Pension Plan Fix-It Handbook

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Fed Agencies Closely Watching Independent Contractor vs. Employee Debate — And Plan Sponsors Should, Too

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Many employers try to control retirement plan costs by excluding certain employees from participation (see ¶222 in Thompson's *Pension Plan Fix-It Handbook*). Independent contractors are often among the excluded, but it is critical that exclusions comply with applicable law. This is now more critical than ever, because several government agencies are working together to determine whether that person you thought you were doing business with as an independent contractor is really an employee, in the government's view.

Retirement plan language today includes what is often referred to as "Microsoft language" to recognize this need for compliance, as a result of a much-publicized ruling (*Vizcaino v. Microsoft Corp.*) in 1996 in which thousands of independent contractors were reclassified as common law employees and became retroactively eligible to participate in the company's 401(k) plan (see ¶300).

Not only must the language in plan documents on eligibility requirements be as clear as possible, the agreement between the worker and the employer must be clear as well.

Benefit plan responsibility may fall within the human resources function, but the relationship between worker and employer generally lies elsewhere within HR. It is important that the department responsible for structuring independent contractor relationships be aware of all employee benefit implications.

So, exactly who is watching? At the least, the U.S. Department of Labor, IRS and the state government agencies (through mechanisms such as workers' compensation, unemployment and taxes). DOL has entered into memoranda of understanding with IRS and with many states to share information and compliance efforts. If DOL, the states and IRS truly share information and coordinate compliance efforts as intended, it will not be long before employee benefit plans are targeted for independent contractor treatment.

DOL vs. IRS vs. the States

DOL is interested in protecting workers' rights. DOL starts from the belief that all workers are employees. Employees are covered under the Fair Labor Standards Act; independent contractors are not. DOL is primarily responsible for minimum wage and overtime requirements, as well as the Family and Medical Leave Act rules. And as we know, compensation amounts have a major impact on retirement plan costs.

IRS is interested in collection of employment and withholding taxes on a timely basis. Employers neither collect nor pay taxes on payments to independent contractors. Instead, the independent contractor pays his or her own taxes (FICA and withholding), either quarterly or at the end of the year. More important to the benefits professional, the term "common law employee" is relevant in many employee benefit plan eligibility determinations. Correctly determining who is an employee for benefit plan purposes is key to satisfying a number of compliance requirements (for example, eligibility, coverage and nondiscrimination testing).

Like IRS, the states are interested in collection of taxes on a timely basis as well as funding unemployment, workers' compensation and temporary disability insurance premiums in some states. States also have their own minimum wage requirements.

At present, DOL is focusing on the economic impact of the relationship between employers and independent contractors, while IRS is looking at the control aspect.

See *Andersen*, p. 2

Andersen (continued from p. 1)

Employers should consult their states' websites to learn more about the agencies' focus.

Two DOL Announcements Sponsors Should Note

Two recent DOL announcements should stay on the radar screen of those responsible for their company's employee benefits. The first is Administrator's Interpretation No. 2015-1, which relates to whether a worker is an employee or independent contractor. The second is proposed overtime regulations, which would expand the pool of white-collar workers subject to overtime.

Key DOL takeaways:

- DOL's Wage and Hour Division has entered into an MOU about independent contractors' status with many states and IRS that, in part, is intended to provide educational and outreach efforts to employers as well as coordinate compliance investigations.
- The previous DOL emphasis on "control" appears to have shifted to "economic realities factors." In other words, is the worker economically dependent on the employer, or truly in business for him- or herself?
- DOL has a Misclassification Initiative (http://www.dol.gov/whd/workers/misclassification) that is adding emphasis to the importance of its worker misclassification efforts.
- DOL's proposed overtime regulations, Fact Sheet and FAQs, among other documents — all of which are posted on its website (http://www.dol.gov/whd/overtime/NPRM2015/) — focus on updating the salary and compensation levels for white-collar workers. Employees covered by FLSA are entitled to overtime pay after 40 hours of work in a workweek. The proposal would raise the salary level at which workers are entitled to overtime pay, expanding the group of eligible white-collar employees. This could increase plan costs, depending on the plan's definition of compensation. In addition, the "highly compensated" salary level would be increased to $122,148 annually for overtime purposes, subject to automatic updates.

Independent Contractor or Employee to DOL?

DOL believes that most workers are employees under FLSA, as it stated in AI No. 2015-1 recently.

The level of control an employer exerts over a worker has been a key factor in determining whether a worker is an employee or an independent contractor. This latest guidance notes that DOL believes that the "control" factor shouldn't play a major role in determining worker status, and shouldn't overtake the economic realities factors.

Highlights of some of the factors DOL considers in making the general determination include:

1. Is the work an integral part of the business? An example in the new AI relates to a common employee benefit operation — the call center. The AI concluded that a worker answering calls is integral to the call center's business. If you staff your call center with independent contractors, any employment contracts should be reviewed in light of this AI.
2. Does the worker's managerial skill affect his or her profit or loss?
3. What does the employee invest in providing services, and how does that compare with the employer's investment in providing the services?
4. What is the skill level and degree of initiative of the employee?
5. Is the relationship between the worker and the employer permanent or indefinite? Even if the relationship is not permanent or indefinite, that doesn't automatically mean the worker is an independent contractor. Sometimes an employer will rehire terminated or retired employees in what they believe are independent contractor relationships. Also, some employers have turned to independent contractors to avoid reaching certain key staffing numbers (for example, 50 employees for purposes of the Affordable Care Act provisions). If this is your practice, carefully review the agreement to ensure a worker would not be considered an employee under the latest guidance.

See *Andersen*, p. 3

Andersen (continued from p. 2)

More a Matter of Control to IRS

IRS (http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee) has its own criteria for determining whether an individual is an employee or an independent contractor in cases in which the degree of control and independence must be examined. It offers a Voluntary Classification Settlement Program (http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Voluntary-Classification-Settlement-Program) for employers that want to voluntarily change the prospective classification of workers.

IRS will examine behavioral and financial aspects, as well as the type of the relationship, to make a determination. All factors must be examined; no one aspect is determinative. Also, the determination is fact-specific to each situation. It is important to look at the entire employment relationship and to document each of the factors you used as an employer in coming up with the determination.

Bottom line: Both IRS and DOL are taking worker misclassification seriously. Excluding eligible employees is a qualification issue that could lead to serious financial consequences for retirement plan sponsors. However, incorrectly excluding eligible employees can be corrected by using the IRS Employee Plans Compliance Resolution System. To minimize the effect of any potential reclassification, plan sponsors should review their plan documents and employee communications carefully, to ensure that independent contractors are excluded for benefit purposes. Likewise, any independent contractor agreements regarding benefits eligibility or lack thereof should be as clear as possible.

Determining whether a worker is an employee or an independent contractor is complex and fact-specific. Counsel should be included in any such determination, and the results documented.

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