must also adopt the plan if the leased employees are in fact the recipient's common law employees.

Further, it is incorrect to assume that, once a leasing/staffing arrangement is entered into, the leasing/staffing firm assumes all of the responsibilities of the recipient organization for that function. Contrary to the basic premise of the leasing/staffing arrangement, the recipient organization cannot contract its statutory responsibilities and liabilities to another entity for employment tax and employee benefit purposes. The recipient organization can contract for the leasing/staffing firm to perform certain administrative functions, but the recipient organization will remain ultimately liable for the payment of its employment taxes and provision of its employee benefits.

In order to determine the consequences to the leasing/staffing firm and the recipient organization that result from the implementation of an employee outsourcing arrangement, the common law employer of the worker must first be identified.

b. <u>Common Law Employees Classified by the Company as Independent Contractors Properly Excluded From Plan</u>.

In *Martin v. Public Service Electric & Gas Co., Inc.*, 2006 WL 3491063 (D. N.J. 2006) plaintiffs performed work for the company and were classified by the company as independent contractors. Both the company's qualified retirement plans excluded from participation independent contractors. While neither plan defined the term, several of its plans contained a disclaimer, indicating that designations of governmental agencies or courts do not change the status of employees as determined by the company. The plaintiffs claimed that they were misclassified as independent contractors and, as employees, were entitled to participate in the various benefit plans. The court (like many others) rejected the plaintiff's theory, stating that employees can be excluded from participation in ERISA benefit plans as long as the coverage and nondiscrimination tests of the Code are met.

2. <u>Can Statutory Employee Have His Or Her Own Qualified Retirement Plan?</u>

Except for full time insurance salespersons, the answer is yes if they are in one of three other categories (agent-driver, home worker, or traveling or city salesperson meeting certain requirements). By definition, certain statutory employees are persons who are not common-law employees of the business they serve. They must meet several specific code requirements, such as performing substantially all the work themselves, not having a substantial investment in facilities, having a continuing relationship with the company, and falling into one of <u>4 categories</u>: agent-driver, full-time life insurance salesperson, home worker, or traveling or city salesperson. The law requires businesses to withhold FICA taxes from statutory employees, but not income taxes. Because they are not common-law employees, statutory employees are not eligible to participate in plans sponsored by the company that pays them. To cover them would violate the exclusive benefit rule of the Internal Revenue Code.

Although these 4 categories of statutory employees receive a Form W-2, the income reported there is trade or business income that should be reported on Schedule C, against which any expenses of the statutory employee's business are deducted. They are independent contractors because they are not common-law employees. As such, they have "earned income" and are regarded as "self-employed individuals" under Code section 401(c)(1). This allows them to set up their own retirement plans. However, Code § 7701(a)(20) says that full time life insurance salespersons are employed by the insurance company whose policies they sell for retirement and health plan purposes. This means they can be covered under the insurance company plan; and they cannot set up their own plan.

### B. Deductions Allowed.

Prohibited to “Employees” vs. non-“Employees” on Their Tax Returns (e.g., business expenses of employees on IRS Schedule A / IRS Form 2106 vs. business expenses of certain non-“Employees” on IRS Schedule C)

### C. Other Federal Laws.

Worker classification is relevant for other federal laws, e.g., employment laws, such as Fair Labor Standards Act, Title VII prohibitions on discrimination, the Americans with Disabilities Act, etc. The rules are not the same as the income tax rules.

### D. State Employment Taxes.

It is possible to have difference results in federal and state proceedings (income tax and unemployment) in the same case.

### E. Other State Laws (E.G., Employment And Labor Laws).

### F. Terminology.

“Employee” vs. non-“employee” terminology is used in many ways, e.g., “independent contractor,” “consultant,” “self-employed,” “sole proprietor,” “partner,” “limited liability company member,” etc. Note that unincorporated organizations, such as LLCs, may elect to be taxed as corporations and if they do, their members will not be partners but will be employees for federal income tax purposes.

## III. DEFINITIONS OF “EMPLOYEE” & “EMPLOYER.”

### A. Common Law Definition Often Applies To Tax Statutes.

*Nationwide Mutual Insurance Co. v Darden,* 503 U.S. 318 (1992), an ERISA case, holds that where “employee” is not defined by a statute, one looks to the federal common law and not state law to determine how an employee is defined. *Darden* looks to multiple factors and holds that in the end, it is the service recipient’s right to direct and control a worker not only as to the result to be accomplished, but also the means and manner by which the result is accomplished, even if that right remains unexercised; i.e., right to control not only what work will be done, but also how it will be done.

### B. Non-Common Law Definitions Under Certain Other Federal Statutes.

There are special definitions and rules for certain types of workers in the Tax Code. Additionally, there are rules under federal employment law, the most important being The Americans With Disabilities Act of 1990 (the “ADA”), The Family and Medical Leave Act of 1993 (the “FMLA”), The Fair Labor Standards Act of 1938 (the “FLSA”), and The Pregnancy Discrimination Act (the “PDA”).

## IV. IRC DEFINITIONS OF "EMPLOYEE" AND "EMPLOYER."

### A. Common Law Definition (e.g., FICA, FUTA, FIT (Federal Income Tax).

The definition of "employee" is from the regulations and court cases. The term employee is used for tax purposes in the following statutes:

Code § 3121(d)(1) – FICA definition of "employee";

Code §3306(i) – FUTA definition of "employee";

Code §3401(c) – FIT reference to "employee").

Section 3121(d) defines an employee as:

(1) any officer of a corporation; or

(2) individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2) ) who performs services for remuneration for any person—

(A) as an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal;

(B) as a full-time life insurance salesman;

(C) as a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by him; or

(D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations if the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

Sections 3121(d)(1), 3306(i) and 3401(c) specifically define corporate officers as employees for FICA, FUTA and FIT withholding purposes. In effect, they are statutory employees. On the other hand, under Reg. 31.3121(d)-1(b) says generally an officer is an employee. It then says: "However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation. Additionally, a director in his capacity as a director is not an employee."

<u>Common law employees are defined by Reg. § 3121(d)-1(c)</u>:

(1) Every individual is an employee if under the usual common law rules the relationship between him and the person for whom he performs services is the legal relationship of employer and employee.

(2) Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services (1) as to the result to be accomplished by the work and (2) the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. An individual performing services as an independent contractor is not as to such services an employee under the usual common law rules. Individuals such as physicians, lawyers, dentists, veterinarians, construction contractors, public stenographers, and auctioneers, engaged in the pursuit of an independent trade, business, or profession, in which they offer their services to the public, are independent contractors and not employees.

(3) Whether the relationship of employer and employee exists under the usual common law rules will in doubtful cases be determined upon an examination of the particular facts of each case.

**B. Selected Cases.**

*Bartels v. Birmingham*, 332 US 126 (1947) (similar employer-employee problem in applying social security tax law; musicians in dance bands were employees of bandleaders, notwithstanding contracts seeking to shift liability to ballroom operators hiring bands for limited engagements); *Simpson v. CIR*, 64 TC 974, 984–985 (1975) (seven-prong test); *Newhouse v. McCormick & Co.*, 98-2 USTC ¶ 50,768 (8th Cir. 1998) (age discrimination settlement with unsuccessful applicant for employment not subject to withholding because there was no employer-employee relationship); *Alford v. US*, 116 F3d 334 (8th Cir. 1997) (pastor was independent contractor, not employee of church, because he could, "for the most part," "set his own schedule" and retain fees for weddings, funerals, and revivals); *Walker v.*

*CIR*, 101 TC 537 (1993) (timber cutter was independent contractor because he supplied equipment, tools, fuel, and supplies, incurred expenses that were substantial in relation to gross income, was responsible for damage he might cause, and received no fringe benefits).

## C. IRS Rulings.

1. IRS Revenue Ruling 87-41 provides a list of 20 separate "Common Law Factors" ("CLF").

These twenty factors below were used to determine if a worker is an "employee" for federal employment tax purposes. Rev. Rul. 87-41 is the most comprehensive guidance regarding this determination. According to this Revenue Ruling: "As an aid to determining whether an individual is an employee under the common law rules, twenty factors or elements have been identified as indicating whether sufficient control is present to establish an employer-employee relationship. The twenty factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. The twenty factors are designed only as guides for determining whether an individual is an employee; special scrutiny is required in applying the twenty factors to assure that formalistic aspects of an arrangement designed to achieve a particular status do not obscure the substance of the arrangement . . . ."

Rev. Rul. 87-41 lists the following 20 factors as being relevant in classifying a worker as an employee or independent contractor:

(1) Instructions.

(2) Training.

(3) Integration.

(4) Services rendered personally.

(5) Hiring, supervising, and paying assistants.

(6) Continuing relationship.

(7) Set hours of work.

(8) Full time required.

(9) Doing work on employer's premises.

(10) Order or sequence set.

(11) Oral or written reports.

(12) Payment by hour, week, or month.

(13) Payment of business or traveling expenses.

(14) Furnishing of tools and materials.

(15) Significant investment.

(16) Realization of profit or loss.

(17) Working for more than one firm at a time.

(18) Making services available to the general public.

(19) Right to discharge.

(20) Right to terminate.

2. Classifying The 20 Factors.

Under pressure from Congress and from representatives of labor and business, the IRS attempted to simplify and refine the twenty factor test, consolidating the twenty factors into eleven main tests, and organizing them into three main groups: behavioral control, financial control, and the type of relationship of the parties. Those factors appear below, along with comments regarding each one (source: IRS Publication 15-A, 2010 Edition, page 6; available for downloading from http://www.irs.gov/pub/irs-pdf/p15a.pdf (PDF). Another good IRS resource for understanding the IRS tests is at http://www.irs.gov/businesses/small/article/0,,id=99921,00.html.

a. Behavioral control.

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 include the type and degree of—

Instructions the business gives the worker. An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work:

When and where to do the work

What tools or equipment to use

What workers to hire or to assist with the work

Where to purchase supplies and services

What work must be performed by a specified individual

What order or sequence to follow

The amount of instruction and training needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training the business gives the worker. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

b. Financial Control.

Facts that show whether the business has a right to control the business aspects of the worker's job include:

The extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.

The extent of the worker's investment. An employee usually has no investment in the work other than his or her own time. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.

The extent to which the worker makes services available to the relevant market. An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

How the business pays the worker. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

The extent to which the worker can realize a profit or loss. Since an employer usually provides employees a workplace, tools, materials, equipment, and supplies needed for the work, and generally pays the costs of doing business, employees do not have an opportunity to make a profit or loss. An independent contractor can make a profit or loss.

c. Type Of Relationship Of Parties.

Facts that show the parties' type of relationship include:

Written contracts describing the relationship the parties intended to create. This is probably the least important of the criteria, since what really matters is the nature of the underlying work relationship, not what the parties choose to call it. However, in close cases, the written contract can make a difference.

Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay. The power to grant benefits carries with it the power to take them away, which is a power generally exercised by employers over employees. A true independent contractor will finance his or her own benefits out of the overall profits of the enterprise.

The permanency of the relationship. If the company engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.

The extent to which services performed by the worker are a key aspect of the regular business of the company. If a worker provides services that are a key aspect of the company's regular business activity, it is more likely that the company will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

3. 1996 IRS Training Materials.

On August 2, 1996, the IRS issued training manual, entitled "Employee or Independent Contractor?" Training 3320-102 (July 1996), for employment tax specialists and revenue officers to use to determine whether a worker is a common law employee and to identify the employer. ***In the training manual, the IRS identifies three general categories of evidence to be considered: behavioral control, financial control and relationship of the parties.***

***According to the Training Materials, "The twenty common law factors listed in Rev. Rul. 87-41 are NOT the only ones that may be important. Each piece of information that helps determine the extent to which the business retains the right to control the worker is important." For example, a noncompete provision between the business and the worker would be a factor in behavioral control. In addition, the relative importance and weight of the twenty common law factors can vary significantly.*** Bear in mind that information important in helping determine worker status may change over time because business relationships change over time. As a result, some of the twenty common law factors listed in Rev. Rul. 87-41 are no long as relevant as they once were . . . . Control is a matter of degree. In fact, even in the clearest case of an independent contractor, the worker is constrained in some way. Conversely, employees may have autonomy in some areas. To make a correct determination regarding the status of a worker, you need to consider the evidence of both autonomy and the right to control. The absence of a fact that would indicate control may be as important as its presence . . . . There is no 'magic number' of relevant evidentiary facts."

**D. Evidence of "Right to Control" – Common Law Factors (CLFs).**

NOTE: CLFS in ***BOLD ITALICS*** are no longer "separate factors" or they are factors of "lesser" importance with "little independent weight" according to the **1996 IRS Training Materials**.

| FACTORS | SUGGESTS EMPLOYMENT BY SERVICE RECIPIENT | SUGGESTS INDEPENDENT CONTRACTOR STATUS |
|---|---|---|
| **I. BEHAVIORAL CONTROL FACTORS (right to direct or control how work tasks are performed by worker)** | | |

| | | |
|---|---|---|
| INSTRUCTIONS (CLF #1) | Instructions by service worker on when (time and of hours), where (location) and how (method) to do the work, existence and enforcement of evaluation system regarding of how the work is to be performed | Absence of service right to give such instructions when, where or how to work, *Training Materials say "little no weight" should be given behavioral control factors service recipient's non-mandatory suggestions or its imposition of requirements established by government regulations, or its requirement that workers wear business control are especially important in regard to highly-trained professionals (e.g. lawyers,* |
| TRAINING (CLF #2) | Provision of training by service recipient to worker through required attendance at meetings experienced workers, or other training requirements about methods or procedures to be | Worker responsible for own training, and any service recipient training is voluntary and non-compensable or is merely informational about general policies or regulations |
| ***PERSONAL SERVICES #4)*** | Worker must provide services personally | Worker can delegate or subcontract, *but Training Materials do not mention as separate factor and instead include this under Instructions* |

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|---|---|---|
| ***HIRING, SUPERVISING AND PAYING ASSISTANTS (CLF #5)*** | Worker does not hire/fire, supervise and pay assistants, or may do so only with service recipient's approval | Worker has discretion to hire/fire, pay and supervise own assistants to achieve result. *Training Materials do not Instructions* |
| ***SET WORK HOURS* (CLF #7)** | Worker's hours set by service recipient | Worker sets own hours, *but Training Materials include this "lesser" separate factor, and say hours of work may not be relevant because "some work must, by its nature, be performed at a specific time" and "in today's world" other work done* |
| ***FULL TIME REQUIRED* (CLF #8)** | Worker must work full time for service recipient | Worker works less than full for service recipient, *but Training Materials include this as "lesser" separate factor and "neutral fact" and "no longer* |
| ***LOCATION OF WORK* (CLF #9)** | Work must be done on service recipient premises | Worker works on own or away from service recipient premises, *but Training Materials include this under Instructions and as "lesser" factor and* |
| ***ORDER OR SEQUENCE OF WORK (CLF #10)*** | Worker must perform work in order or sequence set by recipient | Worker sets own order or sequence, *but Training Materials do not mention as separate factor and instead include this under* |
| ***ORAL OR WRITTEN REPORTS (CLF #11)*** | Worker must provide ongoing or written progress or other to service recipient | Worker provides no ongoing reports, *but Training do not mention this under any factor (but use it in one 'Exercise')* |

| | | |
|---|---|---|
| **II. FINANCIAL CONTROL FACTORS (right to direct or control how business aspects of worker's activities are conducted – and worker's opportunity for profit / loss)** | | |
| METHOD OF PAYMENT (CLF #12) | Worker is paid by hour, week month | Worker is paid by flat fee for or straight commission, *but Training Materials say that in some lines of business it is typical to pay an independent contractor on an hourly basis,* |
| BUSINESS EXPENSES (CLF #13) | Service recipient pays or reimburses worker for business expenses (e.g., travel, postage, supplies, insurance, dues, advertising, training, rent, utilities) | Worker incurs and pays own business expenses without reimbursement, *but Training Materials say that even independent contractors get some reimbursements (e.g., travel), some employees pay their own minor expenses, other employees incur their own major* |
| ***TOOLS AND MATERIALS (CLF #14)*** | Service recipient furnishes significant tools, materials (e.g., | Worker provides significant tools, materials (e.g., supplies) *Materials do not mention as a separate factor and include Expenses* |
| SIGNIFICANT INVESTMENT (CLF #15) | Service recipient provides (e.g., office) or equipment for performance of work, and there lack of such an investment by worker | Worker invests in facilities or equipment used to perform work, *but Training Materials that no precise dollar amount investment is necessary and for some types of work no significant investment is* |

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|---|---|---|
| REALIZATION OF PROFIT AND LOSS (CLF #16) | Worker cannot realize a profit suffer a loss, and risk of nonpayment for services is not sufficient economic risk of loss | Worker can realize a profit or suffer a loss, such as risk of due to significant investments liability for expenses, *and* *Training Materials say ability to* *"probably strongest evidence"* *that worker controls business* |
| ***WORK CONCURRENTLY FOR MULTIPLE SERVICE RECIPIENTS (CLF #17)*** | Worker performs services for one service recipient at a time | Worker performs more than minor services for multiple unrelated service recipients, *but* *Training Materials include this* *as a "lesser" separate factor and say "an independent contractor may work full-time* *for one business" and* |
| SERVICES AVAILABLE TO PUBLIC (CLF #18) | Worker does not make services available to general public on a regular and consistent basis | Worker makes services to general public on a regular and consistent basis, *but* *Training Materials say that although independent contractors often advertise, maintain a visible business location and are available to work for the relevant market",* *"these activities are not essential" because independent* |
| **III. RELATIONSHIP OF THE PARTIES (how worker and service recipient perceive the relationship reflects "intent" regarding control)** | | |
| INTEGRATION (REGULAR BUSINESS ACTIVITY) (CLF #3) | Worker is "integrated" into recipient's regular business operations, which depend to an "appreciable degree" upon performed by the worker | Worker is not "integrated" service recipient's regular business operations *Training Materials say "it is possible that work performed is* *part of the principal* *"has hired workers who are outside specialists and may be* |

| | | |
|---|---|---|
| CONTINUING RELATIONSHIP (CLF #6) | Worker and service recipient have continuing relationship, including long-term or at frequently recurring but irregular intervals | Worker and service recipient have no continuing relationship, *but Training Materials say that while continuous, indefinite relationship is evidence of employment, a long-term relationship (especially for a specific project or period, or per a contract renewal) that is not indefinite "is a neutral fact that should be disregarded" and a "temporary relationship" is a "neutral fact" to be "weighed carefully"* |
| RIGHT OF SERVICE RECIPIENT TO DISCHARGE WORKER (CLF #19) | Worker may be easily discharged by service recipient without incurring liability | Worker cannot be fired without cause or unless worker fails to produce required results, *but Training Materials say that inability to freely fire worker – by itself – no longer constitutes persuasive evidence of independent contractor status and must be "used with great caution"* |
| RIGHT OF WORKER TO TERMINATE SERVICES (CLF #20) | Worker may terminate services at any time without incurring liability | Worker must complete specific time period or results before terminating without incurring liability, *but Training Materials say presence or absence of worker's ability to terminate – by itself – no longer constitutes useful evidence in determining worker status as employee or independent contractor and* |

| | | |
|---|---|---|
| *must be "used with great* | *caution"* | |
| WRITTEN CONTRACT (NEW FACTOR) | Contractual designation in and of itself is not sufficient evidence to determine worker status, and designation is "immaterial" if substance of relationship is employment | Written contract designating independent contractor status is "evidence of ... parties' intent" and, "if it is difficult, if not impossible, to decide ... [worker status], the intent of the parties" in the contract is "an effective way to resolve the issue" and is "very significant in close cases." |

| | | |
|---|---|---|
| INCORPORATION (NEW FACTOR) | **Worker is not employee of corporation of worker is an officer** | **Worker who creates through which to perform services "will not usually be treated as an employee" of that corporation and not service recipient if**<br>**"corporate formalities are properly followed and at least one non-tax business purpose exists;**<br>**"disregarding the corporate entity is generally an extraordinary remedy, applied only if clear abuse.** |
| EMPLOYEE BENEFITS (NEW FACTOR) | Worker receives benefits such paid vacation, sick leave, other insurance, retirement coverage, but determination by state or federal agencies that worker is employee for benefits purposes "should be disregarded" because laws or regulations may use different definitions or be interpreted to achieve other policy objectives (e.g., workers' compensation / unemployment insurance) | Worker is excluded from plans because not considered employee, and this is (though not conclusive) in establishing worker's status" |

See Rev. Rul. 87-41, 1987-1 CB 296 (identifying 20 factors relevant to employee/independent contractor dichotomy); Eastern Inv. Corp. v. US, 95-1 USTC ¶ 50,188 (10th Cir. 1995) (applying 20 factors in Rev. Rul. 87-41 ); Weber v. CIR, 103 TC 378 (1994) ("the threshold level of control necessary to find employee status is generally lower when applied to professional services than when applied to nonprofessional services"; provision of "many benefits…typical of those provided to employees" is also evidence of employment relationship). See also Rev. Proc. 2006-3, 2006-1 IRB 122, § 3.01(58) (IRS will not make advance ruling on employee versus independent contractor issue "for purposes of determining prospective employment status," but "ruling with regard to prior employment status may be issued").

The control factor is the "crucial test" to determine the nature of the working relationship.…To retain the requisite control over the details of an individual's work, the employer need not stand over the individual and direct every move made by the individual; it is sufficient if the employer has the right to do so.…Similarly, the employer need not set the employee's hours or supervise every detail of the work environment to control the employee.…Workers who set their own hours are not necessarily independent contractors. Kumpel v. CIR, 86 TCM (CCH) 358, 360 (2003) (lawyer's office staff were employees). See Levine v. CIR, 89 TCM (CCH)

1063, 1070 (2005) (finding industrial hygienist performing services under contract with State Department was independent contractor, but noting other decisions in which court found persons with similar contracts with federal agencies were employees; "a close case").

Rev. Rul. 73-591, 1973-2 CB 337 (beautician leasing space but required to work specified number of hours and furnish reports to owner of premises; held, employee); Rev. Rul. 73-592, 1973-2 CB 338 (contra where free to work as she pleases); Rev. Rul. 71-571, 1971-2 CB 347 (drivers operating cabs under conditional sales agreement requiring daily payments but giving no control over operations; held, not employees); Rev. Rul. 71-572, 1971-2 CB 347 (same where taxicab company furnishes cabs and services, or provides services to cab owners, for fixed fees; contra where company owns cabs and drivers must report amount of fares collected and pay company set percentage of that amount); Rev. Rul. 68-625, 1968-2 CB 465 (golf pro selling equipment and lessons; held, not employee of club); Rev. Rul. 68-626, 1968-2 CB 466 (other golf pros); Rev. Ruls. 76-138 , 76-139, 1976-1 CB 312, 313, 315, and 318 (various types of real estate and securities salesmen, some treated as employees and others as independent contractors).

## E. Special "Statutory Employees"

The Code provides that certain classes of persons are employees: Code §3121(d)(1) for corporate officers; Code §3121(d)(3) for agent-drivers or commission-drivers, or full-time life insurance salespersons, or home workers, or traveling or city salespersons; Code §3121(d)(4) for certain state and local government employees covered by agreements with the Social Security Administration). Note that certain Code §3121(d)(3) "employees" for purposes of FICA and FUTA are not covered by FIT withholding per Code §3306(i) and may deduct expenses incurred as employees on Schedule C, e.g., phone charges, travel. A regulation provides an exception for salesmen selling to wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations. These salesmen are employees. See Reg. Section 31.3121(d)-1(d)(iv).

## F. Special Statutory "Non-Employees" - Qualified Real Estate Agents And Direct Sellers Under IRC § 3508; IRC §3506 Regarding Companion Sitters Placed But Not Paid By, Nor Paying, The Sitters).

Certain categories of workers, while they may qualify as Employees under the Common Law Test, are nevertheless treated under the Code as independent contractors for federal income tax withholding and Social Security, Medicare, and FUTA tax purposes. They are known as Statutory Non-employees and are not subject to federal income tax withholding or Social Security, Medicare, or FUTA taxes regardless of their status under the Common Law Test, so long as certain conditions are met. There are two categories of Statutory Non-employees.

1. Qualified Real Estate Agents.

This exemption applies to salespersons who are licensed real estate agents performing services in connection with the sale of real property, including advertising or showing the real property. Code § 3508(b)(1).

a. The worker is a licensed real estate agent.

b. Substantially all of such worker’s remuneration for services is directly related to sales or other output rather than to the number of hours worked.

c. A written contract exists between the worker and the taxpayer for which services are being performed that provides that the worker will not be treated as an employee for federal tax purposes.

2. Direct Sellers.

This exemption applies to individuals who sell consumer products or newspapers on a buy-sell or deposit commission basis to be resold in the home or somewhere other than a permanent retail establishment. It also applies to individuals who sell the products themselves in the home or somewhere other than a permanent retail establishment. Code § 3508(b)(2).

a. Most of their compensation must be directly related to sales or other work output rather than the number of hours worked.

b. Their work must be performed under a written contract providing that the individual will not be treated as an employee for federal income, Social Security, Medicare, or FUTA tax purposes.

3. Companion Sitters.

Code § 3506 provides that a companion sitter will not be an employee of a companion sitting placement service if the companion sitting placement service neither pays nor receives the salary or wages of the sitter. The placement service may be compensated on a fee basis by either the sitter or the individual for whom the sitting is performed. The companion sitter is deemed to be self-employed unless a statutory or common law employee of the individual for whom the services are performed.

4. State and Local Government Employees Coverage.

State and local government employees were excluded from social security coverage from 1935 (the date of the original Social Security Act) until 1950 because there was a legal question regarding the federal government's authority to tax state and local governments. Beginning in 1951, states were allowed to enter into voluntary agreements with the federal government to provide social security coverage to public employees. These agreements are called Section 218 Agreements because they are authorized by Section 218 of the Social Security Act. See Code 3121(b)(7)(E). Because of the voluntary nature of Section 218 Agreements, the extent of social security coverage varies from state to state.

State and local government employees can be covered for social security and Medicare purposes through an agreement between the state and the Social Security Administration (SSA). Each state's original Section 218 Agreement ("Agreement" ) incorporates the basic provisions, definitions, and conditions for coverage. Additional coverage is provided by modifications. Each modification, like the original Agreement, is binding upon all parties. The initiative for securing coverage lies with the state. Coverage under an Agreement must be provided for employees by groups. An Agreement may be modified to increase the extent of coverage but generally not to reduce the amount of coverage. (An exception applies to election worker services and solely fee–based positions.) Effective July 2, 1991, social security and Medicare coverage is mandatory for state and local government employees who are not qualified participants in a public retirement system and who are not covered under a Section 218 Agreement. See Code § 3121(b)(7)(F). Employees hired or rehired after March 31, 1986, and currently covered under the Medicare portion of FICA remain subject to that tax regardless of their membership in a retirement system. Employees covered by social security under a Section 218 Agreement are automatically covered.

Next

### G. Students' FICA Exemption.

Code § 3121(b)(10) exempts from FICA service performed in the employ of a school, college, or university "if such service is performed by a student who is regularly enrolled and regularly attending classes at" such an institution. For purposes of the student employment exemption, Reg. § 31.3121(b)(10)-2 (before it was amended by IRS effective Apr. 1, 2005)—the regs applicable to the case at issue—said that the status of the employee is determined on the basis of his relationship with the organization for which the services are provided. Under that reg, an employee had student status for services performed "as an incident to and for the purpose of pursuing a course of study" at the school, college, or university. The Seventh Circuit finds that medical residents may be eligible for student FICA exception. *University of Chicago Hospitals v. U.S.*, 102 AFTR 2d ¶2008-5317 (7th Cir. 9/23/2008), The Seventh Circuit held that medical residents may qualify for the 3121(b)(10) student FICA exception. Thus, to deny the student FICA exception to medical residents, IRS must make a case-by-case determination based on the facts of each residency. The decision does not affect the income tax aspects of medical residents' stipends. It is well settled that they are not excludible. Accord, *U.S. v. Mount Sinai Medical Center of Florida*, 99 AFTR 2d 2007-2800 (11th Cir. 2007) (Medical residents are not automatically ineligible for 3121(b)(10) student FICA exemption. Rather, whether the exemption applies must be determined on a case-by-case basis.)

## V. <u>Obligations Of Employer Versus Special Obligations Of Non-Employer.</u>

Certain non-employers are responsible for tax obligations imposed on "employers," e.g., Code § §3401(d) regarding obligations of "imputed" employers such as trustees in bankruptcy who have legal "control of the payment of the wages" or agents paying wages on behalf of a foreign corporation not engaged in business in the U.S.; Code §3504 regarding obligations of fiduciary agents and others who pay wages and are covered by Treasury Department regulations; Code §

3505 regarding obligations of lenders, sureties and others involved with an employer who pay wages directly to an employer's employees or supply funds to employer accounts in certain situations; Code §6672 regarding personal liability of certain "responsible persons," such as corporate officers of an employer, where an employer fails to pay employment taxes).

## VI. IRS EMPLOYMENT TAX AUDITS, TAX LIABILITY AND SETTLEMENTS.

### A. Audits in Which Worker Classification May Be Raised.

Worker classification issues can be raised in IRS audits of the healthcare reform employer mandate penalty, employment tax audits of employer, income tax audits of employers and individuals, benefit plan audits for both employers and individuals, federal income tax audits of worker status. The can also be raised on state income tax audits for the same issues and workers' compensation investigations, etc.

### B. Fact-Gathering in IRS Employment Tax Audits of "Employers."

This process is supposed to be a neutral fact-gathering process, and not an effort by the IRS auditor to find information that solely or primarily "supports" a specific conclusion (e.g., conclusion that worker is an "employee"). Among other things, auditors will often consider tax returns filed by "employer"; contracts between service recipients and workers; other business documentation (e.g., invoices submitted by workers, "employee handbooks", benefit plan documents, etc.); written submissions and/or oral interviews regarding actual treatment of worker by service recipient; tax returns filed by workers; documents and information involving "third parties" (e.g., suppliers, customers, patients of "employer")

### C. "Red-Flags" to the IRS.

There are many situations that may make the IRS more likely to commence an employment tax audit or more inclined to find that a worker is an "employee", even though the worker might in fact be a valid non-employee. Some of these include situations in which a service recipient treats some workers as employees and some as independent contractors even though both groups perform the same type of job; a worker treated by a service recipient as an independent contractor was previously treated by the same service recipient as an employee; a worker treated by a service recipient as an independent contractor participates in the service recipient's health benefit or retirement plan; a state tax agency or another federal agency has reclassified a worker of a service recipient from independent contractor to employee status for state tax or other federal non-tax purposes; the worker has not filed federal tax returns as a sole proprietor or other non-employee entity such as an LLC or corporation, or the worker has made such a filing but has not paid self-employment taxes as a sole proprietor or such other entity has not paid employment taxes on the worker as its employee; etc.

### D. Amount of Employment Tax Liability of Service Recipient in Case of Worker Classification.

Full employment tax rates (e.g., 15.3% FICA and Medicare up to FICA limit, then additional Medicare, plus FUTA, plus full FIT at 25% +/-, for potential total of 40%+ of compensation paid to worker) or reduced rates per Code §3509 (which often average 11 % to

12% of compensation paid to worker if Form 1099 has been issued where required by law, or higher amounts if no Form 1099). Additional penalties and interest also apply. Service recipient does not receive "credit" for taxes already paid by the worker if the IRS gives the service recipient the "benefit" of the reduced §3509 rates. These amounts of back taxes can add up very quickly, even in relatively "small" audits. It is not uncommon for IRS to audit multiple years in the same audit.

**E. IRS Classification Settlement Program ("CSP").**

This program provides an opportunity for a service recipient to settle an audit in which workers were reclassified as its employees by paying relatively little back taxes if the service recipient is willing to treat such workers as employees in future tax periods after the audit ends. Rev. Proc. 99-28, Sec. 4.01(1). CSP is not available for issues other than worker classification, the CSP is not available for cases in which a threshold issue, such as the nature of a payment as dividends or wages, has not been resolved at the examination level, nor is it available to resolve issues involving the nature of compensation paid to corporate officers. Chief Counsel Advice 200038045.

**F. Voluntary Classification Settlement Program (VCSP).**

The VCSP is a voluntary program that provides an opportunity for taxpayers to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes. To participate in this voluntary program, the taxpayer must meet certain eligibility requirements and apply to participate in the VCSP by filing Form 8952, Application for Voluntary Classification Settlement Program, and enter into a closing agreement with the IRS. The VCSP allows eligible taxpayers to obtain relief similar to that currently available through the Classification Settlement Program for taxpayers under examination. See Announcement 2011-64, modified in Announcement 2012-45. The VCSP:

•Permits a taxpayer under IRS audit, other than an employment tax audit, to be eligible to participate in the VCSP

•Clarifies the current eligibility requirement that a taxpayer who is a member of an affiliated group within the meaning of section 1504(a) is not eligible to participate in the VCSP if any member of the affiliated group is under employment tax audit

•Clarifies that a taxpayer is not eligible to participate if the taxpayer is contesting in court the classification of the class or classes of workers from a previous audit by the IRS or Department of Labor; and

•Eliminates the requirement that a taxpayer agree to extend the period of limitations on assessment of employment taxes as part of the VCSP closing agreement with the IRS.

1. Eligibility.

The VCSP is available for taxpayers who want to voluntarily change the prospective classification of their workers. The program applies to taxpayers who are currently treating their workers (or a class or group of workers) as independent contractors or other nonemployees and want to prospectively treat the workers as employees.

A taxpayer must have consistently treated the workers as independent contractors or other nonemployees, and must have filed all required Forms 1099 for the workers to be reclassified under the VCSP for the previous three years to participate. However, see the heading below, “VCSP Temporary Eligibility Expansion,” for a temporary expansion to eligibility for the VCSP.

Additionally, the taxpayer cannot currently be under employment tax audit by the IRS and the taxpayer cannot be currently under audit concerning the classification of the workers by the Department of Labor or by a state government agency.

If the IRS or the Department of Labor has previously audited a taxpayer concerning the classification of the workers, the taxpayer will be eligible only if the taxpayer has complied with the results of that audit and is not currently contesting the classification in court.

Exempt organizations and government entities may participate in VCSP if they meet all of the eligibility requirements.

2. VCSP Agreements.

A taxpayer participating in the VCSP will agree to prospectively treat the class or classes of workers as employees for future tax periods. In exchange, the taxpayer will:

•Pay 10 percent of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates of section 3509(a) of the Internal Revenue Code. See VCSP FAQ 15, for information on how payment under the VCSP is calculated. Also see Instructions to Form 8952;

•Not be liable for any interest and penalties on the amount; and

•Not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified under the VCSP for prior years.

3. Applying for VCSP.

To participate in the VCSP, a taxpayer must apply using Form 8952, Application for Voluntary Classification Settlement Program. The application should be filed at least 60 days prior to the date the taxpayer wants to begin treating its workers as employees. The IRS will make every effort to process Form 8952 with sufficient time to allow for the voluntary reclassification on the requested date.

Along with the application, the taxpayer may provide the name of a contact or an authorized representative with a valid Power of Attorney (Form 2848). However, the taxpayer, and not the taxpayer's representative, is required to sign Form 8952. The IRS will contact the taxpayer or authorized representative to complete the process after reviewing the application and verifying the taxpayer’s eligibility.

Eligible taxpayers accepted into the VCSP will enter into a closing agreement with the IRS to finalize the terms of the VCSP, and will simultaneously make full and complete payment of any amount due under the closing agreement.

4. <u>VCSP – Temporary Eligibility Expansion (VCSP TEE) Through June 30, 2013.</u>

Announcement 2012-46 provides notice and information regarding a temporary expansion of eligibility for the VCSP that will be available through June 30, 2013. The temporary eligibility expansion makes a modified VCSP available to taxpayers who would otherwise be eligible for the current VCSP, but who have not filed all required Forms 1099 for the previous three years with respect to the workers to be reclassified.

Like the VCSP, the VCSP TEE permits eligible taxpayers to voluntarily reclassify their workers as employees for federal employment tax purposes and obtain relief similar to that obtained through the current Classification Settlement Program. Payment due under the VCSP TEE is higher than the payment under the VCSP, but the benefits are otherwise the same for taxpayers who participate.

To participate in the VCSP TEE, the taxpayer must meet certain eligibility requirements, apply on or before June 30, 2013, and enter into a closing agreement with the IRS. Taxpayers who would otherwise be eligible for the current VCSP, but have not filed all required Forms 1099 for the previous three years with respect to the workers to be reclassified are eligible for the VCSP TEE. In addition, once a taxpayer is deemed eligible to participate, they must furnish to the workers and electronically file all required Forms 1099 for the workers being reclassified for the previous three years prior to executing the VCSP TEE closing agreement with the IRS. The IRS will provide instructions on how to electronically file Forms 1099 once it has reviewed the taxpayer's application and verified that the taxpayer is otherwise eligible.

a. <u>VCSP TEE Agreements</u>.

A taxpayer participating in the VCSP TEE will agree to prospectively treat the class or classes of workers as employees for future tax periods. In exchange, the taxpayer will:

•Pay 25 percent of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates of section 3509(b) of the Internal Revenue Code;

•Not be liable for any interest and penalties on the liability;

•Pay a reduced, graduated penalty for unfiled Forms 1099 for the previous three years for the workers being reclassified (see the worksheet provided with Announcement 2012-46.

•Not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified for prior years.

The taxpayer must certify as part of the VCSP TEE closing agreement with the IRS that it has furnished to the workers and has electronically filed all required Forms 1099, as instructed by the IRS, for the previous three years.

b. Applying for VCSP TEE.

Eligible taxpayers who want to participate in the VCSP TEE must submit Form 8952, Application for Voluntary Classification Settlement Program (VCSP), on or before June 30, 2013. When applying for the VCSP TEE, applicants must:

•Write “VCSP Temporary Eligibility Expansion” at the top of Form 8952;

•Put a line through Part V, Line A3, to indicate that the applicant has not satisfied all Form 1099 requirements for each of the workers for the three preceding calendar years ending before the date of the application; and

•Not complete Part IV, Payment Calculation. Instead, taxpayers should complete and attach the worksheet provided in Announcement 2012-46 to calculate their payment under the VCSP TEE.

Along with the application, the taxpayer may provide the name of a contact or an authorized representative with a valid Power of Attorney (Form 2848). However, the taxpayer, and not the taxpayer’s representative, is required to sign Form 8952. The IRS will contact the taxpayer or authorized representative to complete the process after reviewing the application and verifying the taxpayer’s eligibility.

### G. Other Avenues.

After the audit is concluded at the examination level, opportunities exist for IRS Appeals and, thereafter, litigation in the federal district court, the Court of Federal Claims, or the Tax Court. different considerations come into play in determining which court should be chosen.

## VII. SECTION 530 “SAFE HAVEN” RELIEF FOR SERVICE RECIPIENTS.

### A. General Principle and Process.

Even if a service recipient would otherwise be responsible for employment taxes for a worker, Section 530 (this is not a Code section but a special provision enacted in 1978) terminates the service recipient’s employment tax liability with regard to FICA, FUTA and FIT, and any associated penalties or interest if the service recipient meets certain “safe haven” requirements. The IRS is required to construe Section 530 “liberally”. The service recipient does not have to concede that a worker is its employee before it may claim the benefit of a “safe haven”. Therefore, the first step in any IRS employment tax audit involving worker classification – even before application of the common law employment test – is to consider whether Section 530 relief is available to the service recipient. Section 530 is potentially applicably to every type of service recipient, except that pursuant to Section 1706 of the 1986 Tax Reform Act the “safe havens” may never be used by a service recipient in regard to a technical services worker (e.g., engineer, drafter, computer programmer, systems analyst) hired by the service recipient to provide technical services to the service recipient's customers.

**B. Section 530.**

1. General.

In order for a service recipient to receive Section 530 relief from its employment tax obligations regarding certain workers in question, the following two general requirements (and their subparts) must be met:

(1) the service recipient (a) must have been consistent in reporting its treatment of the workers to the IRS (e.g., filing of IRS Form 1099, where required) (i.e., "reporting consistency") and (b) must have been consistent in actually treating all workers in substantially similar positions in the same manner (i.e., "substantive consistency"); and

(2) in deciding to treat workers as independent contractors, the service recipient must have reasonably relied on either (a) a qualified prior IRS audit of the service recipient in which there was no IRS reclassification of workers holding positions "substantially similar" to the positions of the workers in question, or (b) prior judicial precedent or published rulings in situations sufficiently similar to (but not identical to) the service recipient's situation, or IRS technical advice or an IRS letter ruling specifically directed to the service recipient, or (c) a long-standing recognized practice of a significant segment of the industry (but not a uniform practice) in which such worker was performing services for the service recipient, or (d) any other reasonable basis for not treating the workers in question as employees (Note: Items (a), (b) and (c) are "specific safe havens" and item (d) is the generic "any other reasonable basis" safe haven, which is an extremely important "safe haven" that has been further developed in the above-mentioned 1996 IRS Training Materials).

2. 1996 Statutory Clarifications to Section 530.

In 1996, Congress added Section 530(e) that provided certain special rules to applying Section 530. In particular, these include the following:

(1) as to the requirement that the service recipient has relied on a long-standing practice of a significant segment of its industry, it is sufficient to make "a reasonable showing of the practice of more than 25 percent of the industry" and it is sufficient to show a practice that has continued for more than 10 years;

(2) the IRS will have the burden of proof to justify the reclassification of a worker if the service recipient has established a prima facie case of its reasonable treatment of a worker under the three "specific safe havens" and if the service recipient has fully cooperated with the IRS requests for information during the audit; and

(3) The determination of whether a worker holds a "substantially similar position" to a position held by another worker must "include consideration of the relationship between" the service recipient and the worker (i.e., the IRS may not look solely at job duties and determine, for example, that a service recipient's independent contractor painter and its employee painters hold "substantially similar positions").

# VIII. PLANNING; INCORPORATION OF THE INDIVIDUAL INDEPENDENT CONTRACTOR; DUAL STATUS WORKERS.

## A. IRS Form SS-8.

Taxpayers the opportunity to obtain “advisory” rulings on whether certain workers in specific factual situations are either employees or independent contractors under the common law. IRS Form SS-8 may be filed by a service recipient or a worker. Typically, the IRS will not issue a ruling unless all affected parties (i.e., the service recipient, the worker, and sometimes the service recipient’s customers) have responded to questions on the Form SS-8.

Very few business service recipients that use the services of independent contractors want to submit a Form SS-8, and the particular phrasing of the questions on Form SS-8 (and the inclusion of some questions, but exclusion of other questions) has been questioned by many service recipients. In the past, the filing of Form SS-8 has many times been followed by the initiation of an IRS employment tax audit of the service recipient. Taxpayers should strongly consider the risks and benefits of filing Form SS-8, and should never file it without prior assistance of a specialized employment tax practitioner.

## B. Incorporation To Avoid Employee Status.

The 1996 IRS Training Materials discussed above mention both incorporation of the worker and exclusion from employee benefits paid by recipient as factors help in finding independent contractor status, although not conclusive.

### 1. Section 269A.

In order to prevent the use of a PSC to avoid or evade federal income taxes, Congress enacted Code Section 269A, which permits the IRS to allocate the income and other items of a PSC to its owner if such allocation is necessary to prevent avoidance or evasion of federal income tax or to clearly reflect the income of the PSC or its owner. The term "personal service corporation" is defined for purposes of Code Section 269A as "a corporation the principal activity of which is the performance of personal services and such services are substantially performed by employee-owners." Code Section 269A(b)(1).

The IRS may make a Code Section 269A allocation only if substantially all the services of the PSC are performed for one other entity and the principal purpose of using the PSC for the performance of services is the avoidance or evasion of federal income taxes. Code Section 269A(a). The provision is aimed at taxpayers who use a PSC as a vehicle to provide services to the one employer that they would have provided services to directly in the absence of a PSC. If a taxpayer forms a PSC that provides services for more than one entity, Code Section 269A is not implicated.

When a corporation whose principal activity is the performance of personal services by owner-employees (personal service corporation) (1) performs substantially all its services for one entity and (2) the principal purpose of forming the personal service corporation is to avoid tax, the IRS can allocate all income, deductions and credits between the personal service corporation and its owner-employees. Code Sec. 269A. Even prior to enactment of 269A, avoiding federal income taxes has not an acceptable business purpose. The leading authority is a case in which a transitory corporation was formed in connection with a corporate reorganization solely to save its shareholder income taxes. *Gregory v. Helvering*, 293 US 465 (1935). Regulations under 269A were proposed in 1983, widely criticized, and have never been finalized.

In determining whether a taxpayer's use of a PSC will be recognized as valid under the assignment of income doctrine, the courts look at (1) whether the PSC controls the taxpayer's actions and income; and (2) whether the PSC's control is recognized by the entity paying the taxpayer's salary. *Johnson v. United States*, 698 F.2d 372 (9th Cir. 1982). If the contract is with the taxpayer and a third party, an assignment to the PSC by the taxpayer is invalid. All income attributable to the taxpayer's personal services remains taxable to the taxpayer.

In footnote 6 of the *Leavall* decision, the Tax Court noted: "Respondent has not argued and has disavowed reliance on sec. 269A."

In *Roberts v. CIR*, T.C. Memo. 1991-490, the applicability of 269A was argued by the IRS but not addressed by court.

In *Sams v. CIR*, T.C. Summary Opinion 2002-95, a real estate broker was not considered an employee of an S-corporation that she set up to conduct her business. She was considered to be self-employed and thus, the IRS properly allocated gross receipts that she reported on the entity's return to her under the assignment of income doctrine. She was the president and sole shareholder; she was not paid a salary by the entity, and she did not have any source of income outside of ventures in which she personally participated. She did not have a contract of employment with the entity, and amounts received were deposited into an account under her own name. In footnote 5 the Tax Court stated: "The application of sec. 269A to a personal service corporation (PSC) requires a finding that the principal purpose for forming or availing of that PSC is the avoidance or evasion of income tax by reducing income or securing the benefit of an expense, deduction, credit, exclusion, or other allowance for any employee-owner which would not otherwise be available. . . . There are no facts in the record that would lead us to conclude that petitioner's principal purpose for incorporating Sams, Inc. was avoidance or evasion of income tax. Therefore, sec. 269A is inapplicable."

2. <u>Section 482.</u>

The IRS can also allocate income, deductions and credits between or among two or more organizations, trades or businesses owned or controlled by the same interests to prevent tax evasion or to clearly reflect income of the organizations, trades or businesses. Code Sec. 482; Rev. Rul. 90-106.

The IRS attempted in Rev. Rul. 70-101 to resist honoring assignments even in these situations, but the courts and Congress have consistently rejected the IRS's position to allow the assignors to take advantage of the corporate form of operation. See, e.g., *Foglesong v. CIR*, 691 F. 2d 848 (7th Cir. 1982).

Generally, any business, including a personal service business composed of one person, may incorporate and divert that person's compensation income to the corporation. In one case, the IRS sought to tax the individual directly on all of the income that the professional corporation received based upon Code Sec. 482, which grants the IRS the authority to allocate gross income among or between controlled organizations, trades or businesses. However, the Tax Court found that, to the extent that the IRS attempted to shift all of the professional corporation's income to the individual, its determination was arbitrary and capricious. *Keller v CIR*, 77 T.C. 1014, aff'd, 723 F.2d 58 ($10^{th}$ Cir. 1983). The corporation must be the person actually performing the services for which the payment is received. Code Sec. 269A(b)(1).

The IRS itself has ruled that a medical corporation that employed its sole shareholder as the sole practicing physician was not formed or availed of for the principal purpose of avoiding or evading income tax. Thus, the special reallocation rule regarding personal service corporations was inapplicable. Although contributions made to the corporation's pension plan were in excess of the maximum allowed for a self-employed individual, such plans could not be taken into account in determining the purpose of the corporation. The relatively small amount of taxable income retained by the corporation did not establish that its principal purpose was tax avoidance. See PLR 8737001.

Wages that a taxpayer received for managerial services performed under contract with a company that employed him were taxable to the taxpayer as an employee even though he turned the wages over to a consulting firm in which he was a shareholder. The taxpayer had negotiated his contract with his employer before the consulting firm came into existence. The consulting firm did not control, contract for, or manifest control over the taxpayer's services. *Willett v CIR*, T.C. Memo. 1988-439.

3. Business Purpose.

The courts are lenient about finding a business purpose for incorporation for general-purpose business corporations. For example, corporations formed to encourage the founders' children to take an active interest in business, and to provide the children with additional income and to facilitate estate planning were held viable enterprises because they engage in sufficient business activities. These activities consist of complying with outside creditors' requests that the corporation sign promissory notes and mortgages that affected business property, the receipt of dividends, and use of the corporate name in connection with receipts and disbursements. *Britt v US*, 431 F.2d 227 ($5^{th}$ Cir. 1970). Another case validated a corporation organized to hold title to real estate so as to avoid ancillary administration of the taxpayer's estate. *Est. of Whitfield v CI*R, 192 F.2d 494 ($5^{th}$ Cir. 1951); *Hagist Ranch, Inc. v CIR*, 295 F.2d 351 ($7^{th}$ Cir. 1961). However, if a corporation performs the necessary quantum of activity to be recognized as a corporation, it does not matter that a purpose for forming the corporation was avoidance or reduction of estate taxes. *Sparks Farm, Inc. v. CIR*, T.C. Memo. 1988-492.

Similarly, incorporation to avoid self-employment tax has been approved. The taxpayers formed an S corporation on the advice of an attorney and ran the business out of their residence. The corporation had a telephone, corporate stationery and business cards, but checks were deposited to and issued from the taxpayer's personal account. The corporation paid no salaries or commissions. The taxpayers filed a Schedule C, Profit or Loss From Business

(Form 1040), identifying the business as a sole proprietorship, because they did not have the proper form for an S corporation. Although the court found that the taxpayers had not followed all corporate formalities, it refused to disregard the corporate form. The business was properly incorporated and run as an entity that was respected for tax purposes. *Marzullo v CIR*, T.C. Memo. 1997-261.

4. Incorporation To Avoid Use Of 20 Factor Test.

In *Sargent v. CIR*, 929 F.2d 1252 (8th Cir. 1991), the Eighth Circuit held that Code Section 269A did not apply because the PSC was established for legitimate business purposes -- increased bargaining power and the possibility of placing money into a pension plan -- not with the principal purpose of avoiding or evading federal income tax by reducing the amount of income taxed to the employee-owner. Thus, the IRS was not justified in reallocating the income to the taxpayer. In *Sargent*, the Tax Court had held that players Sargent and Cristoff were not bona fide employees of their corporations but rather their team, the Minnesota North Stars. The Tax Court ruled that because Sargent and Christoff were members of a hockey team, the requisite control over them--for purposes of taxation--was lodged in the hockey team, not in their respective corporations (PSCs), with which they had a contractual employment relationship.

The Tax Court held: "The long and short of the matter is that we conclude that the instant case is a classic situation for the application of the assignment of income doctrine articulated in *Lucas v. Earl*, 281 U.S. 111 (1930), and its progeny, and that the amounts received by Chiefy-Cat and RIF, respectively, for services rendered by petitioners to the Club should be includable in their income under section 61."

But the Eighth Circuit reversed the Tax Court and held that the two PSCs in question conducted business and met all organizational and operational requirements, withholding and filing employment taxes and paying all applicable federal and state corporate income taxes. The IRS was required to recognize and respect the corporate entity for tax purposes regardless of the fact that it was formed to take advantage of certain beneficial corporate retirement plan tax provisions. The assignment and allocation of income doctrines were inapplicable. Importantly, the Eighth Circuit in footnote 17 stated that section 269A did not apply: "Congress enacted Section 269A of the Code in 1982 to specifically address personal service corporations. . . . .We have already concluded, however, that Appellants' PSCs were established for a legitimate purpose, and Appellants had bona fide employment contracts with their respective PSCs." *Sargent v. CIR*, 929 F.2d 1252 (8th Cir. 1991), rev'g the Tax Court, 93 TCM 572.

While another case held that an incorporated professional basketball player's income from the team was taxable to him, because his PSC had no contractual arrangement with the Warriors basketball team. *Johnson v. CIR*, 78 T.C. 882, 889-890 (1982), aff'd without published opinion 734 F.2d 20 (9th Cir. 1984). The Eighth Circuit in *Sargent* distinguished Johnson because Sargent had a contract with his PSC and his PSC had a contract with the hockey team.

*Sargent v. CIR*, 929 F.2d 1252 (8th Cir. 1991) held: "As long as a corporation carries on some form of business, the Supreme Court has concluded that the tax advantages which properly flow from incorporation should not be questioned. The Supreme Court reasoned: 'The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity.' *Moline Prop. Inc. v. CIR*, 319 U.S. 436, 438-39 (1943)."

The Tax Court distinguished the Eight's Circuit's decision in *Sargent* in *Leavell v. CIR*, 104 T.C. 140 (Jan. 30, 1995), where even though the Houston Rockets entered into a contract with Allen Leavell, Leavell personally guaranteed the contract and many of the terms of the contract referred to Leavell individually, including his manner of attire and the teams right to discipline him and fine him. The Tax Court thus held he was an employee of the team, not his corporation, because the "Rockets had the right to control the manner and means by which P's personal services were performed; accordingly, with respect to P's services as a player for the Rockets, P was an employee of the Rockets."

**C. Dual Status Workers OK In Corporation But Not Partnership.**

The IRS has stated than an individual can work in two capacities for one corporation (but not a partnership). TAM 200033014 provides that a qualified real estate agent can, as such be an independent contractor of the firm in that capacity and an employee of the firm as to his management service under normal common law principles. The same person can be an employee and an independent contractor. However, the same person cannot be a partner and an employee. See, e.g., *Estate of Tilton*, 8 BTA 914 (1927) (acq.); *John A.L. Blake*, 9 BTA 651 (1927) (acq.); Rev. Rul. 55-30; Rev. Rul. 69-184. Rather, that is taxed under 707(a)(2)(iii). Payments to partners for services or the use of capital are § 707(c) guaranteed payments if they are (1) not subject to § 707(a), (2) determined "without regard to the income of the partnership," and (3) not in substance distributions by the partnership subject to § 731.

**D. Corporate Officers.**

Individuals who are officers of a corporation and perform services for that corporation that are more than minor in nature are employees of the corporation. See Reg. Section 31.3121(d)-1(b). See, e.g., *Idaho Ambucare Center, Inc. v. United States*, 57 F.3d 752 (9th Cir. 1995) (officer treated as an employee even though he only worked four or five hours per week); *Western Management, Inc. v. United States*, No. 97-340T (Fed. Cl. Jan. 21, 2000) (president of corporation was an employee); V*an Camp & Bennion v. United States*, Nos. 2:94-cs-00409, CS-94-409-CI (E.D. Wash. 1996) (one officer deemed an employee; another considered independent contractor); Rev. Rul. 74-390 (individuals were employees of management corporation but not of operating corporations); *Veterinary Surgical Consultants, P.C. v. Commissione*r, 117 T.C. 141 (2001), aff'd, No. 02-1214 (3d Cir. Dec. 18, 2002), cert. denied, No. 02-1654 (U.S. Sp. Ct. June 23, 2003) (sole shareholder and president of an S corporation that provides consulting and surgical services to veterinarians was an employee because he performed substantial services as a veterinarian for the S corporation and received remuneration for those services); *Yeagle Drywall Company, Inc. v. Commissioner*, T.C. Memo. 2001-284, aff'd, 54 Fed. Appx. 100 (3d Cir. 2002), cert. denied, No. 02-1682 (U.S. Sp. Ct .

June 23, 2003) (the 99 percent shareholder and president of an S corporation in the drywall construction business was an employee for federal employment tax purposes because he performed substantial services for his S corporation and received remuneration for those services). Similar cases involving individuals who were both officers and shareholders of S corporations include *Water Pure Systems, Inc. v. Commissioner,* T.C. Memo. 2003-53; *Nu-Look Design, Inc. v. Commissioner*, T.C. Memo. 2003-52, aff'd, No. 03-2754 (3d Cir. Jan. 26, 2004); *Specialty Transport & Delivery Services, Inc. v. Commissioner*, T.C. Memo. 2003-51; *Superior Proside, Inc. v. Commissioner,* T.C. Memo. 2003-50, aff'd, No. 03-2755 (3d Cir. Jan. 28, 2004); *Mike J. Green Trucking, Inc. v. Commissioner,* T.C. Memo. 2003-49; and *Veterinary Surgical Consultants, P.C. v. Commissioner*, T.C. Memo. 2003-48.

*The U.S. Equal Employment Opportunity Commission*

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EEOC NOTICE
Number 915.002

Date 12/03/97

1. SUBJECT: Enforcement Guidance: Application of EEO Laws to Contingent Workers Placed by Temporary Employment Agencies and Other Staffing Firms.

2. PURPOSE: This document provides guidance regarding the application of the anti-discrimination statutes to temporary, contract, and other contingent employees.

3. EFFECTIVE DATE: Upon receipt.

4. EXPIRATION DATE: As an exception to EEOC Order 205.001, Appendix B, Attachment 4, § a(5), this Notice will remain in effect until rescinded or superseded.

5. ORIGINATOR: Title VII/EPA/ADEA Division, Office of Legal Counsel.

6. INSTRUCTIONS: File after Section 605 of Volume II of the Compliance Manual.

| 12/3/97 | \s\ |
|---|---|
| Date | Gilbert F. Casellas<br>Chairman |

EXECUTIVE SUMMARY

This Guidance addresses the application of the federal employment discrimination statutes to individuals placed in job assignments by temporary employment agencies, contract firms, and other firms that hire workers and place them in job assignments with the firms' clients. The term "staffing firm" is used in this document to refer to these types of firms.

Staffing firm workers are generally covered under the anti- discrimination statutes. This is because they typically qualify as "employees" of the staffing firm, the client to whom they are assigned, or both. Thus, staffing firms and the clients to whom they assign workers may not discriminate against the workers on the basis of race, color, religion, sex, national origin, age, or disability.

The guidance makes clear that a staffing firm must hire and make job assignments in a non-discriminatory manner. It also makes clear that the client must treat the staffing firm worker assigned to it in a non-discriminatory manner, and that the staffing firm must take immediate and appropriate corrective action if it learns that the client has discriminated against one of the staffing firm workers. The document also explains that staffing firms and their clients are responsible for ensuring that the staffing firm workers are paid wages on a non-discriminatory basis. Finally, the guidance describes how remedies are allocated between a staffing firm and its client when the EEOC finds that both have engaged in unlawful discrimination.

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## Enforcement Guidance: Application of EEO Laws to Contingent Workers Placed by Temporary Employment Agencies and Other Staffing Firms

## INTRODUCTION

This Guidance addresses the application of Title VII of the Civil Rights Act of 1964 (Title VII), the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA), and the Equal Pay Act (EPA) to individuals placed in job assignments by temporary employment agencies and other staffing firms, i.e., "contingent workers." The term "contingent workers" generally refers to workers who are outside an employer's "core" work force, such as those whose jobs are structured to last only a limited period of time, are sporadic, or differ in any way from the norm of full-time, long-term employment.

This guidance focuses on a large subgroup of the contingent work force -- those who are hired and paid by a "staffing firm," such as a temporary employment agency or contract firm, but whose working conditions are controlled in whole or in part by the clients to whom they are assigned.

Recent statistics compiled by the National Association of Temporary and Staffing Services (NATSS) show that the temporary help industry currently employs more than 2.3 million individuals.1 That number represents a 100% increase since 1991, when 1.15 million individuals were employed in temporary help jobs. NATSS statistics also show that the professional segment of the temporary help industry (including occupations in accounting, law, sales, and management) has risen significantly.

A 1995 survey by the Bureau of Labor Statistics (BLS) showed that workers paid by temporary employment agencies were more likely to be female and African American than workers in traditional job arrangements,2 while workers provided by contract firms were disproportionately male.3 BLS found that workers paid by temporary help agencies were heavily concentrated in administrative support and laborer occupations and earned 60 percent of the traditional worker wage.4 The largest proportion of contract workers was employed in the services industry, and female contract workers earned slightly less than traditional workers while male contract workers earned more. BLS also found that contract and temporary workers had lower rates of health insurance and pension coverage than traditional workers, and that the majority of temporary workers would have preferred traditional work arrangements.

Staffing firms may assume that they are not responsible for any discrimination or harassment that their workers confront at the clients' work sites. Similarly, some clients of staffing firms may assume that they are not the employers of temporary or contract workers assigned to them, and that they therefore have no EEO obligations toward these workers. However, as this guidance explains, both staffing firms and their clients share EEO responsibilities toward these workers.

The Commission has addressed in previous guidance several of the coverage issues discussed in this document.5 However, because use of contingent workers is increasing, it is important to set out an updated and unified policy that more specifically explains how the anti-discrimination laws apply to this segment of the workforce.

This document provides guidance concerning the following issues:

- coverage under the EEO laws, including coverage of workers assigned to federal agencies;
- liability of staffing firms and/or clients for discriminatory hiring, assignment, or wage practices;
- liability of staffing firms and/or clients for unlawful discrimination or harassment at the assigned work site; and
- allocation of damages where both the staffing firm and its client violate EEO laws.

STAFFING SERVICE WORK ARRANGEMENTS

The activities of the following types of staffing firms are addressed in this guidance6:

### Temporary Employment Agencies

Unlike a standard employment agency, a temporary employment agency employs the individuals that it places in temporary jobs at its clients' work sites. The agency recruits, screens, hires, and sometimes trains its employees. It sets and pays the wages when the worker is placed in a job assignment, withholds taxes and social security, and provides workers' compensation coverage. The agency bills the client for the services performed.

While the worker is on a temporary job assignment, the client typically controls the individual's working conditions, supervises the individual, and determines the length of the assignment.

### Contract Firms

Under a variety of arrangements, a firm may contract with a client to perform a certain service on a long-term basis and place its own employees, including supervisors, at the client's work site to carry out the service. Examples of contract firm services include security, landscaping, janitorial, data processing, and cafeteria services.

Like a temporary employment agency, a contract firm typically recruits, screens, hires, and sometimes trains its workers. It sets and pays the wages when the worker is placed in a job assignment, withholds taxes and social security, and provides workers' compensation coverage.

The primary difference between a temporary agency and a contract firm is that a contract firm takes on full operational responsibility for performing an ongoing service and supervises its workers at the client's work site.

### Other Types of Staffing Firms

There are many variants on the staffing firm/ client model. For example, "facilities staffing" is an arrangement in which a staffing firm provides one or more workers to staff a particular client operation on an ongoing basis, but does not manage the operation.

Under another model, a client of a staffing firm puts its workers on the firm's payroll, and the firm leases the workers back to the client. The purpose of this arrangement is to transfer responsibility for administering payroll and benefits from the client to the staffing firm. A staffing firm that offers this service does not recruit, screen, or train the workers.

The term "staffing firm" is used in this document to describe generically these types of firms, although more specific terms are used where necessary for purposes of clarity.

## COVERAGE ISSUES

This section sets forth criteria for determining whether a staffing firm worker qualifies as an "employee" within the meaning of the anti-discrimination statutes or an independent contractor; whether the staffing firm and/or its client qualifies as the worker's employer(s); and whether the staffing firm or its client can be liable for discriminating against the worker even if it does not qualify as the worker's employer. This section also discusses coverage of staffing firm workers assigned to jobs in the Federal Government and coverage of workers assigned to jobs in connection with welfare programs. Finally, this section explains the method for counting workers of a staffing firm or its client to determine whether either entity has the minimum number of employees to be covered under the applicable anti-discrimination statute.

1. Are staffing firm workers "employees" within the meaning of the federal employment discrimination laws?

Yes, in the great majority of circumstances.7 The threshold question is whether a staffing firm worker is an "employee" or an "independent contractor." The worker is a covered employee under the anti-discrimination statutes if the right to control the means and manner of her work performance rests with the firm and/or its client rather than with the worker herself. The label used to describe the worker in the employment contract is not determinative. One must consider all aspects of the worker's relationship with the firm and the firm's client.8 As the Supreme Court has emphasized, there is " no shorthand formula or magic phrase that can be applied to find the answer, . . . all incidents of the relationship must be assessed with no one factor being decisive.'"9 Factors that indicate that the worker is a covered employee include:10

a) the firm or the client has the right to control when, where, and how the worker performs the job;

b) the work does not require a high level of skill or expertise;

c) the firm or the client rather than the worker furnishes the tools, materials, and equipment;

d) the work is performed on the premises of the firm or the client;

e) there is a continuing relationship between the worker and the firm or the client;

f) the firm or the client has the right to assign additional projects to the worker;

g) the firm or the client sets the hours of work and the duration of the job;

h) the worker is paid by the hour, week, or month rather than for the agreed cost of performing a particular job;

I) the worker has no role in hiring and paying assistants;

j) the work performed by the worker is part of the regular business of the firm or the client;

k) the firm or the client is itself in business;

l) the worker is not engaged in his or her own distinct occupation or business;
m) the firm or the client provides the worker with benefits such as insurance, leave, or workers' compensation;

n) the worker is considered an employee of the firm or the client for tax purposes (i.e., the entity withholds federal, state, and Social Security taxes);

o) the firm or the client can discharge the worker; and

p) the worker and the firm or client believe that they are creating an employer-employee relationship.

This list is not exhaustive. Other aspects of the relationship between the parties may affect the determination of whether an employer-employee relationship exists. Furthermore, not all or even a majority of the listed criteria need be met. Rather, the fact-finder must make an assessment based on all of the circumstances in the relationship between the parties.

Example 1: A temporary employment agency hires a worker and assigns him to serve as a computer programmer for one of the agency's clients. The agency pays the worker a salary based on the number of hours worked as reported by the client. The agency also withholds social security and taxes and provides workers' compensation coverage. The client establishes the hours of work and oversees the individual's work. The individual uses the client's equipment and supplies and works on the client's premises. The agency reviews the individual's work based on reports by the client. The agency can terminate the worker if his or her services are unacceptable to the client. Moreover, the worker can terminate the relationship without incurring a penalty. In these circumstances, the worker is an "employee."

2. Is a staffing firm worker who is assigned to a client an employee of the firm, its client, or both?

Once it is determined that a staffing firm worker is an "employee," the second question is who is the worker's employer. The staffing firm and/or its client will qualify as the worker's employer(s) if, under the factors described in Question 1, one or both businesses have the right to exercise control over the worker's employment. As noted above, no one factor is decisive, and it is not necessary even to satisfy a majority of factors. The determination of who qualifies as an employer of the worker cannot be based on simply counting the number of factors. Many factors may be wholly irrelevant to particular facts. Rather, all of the circumstances in the worker's relationship with each of the businesses should be considered to determine if either or both should be deemed his or her employer. If either entity qualifies as the worker's employer, and if that entity has the statutory minimum number of employees (see Question 6), then it can be held liable for unlawful discriminatory conduct against the worker. If both the staffing firm and its client have the right to control the worker, and each has the statutory minimum number of employees, they are covered as "joint employers."11

a. Staffing Firm:

The relationship between a staffing firm and each of its workers generally qualifies as an employer-employee relationship because the firm typically hires the worker, determines when and where the worker should report to work, pays the wages, is itself in business, withholds taxes and social security, provides workers' compensation coverage, and has the right to discharge the worker. The worker generally receives wages by the hour or week rather than by the job and often has a continuing relationship with the staffing firm. Furthermore, the intent of the parties typically is to establish an employer-employee relationship.12
In limited circumstances, a staffing firm might not qualify as an employer of the workers that it assigns to a client. For example, in some circumstances, a client puts its employees on the staffing firm's payroll solely in order to transfer the responsibility of administering wages and insurance benefits. This is often referred to as employee leasing. If the firm does not have the right to exercise any control over these workers, it would not be considered their "employer."13

b. Client:

A client of a temporary employment agency typically qualifies as an employer of the temporary worker during the job assignment, along with the agency. This is because the client usually exercises significant supervisory control over the worker.14

> Example 2: Under the facts of Example 1, above, the temporary employment agency and its client qualify as joint employers of the worker because both have the right to exercise control over the worker's employment.
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> Example 3: A staffing firm hires charging party (CP) and sends her to perform a long term accounting project for a client. Her contract

with the staffing firm states that she is an independent contractor. CP retains the right to work for others, but spends substantially all of her work time performing services for the client, on the client's premises. The client supervises CP, sets her work schedule, provides the necessary equipment and supplies, and specifies how the work is to be accomplished. CP reports the number of hours she has worked to the staffing firm. The firm pays her and bills the client for the time worked. It reviews her work based on reports by the client and has the right to terminate her if she is failing to perform the requested services. The staffing firm will replace her with another worker if her work is unacceptable to the client.

In these circumstances, despite the statement in the contract that she is an independent contractor, both the staffing firm and the client are joint employers of CP.15

Clients of contract firms and other types of staffing firms also qualify as employers of the workers assigned to them if the clients have sufficient control over the workers, under the standards set forth in Question 1, above.16 For example, the client is an employer of the worker if it supplies the work space, equipment, and supplies, and if it has the right to control the details of the work to be performed, to make or change assignments, and to terminate the relationship. On the other hand, the client would not qualify as an employer if the staffing firm furnishes the job equipment and has the exclusive right, through on-site managers, to control the details of the work, to make or change assignments, and to terminate the workers.

Example 4: A staffing firm provides janitorial services for its clients. It hires the workers and places them on each client's premises under the supervision of the contract firm's own managerial employees. The firm's manager sets the work schedules, assigns tasks to the janitors, provides the equipment they need to do the job, and supervises their work performance. The client has no role in controlling the details of the work, making assignments, or setting the hours or duration of the work. Nor does the client have authority to discharge the worker. In these circumstances, the staffing firm is the worker's exclusive employer; its client is not a joint employer.

Example 5: A staffing firm provides

landscaping services for clients on an ongoing basis. The staffing firm selects and pays the workers, provides health insurance and withholds taxes. The firm provides the equipment and supplies necessary to do the work. It also supervises the workers on the clients' premises. Client A reserves the right to direct the staffing firm workers to perform particular tasks at particular times or in a specified manner, although it does not generally exercise that authority. Client A evaluates the quality of the workers' performance and regularly reports its findings to the firm. It can require the firm to remove the worker from the job assignment if it is dissatisfied. The firm and the Client A are joint employers.

3. Can a staffing firm or its client be liable for unlawfully discriminating against a staffing firm worker even if it does not qualify as the worker's employer?

An entity that has enough employees to qualify as an employer under the applicable EEO statute can be held liable for discriminating against an individual who is not its employee. The anti-discrimination statutes not only prohibit an employer from discriminating against its own employees, but also prohibit an employer from interfering with an individual's employment opportunities with another employer.17 Thus, a staffing firm that discriminates against its client's employee or a client that discriminates against a staffing firm's employee is liable for unlawfully interfering in the individual's employment opportunities.18

Example 6: A staffing firm assigned one of its employees to maintain and repair a client's computers. The firm supplied all the tools and direction for the repairs. The technician was on the client's premises only sporadically over a three to four week period and worked independently while there. The client did not report to the firm about the number of hours worked or about the quality of the work. The client had no authority to make assignments or require work to be done at particular times. After a few visits, the client asked the contract firm to assign someone else, stating that it was not satisfied with the worker's computer repair skills. However, the worker believes that the true reason for the client's action was racial bias.

The client does not qualify as a joint employer of the worker because it had no ongoing relationship with the worker, did not pay the worker or firm based on the hours worked, and had no authority over hours, assignments, or other aspects of the means or manner by which the work was achieved. However, if the client's request to replace the worker was due to racial bias, and if the client had fifteen or more employees, it would be liable for interfering in the worker's employment opportunities with the staffing firm.

Example 7: A company puts its employees on the payroll of a staffing firm solely in order to transfer the responsibility of administering wages and insurance benefits for the company's workers. The staffing firm administers a health insurance policy for its client's workers that does not cover AIDS-related illness. Two workers file ADA charges against the staffing firm and the client. The staffing firm claims that it is not an employer of the workers and therefore falls outside ADA coverage.

The staffing firm does not qualify as a joint employer of the workers because it does not have the requisite degree of control -- it did not hire the workers; establish their wage rates or hours; control the conditions of work; manage personnel disputes; or have the right to fire the workers. Nevertheless, the firm shares liability with its client for the discriminatory health insurance plan if it has fifteen or more employees of its own to fall under the coverage of the ADA.19 This is because the firm's administration of the insurance plan interferes in the workers' access to employment opportunities or benefits.20

4. Do the same coverage principles apply when a staffing firm assigns a worker to a federal agency?

The principles regarding joint employer coverage are the same. Thus, a federal agency qualifies as a joint employer of an individual assigned to it if it has the requisite control over that worker, as discussed in Questions 1 and 2. If so, and if the agency discriminates against the individual, it is liable whether or not the individual is on the federal payroll.21

In contrast to private employers, a federal agency that does not qualify as a joint employer of the worker assigned to it cannot be found liable for discrimination under a "third party interference" theory. This is because Title VII, the ADEA, and Section 501 of the Rehabilitation Act only permit claims against the federal government by "employees or applicants for employment."22

5. Are workers participating in work-related activities in connection with welfare programs protected by the federal employment discrimination laws? If so, who is the employer of such a worker? What types of claims might arise?

a. Employee Status

Welfare recipients participating in work-related activities23 are protected by the federal anti-discrimination statutes if they are "employees" within the meaning of the federal employment discrimination laws.24 See Question 1. The simple fact of participation in one of these activities is not dispositive of the question of whether the federal employment discrimination laws apply. Rather, the same analysis applies which is used to determine whether any other worker is covered by the federal employment discrimination laws. Under the criteria that have been set out, welfare recipients would likely be considered employees in most of the work activities described in the new welfare law, including unsubsidized and subsidized public and private sector employment, work experience, and on-the-job training programs.25 On the other hand, individuals engaged in activities such as vocational education, job search assistance, and secondary school attendance would probably not be covered.26

b. Employer Status

While some workers participating in these programs will have a single employer, others may have joint employers. For example, a state or local welfare agency may function as a staffing firm and the "direct" employer may function as the client. In some cases, a state or local welfare agency may contract with a temporary employment agency to place the welfare recipients in job assignments. The determination of whether any or all of these entities are employers of the worker is based on the same criteria set forth in answer to Questions 1 and 2 that apply to any other employment situation. The fact that an entity does not pay the worker a salary does not, by itself, defeat a finding of an employment relationship. Moreover, even if an entity is not the worker's employer, it can be found liable under the employment discrimination laws based on the interference theory explained in the answer to Question 3.

c. Types of Claims

Types of claims which may arise include, for example, harassment, discriminatory assignments, discriminatory termination, failure to provide reasonable accommodation to persons covered under the Americans with Disabilities Act, and retaliation.

6. Which workers are counted when determining whether a

staffing firm or its client is covered under Title VII, the ADEA, or the ADA?

The staffing firm and the client each must count every worker with whom it has an employment relationship.27 Although a worker assigned by a staffing firm to a client may not appear on the client's payroll, (s)he must be counted as an employee of both entities if they qualify as joint employers.28 Questions 1 and 2, above, set forth the legal standards for determining whether a worker has an employment relationship with either the staffing firm or its client, or both.

The Supreme Court has made clear that a respondent must count each employee from the day that the employment relationship begins until the day that it ends, regardless of whether the employee is present at work or on leave on each working day during that period.29 Thus, a client of a staffing firm must count each worker assigned to it from the first day of the job assignment until the last day. The staffing firm also must count the worker as its employee during every period in which the worker is sent on a job assignment.

Staffing firms are typically covered under the anti- discrimination statutes, because their permanent staff plus the workers that they send to clients generally exceeds the minimum statutory threshold. Clients may or may not be covered, depending on their size.
In cases where questions are raised regarding coverage, the investigator should ask the respondent to name and provide records regarding every individual who performed work for it, including all individuals assigned by staffing firms and any temporary, seasonal, or other contingent workers hired directly by the respondent. If the investigator has questions about the documents produced and cannot otherwise obtain the necessary information, he or she may consider deposing the respondent. The investigator should then determine which of the named individuals qualified as employees of the respondent rather than independent contractors, according to the standards set forth in Questions 1 and 2, above.

## DISCRIMINATORY ASSIGNMENT PRACTICES

A staffing firm is obligated, as an employer, to make job assignments in a nondiscriminatory manner.30 It also is obligated as an employment agency to make job referrals in a nondiscriminatory manner. The staffing firm's client is liable if it sets discriminatory criteria for the assignment of workers. The following question and answer explore these issues in detail.

7. If a worker is denied a job assignment by a staffing firm because its client refuses to accept the worker for discriminatory reasons, is the staffing firm liable? Is the client?

a. Staffing Firm

The staffing firm is liable for its discriminatory assignment decisions. Liability can be found on any of the following bases: 1) as an employer of the workers assigned to clients (for discriminatory job assignments); 2) as a third party interferer (for discriminatory interference in the workers' employment opportunities with the firm's client); and/or 3) as an employment agency for (discriminatory job referrals).31

The fact that a staffing firm's discriminatory assignment practice is based on its client's requirement is no defense. Thus, a staffing firm is liable if it honors a client's discriminatory assignment request or if it knows that its client has rejected workers in a protected class for discriminatory reasons and for that reason refuses to assign individuals in that protected class to that client. Furthermore, the staffing firm is liable if it administers on behalf of its client a test or other selection requirement that has an adverse impact on a protected class and is not job-related for the position in question and consistent with business necessity. 42 U.S.C. § 2000e-2(k).

b. Client

A client that rejects workers for discriminatory reasons is liable either as a joint employer or third party interferer if it has the requisite number of employees to be covered under the applicable anti-discrimination statute.

> Example 8: A staffing firm that provides job placements for nurses receives a job order from an individual client for a white nurse to provide her with home-based nursing care. The firm agrees to refer only white nurses for the job. The firm is violating Title VII, both as an employment agency for its discriminatory referral practice and as an employer for the discriminatory job assignment. The client is not covered by Title VII because she does not have fifteen or more employees.

> Example 9: A temporary employment agency receives a job order for a temporary receptionist. The client requires that the individual assigned to it speak English fluently because a large part of the job entails communication with English-speaking persons who call the client or who come to the client's work place. The agency assigns an Asian American individual who speaks English fluently, but with an accent. The client insists that the agency replace her with someone who can speak unaccented English. The agency complies with that request and sends an individual who speaks English fluently with no accent.

The Asian American individual files a charge with the EEOC. The investigator determines that English fluency was necessary for the job. However, he further determines that CP's accent does not interfere with her ability to communicate and that she has effectively performed similar jobs. The investigator properly concludes that both the client and the staffing firm are liable for terminating CP on the basis of her national origin.

Example 10: A staffing firm provides machine operators to its clients. One of its clients requires that all workers assigned to it pass a certain paper and pencil test. The firm administers the test to its available workers and refers only those who pass the test. An African American individual who is denied an assignment with the client files charges against both the staffing firm and its client, alleging that administration of the test results in the disproportionate exclusion of African Americans. An investigation shows that the test does have an adverse impact on African Americans and does not accurately measure the skills that are necessary for job performance. Therefore, both the staffing firm and its client are in violation of Title VII.

## DISCRIMINATION AT WORK SITE

A client of a staffing firm is obligated to treat the workers assigned to it in a nondiscriminatory manner. Where the client fails to fulfill this obligation, and the staffing firm knows or should know of the client's discrimination, the firm must take corrective action within its control.32 The following questions and answers explore these issues in detail.

8. If a client discriminates against a worker assigned by a staffing firm, who is liable?

Client: If the client qualifies as an employer of the worker (see Questions 1 and 2), it is liable for discriminating against the worker on the same basis that it would be liable for discriminating against any of its other employees.

Even if the client does not qualify as an employer of the worker, it is liable for discriminating against that individual if the client's misconduct interferes with the worker's employment opportunities with the staffing firm, and if the client has the minimum number of employees to be covered under the applicable discrimination statute. See Question 3.

Staffing Firm: The firm is liable if it participates in the client's discrimination. For example, if the firm honors its client's request to remove a worker from a job assignment for a discriminatory reason and replace him or her with an individual outside the worker's protected class, the firm is liable for the discriminatory discharge. The firm also is liable if it knew or should have known about the client's discrimination and failed to undertake prompt corrective measures within its control.33

The adequacy of corrective measures taken by a staffing firm depends on the particular facts. Corrective measures may include, but are not limited to: 1) ensuring that the client is aware of the alleged misconduct; 2) asserting the firm's commitment to protect its workers from unlawful harassment and other forms of prohibited discrimination; 3) insisting that prompt investigative and corrective measures be undertaken; and 4) affording the worker an opportunity, if (s)he so desires, to take a different job assignment at the same rate of pay. The staffing firm should not assign other workers to that work site unless the client has undertaken the necessary corrective and preventive measures to ensure that the discrimination will not recur. Otherwise, the staffing firm will be liable along with the client if a worker later assigned to that client is subjected to similar misconduct.34

> Example 11: A temporary receptionist placed by a temporary employment agency is subjected to severe and pervasive unwelcome sexual comments and advances by her supervisor at the assigned work site. She complains to the agency, and the agency informs its client of the allegation. The client refuses to investigate the matter, and instead asks the agency to replace the worker with one who is not a "troublemaker." The agency tells the worker that it cannot force the client to take corrective action, finds the worker a different job assignment, and sends another worker to complete the original job assignment.
>
> The client is liable as an employer of the worker for harassment and for retaliatory discharge.
>
> The temporary employment agency also is liable for the harassment and retaliatory discharge because it knew of the misconduct and failed to undertake adequate corrective action. Informing the client of the harassment complaint was not sufficient -- the agency should have insisted that the client investigate the allegation of harassment and take immediate and appropriate corrective action. The agency should also have asserted the right

of its workers to be free from unlawful discrimination and harassment, and declined to assign any other workers until the client undertook the necessary corrective and preventive measures. The agency unlawfully participated in its client's discriminatory misconduct when it acceded to the client's request to replace the worker with one who was not a "troublemaker." If the replacement worker is subjected to similar harassment, the agency and the client will be subject to additional liability.

Example 12: A staffing firm provides computer services for a company that has more than 15 employees. The staffing firm assigns an individual to work on-site for that client. When the client discovers that the worker has AIDS, it tells the staffing firm to replace him because the client's employees fear infection. The staffing firm alerts the client that they are both prohibited from discriminating against the worker, and that such a discharge would violate the ADA. The client nevertheless continues to insist that the firm remove the worker from the work assignment and replace him with someone else. The staffing firm has no choice but to remove the worker. However, it declines to replace him with another worker to complete the assignment because to do so would constitute acquiescence in the discrimination. Furthermore, the firm offers the worker a different job assignment at the same rate of pay. The client is liable for the discriminatory discharge, either as an employer or third party interferer. The staffing firm is not liable because it took immediate and appropriate corrective action within its control.

9. If a staffing firm sends its employee on a job assignment with a federal agency and the individual is subjected to discrimination while on the assignment, is the federal agency liable? Is the staffing firm? What procedures should the individual follow in filing a complaint?

The federal agency is liable for discriminating against the worker if it qualifies as an employer of the worker. If the federal agency does not qualify as an employer of the staffing firm worker under the criteria in Questions 1 and 2, it will not be liable for discriminating against that worker under the statutes enforced by the EEOC. A federal agency is liable for employment discrimination under these statutes only where it has sufficient control to be deemed an employer of the worker. See Question 4.

The staffing firm is liable if it participated in the federal agency's discrimination or if it knew or should have known of the discrimination and failed to intervene, under the principles discussed in Question 8, above.

If the staffing firm worker seeks to pursue a complaint against the federal agency as his or her employer, (s)he should contact an EEO Counselor at the federal agency within 45 days of the date of the alleged discrimination. If the individual also seeks to pursue a claim against the staffing firm, (s)he should file a separate charge with an EEOC field office. In such circumstances, the EEOC investigator should alert the individual as to the different time frames and procedures in the federal and private sectors.35 The investigator should also contact the EEO office of the federal agency once the individual files the federal sector complaint in order to coordinate the federal and private sector investigations.36

DISCRIMINATORY WAGE PRACTICES

A staffing firm may not discriminate in the payment of wages on the basis of race, sex, religion, national origin, age, or disability. Its clients share that obligation.

10. If a staffing firm assigns a male and female to a client to perform substantially equal work, and the female is paid a lower wage than the male, would the firm and/or the client be subject to Equal Pay Act or Title VII liability?

Under the EPA, men and women must receive equal pay for equal work.37 The jobs need not be identical, but they must be substantially equal. It is job content, not job titles, that determines whether jobs are substantially equal. Specifically, a sex-based wage disparity violates the EPA if the jobs are in the same establishment, require substantially equal skill, effort, and responsibility, are performed under similar working conditions, and if no statutory defense applies. Wage differences that are not based on sex, but on bona fide distinctions between temporary and permanent workers, can be justified under the EPA as based on a "factor other than sex."38 Both the staffing firm and its client are liable for a violation of the Equal Pay Act if they both qualify as "employers" of the worker bringing the complaint.39

A violation of the EPA also constitutes a violation of Title VII as long as there is Title VII coverage.40 Furthermore, a sex-based wage disparity violates Title VII even if the jobs are not substantially equal under EPA standards, if there is other evidence of wage discrimination.41 Moreover, an entity with fifteen or more employees is liable under Title VII for wage discrimination even if it does not qualify as an employer of the worker assigned to it, if the wage discrimination interferes in the worker's employment opportunities.

Example 13: A temporary employment agency assigned CP (female) to a temporary job as a hospital aide. CP discovered that the agency had also assigned a male to a temporary job as an "orderly" at the same hospital at a higher wage. CP files charges against the agency and the hospital, alleging that her job and that of the male orderly were substantially equal, and that the wage disparity violated the Equal Pay Act and Title VII. CP's charge against the hospital also challenges a disparity between her wages and those of permanent male aides and orderlies at the hospital.

The investigator determines that the temporary employment agency and the hospital were joint employers of CP and that both entities had control over the rates of pay for the hospital aide and orderly jobs. The investigator also determines that the temporary aide and orderly jobs were substantially equal under EPA standards, and that no defense applies. Therefore, he finds that the agency and the hospital are both liable under the EPA and Title VII on the claim that the temporary aide and orderly should have received the same wage. The investigator further determines that the wage differential between the temporary and permanent aide and orderly jobs was based on a factor other than sex, since the hospital paid all its temporary workers less than permanent workers filling the same jobs, regardless of sex. Therefore, "no cause" is found on this latter claim.

## ALLOCATION OF REMEDIES

11. If the Commission finds reasonable cause to believe that both a staffing firm and its client have engaged in unlawful discrimination, how are back wages and damages allocated between the respondents?

Where the combined discriminatory actions of a staffing firm and its client result in harm to the worker, the two respondents are jointly and severally liable for back pay, front pay, and compensatory damages. This means that the complainant can obtain the full amount of back pay, front pay, and compensatory damages from either one of the respondents alone or from both respondents combined.42 Punitive damages under Title VII and the ADA,43 and liquidated damages under the ADEA,44 are individually assessed against and borne by each respondent in accordance with its respective degree of malicious or reckless misconduct.45 This is because punitive damages are designed not to compensate the victim for his or her harm, but to punish the respondent.46 Of course, no respondent can be required to pay a sum of future pecuniary damages, damages for emotional distress, and punitive damages, in excess of its applicable statutory cap. The investigator should contact the legal unit in his or her office for advice in determining how to allocate damages between the parties.

Computation of Monetary Relief

The first step is to compute lost wages (including back and front pay); compensatory damages for both pecuniary loss and emotional distress; and punitive damages.47 This computation should be made without regard to the statutory caps on damages,48 and, except for punitive damages, without regard to either respondent's ability to pay.49 This initial computation will establish the charging party's total wage and other compensable losses, as well as the full calculation of punitive damages.

Back Pay, Front Pay, and Past Pecuniary Damages

The next step is to determine the allocation between the respondents of back and front pay and past pecuniary damages. The charging party can obtain the full amount of these remedies because they are not subject to the statutory caps. The Commission can pursue the entire amount from either the staffing firm or the client, or from both combined.50 However, the total amount actually paid cannot exceed the sum of back and front wages and past pecuniary damages owed to the worker.

Application of the Statutory Cap on Damages

The final step is to determine each respondent's liability for compensatory and punitive damages subject to the statutory caps. The total amount paid by a respondent for compensatory damages for emotional distress and future pecuniary harm, and for punitive damages, cannot exceed its statutory cap. Thus, while the initial determination of the appropriate amount of compensatory and/or punitive damages is made without regard to the caps, the caps may affect the allocation of damages between two respondents as well as the total damages paid to the charging party. In applying the caps to the actual allocation of damages, the following principles apply:

- For compensatory damages subject to the caps, each respondent is responsible for any portion of the total damages up to its cap.
- For punitive damages, each respondent is only responsible for the damages which have been assessed against it and only up to its applicable statutory cap.
- After the fact-finder has determined the amount of compensatory damages for emotional distress

and future pecuniary harm, and the amount of punitive damages for which either or both respondents are liable, these amounts should be allocated between the two respondents in order to yield the maximum payable relief for the charging party.

- If the total compensatory damages are within the sum of the two respondents' caps, the damages should be allocated to assure that the full amount is paid.

- If one or both respondents are liable for punitive damages as well as compensatory damages, and the total sum of damages is within the applicable caps, the damages should be allocated, both between the respondents, and between compensatory and punitive damages for each respondent, to assure full payment. Thus, each respondent should pay the full amount of punitive damages for which it is liable, and any portion of the compensatory damages up to its statutory cap.

- If the sum of damages exceeds the sum of the applicable caps, the damages should be allocated, both between the respondents and between compensatory and punitive damages for each respondent, to maximize the payment to the charging party.

Example 14: CP was assigned by Staff Serve to work as a security guard at a store called Value, U.S.A. ("Value"). CP was subjected to persistent and egregious racial epithets by two supervisory employees of the store. CP complained several times to both a higher level manager at Value and to a supervisor at Staff Serve, but neither took any action to address the problem. After being subjected to egregious racial epithets that involved his family, CP informed the manager at Value and the supervisor at Staff Serve that the situation was intolerable. These individuals told CP to stop complaining and to live with these epithets as the price of holding the job. CP stopped reporting to work and asked Staff Serve to assign him elsewhere, but the firm failed to do so. CP was unable to find work for eight months.

CP files a charge against Staff Serve and Value. The investigator determines that both are liable for the racial harassment and constructive discharge. The investigator further determines that CP is due $40,000 in back pay and $60,000 in damages for emotional distress and that Staff Serve and Value are jointly and severally liable for these amounts. Although Value's conduct was at least as egregious as Staff Serve's, the investigator determines that Value's financial position is relatively weak, and that a punitive damage award of $30,000 against Value is appropriate, as compared to $50,000 for Staff Serve.

Staff Serve employs 137 employees (counting its regular staff people and the workers it has sent on assignment), and is subject to the $100,000 damages cap. Value employs 45 workers and is subject to the $50,000 cap on damages.

In conciliation, the investigator determines that Staff Serve and Value should work out a division of the $40,000 in back pay, for which they are jointly and severally liable. The investigator further determines that the damages should be allocated as follows: Staff Serve should pay $40,000 and Value $20,000 in compensatory damages, and Staff Serve should pay $50,000 and Value $30,000 in punitive damages. CP can thus obtain the full amount of damages due him, with neither respondent's liability exceeding its cap.

Example 15: Same facts as in Example 14, but CP only names Staff Serve as a respondent because Value has gone bankrupt. The sum of compensatory and punitive damages assessed by the Commission is $110,000 ($60,000 for emotional distress and $50,000 in punitive damages assessed against Staff Serve). The Commission pursues $100,000 in combined damages due to Staff Serve's statutory cap. The Commission and Staff Serve may agree to deduct the $l0,000 in excess of the caps from either the emotional distress or the punitive damages. The Commission also pursues the full $40,000 in back pay from Staff Serve, which is not subject to the cap.

Example 16: Same facts as Example 14, except that both Staff Serve and Value are subject to the $50,000 cap. CP could obtain only a total of $100,000 in damages, even though the sum of compensatory and punitive damages was $140,000. The investigator works with CP and the respondents to determine how to allocate the damages between compensatory and punitive damages. The full amount of back-pay remains payable since it is not subject to the caps.

## CHARGE PROCESSING INSTRUCTIONS

When a charge is filed by a worker who was hired by a temporary agency, contract firm, or other staffing firm and who alleges discrimination by the staffing firm or the firm's client, consider the following questions (refer to the questions and answers in the guidance for detailed information):

I. Coverage

1. Is the charging party (CP) an employee or an independent contractor? (Q&A 1)

   - Determine whether the right to control the means and manner of CP's work performance rested with the staffing firm and/or the client or with the worker herself. Consider the factors listed in Question and Answer 1 of this guidance and all other aspects of CP's relationship to the firm and its client.

If CP is an independent contractor, dismiss the charge for lack of jurisdiction. If CP is an employee, determine who qualifies as his or her employer. It is possible that both the staffing firm and its client qualify as joint employers. In that regard consider the following:

2. Is CP an employee of the staffing firm? (Q&A 2(a))

   - Consider the factors listed in Question 1 as they apply to the relationship between CP and the staffing firm.

3. Is CP an employee of the firm's client? (Q&A 2(b))

   - Consider the factors listed in Question 1 as they apply to the relationship between CP and the client.

Even if the client does not qualify as CP's employer, it is still covered under the applicable anti-discrimination statute if it interfered on a discriminatory basis with CP's employment opportunities with the staffing firm and has the requisite number of employees. (Q&A 3) The same is true if the staffing firm does not qualify as CP's employer. However, a federal agency can only be held liable as an employer, not as a third-party interferer. (Q&A 4)

If CP is a welfare recipient alleging discrimination in a work-related activity connected with a welfare program, the above considerations apply to determine coverage. (Q&A 5) In such circumstances, the state or local welfare agency may function as a staffing firm and the employer for whom CP performed work as the client.

4. If there is a question about coverage, does the staffing firm and/or the client have the minimum number of employees to be covered under the applicable anti- discrimination statute? (Q&A 6)

- Ask the respondent to name and provide records regarding each individual who performed work for it during the applicable time period, including individuals assigned by staffing firms and any temporary, seasonal, or other contingent workers hired directly by the respondent. Determine which of these individuals qualified as employees rather than independent contractors.

II. Assignment Practices (Q&A 7)

If CP alleges that a staffing firm declined to assign him or her to its client for discriminatory reasons, consider the following questions:

1. Does the evidence show that the staffing firm denied CP a job assignment for discriminatory reasons?

   - If so, the staffing firm is liable as an employer of CP for its discriminatory assignment practice, as a third party interferer, and/or as an employment agency for its discriminatory referral practice.

2. Does the evidence show that the client set discriminatory criteria for assignments by the staffing firm?

   - If so, the client is liable either as a joint employer of CP or a third party interferer.

III. Discrimination at Work Site (Q&A 8, 9)

If CP alleges that (s)he was subjected to discrimination while performing a job assignment for the staffing firm's client, consider the following questions:

1. Client: Does the evidence show that the client discriminated against CP?

   - If so, the client is liable as CP's employer or as a third party interferer. However, if the client is a federal agency it can only be held liable as an employer.

2. Staffing firm:

   a. Does the evidence show that the staffing firm participated in its client's discrimination, e.g., by honoring the client's discriminatory request to replace CP with someone outside his or her protected class?

   b. Does the evidence show that the staffing firm knew or should have known of its client's discrimination and failed to take immediate and appropriate corrective measures within its control?

   If the answer to (a) or (b) is "yes," the staffing firm is liable for its discrimination.

IV. Discriminatory Wage Practices (Q&A 10)
If CP alleges that the staffing firm paid discriminatory wages for his or her work for the firm's client, consider the following:

1. Is there an Equal Pay Act violation?

- Did the staffing firm assign a person of the opposite sex to the same client to perform substantially equal work and pay that individual a higher wage?

If so, the staffing firm is liable for the EPA violation. The client also can be found liable if it qualified as CP's joint employer.

2. Is there a violation of Title VII, the ADEA, or the ADA?

- A violation of the EPA also constitutes a violation of Title VII as long as there is Title VII coverage.

- A sex-based wage disparity violates Title VII even if the jobs are not substantially equal under EPA standards, if there is other evidence of wage discrimination. Title VII also prohibits wage discrimination based on race, national origin, and religion.

If the respondent committed wage discrimination in violation of Title VII, the ADEA, or the ADA it is liable as CP's employer or as a third-party interferer.

V. Allocation of Remedies (Q&A 11)

If both the staffing firm and its client have unlawfully discriminated against CP, remedies can be allocated as follows:

1. CP can obtain the full amount of back pay, front pay, and compensatory damages from either respondent, or from both combined.

2. Punitive damages under Title VII and the ADA, and liquidated damages under the ADEA, are individually assessed against each respondent according to its degree of malicious or reckless misconduct.

3. The total amount paid by a respondent for future pecuniary damages, damages for emotional distress, and punitive damages cannot exceed its statutory cap.

Damages should be allocated between the respondents in a way that maximizes the payable relief to CP. Contact the legal unit for advice in determining the allocation.

1 June 18, 1997 News Release of the National Association of Temporary and Staffing Services.

2 Seasonal and temporary foreign employees performing work for companies

in this country form another category of the contingent workforce. The Commission intends to address at a future date particular issues regarding coverage of these workers.

3 Bureau of Labor Statistics, U.S. Dept. of Labor, Report 900, Contingent and Alternative Employment Arrangements (August 1995).

4 For a discussion of wage data for contingent workers, see Steven Hipple and Jay Stewart, Earnings and benefits of workers in alternative work arrangements, Monthly Labor Review 46 (October 1996).

5 See Policy Statement on control by third parties over the employment relationship between an individual and his/her direct employer, Compliance Manual Section 605, Appendix F (BNA) 605:0087 (5/20/87); Policy Statement on the concepts of integrated enterprise and joint employer, Compliance Manual Section 605, Appendix G (BNA) 605:0095 (5/6/87); Policy Statement on Title VII Coverage of Independent Contractors, Compliance Manual Section 605, Appendix H (BNA) 605:0105 (9/4/87); and Policy Statement: What constitutes an employment agency under Title VII, how should charges against employment agencies be investigated, and what remedies can be obtained for employment agency violations of the Act, Compliance Manual (BNA) N:3935 (9/20/91).

The above-referenced policy documents set forth some general principles regarding coverage under the anti-discrimination statutes, and they remain in effect. The current guidance explains more specifically how the coverage principles apply to workers who are hired by staffing firms and placed in job assignments with the firms' clients.

6 For a detailed explanation of the various types of staffing service work arrangements, see Edward A. Lenz, Co-Employment - A Review of Customer Liability Issues in the Staffing Services Industry, 10 The Labor Lawyer 195, 196-99 (1994).

7 See, infra, cases cited in notes 12, 14, and 15.

8 The coverage principles set forth here apply not only to workers who are hired by staffing firms and assigned to the firms' clients, but also to temporary, seasonal, part-time, and other contingent workers who are hired directly by employers.

9 Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318, 324 (1992) (quoting NLRB v. United Ins. Co. of America, 390 U.S. 254, 258 (1968)) (emphasis added).

10 The listed factors are drawn from Darden, 503 U.S. at 323-324 (quoting Community for Creative Non-Violence v. Reid, 490 U.S. 730, 751-752 (1989)); Rev Ruling 87-41, 1987-1 Cum. Bull. 296 (cited in Darden, 503 U.S. at 325); and Restatement (Second) of Agency § 220(2) (1958) (cited in Darden, 503 U.S. at 325). The Court in Darden held that the "common law" test governs who qualifies as an "employee" under the Employee Retirement Income Security Act of 1974 (ERISA). That test, as described by the Court, is indistinguishable from the "hybrid test" for determining an employment relationship adopted by the EEOC in the Policy Statement on Title VII Coverage of Independent Contractors, Compliance Manual Section 605, Appendix G (BNA) 605:0105 (9/4/87). Although the Supreme Court has not had occasion to address the standards that govern who is an "employee" under Title VII, the ADEA, and the ADA, the rationale in Darden should apply. This is because the ERISA definition of "employee" that the Court interpreted in Darden is identical to the definition of "employee" in Title VII, the ADEA, and the ADA.

Courts have stated that the definition of "employee" is broader under the Fair Labor Standards Act (FLSA), of which the Equal Pay Act is a part, than under the other EEO statutes. However, there is no significant functional difference between the tests. Under the FLSA, employees are those who, as a matter of economic reality, are dependent upon the business to which they render service. See 29 C.F.R. § 1620.8 (1996);

Hodgson v. Griffin & Brand of McAllen, Inc., 471 F.2d 235 (5th Cir.) (under FLSA's "economic realities" test, fruit and vegetable company qualified as joint employer of harvest workers supplied by crew leaders), reh'g denied, 472 F.2d 1405 (5th Cir.), cert. denied, 414 U.S. 819 (1973). All three tests (common law, hybrid, and economic realities) consider similar factors and often result in the same conclusions as to "employee" status.

11 For additional guidance on criteria for determining whether two or more entities are joint employers of a charging party, see EEOC's Policy Statement on the concepts of integrated enterprise and joint employer, Compliance Manual Section 605, Appendix G (BNA) 605:0095 (5/6/87).

12 For cases holding that a staffing firm is an "employer" of the workers it sends on job assignments, see Magnuson v. Peak Technical Services, Inc., 808 F. Supp. 500, 508 (E.D. Va. 1992) (personnel firm that provided employees to clients pursuant to service contracts and the worker that it assigned to one of its clients "clearly had the type of direct employer-employee relationship that is typically the subject of Title VII lawsuits"), aff'd mem., 40 F.3d 1244 (4th Cir. 1994); Amarnare v. Merrill, Lynch, Pierce, Fenner & Smith, 611 F. Supp. 344, 349 (D.C.N.Y. 1984) (worker paid by "Mature Temps" employment agency and assigned to Merrill Lynch for temporary job assignment was employee of both Mature Temps and Merrill Lynch during period of assignment), aff'd mem., 770 F.2d 157 (2d Cir. 1985). Cf. NLRB v. Western Temporary Services, Inc., 821 F.2d 1258, 1266-67 (7th Cir. 1987) (NLRB correctly determined that temporary employment service and its client were joint employers of temporary worker); Maynard v. Kenova Chemical Company, 626 F.2d 359, 362 (4th Cir. 1980) (temporary employee injured while working on defendant's premises could not sue defendant in tort because he was employee of both defendant and temp agency, and workers' compensation provided sole remedy).

The Commission disagrees with the rulings of the District Court of Delaware in Williams v. Caruso, 966 F. Supp. 287 (D. Del. 1997), and Kellam v. Snelling Personnel Services, 866 F. Supp. 812 (D. Del. 1994), aff'd mem., 65 F.3d 162 (3d Cir. 1996). In Williams, the court ruled that a temporary employment agency was not a Title VII employer of a temporary worker whom it hired and placed in a job assignment. The court followed its earlier reasoning in Kellam, in which it declined to count the workers assigned by a temporary employment agency as its employees on the ground that the agency did not supervise the workers on a day-to-day basis. In the Commission's view, the court in both cases placed undue emphasis on daily supervision of job tasks and underestimated the significance of other factors indicating an employment relationship.

13 See, e.g., Astrowsky v. First Portland Mortgage Corp., 887 F. Supp. 332 (D. Me. 1995) (holding that employee leasing firm was not a joint employer of workers that it leased back to original employer; firm only processed pay checks and made tax withholdings but did not exercise any control over employees; original employer remained exclusive employer of the workers for purposes of EEO coverage).

14 See Reynolds v. CSX Transportation, Inc., 115 F.3d 860 (11th Cir. 1997) (finding that temporary employment agency's client qualified as employer of worker assigned to it and upholding jury award for retaliation by client); King v. Booz-Allen & Hamilton, Inc., No. 83 Civ. 7420 (MJL), 1987 WL 11546, n.3 (S.D.N.Y. May 21, 1987) (finding that plaintiff who was paid by temporary employment agency and assigned to work at Booz-Allen was an employee of Booz- Allen); Amarnare, 611 F. Supp. at 349 (finding that temporary employment agency's client qualified as joint employer of worker assigned to it).

15 See Rev. Rul. 87-41, 1987-1 Cum. Bull. 296, 298-99, cited in Nationwide Mutual Insurance Company v. Darden, 503 U.S. 318, 324 (1992) (concluding on above facts that the staffing firm was the individual's employer, but not addressing the status of the client vis-a-vis the worker).

16 For examples of cases finding that a client of a staffing firm can

qualify as a joint employer of the worker assigned to it, see Poff v. Prudential Insurance Co. of America, 882 F. Supp. 1534 (E.D. Pa. 1995) (where plaintiff was hired by computer services contractor and assigned to work on-site at insurance company, issue of fact existed as to whether insurance company exercised sufficient control over the manner and means by which plaintiff's work was accomplished to qualify as employer); Magnuson, 808 F. Supp. at 508-10 (where car company contracted with staffing firm for plaintiff's services and assigned her to work at its car dealership, genuine issue of fact was raised as to whether car company, dealership, and staffing firm all qualified as her joint employers); Guerra v. Tishman East Realty, 52 Fair Empl. Prac. Cas. (BNA) 286 (S.D.N.Y. 1989) (security guard employed by management firm who worked in building owned by insurance company could seek to prove that insurance company exercised sufficient control over him to qualify as his "employer"); EEOC v. Sage Realty, 507 F. Supp. 599 (S.D.N.Y. 1981) (building management company that contracted with cleaning company for services of building lobby attendant qualified as joint employer of lobby attendant; contractor carried lobby attendant on its payroll but management company supervised her day-to-day work).

For examples of cases finding that the client did not qualify as a joint employer of the contract worker because the client did not have sufficient control over the worker, see Rivas v. Federacion de Asociaciones Pecuarias, 929 F.2d 814 (1st Cir. 1991) (client of shipping services contractor was not a joint employer of workers who unloaded ships; although client set time for ship unloading, had some disciplinary authority over foremen, and directed order of unloading, contractor selected, scheduled, and supervised the workers and handled disciplinary matters); King v. Dalton, 895 F. Supp. 831 (E.D. Va. 1995) (Navy was not joint employer of worker assigned by contract firm to work on project due to insufficient direct supervisory control over the daily details of the plaintiff's work).

17 See 42 U.S.C. § 2000e-2(a) (Title VII), 29 U.S.C. § 623(a) (ADEA), and 42 U.S.C. § 12112(a) (ADA), which do not limit their protections to a covered employer's own employees, but rather protect an "individual" from discrimination. Section 503 of the ADA, 42 U.S.C. § 12203(b), additionally makes it unlawful to "interfere with any individual in the exercise or enjoyment of ... any right granted or protected by this chapter." The EPA, 29 U.S.C. § 206, limits its protections to an employer's own employees, and therefore third party interference theory does not apply.

For cases allowing staffing firm workers to bring claims against the firms' clients as third party interferers, see King v. Chrysler Corp., 812 F. Supp. 151 (E.D. Mo. 1993) (cashier employed by company that operated cafeteria on automobile company's premises could sue automobile company for failing to take sufficient corrective action to remedy sexually hostile work environment; Title VII does not specify that employer committing an unlawful employment practice must employ the injured individual); Fairman v. Saks Fifth Avenue, 1988 U.S. Dist. LEXIS 13087 (W.D. Mo. 1988) (plaintiff who was employed by cleaning contractor to perform cleaning duties at store and who was allegedly discharged due to her race could proceed with Title VII action against store; store claimed that it was not plaintiff's employer because it did not pay her wages, supervise her or terminate her; however, even if the store was not plaintiff's employer, it could be sued for improperly interfering with her employment opportunities with the cleaning contractor); Amarnare, 611 F. Supp. at 349 (temporary employee assigned by "Mature Temps" to work for Merrill Lynch could challenge discrimination by Merrill Lynch either on basis that Merrill Lynch was her joint employer or that Merrill Lynch interfered with her employment opportunities with Mature Temps).

18 See Policy Statement on control by third parties over the employment relationship between an individual and his/her direct employer, Compliance Manual Section 605, Appendix F (BNA) 605:0087 (5/20/87).

19 While Title I of the ADA only applies to entities with fifteen or more employees, the Commission has not yet addressed the scope of the

interference provision in Section 503, which applies to all titles of the ADA and does not contain a specific coverage limitation. See n.17.

20 See Carparts Distribution. Ctr. v. Automotive Wholesalers, 37 F.3d 12, 17-18 (1st Cir. 1994) (trade association and its administering trust for health benefit plan provided by plaintiff's employer was sued under Title I for limiting coverage of AIDS; court held that defendants were covered under Title I if they functioned as plaintiff's employer with respect to his health care coverage or if they affected plaintiff's access to employment opportunities); Spirt v. Teachers Insurance and Annuity Ass'n, 691 F.2d 1054, 1063 (2d Cir. 1982) (association that managed retirement plans for college and university employees could be found liable for using sex-based mortality tables to calculate benefits; although association was not plaintiff's "employer" in any commonly understood sense, the term "employer" under Title VII encompasses any party who significantly affects worker's access to employment opportunities), vacated and remanded sub nom Long Island University v. Spirt, 463 U.S. 1223 (1983), reinstated on remand, 735 F.2d 23 (2d Cir.), cert. denied, 469 U.S. 883 (1984).

21 See Mares v. Marsh, 777 F.2d 1066 (5th Cir. 1985) (in determining whether individual is a federal employee for purposes of Title VII coverage, key issue is extent to which government exercises control over that individual). For guidance on procedures in handling joint federal sector/private sector complaints, see Question 9.

22 42 U.S.C. § 20003-16(a) (Title VII); 29 U.S.C. § 633(a) (ADEA); 29 U.S.C. § 794a (Rehabilitation Act, incorporating remedies, procedures and rights set forth in 42 U.S.C. § 2000e-16). See King v. Dalton, 895 F. Supp. at 836 n.7 (plain terms of § 2000e-16 require a plaintiff to be an employee of the defendant agency); Spirides v. Reinhardt, 613 F.2d 826, 829 (D.C. Cir. 1979) (§ 2000e-16 "cover[s] only those individuals in a direct employment relationship with a government employer").

23 A variety of work and work-related activities may be required as a condition of receipt of welfare, food stamps, or other benefits. Under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, P.L. 104-193, 110 Stat. 2105 (1996), for example, welfare recipients may be required to perform work activities which are defined to include unsubsidized employment, subsidized private or public sector employment, work experience, on-the-job training, job search and job readiness assistance, community service programs, vocational educational or job skills training, educational activities, or child care services. Section 103 of Welfare Reform Act, 110 Stat. 2133, amending Part A of Title IV of Social Security Act, 42 U.S.C. § 601, et seq. See also Section 824 of Welfare Reform Act, 110 Stat. 2323, amending Section 6 of Food Stamp Act of 1977, 7 U.S.C. § 2015.

24 The Balanced Budget Act of 1997, P.L. 105-33, 111 Stat. 251 (1997), requires each state that receives a grant from the Secretary of Labor as a "welfare-to-work state" to establish a procedure for handling complaints by participants in work activities who allege certain violations, including gender discrimination. The Act does not preempt application of Title VII, the ADEA, the ADA, or the EPA. See Morton v. Mancari, 417, U.S. 535, 550 (1973). Therefore, welfare recipients who perform work activities and qualify as "employees" are covered under the anti-discrimination statutes enforced by the EEOC.

25 Title VII specifically makes it unlawful to discriminate in admission to or employment in any program established to provide apprenticeship or other training. 42 U.S.C. § 2000e- 2(d). The ADA and the ADEA also prohibit discrimination in job training and apprenticeship programs. 42 U.S.C. § 12112(a); 29 C.F.R. § 1625.21.

26 The Commission notes that other federal statutes prohibit discrimination in federally-assisted education and training programs. See, e.g., Title VI of the Civil Rights Act of 1964, 42 U.S.C.§ 2000d, et seq.; Title IX of the Education Amendments of 1972, 42 U.S.C.§ 1681, et seq., and Section 504 of the Rehabilitation Act of 1973, 29 U.S.C. § 794.

Complaints about discrimination in education or other non-employment programs should be referred to the Offices for Civil Rights in the federal agencies that fund such programs.

27 Title VII and the ADA apply to any employer who has fifteen or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year. 42 U.S.C. § 2000e(b). The ADEA applies to any employer who has twenty or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year. 29 U.S.C. § 630(b). Counting issues do not arise in EPA claims because that Act applies to any employer who has more than one employee engaged in commerce or in the production of goods for commerce, unless an exception applies. 29 C.F.R. § 1620.1 - 1620.7.

28 Cf. 29 C.F.R. § 825.106(d) (1996) (under the Family and Medical Leave Act, employees jointly employed by two employers must be counted by both employers, whether or not they are maintained on both employers' payrolls, in determining employer coverage and employee eligibility).

29 EEOC & Walters v. Metropolitan Educ. Enterprises, 117 S. Ct. 660 (1997). For guidance on how to count employees when determining whether a respondent satisfies the jurisdictional prerequisite for coverage, see Enforcement Guidance on Equal Employment Opportunity Commission & Walters v. Metropolitan Educational Enterprises, 117 S. Ct. 660 (1997), Compliance Manual (BNA) N:2351 (5/2/97).

30 Staffing firms and their clients are subject to the same record preservation requirements as other employers that are covered by the anti-discrimination statutes. They therefore must preserve all personnel records that they have made relating to job assignments or any other aspect of a staffing firm worker's employment for a period of one year from the date of the making of the record or the personnel action involved, whichever occurs later. Personnel records relevant to a discrimination charge or an action brought by the EEOC or the U.S. Attorney General must be preserved until final disposition of the charge or action. 29 C.F.R. §§ 1602.14, 1627.3(b). The Commission can pursue an enforcement action where the respondent fails to keep records pertaining to all its contingent and non-contingent employees and applicants for employment.

31 Section 701(c) of Title VII defines the term "employment agency" as "any person regularly undertaking with or without compensation to procure employees for an employer or to procure for employees opportunities to work for an employer and includes an agent of such a person." For further guidance, see Policy Guidance: What constitutes an employment agency under Title VII, how should charges against employment agencies be investigated, and what remedies can be obtained for employment agency violations of the Act?, Compliance Manual (BNA) N:3935 (9/29/91).

32 The questions and answers in this section assume that the staffing firm is an "employer" of the worker.

33 See EEOC Guidelines on Sexual Harassment, 29 C.F.R. § 1604.11(3) (1996) (an employer is liable for harassment of its employee by a non-employee if it knew or should have known of the misconduct and failed to take immediate and appropriate corrective action within its control). See also Caldwell v. ServiceMaster Corp. and Norrell Temporary Services, 966 F. Supp. 33 (D.D.C. 1997) (joint employer temporary agency is liable for discrimination against temporary worker by agency's client if agency knew or should have known of the discrimination and failed to take corrective measures within its control); Magnuson v. Peak Technical Servs., 808 F. Supp. 500, 511-14 (E.D. Va. 1992) (where plaintiff was subjected to sexual harassment by her supervisor during a job assignment, three entities could be found liable: staffing firm that paid her salary and benefits, automobile company that contracted for her services, and retail car dealership to which she was assigned; staffing firm and automobile company were held to standard for harassment by non-employees, under which an entity is liable if it had actual or constructive knowledge

of the harassment and failed to take immediate and appropriate corrective action within its control); EEOC v. Sage Realty, 507 F. Supp. 599, 612-613 (S.D.N.Y. 1981) (cleaning contractor and joint employer building management company found jointly liable for sex discrimination against lobby attendant on contractor's payroll where management company required attendant to wear revealing costume that subjected her to harassment by passersby, and where plaintiff was discharged for refusing to continue wearing outfit; court rejected contractor's argument that management company was exclusively liable because it had set the costume requirement; contractor knew of plaintiff's complaints of harassment and there was no evidence that it was powerless to remedy the situation); cf. Capitol EMI Music, Inc., 311 N.L.R.B. No. 103, 143 L.R.R.M. (BNA) 1331 (May 28, 1993) (in joint employer relationships in which one employer supplies employees to the other, National Labor Relations Board holds both joint employers liable for unlawful employee termination or other discriminatory discipline if the non- acting joint employer knew or should have known that the other employer acted against the employee for unlawful reasons and the former has acquiesced in the unlawful action by failing to protest it or to exercise any contractual right it might possess to resist it).

34 Cf. Paroline v. Unisys Corp., 879 F.2d 100, 107 (4th Cir. 1989) (employer is liable where it anticipated or reasonably should have anticipated that plaintiff would be subjected to sexual harassment yet failed to take action reasonably calculated to prevent it; "[a]n employer's knowledge that a male worker has previously harassed female employees other than the plaintiff will often prove highly relevant in deciding whether the employer should have anticipated that the plaintiff too would become a victim of the male employee's harassing conduct"), vacated in part on other grounds, 900 F.2d 27 (4th Cir. 1990).

35 If the federal agency refuses to accept the complaint based on a belief that the staffing firm worker is not its employee, the worker can file an appeal with the Commission's Office of Federal Operations.

36 If the federal agency does not wish to coordinate the investigations, then the EEOC office should proceed independently. If the federal agency refuses to provide documents or testimony requested by the EEOC investigator, the Commission can issue a subpoena to compel production of the evidence.

37 The EPA applies to any employer that has more than one employee engaged in commerce or in the production of goods for commerce, unless a statutory exception applies. 29 U.S.C. § 203(s).

38 See Compliance Manual Section 708.5(3) (BNA) 708:0023. As that subsection explains, in determining whether a wage differential between temporary and permanent employees is based on a factor other than sex, the following issues should be considered: 1) whether the wage differential is applied uniformly to males and females; 2) whether the differential conforms with the nature and duration of the job; and 3) whether the differential conforms with a nondiscriminatory customary practice within the industry and establishment.

39 See 29 C.F.R. § 1620.8 (1996) (two or more employers may be jointly or severally responsible for compliance with EPA requirements applicable to employment of a particular employee). For guidance on elements of an EPA claim, see Compliance Manual Sections 704 and 708 (BNA) 704:001 and 708:001, et seq. Cf., 29 C.F.R. § 791.2 (1996) (regulations issued by Wage and Hour Division, Department of Labor, on Joint Employment Relationship under FLSA) (joint employers are individually and jointly responsible for compliance with FLSA, including overtime requirements).

The EPA, unlike Title VII, the ADA, and the ADEA, only permits claims by employees against their employers, not against third party interferers.

40 If the EEOC determines that the client had no involvement in or control over the wages paid to the worker, it may decline to pursue relief against the client.

41 For guidance on wage discrimination claims under Title VII, see Compliance Manual Section 633 (BNA) 633:001, et seq. Title VII prohibits wage discrimination on the basis of race, national origin, and religion, as well as sex.

42 However, even where there is joint liability, neither a charging party nor the Commission is obliged to pursue a claim against both entities; nor does one party have a right to bring the other into the proceeding, or a right of contribution from the other. See Northwest Airlines, Inc. v. Transport Workers Union of America, 451 U.S. 77, 91-95 (1981); EEOC v. Gard Corp. v. Tall Services, Inc., 795 F. Supp. 1070, 1071-72 (D. Kan. 1992).

43 Punitive damages are not available against federal, state, and local government agencies.

44 Liquidated damages under the ADEA are punitive in nature. Trans World Airlines v. Thurston, 469 U.S. 111, 125 (1985). Therefore, each respondent individually bears a liquidated damages award under the ADEA.

45 See Hafner v. Brown, 983 F.2d 570, 573 (4th Cir. 1992) (holding under 42 U.S.C. § 1983 that compensatory damages are joint and several but punitive damages are born by each defendant individually); Erwin v. County of Manitowoc, 872 F.2d 1292, 1296 (7th Cir. 1989) (same); Bosco v. Serhant, 836 F.2d 271, 280-81 (7th Cir. 1987) (tort principles require joint and several liability for compensatory damages but not punitive damages), cert. denied, 108 S. Ct. 2824 (1988); Hurley v. Atlantic City Police Dept., 933 F. Supp. 396, 420-23 (D.N.J. 1996) (reaching same conclusion in a Title VII case).

46 The respondents are also jointly and severally liable for liquidated damages in EPA claims because such damages are compensatory in nature. Laffey v. Northwest Airlines, 740 F.2d 1071, 1096 (D.C. Cir. 1984), cert. denied, 469 U.S. 1181 (1985); Marshall v. Bruner, 668 F.2d 748, 753 (3d Cir. 1982).

47 Compensatory and punitive damages are available in Title VII and ADA cases, and in retaliation cases under the ADEA and the EPA. The ADEA and EPA damages, which are not subject to statutory caps, are available pursuant to a 1977 amendment to the Fair Labor Standards Act that authorizes both legal and equitable relief for retaliation claims. 29 U.S.C. § 216(b). See Moskowitz v. Trustees of Purdue University, 5 F.3d 279, 283-84 (7th Cir. 1993) (FLSA amendment allows common law damages where plaintiff is retaliated against for exercising his rights under ADEA); Soto v. Adams Elevator Equip. Co., 941 F.2d 543, 551 (7th Cir. 1991) (FLSA amendment authorizes compensatory and punitive damages for retaliation claims under EPA, in addition to lost wages and liquidated damages).

48 42 U.S.C. § 1981a(c)(2).

49 The financial position of the respondent is a relevant factor in assessing punitive damages. City of Newport v. Fact Concerts, Inc., 453 U.S. 47, 270 (1981).

For guidance on the various factors to consider in calculating compensatory and punitive damages, see Enforcement Guidance: Compensatory and Punitive Damages Available under § 102 of the Civil Rights Act of 1991, Compliance Manual (BNA) N:6071 (7/14/92).

50 See EEOC v. Sage Realty, 507 F. Supp. 599, 612-13 (finding two joint employers responsible for harassment of worker and holding them jointly and severally liable for back pay).

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