

Owner Operators or Employees? DOL and IRS have their opinion.

Does it match yours?

In This Paper: Government Applying Pressure to Trucking Industry with Increased Scrutiny to Employee Classification Methods

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It's certainly no secret that the government is seeking to convert transportation companies' contractors to employees. The revenue stream is far too vast for the government to ignore. Many trucking companies are unaware of how strictly the IRS defines the roles of employer and employee. Moreover, trucking companies might not understand the extent to which federal, state, and local agencies are working to discover the misclassifications of independent contractors / owner-operators, in order to recover lost revenue from taxes. There seems to be an endless list of criteria developed by regulative bodies that identify risk. What's worse, companies are unsure about best practices to deploy a pro-active approach.

Strict Definitions: Contractor - Employee - Employer

When defining an independent contractor, the IRS is very specific about three things:

1. Either a written contract for a person, business, or corporation to provide with terms for providing good or services

OR

2. Within a *verbal and physical agreement*
3. The business specifies the result, but not the means and methods of delivery of the result

The Department of Transportation (DOT) also issued guidance with their own definition of owner-operator. The DOT states that owner-operators own their own commercial vehicle or small fleet (typically truck tractors), they serve as the driver of these vehicles, and maybe most importantly *they can provide their vehicle and driving services to another motor carrier*.¹ Trucking companies have a variety of areas of risk exposure that can fall within the parameters of the IRS and DOT definitions.

Traditionally, employers could use the IRS's 20 Factor Test. However, the IRS has streamlined the 20 factors to a list of "3 Facts".² In other words, when in doubt in regard to employee misclassification, utilize the *IRS 3 Facts*. The IRS 3 Facts and some sample questions are:

1. Behavioral Factors

- a. What type of instructions are given? To what degree are they given the driver?
- b. Who conducts training?
- c. Who is evaluating the drivers work performance?

2. Financial Factors

- a. Who is responsible for unreimbursed expenses?
- b. Who absorbs profit or loss?
- c. What is the method of payment of services?

3. Relational Factors

- a. Who provides health, dental, or retirement benefits?
- b. What determines the permanency of the relationship?
- c. What services are considered to be the "key activity" of the business?

The questions above are not an exhaustive list for compliance. Also, you can visit the IRS Website.³

Collaborative Effort of Governmental Agencies

In September 2011, the Department of Labor (DOL) and the Internal Revenue Service (IRS) signed a Memorandum of Understanding (MOU) to help reduce the incidence of employee misclassification. Through early 2015, labor commissioners and other agency leaders representing twenty-two states have signed MOU's with the DOL's Wage and Hour Division, its Employee Benefits Security Administration (EBSA), the Occupational Safety and Health Administration (OSHA), Office of Federal Contract Compliance Programs (OFCCP), and the Office of the Solicitor. It can easily be concluded that the government is stepping up their collaborative efforts to recover tax revenue from employee misclassifications.

Federal and State Governments Cashing in on Driver Misclassifications

The billions that the government is recovering in fines, fees, and back taxes are impossible to ignore. According to *usdebtclock.org*, our national debt will be well over \$18 trillion dollars by the end of 2015. Many consider it an employer's duty to be fully compliant when classifying employees. Moreover, the Federal Government claims billions are underpaid in income, Social Security, and unemployment taxes. According to a CBS News report in 2012, US citizens underpaid their taxes by a staggering \$450 billion dollars! Certainly, employment taxes are a significant portion of that figure.

The cost to employers who misclassify also includes costly litigation. Most certainly, everyone in the transportation industry has heard of the multi-district litigation FedEx has faced. FedEx was sued by a class of 20,000 drivers making claims in thirty-five states. Charges were settled in Massachusetts for a whopping \$3 million dollars simply for violating the state's independent contractor law. California Senate Bill 459 (enacted on October 9, 2011), which prohibits the willful misclassification of individuals as independent contractors, created civil penalties of between \$5,000 and \$25,000 per violation. We have merely witnessed the beginning of the recovery of tax payer dollars due to worker misclassification.

Compliance Begins and Ends with Best Practices

Whether or not you conclude that your business is compliant, the ideal methodology is to deploy best practices as soon as possible in order to mitigate risk when classifying a worker as employee or contractor. Some of those best practices include:

- ⇒ Centralize worker classification – one place employment decisions
- ⇒ Classify workers performing the same or similar work identically
- ⇒ Pay independent contractors via invoice or social security number
- ⇒ Use an independent contractor / lease agreement

Conclusion

Remember the direction from the government, an employer has the right to control AND the right to direct their employees. Violation of the criteria set forth by local, state, and federal regulations can be financially crippling, regardless of the size of your business. President Obama promised 16,000 new IRS agents to support the Affordable Care Act. Policing of employee classification is not going away any time soon. Be prepared. Start mitigating your risk today! If you have questions, consult your attorney, accountant, or your PEOPLEASE HR Business Partner.

References

¹ <http://ai.fmcsa.dot.gov/DataQuality/CrashCollectionTraining/lesson2/owner.html>

² <http://www.irs.gov/taxtopics/tc762.html>

³ <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee>



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