

Fifth Edition of *Legal Guide to Independent Contractor Status*

Reviewed by Lawrence B. Gibbs

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

Gibbs, a member of Miller & Chevalier, was IRS commissioner from 1986 to 1989.

Earlier this year, an increase in employment tax rates was proposed by Congress to help pay for the cost of healthcare reform legislation. Also this year, Congress considered legislation that would impose employment taxes on the income of many small S corporation shareholders. The combination of the baby boomers' retirement, the resultant reduction in the number of active workers, and the increases in the costs of federal retirement (Social Security) and healthcare (Medicare) programs virtually assures that employment taxes imposed on employers and their workers will rise in future years. In part because of this apparent trend toward ever-escalating employment taxes, employers and their advisers today are weighing the possibility of converting employees in their workforce to independent contractors.

Three years ago, Congress conducted hearings on the tax rules governing worker status as an employee or an independent contractor, and the consensus appeared to be that misclassification of workers could be costing the federal government billions in tax revenue. Also, tax schemes to avoid the payment of employment taxes abound. These tax avoidance strategies target withholding at the source — the crown jewel of our voluntary federal tax system — and many states depend largely on the integrity of the federal system to protect their own tax bases. In light of the increasing importance of employment taxes to the tax base of the United States, the IRS recently announced that it would increase employment tax audits, including focused, intensive audits for its National Research Program. The Service also mentioned that worker classification will be a target issue in these audits to determine whether the proper amount of employment taxes has been paid.

Against this background, Robert Wood has published the fifth edition of his excellent treatise, *Legal Guide to Independent Contractor Status*. As the new edition points out, the employee/independent contractor issue is important not only to the IRS: "The U.S. Department of Labor, state employment development departments, workers compensation insurers and authorities, and other government bodies may all have an interest in determining the status of workers as either employees or independent contractors." One also might add to this list the Social Security Administration. Wood notes that the myriad of increased state and federal tax and non-tax laws, as well as civil and criminal penalties, make it important for employers and their advisers to be sure that worker classification programs are in compliance. Wood points out that if federal and state enforcement were not cause enough to emphasize the necessity of getting the employment tax treatment of workers right, the financial cost to employers of getting it wrong is magnified by decisions like *Vizcaino v. Microsoft*, No. 94-35770 (9th Cir. Feb. 10, 1997), *Doc 97-4852*, 97 TNT 33-4, and its progeny, in which workers initially classified as independent contractors, individually and as a class, were permitted to sue their alleged employers to obtain benefits to which only employees (and not independent contractors) are entitled.

In one of the best summaries I have read regarding the breadth and complexity of the worker classification issue, the new treatise states:

Far from being merely a tax issue, significant employee benefits and other liability questions arise, including:

- Will you face liability for employee benefits (pension plans, stock option plans, etc.) if your workers are deemed to be employees rather than independent contractors?
- Are there civil or criminal liabilities for characterizing workers in a certain way?
- If workers are recharacterized, is there any way you can avoid the penalties?
- What should you do if you are currently involved in an employee/independent contractor audit with the IRS or state taxing authority?
- If you encourage your workers to incorporate and then you hire their corporation, will you avoid their characterization issue?

- Is it possible to have some workers treated as employees and others performing the same functions treated as independent contractors?
- What kind of contract or tort (personal injury) liability issues can arise with independent contractors?
- What are the chances that a business which fails to treat workers as employees can subject its owners to personal liability for employment taxes, penalties, and interest?
- How safe is a written contract in which the worker expressly says — under penalty of perjury — that he is an independent contractor?
- What factors will the IRS (and the various states) use to determine whether your workers are employees or independent contractors?

When companies cannot give clear guidance about who is an employee and who is not, tax, employee benefit, and liability considerations can be enormous. . . . The area, in short, is a legal, tax, and contractual minefield. Moreover, it can be a terribly expensive one. It seems likely that worker status controversies will flourish for many years.

For employers and their advisers who often find themselves coping with this “legal, tax, and contractual minefield” to reduce or avoid the impact of the employer’s ever-mounting employment tax obligations, the new treatise offers a helpful reference, planning, and controversy tool. In a well-organized, clear, and relatively straightforward manner, the new edition explains the tax treatment of employees and independent contractors, the federal tax factors bearing on a worker’s classification as either an employee or independent contractor, the employer’s potential tax and nontax liabilities (including for contract and tort purposes) arising from misclassification, the safe harbor relief provided by

IRS rulings and by section 530 of the Revenue Act of 1978, relevant federal labor and employment laws, and pension and employee benefit considerations. There are also helpful client checklists and questionnaires; government forms, publications, and authorities; and various forms and how-to explanations for using the forms to assist the reader in drafting independent contractor agreements. Finally, adequate tables and indexes are included.

Like many of Wood’s books, one of the most helpful things about the new treatise is that it pulls together in one place the tax and nontax considerations that employers and their advisers must evaluate in deciding whether and how to structure independent contractor relationships. With this new edition comes Wood’s usual promise of periodic, usually annual, supplements to reflect periodic changes in this ever-changing, always developing area. The updates are a must, as Wood’s new treatise is his fifth edition within the last 18 years.

The employee/independent contractor area is inherently uncertain and difficult. In the late 1960s and early 1970s, the IRS published many revenue rulings that were structured to provide the facts and applicable law for determining whether a worker was an employee or an independent contractor, followed by a conclusion regarding the worker’s classification, based on little, if any, analysis. I like to describe the rulings as IRS versions of O. Henry short stories because the reader is left guessing whether the worker will be classified as an employee or an independent contractor, right up to the surprise ending. Given this inherent level of difficulty and uncertainty surrounding the employee/independent contractor area, Wood’s new treatise provides comprehensive analysis, clarity, and constructive approaches and techniques worth considering by employers and their tax advisers for determining whether and how to structure independent contractor arrangements.

SUBMISSIONS TO TAX NOTES

Tax Notes welcomes submissions of commentary and analysis pieces on federal tax matters that may be of interest to the nation’s tax policymakers, academics, and practitioners. To be considered for publication,

articles should be sent to the editor’s attention at taxnotes@tax.org. A complete list of submission guidelines is available on Tax Analysts’ Web site, <http://www.taxanalysts.com/>.