

## **The Fair Playing Field Act of 2010**

The Fair Playing Field Act of 2010 will provide a fairer playing field to America's businesses and workers. It will ensure workers are afforded protections already in the law, such as workers' compensation, Social Security, Medicare, payment of overtime, unemployment compensation, and the minimum wage. It will also help employers who play by the rules are not forced to compete against those businesses who don't play by the rules.

Under current law, employers are required to take certain actions on behalf of their employees including withholding income taxes, paying the employer's share of Social Security and Medicare taxes, paying for unemployment insurance, and providing a safe and nondiscriminatory workplace. Employers are not required to undertake these obligations for independent contractors. When workers are misclassified, businesses that play by the rules lose business to competitors that do not play by the rules and workers lose valuable rights and protections.

The Internal Revenue Service uses a common law test to determine whether a worker is an employee or independent contractor. Unfortunately, a loophole exists which allows a business to not apply the test and to escape liability for misclassifying individuals who would be employees under the common law test as independent contractors for Federal employment taxes. Furthermore, there is a statutory prohibition on the IRS providing general guidance (including through regulation) on employee classification.

Federal and state revenue is lost when businesses misclassify their workers as independent contractors. A study estimated that, between 1996 and 2004, \$34.7 billion of federal tax revenues went uncollected due to the misclassification of workers and the tax loopholes that allow it. Recent GAO and Treasury Inspector General reports have cited misclassification as posing significant concerns for workers, their employers, and government revenue.

### **Current Law**

The determination of whether an employer-employee relationship exists for federal tax purposes is made under a common-law test that has been incorporated into specific provisions of the Internal Revenue Code or is required to be used pursuant to Treasury regulations or case law. Specifically, there are regulations which incorporate the common-law test for purposes of an employer's Federal income tax withholding obligations with respect to employees. An employer-employee relationship generally exists if the person contracting for services has the right to control not only the result of the services, but also the means by which that result is accomplished.

In 1987, based on an examination of cases and rulings, the Internal Revenue Service developed a list of 20 factors for determining whether an employer-employee relationship exists. The IRS recognizes that there may be relevant factors in addition to the 20 factors. Most recently, the IRS has structured its inquiry into three groupings: behavioral control, financial control, and the relationship of the worker and firm.

Section 530 of the Revenue Act of 1978 generally allows taxpayers to treat a worker as not being an employee for employment tax purposes, regardless of the worker's actual status under the

common law test, unless the taxpayer has no reasonable basis for such treatment or fails to meet certain requirements. Section 530 is commonly referred to as a “safe harbor.” This provision was initially enacted in 1978 for a year to give Congress time to resolve these complex issues. In 1982, the safe harbor was made permanent.

Under the section 530 safe harbor, a reasonable basis for treating a worker as an independent contractor is considered to exist if the taxpayer relied on (1) a past IRS audit with respect to the taxpayer, (2) published rulings or judicial precedent, or (3) long-standing recognized practice in the industry. Additional requirements also need to be met for an employer to take advantage of the section 530 safe harbor. The taxpayer must not have treated the worker as an employee for any period, and for periods after 1978, all Federal tax returns must have been filed on a basis consistent with treating workers as independent contractors and the taxpayer must have not treated substantially similar workers as employees for purposes of employment taxes. In addition, section 530 prevents the IRS from requiring an employer afforded a safe harbor to reclassify a worker prospectively.

Under the Code, reduced penalties apply to a taxpayer who is not eligible for the section 530 safe harbor and who fails to deduct and withhold income taxes and the employee’s share of FICA taxes by reason of the taxpayer’s treatment of an employee(s) as an independent contractor. These reduced penalties are not available if the taxpayer intentionally disregarded the requirement to deduct and withhold income tax.

### **Prospective Reclassification of Workers**

The Fair Playing Field Act of 2010 ends the moratorium on IRS guidance addressing worker classification. The legislation requires the Secretary of Treasury to issue prospective guidance clarifying the employment status of individuals for Federal employment tax purposes. The effective date for the provision of authority to issue guidance is the date of enactment.

The section 530 safe harbor will continue to be available to employers with respect to the treatment of an individual for Federal employment tax purposes until the individual has a reclassification date. Under the Fair Playing Field Act of 2010, the section 530 prohibition on retroactive assessment remains in effect with respect to a taxpayer if the taxpayer did not treat an individual as an employee for any period before the reclassification date. Further, in the period after December 31, 1978 and before the reclassification date, all federal tax returns required to be filed with respect to the individual for this period must have been filed on a consistent basis with the taxpayer’s treatment of the individual not being an employee. As under current law, the section 530 safe harbor is not available if the taxpayer has no reasonable basis for the treatment of an individual as an independent contractor.

Under the Fair Playing Field Act of 2010, an individual’s “reclassification date” is the earlier of the following two dates: (1) the first day of the first calendar quarter beginning more than 180 days after the date of an “employee classification determination” with respect to such individual; or (2) the effective date of the “first application final regulation” issued by the Secretary of the Treasury with respect to such individual (or if later, the first day of the first calendar quarter beginning more than 180 days after such regulation is issued). The “first applicable final

regulation” is the first final regulation or other guidance of general applicability which sets forth the factors for determining the employment status of a class of individuals holding positions similar to the position held by such individual. An “employee classification determination” with respect to an individual is a determination by the Secretary of the Treasury, in connection with an audit of the taxpayer that begins after the date that is one year after the date of enactment, that a class of individuals holding positions with the taxpayer that are substantially similar to the position held by the individual are employees.

Guidance required by this legislation applies to services rendered one year after the date of enactment.

The legislation amends the provisions of the Code that provide for reduced penalties for failure to deduct and withhold income taxes and the employee’s share of FICA taxes to provide that the reduced penalties are not available in cases where there is noncompliance with guidance issued by the Secretary of the Treasury without a reasonable basis for treating an individual as an independent contractor.

In addition, the legislation requires persons who contract independent contractors on a regular and ongoing basis to provide a written statement to each independent contractor of the Federal tax obligations of independent contractors, the labor and employment law protections that do not apply to independent contractors, and the right of the independent contractor to seek a status determination from the IRS. Taxpayers who fail to provide such a statement in a timely manner or who provide an incorrect/incomplete statement will be subject to the penalties imposed by the Code for failures to meet certain information reporting requirements.

#### **Annual Reports on Worker Misclassification**

The Fair Playing Field Act of 2010 requires the Secretary of the Treasury to issue reports on worker misclassification. The first report will be an annual report on the number of examinations based on classification issues, the types of enforcement actions taken, and the number of workers reclassified as a result of these actions. The second report will be every three years and will provide a statistical estimate of the number of employers misclassifying workers, the number of workers misclassified, the industries involved, and an interpretive analysis of the data.