INDEPENDENT CONTRACTORS AND THE INTERNAL REVENUE SERVICE'S "TWENTY FACTOR" TEST: PERSPECTIVE ON THE PROBLEMS OF TODAY AND THE SOLUTIONS FOR TOMORROW

I. INTRODUCTION

As a microcosm of today's ever-so-delicate economic state, it is quite fitting that the latest edition of *USA Today*'s Money Section is headlined by "Government Cuts Trim Q4 Economic Growth."[1] It would be even more telling to admit that, in this particular context, the newspaper was displayed on a rack inside of a gas station where the going rate for a gallon of unleaded gas was $3.45. Adding it all up, it would not be a stretch of the imagination to say that our inherent economic uncertainty has been fueling one of the most challenging marketplaces ever, relative to how Americans conduct business. In response, businesses are going outside-of-the-box more than ever to cut costs while maintaining a high level of operational efficiency.[2]

One of the primary alternatives to traditional staffing has become the utilization of independent contractors. Granted, the "independent contractor" designation has been around for a long time,[3] but the unique legal classification of a worker as such for tax purposes has become a key component of many successful businesses. In particular, the earnings of a person who is working as an independent contractor are subject to self-employment taxes for Medicare and Social Security, while the earnings of an employee are not subject to such taxes.[4] Although it is very difficult to find a simple definition of independent contractor, an article located in the Small Business/Self-Employed section of the Internal Revenue Service (IRS) website describes independent contractors as "people . . . who are in an independent trade, business, or

1. Jeannine Aversa, *Government Cuts Trim Q4 Economic Growth*, USA TODAY, Feb. 25, 2010, at B1, *available at* http://www.usatoday.com/money/economy/2011-02-25-economy-gdp_N.htm (last updated Mar. 3, 2011).

2. Throughout this Note, "business," "worker," "employer," and "employee" are the main terms that will be used to describe the parties involved with worker classification. Therefore, for the purposes of this Note, "business" and "worker" will serve as generic terms to describe the relationship between the parties to any given agreement for services. More specifically, the terms "employer" and "employee" describe the relationship between the parties to a literal employment agreement. Conversely, "independent contractor" is a job status that is under the umbrella of "worker" but distinct from an "employee" in many ways that will be discussed throughout this Note.

3. *See, e.g.*, United States v. Silk, 331 U.S. 704, 713 (1947).

4. *See* I.R.C. §§ 1401, 1402(b) (2006).

profession in which they offer their services to the general public . . . ."[5] The article offers specific examples of professions that are often included within the realm of independent contractors, including "doctors, dentists, . . . lawyers, accountants, contractors, [and] subcontractors. . . ."[6] Among the many benefits that the use of independent contractors allows for, the two most prominent are improved productivity and increased profits. To increase productivity, business owners can maintain strict control over the final work product of their independent contractors while leveraging the use of more outsourced work when the productivity of regular employees may be lacking. To increase profits, business owners do not have to include an independent contractor's compensation in their share of Social Security, Medicare, or unemployment insurance taxes, nor do employers have to include independent contractors in their pension, health insurance, or fringe benefit plans.[7]

However, several issues arise when businesses and their legal counsel attempt to craft service agreements with independent contractors. The government has devised many policies to govern the compliance requirements for using independent contractors, but to no one's surprise, confusion and ambiguities are the most common byproducts of such policies. Taken as a whole, the government's attempts to create clear distinctions between employees and independent contractors have only resulted in an ever-widening grey area. To make matters worse, there has tended to be a very limited amount of direct follow-up from executive agencies like the IRS, very little specifically tailored legislation from Congress, or any kind of bright line test or succinct delineation from the courts in applying such standards.

Overall, this Note will sift through the key sources of authority pertaining to worker classification and attempt to establish a clear perspective on where the lines are currently drawn between employees and independent contractors. To accomplish this, the Note will proceed down a somewhat unorthodox path by examining this topic through a business law lens as opposed to the many employment, tax, and tort law dimensions that are intertwined. First, the Note will provide background of the development of the main standard that the IRS uses for worker classification,[8] as well as important derivative standards and factors that

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5. I.R.S., *Independent Contractor Defined*, IRS.GOV, http://www.irs.gov/businesses/small/article/0,,id=179115,00.html (last updated Jan. 27, 2011).

6. *Id.*

7. I.R.S., *Independent Contractor (Self-Employed) or Employee?*, IRS.GOV, http://www.irs.gov/businesses/small/article/0,,id=99921,00.html (last updated Feb. 18, 2011).

8. Treas. Reg. § 31.3121(d)-1 (1987).

often come into play.[9] Second, the Note will analyze the inconsistencies and ambiguities that plague such standards and lead to a continually high level of misclassifications. Third, the Note will offer a variety of national and Michigan-oriented cases that further illustrate the constant state of flux that worker classification is mired in.[10] Fourth, the Note will point out the many different opinions of experts and commentators on how the unpredictability associated with worker classification creates significant issues for businesses.[11] Ultimately, the Note will conclude by arguing in favor of an overhaul of the entire worker classification system by focusing on the goal of significantly reducing the number of misclassifications and making the regulatory standards more business-friendly and less convoluted.

II. BACKGROUND

A. The Enactment of Revenue Ruling 87-41 and the Development of the Internal Revenue Service's "Twenty Factor Test"

To serve as an aid in determining whether a worker is an employee under the common law rules that have been incorporated over the years into federal tax regulations,[12] the IRS identified twenty factors indicative of an employer-employee relationship in Revenue Ruling 87-41.[13] Commonly referred to as the "twenty factor test," or alternatively, the "twenty factors," the IRS stated that the factors were developed based on an examination of past cases and rulings bearing on the determination of whether a business's purported independent contractors were actually employees.[14] However, the IRS also emphasized in Revenue Ruling 87-41 that no single factor is weighed more heavily than another and that there is no minimum number of factors that must be present to find an employer-employee relationship.[15] Rather, in the IRS's own words, "the twenty factors are designed only as guides for determining whether an individual is an employee . . . ."[16]

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9. I.R.S. Pub. No. 1779, *Independent Contractor or Employee?* (2008).

10. *See, e.g.*, Ill. Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1971); Askew v. Macomber, 247 N.W.2d 288 (Mich. 1976).

11. *See, e.g.*, Robert W. Wood, *Independent Contractor or Employee?*, 80 N.Y. ST. B.J. 28, 32 (2008).

12. I.R.C. § 3401 (2010).

13. Rev. Rul. 87-41, 1987-1 C.B. 296 (codified at Treas. Reg. § 31.3121(d)-1 (1987)).

14. *Id.*

15. *Id.*

16. *Id.*

1. The Literal Text of the "Twenty Factors"

The first factor is "instructions," which focuses on whether a worker must comply with instructions about where, when, and how the work must be completed.[17] Ordinarily, the IRS would find that the worker is an employee if the business has established a level of control that it affords itself "the [right] to require compliance with the instructions."[18]

The second factor is "training," which centers on whether more experienced workers are required to work directly with less experienced workers and offer on-going training at the direction of the business.[19] Since independent contractors traditionally use their own methods and rely on their own expertise, a continued pattern of business-administered training usually shows that the worker is actually an employee.[20]

The third factor is "integration," which relates to whether the overall success of the business is, to a certain degree, dependent on the specific services rendered by the worker.[21] Usually, if the business's day-to-day operations appear to rely upon the worker's services, then it is likely that the worker is subject to the kind of control signified by an employee-employer relationship.[22]

The fourth factor is "services rendered personally," which looks to whether the worker has the ability to assign his work to others.[23] Since independent contractors traditionally have this authority to assign their work to others, the IRS will often apply this factor against the presumption that a business (with respect to its own employees) is interested in both "the methods used to accomplish the work as well as in the results."[24]

The fifth factor is "hiring, supervising, and paying assistants," which concentrates on whether a business can bring in its own assistants to collaborate on the work assigned to a particular worker.[25] Similar to the previous factor, the IRS is primarily looking for signs that the worker has the authority to hire his own assistants, as independent contractors are only responsible for attaining the business's desired results (not confined by any particular methodology).[26]

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17. *Id.*
18. *Id.*
19. Rev. Rul. 87-41.
20. *See id.*
21. *Id.*
22. *See id.*
23. *Id.*
24. *Id.*
25. Rev. Rul. 87-41.
26. *See id.*

The sixth factor is "continuing relationship," which focuses on whether the work performed by the worker is arranged for and carried out on an ongoing basis.[27] Additionally, the IRS emphasizes that an employee-employer relationship exists even if the work occurs at irregular intervals, as the key is whether the worker is performing the services with some degree of recurrence.[28]

The seventh factor is "set hours of work," which centers on whether the worker has the ability to set his or her own schedule.[29] Usually, independent contractors can perform their services in such a manner, while an employee typically has set hours of work that are established by the business.[30]

The eighth factor is "full time required," which relates to whether the worker is required to work full time for the business.[31] Generally, the IRS presumes that when a worker "must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from other gainful work."[32] This factor, although not dispositive for a determination between whether a worker is an employee or an independent contractor, can loom particularly large in some situations since it can be evaluated in such a straightforward, "black-and-white" fashion.[33]

The ninth factor is "doing work on the [business'] premises," which looks to whether the work is performed at a specific location or can be done elsewhere.[34] While "[w]ork done off the premises" of the business indicates some measure of freedom from control, a presumption that the worker is an independent contractor does not necessarily follow.[35] The IRS offers several examples of when a business maintains control over the worker, namely when the worker has "to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required."[36]

The tenth factor is "order or sequence set," which concentrates on whether a worker must perform his services in a particular manner

27. *Id.*
28. *Id.*
29. *Id.*
30. *See id.*
31. Rev. Rul. 87-41.
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.*

specified by the business.[37] Granted, even when an employee-employer relationship is established, it still may be the case that no set order for the services exists; although the IRS has clarified that it is sufficient to make a determination on this factor if the business retains the right to set "the order or sequence" of services.[38] Traditionally, independent contractors are free to follow their own routines, schedules, and patterns of work.[39]

The eleventh factor is "oral or written reports," which focuses on whether the requirements of the worker's performance include the submission of written reports to the business.[40] Customarily, such reports indicate a degree of control becoming of an employee-employer relationship.[41]

The twelfth factor is "payment by hour, week, month," which centers on whether the worker is compensated on a regular basis (hourly, weekly, or monthly) or by lump sum.[42] Generally, independent contractors are compensated by a lump sum or straight commission.[43] However, the IRS clarified that it will not misinterpret situations where multiple payments are just the most convenient way for the business to pay.[44]

The thirteenth factor is "payment of business and/or traveling expenses," which relates to whether the worker received extra remuneration for ordinary business and traveling expenses.[45] Usually, when a business pays such expenses, the worker is an employee since the business is "regulat[ing] and direct[ing] the worker's business activities," even when the work is away from the premises.[46]

The fourteenth factor is "furnishing of tools and materials," which looks to whether the worker is supplied with "significant tools, materials, and other equipment" to perform the business' intended services.[47] The IRS states that a "significant furnishing" of such tools and equipment leads to a showing "of an employee-employer relationship."[48]

The fifteenth factor is "significant investment," which concentrates on whether the worker has invested substantial money and resources into

37. Rev. Rul. 87-41.
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. Rev. Rul. 87-41.
44. *Id.*
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*

the facilities that are used for the performance of services.[49] On the one hand, independent contractors tend to invest in their own facilities, such as workshops and home offices (although the IRS warns that "special scrutiny is required with . . . home offices").[50] On the other hand, employees usually do not make a measurable investment in the facilities where the work is performed, as these tend to be maintained and financed by the business.[51]

The sixteenth factor is "realization of profit or loss," which focuses on whether the worker carries any liability for business expenses.[52] Generally, a worker who can make a profit or suffer a loss is an independent contractor, but a worker that is only paid for his time and labor is an employee.[53] However, the IRS notes that the risk of not being compensated for services rendered can be "common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor."[54]

The seventeenth factor is "working for more than one firm at a time," which centers on whether a worker simultaneously performs services for several businesses.[55] Customarily, independent contractors work for multiple, unrelated businesses at the same time.[56] However, the IRS also points out an exception for when a worker who performs services for more than one business at a time is actually "an employee of each" (such situations usually involve a common service arrangement between multiple employers).[57]

The eighteenth factor is "making services available to general public," which relates to whether a worker markets (or has the authority to make) his services to everyone or operates on an exclusive basis with a certain business.[58] Typically, when a worker is able to make his services universally available on a "regular and consistent basis," that worker is likely to be an independent contractor.[59]

The nineteenth factor is "right to discharge," which looks to whether the business is entitled, without limitation, to discharge the worker at any

49. Rev. Rul. 87-41.
50. *Id.*
51. *See id.*
52. *Id.*
53. *See id.*
54. *Id.*
55. Rev. Rul. 87-41.
56. *See id.*
57. *Id.*
58. *Id.*
59. *See id.*

time.[60] Historically, the IRS has regarded the business' right to discharge a worker as a common feature of the employee-employer relationship, but independent contractors are usually immune from discharge (with certain exceptions usually related to the business's basic code of conduct, if it has one) so long as the desired result is met.[61]

The twentieth factor is "right to terminate," which concentrates on whether a worker can quit at any time without incurring liability.[62] Similar to the previous factor, the IRS has traditionally regarded a worker's right to terminate his relationship with a business as a common feature of the employee-employer relationship.[63]

2. A Step in the Right Direction? The Emergence of the "Control Factor" Categories

In the twenty-plus years since the publication of Revenue Ruling 87-41, the IRS has attempted to simplify the application of the "twenty factors" by grouping them into categories based on the type of control exerted by the business. In 2008, the IRS released Publication 1779, immediately clarifying its developing views toward the "twenty factor" test in the first paragraph of text.[64]

The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. "These relevant facts fall into three main categories: *behavioral control; financial control;* and *relationship of the parties*. In each case, it is very important to consider all the facts—no single fact provides the answer."[65]

While the language in this introduction is noticeably similar to the verbiage in Revenue Ruling 87-41, the IRS is trying to appear sincere in its attempts to reevaluate the application of the "twenty factor" test and offer related categories for the factors.[66]

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60. *Id.*

61. Rev. Rul. 87-41.

62. *Id.*

63. *See id.*

64. I.R.S., PUB. NO. 1779, *Independent Contractor or Employee?* (2008), *available at* http://www.irs.gov/pub/irs-pdf/p1779.pdf.

65. *Id.*

66. The entire 'no factor is weighed more heavily than another factor' stance of the IRS is disingenuous. The IRS's repeated offering of such words is one of the focal points in the early portion of the Analysis Section of this Note. Twenty-plus years of inconsistent jurisprudence and the continued issues with misclassification have proven over and over again that there are certain factors that are more important than others. In the latter portion of the Analysis Section, and then to a greater extent in the Conclusion, I assert that the IRS should finally come clean on the fact that certain factors carry a distinguished significance. By making such an admission, the IRS could follow through

The IRS refers to the first of these new categories as the "behavioral control" factors, indicating that "whether there is a right to control how the worker does the work" is significant in determining whether the worker is an independent contractor, or an employee.[67] Reiterating one of the basic premises from Revenue Ruling 87-41, the "behavioral control" factors clarify that a worker should be classified as an employee if the business retains the authority to control both the means and the ends of the work.[68] Specifically, these factors include "instructions" and "training."[69] Regarding instructions, Publication 1779 states that an employee will often receive somewhat extensive instructions related to how, when, and where the "work is to be done," "what tools or equipment" must be used, whether assistants can be hired by the worker "to help with the work," and where the necessary supplies and services must be purchased.[70] For training, Publication 1779 states that "if the business provides [the worker] with training about required procedures and methods, this indicates that the business wants the work done in a certain way, and . . . suggests that [the worker] may be an *employee*."[71]

The second control factor category is "financial control," which assists in determining" "whether there is a right to direct or control the business part of the work."[72] Closely mirroring some of the key factors in Revenue Ruling 87-41 pertaining to the worker's compensation and expenses for the job, the "financial control" factors make classification as an independent contractor more likely as the amount of investment and financial dependence on the specific job increase.[73] Three main factors are identified—"significant investment," "expenses," and "opportunity for profit or loss."[74] For the first factor, the IRS states that "if [the worker] has a significant investment in [the] work, [the worker] may be an independent contractor," adding that it is not looking for a precise amount of money, just that "the investment must have substance."[75] For the second factor, the IRS states that "if [the worker] is not reimbursed for some or all business expenses, then [the worker] may

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on what was a decent start in discussing the 'control factor' categories and really begin to simplify the twenty factors approach to classifying employees and independent contractors.

67. *Independent Contractor or Employee?*, *supra* note 64.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.*
73. *Independent Contractor or Employee?*, *supra* note 64.
74. *Id.*
75. *Id.*

be an independent contractor, especially if . . . [the] unreimbursed business expenses are high."[76] For the third and final factor, the IRS states that "if [the worker] can realize a profit or incur a loss, this suggests that [the worker] is in business for [himself] and . . . may be an independent contractor."[77]

Lastly, the IRS identifies a third control factor category it calls "relationship of the parties," which illustrates "how the business and the worker perceive their relationship."[78] Unlike the other two "control factor" categories, these factors take a much more practical and direct approach to classifying workers, which was notably absent from Revenue Ruling 87-41.[79] The two primary areas included in the "relationship of the parties" category are "employee benefits" and "written contracts."[80] When considering the "employee benefits" factor, the IRS looks to whether the worker receives "insurance, [a] pension, or paid leave," with the presence of all (or even some) of such benefits likely to lead to an employee classification.[81] When looking at the "written contracts" factor, the IRS considers the actual intent of the worker and the business, and according to the IRS, "[t]his may be very significant if it is difficult, if not impossible, to determine status based on other facts."[82] Other areas that are not directly addressed in Publication 1779's description of the "relationship of the parties" category (but which are implicitly linked from Revenue Ruling 87-41) include the permanency of the position and the extent to which the services performed are a key aspect of the regular operations of the business.[83]

Overall, the three control factor categories represent a noteworthy update to the over-two-decades-old "twenty factor" test. However, they still do not go far enough in parsing down the factors and defining what the IRS is actually looking for when assessing a worker's status. Looking closer at the descriptions the IRS uses in Publication 1779, it is fairly clear that there is no further clarification of how any given factor in the "twenty factor" test is decided upon for classification purposes.[84] Much of the same language is repeated from Revenue Ruling 87-41. The

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76. *Id.*
77. *Id.*
78. *Id.*
79. *Compare Independent Contractor or Employee?*, *supra* note 64, *with* Treas. Reg. § 31.3121, *and* Rev. Rul. 87-41, 1987-1 C.B. 296.
80. *Independent Contractor or Employee?*, *supra* note 64.
81. *Id.*
82. *Id.*
83. *Id. See also* Rev. Rul. 87-41, 1987-1 C.B. 296.
84. *Independent Contractor or Employee?*, *supra* note 64.

language only seems new and refreshed because the IRS was able to slide each of the "twenty factors" into the aforementioned categories.[85]

Additionally, when looking back at the myriad of cases that have created confusing and inconsistent jurisprudence regarding independent contractors, it would be rational to question how narrowly defined the independent contractor status has actually become.[86] Therefore, in Part III of this Note, several examples will be offered, arising both in case law and in everyday life, where the distinctions have become so clouded (and sometimes even contradictory) that it should come as no surprise that misclassifications and litigation on this issue have reached significant highs in recent years.

III. ANALYSIS

A. The Root of the Problem for Businesses: The "Twenty Factor" Test's Inefficiency in Distinguishing Employees and Independent Contractors

The confusion that arises with the "twenty factor" test is simple. Beginning with Revenue Ruling 87-41, the "twenty factors" that were set out have come to represent a multitude of competing considerations for a business to balance when attempting to create relationships with its workers that may not be easily classifiable one way or another.[87] Then add to the mix the three control factor categories that, while created with the best of intentions, only seem to create arbitrary groups to slide each factor into without adding any specific clarification as to any of the individual factors.[88] Finally, courts have interpreted these factors and categories in many different and unexpected ways, adding yet another layer of inconsistency.[89] One might ask whether we have essentially come to the point where a business needs to consult an IRS official or an experienced employment law attorney every time it considers hiring a new worker for fear that misclassification will occur and penalties will follow. Granted, that may be a bit of an overstatement, but it is clear that contracting with workers has become an impractical and an unnecessarily difficult endeavor for many businesses. Therefore, in hopes of ultimately identifying possible solutions to the problem, this section will focus on the areas mentioned above where the problem is

85. *Id.*

86. *See, e.g.*, Goodchild v. Erickson, 134 N.W.2d 191 (Mich. 1965); Tata v. Benjamin Muskowitz Plumbing & Heating, 94 N.W.2d 71 (Mich. 1959).

87. Rev. Rul. 87-41, 1987-1 C.B. 296 (codified at Treas. Reg. § 31.3121(d)-1 (1987)).

88. *Independent Contractor or Employee?*, *supra* note 64.

89. *See, e.g.*, United States v. Silk, 331 U.S. 704 (1947).

perpetuated. This will include a brief return to the text of Revenue Ruling 87-41, as it is the source of the fundamental issue with the IRS's ambiguous and redundant language.[90] It will also include an overview of specific cases and reciprocal legislative action that illustrate the inconsistencies that have plagued the application of the "twenty factor" test.[91] Lastly, it will offer a variety of opinions from articles written by practitioners who attempt to sort out these issues for a living in order to show that while inefficiencies have been common with the "twenty factor" test, the potential exists to simplify the IRS's entire approach and help businesses avoid misclassifications.[92]

1. The Text of the Most Important Factors Revisited Under a Skeptic's Microscope

The original wording of the text in Revenue Ruling 87-41 initiated the first inconsistencies with applying the "twenty factors."[93] Take, for instance, the third factor, which states that "integration of the worker's services into the business operations generally shows that the worker is subject to direction and control."[94] In a practical context, many workers are integrated into a business' operations, including both internal employees *and* any outside attorneys, accountants, corporate consultants, information technology consultants, and sales representatives. The necessary question that follows, then, would be what constitutes sufficient integration to be able, in good faith and under the IRS's guidelines, to properly classify a worker as an employee? Unfortunately, Revenue Ruling 87-41, the original source of the "twenty factors," is silent in response.[95] Granted, the IRS does offer citations to other revenue rulings and cases for each factor to provide a factual illustration of how that particular factor is applied.[96] However, for the third factor, the case that is cited is *United States v. Silk*, which has not only been abrogated, but also predates enactment of the "twenty factors" test in Revenue Ruling 87-41 by forty-four years.[97] Although this is just one example of a lack of clarity, it illustrates the greater problem with the ambiguity and overly simplistic nature of Revenue Ruling 87-41.

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90. Treas. Reg. § 31.3121(d)-1.

91. *See, e.g.*, Kidder v. Miller-Davis Co., 564 N.W.2d 872 (Mich. 1997).

92. *See, e.g.*, Wood, *supra* note 11.

93. Treas. Reg. § 31.3121(d)-1.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* (citing *Silk*, 331 U.S. at 704, *abrogation recognized by* Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992)).

Moreover, such issues become even more pronounced with the IRS's emphasis on the idea that no single factor is more important than any other.[98] After examining the IRS's supplemental bulletins for business owners[99] and training materials for its worker classification auditors,[100] it becomes apparent that there are, in actuality, certain factors that are weighed more heavily than others. In a tax tip bulletin the IRS posted on its website during the summer of 2010, the IRS described the control factor categories as well as made a specific proclamation that seemingly looms large for its ever-changing application of the "twenty factor" test.[101] These include:

> If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees. If you can direct or control only the result of the work done—and not the means and methods of accomplishing the result—then your workers are probably independent contractors.[102]

Though not directly quoting any single factor, the IRS's statement can be read as alluding to certain factors in the behavioral control category. As mentioned in Part II, *supra*, this category includes instructions (first factor from Revenue Ruling 87-41) and training (second factor from Revenue Ruling 87-41).[103]

A training manual for worker classification auditors supports the same level of extra attention for instructions, albeit in a more straightforward manner:

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98. In Revenue Ruling 87-41, the text directly states that "[t]he degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed." Treas. Reg. § 31.3121(d)-1. Publication 1779 also makes a similar declaration, stating that "[i]n each case, it is important to consider all the facts – no single fact provides the answer." *Independent Contractor or Employee?*, *supra* note 64. Overall, this appears to be the IRS's attempt to not pigeonhole itself into maintaining any sort of bright-line rule when determining a worker's classification. Granted, this is an understandable position for the IRS to take considering the vast number of filings it must verify and audits it undertakes each year, but the residual effect seems to lead to many inconsistencies.

99. I.R.S., *Employee vs. Independent Contractor—Seven Tips for Business Owners*, IRS.Gov, http://www.irs.gov/newsroom/article/0,,id=173423,00.html (last updated Aug. 20, 2010) [hereinafter *Employee vs. Independent Contractor*].

100. I.R.S., Training 3320-102 (10-96), *Independent Contractor or Employee?, Training Materials* (1996) [hereinafter *Training Materials*].

101. *Employee vs. Independent Contractor*, *supra* note 99.

102. *Id.*

103. *Independent Contractor or Employee?*, *supra* note 64.

> Virtually every business will impose on workers, whether independent contractors or employees, some form of instruction.... This fact alone is not sufficient evidence to determine the worker's status...the goal is to determine whether the business has retained the right to control the details of a worker's performance or instead has given up its right to control those details. Accordingly, the weight of "instructions" in any case depends on the degree to which instructions apply to *how the job gets done* rather than to the *end result.*[104]

The main reason, then, for devoting additional evaluation during an audit to the degree of instructions given to the worker is that *all* businesses give some degree of instruction to their workers.[105] Therefore, what becomes confounding when looking at the IRS's approach to its auditor training is the fact that it does not make its publications for business owners quite so clear and unambiguous. In the same section of the training manual, the IRS is even more specific by offering examples to its auditor trainees about how to evaluate where a business's instructions fall on the employee-independent contractor spectrum.[106]

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104. *Training Materials, supra* note 100, at 2-8.

105. *Id.*

106. *Id.* In Revenue Ruling 87-41 and Publication 1779 (which are generally considered the main IRS aids provided for business owners), the IRS offered vague descriptions of each factor or control factor category that would only in some cases be supplemented by another Revenue Ruling or case citation. Conversely, in the training materials cited above, the IRS took a different approach. Initially, the training materials made the following statement:

> The more detailed the instructions are that the worker is required to follow, the more control the business exercises over the worker, and the more likely the business retains the right to control the methods by which the worker performs the work. Absence of detail in instructions reflects less control.

Training Materials, supra note 100, at 2-10. In truth, this statement is not that different from the statements that have been the subject of criticism so far in this section. However, that statement is immediately followed by four hypothetical examples of how the auditors should apply the IRS's desired approach to evaluating instructions:

> J is an independent truck driver. J received a call from manufacturing company Y to make a delivery run from the Gulf Coast to the Texas Panhandle. J accepts the job and agrees to pick up the cargo the next morning. Upon arriving at the warehouse, J is given an address to which to deliver the cargo and is advised that the delivery must be completed within two days. This is direction of *what* is to be done rather than *how* it is to be done and is consistent with independent contractor status.

The IRS training manual hints at the importance of training by stating the following:

> Training is a classic means of explaining detailed methods and procedures to be used in performing a task. Periodic or on-going training provided by a business about procedures to be followed and methods to be used indicates that the business wants the services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship.[107]

Using the same rationale (from the instructions section) that training is of the utmost importance because of the fact that all businesses must train their workers to some degree, the IRS goes on to explain specific instructions where training should be disregarded as a factor for worker classification.[108] Again, as is the case with its treatment of instructions, the question of why the IRS does not offer the same level of analysis in its publications to business owners should be asked.

An online article posted by a New England staffing company that provides various resources to employers advances the idea that instructions and training are definitely two of the most important factors to the IRS for worker classification purposes.[109] Yet, as has been pointed out numerous times, the IRS is quick to dispel the notion that any factors are more important than others in its publications for business owners.[110] Quoting a past iteration of the IRS's worker classification training manual, the staffing company provides the following excerpt:

> Instructions to workers: Your worker is probably an employee if you require him or her to follow instructions on when, where, and how work is to be done. This is a very important factor. However, if you tell your electrician you want blue switch plate covers instead of white, you are not exercising control to a

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Id. at 2-11. Overall, the greater point is that the dearth of specificity in the publications that the IRS provides to business owners is one of the main reasons that misclassifications occur so often.

107. *Training Materials, supra* note 100, at 2-15.

108. *Id.* ("If a business requires its workers to comply with rules established by a third party . . . the fact that such rules are imposed by the business should be given little weight in determining the worker's status.").

109. *White Papers: IRS 20-Factor Test for Independent Contractors*, BONNEY STAFFING 4-5 (2009), *available at* http://www.bonneystaffing.com/pdf/IRS20Factor.pdf [hereinafter *White Papers*].

110. Treas. Reg. § 31.3121(d)-1.

> degree that would make the person an employee. Job training: If your company provides or arranges for training of any kind for the worker, this is a sign you expect work to be performed in a certain way; therefore, the worker is your employee. Training can be as informal as requiring the worker to attend meetings or work with someone who's more experienced.[111]

This article corroborates the earlier points made in this section, and suggests the broader conclusion that the "behavioral control" factors of instructions and training are the most important to the IRS.[112] However, this assumes the correctness of the premise that the IRS's ambiguous language and evasion of making straightforward points in its materials is a major reason why so many worker misclassifications occur.

Maybe a compromise can be made regardless of whether one believes the argument set forth in this section. For many pragmatists, the answers to the many questions raised by the IRS's approach center on the need for a more simplified system of classifying employees and independent contractors. Perhaps extension of the IRS's focus in the training materials on practical hypotheticals, as opposed to doctrinal generalities, would be a good first step. Beyond wording and semantics, however, the best strategy going forward may lie in the consolidation of the twenty factors to a more manageable number.

2. Case(s) in Point: How the Courts Have Treated the "Twenty Factors"

From the outset of discussing court cases relating to worker classification, it is important to take note of some inherent difficulties. First, litigation regarding the employee-independent contractor distinction often grows out of workers' compensation claims and vicarious liability tort actions.[113] Needless to say, these are two areas that do not necessarily bear on the application of the IRS "twenty factor" test. Thus, the main role of these cases is to show how courts have developed different tests closely linked to the IRS factors to determine whether a worker is an employee or an independent contractor. By the same token, cases offer some useful factual examples of who specifically may or may not be an independent contractor. However, for the most part, such facts usually focus on meeting the burdens of proof for workers' compensation

111. *White Papers*, *supra* note 109.
112. *Id.*
113. *See, e.g.*, Askew v. Macomber, 247 N.W.2d 288 (Mich. 1976).

and tort law.[114] Therefore, revenue rulings and the hypothetical examples that the IRS provides in its publications are still usually the best sources for factual examples. Lastly, cases on this issue tend to weave federal and state law into a complicated framework that serves different needs.[115] For example, many of the sources of law cited in such cases draw their definitions of employee and independent contractor from the common law rules that went into formulating federal statutes such as the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Revenue Act of 1978.[116] After all, Revenue Ruling 87-41 prefaces its presentation of the "twenty factors" by stating, "[a]s 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."[117] At the same time, states have been able to adopt different tests to determine the employment status of workers, creating an enormous amount of variation.[118] Consequently, this section will provide some of the highlights from the most pertinent federal cases while also mixing in Michigan cases that relate to the issue.

Beginning with *United States v. Silk*, the Supreme Court applied the common law 'right to control' standard to determine whether coal unloaders and coal truck drivers were employees.[119] Despite the many years that *Silk* predates Revenue Ruling 87-41 and the "twenty factors," the Court ominously summarized the difficulties with classifying a worker as an employee or an independent contractor.[120] Therefore, as a means of determining whether workers in controversy were employees or independent contractors, the Court looked to the intent of Congress

114. *See, e.g.*, Goodchild v. Erickson, 134 N.W.2d 191 (Mich. 1965).

115. *See, e.g.*, Ill. Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1971).

116. *See* Treas. Reg. § 31.3121(d)-1. In the introduction of the Revenue Ruling, the IRS states that it limited its scope of analysis to the common law rules promulgated in "the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24 respectively, subtitle C, Internal Revenue Code)[.]" *Id.* The Revenue Ruling also states that the factual situations included in the text represent "the application of section 530(d) of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. xi, 119 (the 1978 Act), which was added by section 1706(a) of the Tax Reform Act of 1986 . . . ." *Id.* As will be discussed in the cases analyzed in this section, the use of such common law rules has been a typical approach for many courts. However, some state courts like Michigan began using an "economic reality" test after the 1940s that is notably different from the common law right to control test. *See Goodchild*, 134 N.W.2d at 193.

117. Treas. Reg. § 31.3121(d)-1 (emphasis added).

118. *See, e.g.*, *Kidder*, 564 N.W.2d at 872; Walling v. Hardy Constr., 807 P.2d 1335 (Mont. 1991); Stephens v. Celeryvale Transp., Inc., 286 N.W.2d 420 (Neb. 1979).

119. *Silk*, 331 U.S. at 714-15.

120. *Id.* at 713.

when it crafted the provisions of the Social Security Act and National Labor Relations Act, and ultimately endorsed the right-to-control standard as the relevant test.[121] Thereafter, the Court took account of the elements that go into an evaluation of the degree that a business maintains the right to control its workers.[122] The Court stated:

> Probably it is quite impossible to extract from the statute a rule of thumb to define the limits of the employer-employee relationship . . . . [T]he courts will find that degrees of control, opportunities for profit or loss, investment in facilities, permanency of relation and skill required in the claimed independent operation are important for this decision. No one is controlling nor is the list complete.[123]

Applying those elements to the facts of the *Silk* case, the Court reversed the lower courts' judgments that the unloaders were independent contractors since the business maintained a position that allowed it to exercise direct supervision and control over the unloaders' work.[124] Accordingly, the Court reached the opposite conclusion with the truck drivers, seeing them as "small businessmen" and thus affirming the judgments of the lower courts that had found the truck loaders to be independent contractors.[125] The *Silk* decision cannot necessarily be

121. *Id.* at 713-15. Speaking for the majority of the Court, Justice Reed stated in the latter half of the opinion that in past cases regarding the administration of the National Labor Relations Act, the Court had "pointed out that the legal standards to fix responsibility for acts of servants, employees or agents had not been reduced to such certainty that it could be said there was 'some simple, uniform and easily applicable test.'" *Id.* at 713. However, the *Silk* case centered on whether the coal company could recover social security taxes that were assessed when its unloaders and truck drivers were initially classified as employees. *Id.* at 706. Therefore, Justice Reed stated that "[a]pplication of the social security legislation should follow the same rule that we applied to the National Labor Relations Act . . . ." *Id.* at 713-14. Applying those standards, the Court determined that the company's "right to control how 'work shall be done' is a factor in the determination of whether the worker is an employee or independent contractor." *Id.* at 714.

122. *Id.* at 716.

123. *Id.*

124. *Id.* at 717-18 ("[The workers] provided only picks and shovels. They had no opportunity to gain or lose except from the work of their hands and these simple tools. That the unloaders did not work regularly is not significant. They did work in the course of the employer's trade or business . . . . [The business] was in a position to exercise all necessary supervision over their simple tasks").

125. *Silk*, 331 U.S. at 718-19 ("[W]here the arrangements leave the driver-owners so much responsibility for investment and management as here, they must be held to be independent contractors . . . . These driver-owners are small businessmen. They own their own trucks. They hire their own helpers. In one instance they haul for a single business,

credited as the first time a court officially applied the right-to-control test.[126] However, *Silk* does represent one of the strongest claims the Supreme Court made in the early line of cases related to worker classification after the legislative overhaul of the New Deal era. Naming specific elements such as the "degrees of control," the "opportunities for profit or loss," the "investment in facilities," the "permanency of relation," and "skill required in the claimed independent operation," the Court unknowingly established a foundation that would drive the development of the IRS's "twenty factors" and other related tests.[127]

Decided only a week after *Silk*, the Supreme Court applied the right-to-control test in *Bartels v. Birmingham* to determine whether band members and leaders were employees or independent contractors.[128] Like *Silk*, *Bartels* arose out of the business's (in this case, a dance hall) claim to recover Social Security taxes it had paid to the band leaders and their band members, all of whom it had been characterizing as employees.[129] Recounting its application of the right-to-control test in *Silk*, the Court emphasized that a totality of the circumstances was the basis for the standard, not any single element or fact.[130] In the end, the *Bartels* Court determined that the band leader, not the operator of the dance hall, was the employer, thus making both the band leader and the band members independent contractors for the purposes of the initial claim.[131] Besides the direct correlation between the outcomes of *Silk* and *Bartels*, however, lies a new development in the progeny of cases bearing on worker classification. Deep into the opinion, the Court actually offered an alternative to the right to control test: "Obviously control is characteristically associated with the employer-employee relationship,

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in the other for any customer. The distinction, though important, is not controlling. It is the total situation, including the risk undertaken, the control exercised, [and] the opportunity for profit from sound management, that marks these driver-owners as independent contractors.").

126. *See, e.g.*, United States v. Mut. Trucking Co., 141 F.2d 655, 658 (6th Cir. 1944).

127. *Silk*, 331 U.S. at 718-19.

128. Bartels v. Birmingham, 332 U.S. 126, 127 (1947).

129. *Id.*

130. *Id.* at 130 ("In *United States v. Silk*, we held that the relationship of employer-employee . . . was not to be determined solely by the idea of control which an alleged employer may or could exercise over the details of the service rendered to his business by the worker or workers . . . . [W]e pointed out that permanency of the relation, the skill required, the investment in the facilities for work, and opportunities for profit or loss from the activities were also factors that should enter into judicial determination . . . It is the total [situation] that controls. These standards are as important in the entertainment field as we have just said, in *Silk*, that they were in that of distribution and transportation.").

131. *Id.* at 132.

but in the application of social legislation employees are those who as a matter of *economic reality* are dependent upon the business to which they render service."[132] While the "economic reality" test would go largely unused until the 1950s and 1960s, it would eventually grow into a fierce rival to the "right to control" test, even being adopted as the preferred standard in states like Michigan.[133] The main point of divergence is the nature of the claim, with cases arising under FICA or FUTA requiring the use of the right-to-control test. In one case, the court took the following view:

> [T]he existence or absence of an employment relationship [within Federal Insurance Contributions and Federal Unemployment Tax Acts] is to be ascertained not by use of the economic reality test but by applying the common-law rules realistically . . . . The end-point determination—whether the person for whom the services are performed is an 'employer' within common-law meaning of that term—must be made on the basis of actual reality by looking to the substance of the arrangement and giving weight to all relevant factors.[134]

Therefore, the economic reality test would grow rapidly in popularity with cases arising under tort claims or other sources of employment law exclusive of FICA or FUTA.

One Michigan case that chronicles the shift in usage from the right-to-control test to the economic reality test is *Kidder v. Miller-Davis Company*.[135] In that case, the plaintiffs were employees of a labor broker in the business of providing the services of "'construction trades personnel on an independent contractor basis[.]'"[136] The labor broker leased the plaintiffs to a construction project in Kalamazoo managed by the defendant corporation.[137] Both plaintiffs were injured while performing demolition work onsite.[138] Subsequently, both brought suit against the labor broker and the corporation that had become its customer.[139] In response, the co-defendants sought immunity from such

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132. *Id.* at 130 (emphasis added).

133. *See, e.g.*, *Askew*, 247 N.W.2d at 295-96; *Goodchild*, 134 N.W.2d at 193; Tata v. Muskovitz, 94 N.W.2d 71, 72-74 (Mich. 1959); Industro-Motive Corp. v. Wilke, 150 N.W.2d 544, 546 (Mich. Ct. App. 1967).

134. *Ill. Tri-Seal Prods., Inc.*, 353 F.2d at 228.

135. *Kidder*, 564 N.W.2d at 872.

136. *Id.* at 873.

137. *Id.* at 874.

138. *Id.* at 873-74.

139. *Id.* at 874.

tort "liability under the exclusive remedy provision of the [Worker's Disability Compensation Act]."[140] Ultimately, the court found that the labor broker and the corporation were co-employers of the plaintiffs, allowing each to be protected by the benefits of the exclusive remedy provision of the WDCA.[141] More important than the facts and holding of *Kidder*, however, is that the court exclusively used the "economic reality" test to determine that the corporation that had leased the employees' services had legally become their co-employer.[142] As mentioned previously, the court devoted an extensive portion of the opinion to describing the development of the "economic reality" test and the shift away from the right-to-control test for cases arising in tort:

> The determination of who is an employer for purposes of the exclusive remedy provision of the WDCA, as well as other statutory schemes, has had a rich and voluminous history. Early cases that addressed this question, first in the arena of unemployment compensation, evaluated the relationship under a "control" test.[143]

The court went on to discuss the role of the right-to-control theory in delineating the master-servant relationship for various kinds of tort cases, citing *Powell v. Employment Security Commission* as the first point of divergence from the right-to-control test[144]:

> Justice Talbot Smith's thoughtful dissent in *Powell*, which later became the prevailing law, strongly criticized the rigid control test and the absurd, chaotic decisions that resulted from it. He noted that the control test failed to achieve any uniformity or certainty and that this tort concept should be inapplicable to the administration of social legislation. Justice Smith noted that accepting this rigid control test could lead to much mischief....[145]

The *Kidder* court then took special note of the fact that Justice Smith was heavily influenced by *Silk* in his criticism of the right-to-control test, and determined that a court should examine the actual work performed

140. *Id.*
141. *Kidder*, 564 N.W.2d at 879-80.
142. *Id.* at 882.
143. *Id.* at 875.
144. *Id.* (citing Powell v. Emp't Sec. Comm'n, 75 N.W.2d 874 (Mich. 1956)).
145. *Id.* at 875-76.

and that "control is only one" of many factors to be considered in this examination.[146] Three years after Justice Smith's dissent in *Powell*, the Michigan Supreme Court would officially abandon the right-to-control test in favor of the "economic reality" test,[147] with Justice Smith getting a carte blanche in his subsequent concurring opinion in *Schulte* to define the new test's elements.[148]

> [T]he "control" test is often meaningless, usually ambiguous, and always susceptible of paperwriting evasions. Consequently we have abandoned it. The test is now one of economic reality. This is not a matter of terminology, oral or written, but of the realities of the work performed. Control is a factor, as is payment of wages, hiring, and firing, and the responsibility for the maintenance of discipline, but the test of economic reality views these elements as a whole, assigning primacy to no single one.[149]

The *Kidder* court resolved that the "economic reality" test had been embraced since *Powell*, *Tata*, and *Schulte* because of its adaptability to the particular facts of a given case, and made it clear that a "totality of the circumstances" test is the more realistic approach to such fact-driven determinations.[150] In the last few decades especially, the economic reality test has progressively developed, with more specific factors and elements being highlighted with each new case.[151]

At this point, it might be appropriate to ask the same question that was asked at the end of Part II.A.1—why spend so much time analyzing these cases? After all, each of the cases discussed above is a case that arose under social legislation or tort. Again, the answer is to look at how

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146. *Id.* at 876.

147. *See Tata*, 94 N.W.2d at 71.

148. *See* Schulte v. Am. Box Bd. Co., 99 N.W.2d 367, 372 (Mich. 1959) (Smith, J., concurring).

149. *Id.* at 372 (citations omitted).

150. *Kidder*, 564 N.W.2d at 877 ("Given the increasingly complicated relationships developing in today's business and economic marketplaces anything other than a totality of the circumstances test would be an insufficient guide by which to evaluate the employee-employer relationship.").

151. *See, e.g.*, *id.* at 880 ("[The economic reality test] . . . examines a number of criteria including control, payment of wages, hiring, firing, the maintenance of discipline, and common objective."); Capital Carpet Cleaning & Dye Co., Inc. v. Emp't Sec. Comm'n, 372 N.W.2d 332, 334 (Mich. Ct. App. 1985) ("Under the economic reality test, among the relevant factors to be used are (1) control of a worker's duties, (2) the payment of wages, (3) the right to hire and fire and the right to discipline, and (4) the performance of the duties as an integral part of the employer's business towards the accomplishment of a common goal.").

and why the inconsistencies with the "twenty factor" test developed in hopes of developing a more simplified approach to determining worker classification. The fact that both federal and state courts have gone back and forth for so many years in determining what test to use and what factors to apply is representative of the inconsistent history that governmental units and businesses have experienced when trying to distinguish employees from independent contractors.

3. Practical Perspectives from Those 'On the Ground'

It is also important to take account of the prevailing opinions of practitioners that must work with the IRS's worker classification policies on a daily basis. By doing this, the goal is to bring the entire topic full-circle and allow for a smooth transition into some possible ideas as to what can be done, both in the short-term and long-term, to address this issue.

A good starting point is summarizing the opinions and writings of Robert Wood, a well-respected attorney and author of *Legal Guide to Independent Contractor Status*.[152] Throughout Wood's work, the recurrent theme is "[a] fight avoided is a fight won" in reference to contracting around the ambiguities and inconsistencies that plague the IRS's policies.[153] Characterizing the independent contractor-employee line as "often not crystal clear," Wood's emphasis lies in the common-sense approach of looking pragmatically at what workers are, using consistent language throughout the contract, and, most of all, creating realistic expectations of what a third party would view the worker to be from the outside looking in.[154] As a matter of the IRS's intensified scrutiny and willingness to dole out significant penalties for misclassification, this mantra is grounded in caution and compromise. Based on his experience with counseling companies that regularly use independent contractors, Wood states that many businesses believe that labeling workers as independent contractors who, in actuality, would have no chance of withstanding the scrutiny of the IRS is an effective cost-benefit approach.[155] However, in Wood's view, this approach is neither expedient nor savvy, as companies will only reap short-term benefits and put themselves prominently under the IRS's microscope as

152. ROBERT W. WOOD, LEGAL GUIDE TO INDEPENDENT CONTRACTOR STATUS (Tax Institute 4th ed. 2007).

153. Wood, *supra* note 11, at 32.

154. *Id.* at 32-33; *see also* Robert W. Wood, *Defining Employees and Independent Contractors*, 17 BUS. L. TODAY 45 (2008).

155. *See* Wood, *supra* note 11, at 33; *see also* WOOD, *supra* note 154.

recidivists.[156] Overall, Wood's opinions represent the mainstream practitioners' approach to the worker classification issue, as contracting around the policies and creating contracts that attempt to address as many of the "twenty factors" as possible seems to be the least of many evils. This often feeds contract-drafting habits that overuse legalese, and adds many complexities to otherwise boilerplate employment contracts, but again, the "fighting fire with fire" approach has served practitioners well over the years in response to the IRS's stance. However, the IRS and other government regulatory agencies are in the process of ratcheting up their crackdown on independent contractor misclassification, as administrative changes and pending legislation threaten to make matters much more difficult for businesses and their attorneys in the months and years ahead.[157]

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156. *See* Wood, *supra* note 11; WOOD, *supra* note 154.

157. Although this Note cannot possibly cover every contingency and possible change to the regulatory scheme, it is definitely important to discuss what the government has in store for worker classification. According to Wood's articles, as well as several other online articles, blogs, and law firm websites, a bill put together by then-Senator Barack Obama and Senator Dick Durbin has regained its traction and could be on the signing table for the President by the end of his first term or early in his second term if he is reelected. *See* Wood, *supra* note 11, at 29; WOOD, *supra* note 154, at 47; Devora L. Lindeman, *Beware Employee Classification, Tread Carefully*, OVERTIME ADVISOR (July 1, 2009), http://www.overtimeadvisor.com/tags/independent-contractor-proper/; Faeger & Benson, LLP, *Misclassifying Independent Contractors as Employees: Risks and Liabilities* (Apr. 26, 2010), http://www.faegre.com/11283; *Obama and the Independent Contractor Classification—Change You Need to Know Now!*, ICON PROF'L SERV. BLOG (Oct. 1, 2008), http://icon1099.wordpress.com/2008/10/01/icpc/ [hereinafter *Obama and the Independent Contractor Classification*]. The "Independent Contractor Proper Classification Act" was introduced by the abovementioned Senators in 2007, although it was not enacted. *See* Faeger & Benson, LLP, *supra*. In 2009, Senator John Kerry introduced an updated version of this legislation that, if enacted, would repeal the "safe harbor" provision of the Revenue Act of 1978. *Id.* The safe harbor has been a "peace of mind" mechanism that businesses have been able to use for decades to classify workers as independent contractors, regardless of the analysis under the twenty factors, unless the business had "no reasonable basis" for such a classification. *Id.* The Kerry Bill, titled the "Taxpayer Responsibility, Accountability, and Consistency Act," would also take away the prospective relief included in the safe harbor provision by only allowing businesses to claim a reasonable basis for classifying a worker as an independent contractor if "the employer did not treat any worker holding a substantially similar position as an employee" since 1977 and "the independent contractor classification was based in reasonable reliance on either a written documentation from the Department of Treasury that the worker was not an employee" or an IRS determination that "the worker was not an employee." *Id.* The Kerry bill would also require all businesses to issue Form 1099s to "every service provider . . . to whom the business pays more than $600 annually and . . . classifie[s] as [an] independent contractor . . . ." *Id.* While this legislation is still pending at the federal level, many states have incorporated similar provisions into their own tax regulations or "established independent contractor task forces . . . to increase

Returning to Wood's stance, many corroborating articles exist to prove just how mainstream the "contracting around the ambiguities" approach is. A somewhat aged (although still remarkably relevant) Michigan Bar Journal article written by Marc Prey offers some of the specific techniques that practitioners have used over the years in the service agreements they have crafted for businesses and their independent contractors.[158] The first suggestion made by Prey is an obvious one: specifically state in the agreement that the worker is an independent contractor and that his duties to be rendered will be deemed as such.[159] Another point of emphasis in the agreement should be that the worker has "full responsibility for state and federal income and employment taxes," as well as "ordinary and necessary expenses" incurred in the performance of the services for the business.[160] When appropriate, the agreement should also clarify that the independent contractor is to use his "own tools, equipment, and materials," that he can hire his own people to help in rendering the services, and that he may work for others during the term of the agreement.[161] In terms of termination, "the agreement should not provide the company nor the independent contractor with the right to arbitrarily end the working relationship" (i.e. no at-will employment).[162] Lastly, and what Prey deems "most important," "the agreement should provide the [business] with as little control over the independent contractor's performance . . . as is reasonably possible under the circumstances."[163] Overall, Prey's points add to Wood's stance as representing the mainstream approach to

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enforcement" of such policies. *Id.* This trend is not a new one, and probably stands to only intensify with President Obama's administration showing an inclination to legislate in favor of unions and seek new sources of tax revenue to combat our nation's massive deficit. Two of the numbers that support the contention that this trend is occurring include the fact that worker classification now comprises thirty percent of all IRS audits and is the single largest IRS enforcement program. *See Obama and the Independent Contractor Classification*, *supra*. On a state level, these trends are even more clear, as the Department of Labor has created incentives for state audit agencies to prove their own programs' effectiveness, which in turn has led to many states using new software programs that analyze all incoming "1099s for common red flags" (which automatically triggers an audit). *Id.* All in all, it has become a true battle between businesses and the government to stay ahead of each other on worker classification, although these new administrative changes and possible legislative policies could escalate this battle into a full-scale war.

158. Marc L. Prey, *Advising the Client Who Employs Independent Contractors*, 70 MICH. B.J. 1328 (1991).

159. *Id.* at 1332.

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

contracting around the IRS's inconsistent enforcement of its worker classification policies. The implicit reliance on satisfying as many of the "twenty factors" in any given independent contractor agreement is the main reason why such tactics have become the mainstream approach, although it is true that other practitioners have taken a somewhat different view.

One of the different streams of opinion, which represents a slight deviation from the norm, mostly on account of his more disapproving view of the IRS workings, is embodied in another Michigan Bar Journal article, *Legal Challenges in Using Independent Contractors*, penned by Rick Pacynski.[164] Pacynski discusses various labor relation reasons, economic reasons, social policy reasons, common tort liability reasons, and tax liability reasons for the shift to using more "alternative forms of employment," such as independent contractors.[165] Throughout this analysis, Pacynski presents a less-than-rosy perspective of the difficulties of working with the system that the federal and state agencies, namely, the IRS, have put in place.[166] Pacynski stated that at the time the article was published, only fifteen percent of possible tax revenue was being collected from unreported independent contractor activities, while one in seven businesses misclassified an aggregated "total of 3.4 million workers per year" (on a national level), which resulted in a estimated loss to the IRS totaling somewhere between 1.5 and 10 billion dollars in any given year.[167] Additionally, on an individual business level, Pacynski claims that a highly publicized 1988 IRS audit "of businesses with assets of less than 3 million dollars" showed that "92% of the returns under-reported income," leading the IRS to assess "higher taxes averaging $67,000 per return."[168] Overall, Pacynski questions the lack of development of a bright-line test from the courts, or at a more realistic level, a more straight-forward and easier-to-interpret IRS standard that businesses can use so that they know where they stand without having to worry about an audit at every turn.[169]

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164. Rick A. Pacynski, *Legal Challenges in Using Independent Contractors*, 72 MICH. B.J. 671 (1993).

165. *Id.* at 671-73.

166. *Id.*

167. *Id.* at 675.

168. *Id.*

169. *Id.* at 677. Pacynski's interest in the possible creation of a bright-line may not be as profound as other contemporaries have advocated for, but the very idea of the courts developing such a standard is interesting:

> The contradictory analyses used by the courts [have made] it impossible to give bright-line advice to management. Simply stated, the case law has not caught

Granted, Pacynski's article predates this Note by almost twenty years. However, the specter he posed is as relevant as ever given the impending administrative changes and possible legislation that will only further complicate the worker classification system. Like Pacynski, I have argued in this Note for a significantly more straightforward (if not 'bright-line') standard to better draw the lines between independent contractor and employee. And foreseeably, if the IRS and the rest of the government do not take steps to accomplish this, prior case law may become totally moot and the entire concept of what an independent contractor truly is could become completely assimilated into that of the traditional employee. All hope should not be lost, however. Regardless of what the future holds with the aforementioned administrative and legislative restructuring, there is still an unsilent majority that believes that real, positive reform is possible.[170]

IV. CONCLUSION

With reform and eternal optimism in mind, one can look for wisdom in the words of Stanley Fendley, the former tax counsel to the U.S. Senate Committee on Small Business during the Clinton Administration.[171] During his appointment in the 1990s, several different ideas were proposed in Congress and the Department of the Treasury that

> up to, and is not prepared to fully address, the complexities of modern commercial contracting. This has two inconsistent results. On the one hand, broad use of the term "independent contractor" can sabotage the underlying purpose behind worker welfare legislation. Some commentators have called for expansion of worker welfare legislation to cover self-employed workers where they, but for the contractual format, act in the role of employees. On the other hand, lack of definiteness in the analysis opens the door for a potentially overbroad and unrealistic definition of "employee" by, among others, the Internal Revenue Service. Its recent, aggressive interpretation of the [twenty factor test] makes it nearly impossible for casual workers to be identified as "independent contractors."

Id. at 677. Granted, it should be said that bright-line tests are not always the most efficient means of getting more clarification on a troubled issue, as you can run the risk of eliminating the many important exceptions that arise given the unique circumstances of a given situation. At any rate, it remains to be seen whether a bright-line test would improve upon the inconsistent approach that has come to represent the IRS's approach to worker classification.

170. *See* Stanley Fendley, *Tax Matters Special Report: Independent Contractor Legislation—Opportunity Knocks for Small Businesses*, 182 J. OF ACCOUNTANCY 34, 34-35 (1996) (offering solutions that pose, based on all of the secondary authority surveyed in this note, the most realistic and potentially impactful changes to the worker classification system and the twenty factors to date).

171. *See id.* at 35.

urged the adoption of a bright-line approach, or alternatively, a vast reduction of the "twenty factors" to a more nominal number that would also "expand the . . . safe harbor protections to include more businesses that have filed form 1099 in good faith."[172] Unfortunately, none of these ideas took hold during the Clinton Administration, leading eventually to a much more strict response under the Obama Administration that, as mentioned above, is developing into a full-scale crackdown.[173] Still, the idea of reforming the IRS's worker classification approach into something closer to a bright-line test or even a simpler, more manageable number of factors could hold a great amount of promise and prevent the wholesale elimination of the independent contractor status as we know it.

Alternatively, there are many who would oppose the development of a bright-line test in the legal community, and rightfully so in certain circumstances. Over time, it has become apparent that bright-line tests, especially, tend to draw lines that can be too inflexible and bulky for the judiciary to apply. However, why not attempt to reduce the number of factors from twenty to a more manageable number? This would reduce the number of ambiguities and inconsistencies when businesses, the IRS, and even the courts must interpret the true nature of an agreement. A reduction in the number of factors would also allow for a straightforward affirmation that instructions, training, and a few other factors have always loomed the largest for the IRS's determination of whether a worker is *truly* an independent contractor. At this juncture, it is not clear where this call for change will lead, but the best hope lies somewhere between the continued activism and lobby of businesses and the perpetual accumulation of misclassifications. Unfortunately, misclassifications tend to be the kind of factor that is the most successful in getting the attention of certain executive agencies. One should hope that legislators and business owners continue to work together to make some noise on this issue. At any rate, it will be interesting to follow the development of the IRS's enforcement and the legislative changes, both of which could significantly affect businesses and their independent contractors throughout the country.

ALEXANDRE ZUCCO

172. *Id.*
173. *See* Lindeman, *supra* note 157.