

# Employment

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## HIRED GUNS

By Robert W. Wood

Hiring an independent worker for a one-time project versus hiring employees for whom you take payroll deductions seems black and white. Yet, disputes over misclassification are common. Paying independent contractors skirts employment taxes, pensions, fringe benefits and other liabilities, so the employer's incentives are huge.

One recent example involves Blackwater, the scandal-plagued defense contractor. Apart from criticism over the deaths of 17 Iraqi civilians, Blackwater now faces queries into whether its security personnel in Iraq are employees. Blackwater has been providing security to the U.S. government since 2002. In 2004, Blackwater contracted to provide security for the State Department in Iraq. The flap over worker status started with a former security guard who requested that the Internal Revenue Service determine if he was an employee or an independent contractor. The IRS ruled he was an employee.

Blackwater settled, paying him back pay and other compensation. By this time, Congress was digging into Blackwater's big-budget tax savings, but the guard's settlement prohibited him from talking. The House Oversight Committee issued a subpoena to compel Blackwater to provide documents, and ever since, Blackwater and the government have been fencing.

### Contractors or Independent Contractors?

Blackwater has about 500 U.S. employees, including secretaries, paralegals, information technology professionals, accountants and landscapers. But its 1,000 workers overseas, specialized military veterans, are contractors. Blackwater says those workers are subject to the control, supervision, standards and protocols of the U.S. government.

The contract between Blackwater and the State Department requires Blackwater to maintain control over the training, equipping and conduct of its guards. Blackwater must provide logistical support, supplies, food, shelter, laundry and housekeeping and ensure its guards follow directions. If Blackwater personnel fail to follow instructions, or incur even minor infractions (such as having a bad attitude or riding a bike that does not belong to them), they are fired.

The guards sign a service contract labeling them "independent contractors," and

it prohibits providing services to any other company. The contract requires guards to report directly to Blackwater supervisors, or to the U.S. government, and to perform duties in accordance with Blackwater's rules and regulations. Guards must maintain personal attire and hygiene in accordance with Blackwater policies. Blackwater has the right to terminate them without notice or cause.

### IRS and Other Criteria

Classifying workers can be difficult. The laws are enforced by the IRS, state unemployment and workers' compensation agencies, insurance companies and the courts. They use different criteria and can reach different decisions. The controlling standard, for most purposes, is the common law right-to-control standard.

The 20 factors the IRS uses to classify workers (also based on common law) have remained unchanged for decades (see Rev. Rul. 87-41, 1987-1 C.B. 296):

1. Instructions: The more instructions given, the more likely is employee status.
2. Training: The more training, the more likely is employee status.
3. Integration: The more closely integrated the work is with the employer's business, the more likely is employee status.
4. Services rendered personally: If the worker must personally do the work, employee status is likely.
5. Hiring, supervising, and paying assistants: A person who does these things will often be an independent contractor.

6. Continuing relationship: The longer the arrangement's term, the more likely is employment status.

7. Set hours of work: Set hours indicate employment status.

8. Full time required: Working full time indicates employment status.

9. Doing work on employer's premises: Working on the employer's premises may suggest employment status.

10. Order or sequence set: Performing services in a particular order or sequence set suggests employment status.

11. Oral or written reports: Reports to an employer tend to suggest employment status.

12. Payment by hour, week or month: Payment by the hour, week or month suggests employment status.

13. Payment of business and traveling expenses: Payment of business and traveling expenses suggests employment status.



14. Furnishing of tools and materials: Furnishing significant tools, materials and other equipment suggests employment status.

15. Significant investment: A worker's significant investment tends to indicate independent contractor status.

16. Realization of profit or loss: A worker's potential to realize a profit or suffer a loss suggests independent contractor status.

17. Working for more than one firm at a time: Working for more than one firm at the same time suggests independent contractor status.

18. Making service available to the general public: Making services available to the general public on a regular and consistent basis suggests independent contractor status.

19. Right to discharge: The right to discharge a worker suggests employment status.

20. Right to terminate: A worker's right to terminate the relationship without incurring a liability suggests employment status.

### Contracts and Controversies

While various federal and state agencies use different tests, there are common themes, so one dispute often has a domino effect. For example, Blackwater was sued by the administrators of the estates of several Blackwater workers murdered in Iraq. The complaint asserted that these "independent contractors" were really employees. One such dispute can lead to others.

Blackwater's service contract is an 18-page, single-spaced form, requiring the contractor to complete name, address and signature. Under the contract:

- The basic job is security, reporting to Blackwater or customer as ordered.
- Fees are payable on a daily basis, with lower rates for training and travel days and higher rates for deployment days.
- The location of the assignment is directed by Blackwater or customer but may change at any time.

• The term of the contract is generally three years, though it is subject to extension or curtailment.

• The basic work schedule is 24 hours a day, seven days a week, with work "scheduled at the sole discretion of [Blackwater] and the needs of Customer."

• No taxes are withheld, and all travel expenses are considered taxable income and thus appear on the worker's IRS Form 1099.

• The worker is required to maintain personal attire and hygiene in accordance with Blackwater or customer policies.

• The worker is bound by a confidentiality covenant while under contract and for five years thereafter.

• The worker is bound not to compete or solicit other workers while under contract and for 18 months thereafter.

• Blackwater can terminate the contract without notice and without cause.

• The worker can terminate the contract only if Blackwater fails to pay him, and even then, only if that pay is "undisputed."

In large part, guards must simply do what they are told. This may be entirely appropriate, even necessary, in the face of wartime hostilities, but does such militarylike seconding and order taking jibe with the independent contractor model?

### Tax Evasion?

The State Department pays Blackwater more than \$460 million a year for security work around the world. One estimate suggests Blackwater may have skirted over \$30 million in federal taxes for its State Department guards. Blackwater contends it treats its security personnel as independent contractors because they prefer it. It also claims it relied on the advice of a large accounting firm and a law firm, arguing it has a reasonable basis for treating its security personnel as independent contractors.

Sens. John Kerry, Barack Obama and Rich-

ard Durbin have called for an investigation. Plus, Obama and Durbin (with Sens. Edward Kennedy and Patty Murray) introduced the Independent Contractor Proper Classification Act of 2007. The bill would improve enforcement of tax and labor laws on worker misclassification, strengthen coordination between the Labor and Treasury Departments, improve worker access to information and establish the worker's right to question classification without employer retaliation.

Blackwater's fate with taxing and other agencies remains uncertain. The IRS may choose to examine Blackwater employees piecemeal or may investigate the company's entire workforce, both at home and abroad. Moreover, Blackwater's guards could sue the company, claiming business expense reimbursement, fringe benefits, pension and other qualified plan benefits, and/or protections under federal and state labor and employment laws.

A cursory review of Blackwater's service contract suggests the guards may be employees. If on-the-ground experience between Blackwater and its security personnel reflects Blackwater's control over the method, manner and means by which its guards do their work (more even than the ubiquitous contract suggests), Blackwater's case may be tougher still.

Increasingly, worker-status controversies can be multijurisdictional and multifaceted. They can involve the IRS, insurance companies, state and federal labor and employment authorities, private lawsuits with third parties and private lawsuits with the workers themselves. Even if Blackwater has a better case than a cursory contract review suggests, it seems likely to be an expensive and protracted engagement.

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