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**ARTICLE:** INDEPENDENT CONTRACTOR VS. EMPLOYEE AND BLACKWATER

**NAME:** Robert W. Wood\*

**BIO:** \* Robert W. Wood practices law with Wood & Porter, in San Francisco ([www.woodporter.com](http://www.woodporter.com)), and is the author of *Taxation of Damage Awards and Settlement Payments* (3d Ed. Tax Institute 2005 with 2008 Update) available at [www.damageawards.org](http://www.damageawards.org). This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.

**LEXISNEXIS SUMMARY:**

... Such companies also may have contracts with their own workers, such as employment contracts or independent contractor contracts. ... Employers are responsible for paying workers' compensation insurance premiums for employees to ensure benefits are available to employees injured on the job. ... Temporary employees, leased employees, and workers provided by contract firms all complicate the jumble of factors to be considered. ... In contrast to its domestic workers, whom Blackwater treats as employees, Blackwater has always classified its overseas security personnel as independent contractors. ... In fact, an IRS training course (for IRS employees) on worker classification has stated that the primary test affecting worker status is control. ... Section 530 provides that when an employer classifies a worker as an independent contractor and the worker is later reclassified as an employee during an audit, the employer may be sheltered from paying employment taxes. ... In his letter, Senator Kerry called on the SBA to explain its potential involvement and requested notification of any determinations reached by the SBA regarding Blackwater's workers. ... These other two companies also provide security services to the State Department in Iraq and treat their guards as employees. ... However, in prior years, the IRS examined Microsoft's employment records and determined that Microsoft's freelancers were not independent contractors but employees for withholding and employment tax purposes.

**TEXT:**

[\*95] I. INTRODUCTION

In our endless 24-hour news cycle, most Americans have heard the term "private contractors" in relation to American military and security operations in Iraq. Since the first Gulf War in 1990, government-contract work (primarily the reconstruction of buildings and infrastructure) has only escalated. Given the significant presence of the United States, we seem to have new industries and nomenclature emerging. Today, most of us are familiar in some vague way with the notion that, not only is Iraq peopled with American service personnel, but also with private American contractors.

The question I want to address is whether one group of those private contractors are: (1) independent contractors,

and thus free agents from an employment law and tax perspective; or (2) employees of the company that sends them to Iraq and gives them their daily orders. The term "contractors" can be confusing in this context, since ostensibly it means only a private person or private company contracting with the U.S. government. Many people may not realize, however, that such contractors include military contractors that do not provide consulting, construction, or infrastructure work, but instead provide military or quasi-military services.

In short, someone dressed like a soldier, armed like a soldier, and carrying on activities like a soldier, may not actually be in the service of the U.S. armed forces. Such a soldier may be a private contractor, or perhaps more accurately, may be working in some capacity for a company that has a contract with the U.S. government. There are three private companies under contract with the U.S. government to provide "security" services in Iraq. The largest and most well-known of these is Blackwater Worldwide, an organization that some refer to as the fifth branch of the U.S. armed forces. n1 Over the last several years there has been considerable debate [\*96] about the role private contracting should play in the U.S. military theater. There have even been Congressional hearings regarding these debates. n2

This article does not intend to contribute to the debate about the merits and demerits of privatizing such operations or to the degree of oversight the U.S. government should have over such functions. Instead, this article focuses on a discrete but important issue: whether soldiers (called "security guards") working for Blackwater Worldwide can do so as independent contractors (as they are now treated by Blackwater), or whether they must be viewed as Blackwater employees. The federal government has also looked into this question, although the point has not been resolved. It is unclear whether the investigation is even proceeding.

At the outset, it is necessary to clarify some unfortunate and potentially confusing nomenclature. Referring to Blackwater and other security companies as "private contractors" should not necessarily bear on the question of whether its workers are independent contractors. A private contractor to the U.S. government might have - as indeed Blackwater does - both its own employees and independent contractors.

Most private security companies - or any other kind of government contractor - who are expecting to be paid by the federal government, presumably have contracts with the federal government. Such companies also may have contracts with their own workers, such as employment contracts or independent contractor contracts. One does not necessarily bear on the other.

The contract between worker and company may be called a service agreement, an independent contractor agreement, a consulting agreement, or any one of several other titles. A consulting contract is one of the traditional labels applied to services intended to be independent. Generally, the only certainty is that a contract intended to qualify as an independent contractor agreement will not be titled as an "employment agreement."

## II. Employee vs. Independent Contractor Fundamentals

The distinction between independent contractors and employees may seem self-evident. The difference between hiring an independent worker for a one-time project and hiring an employee for whom you take payroll deductions for federal income tax withholding and employment taxes may seem straightforward. Although the consequences of hiring one or the other may be marked, the line between these two classes of workers is not. The distinction is often difficult to discern, as the line between employee and independent contractor is a subtle one. Disputes over misclassification are [\*97] common. Unquestionably, however, the legal consequences between engaging independent contractors and employing employees are enormous.

An employer must withhold income and employment taxes from employee wages and pay them to the IRS. This entails significant financial, administrative, and reporting obligations. An employer is also responsible for withholding and paying over state income tax, in a system that, like the federal treatment, involves costs and legal responsibilities. Social Security or Federal Insurance Contributions Act (FICA) and Medicare withholdings are required on all wages, with a cap on the FICA withholding. n3

The employer and the employee each pay half of these taxes. The Federal Unemployment Tax Act (FUTA) allows for the collection of a federal employer tax used to fund state workforce agencies. n4 Employers are responsible for paying workers' compensation insurance premiums for employees to ensure benefits are available to employees injured on the job. n5

Generally, only employees are entitled to medical and retirement benefits, and their costs, both administrative and reporting duties can be substantial. Qualified pensions and other employee benefit plans are generally available and/or required only for employees. Employers must generally pay business expenses incurred by their employees in the course and scope of their employment. Under respondeat superior, an employer is responsible for the torts of employees committed in the course and scope of their duties. The possibility of such liabilities represents an enormous potential cost of having employees.

In contrast to this litany of costs and responsibilities for employees, when an employer hires an independent contractor, the employer escapes all of these problems and costs. This is the core issue behind many, if not most, worker characterization disputes. Some evidence suggests that worker characterization disputes are on the rise, not only with governmental entities hungry for tax revenues, but also in civil litigation between private parties.

The process of attempting to classify a worker involves few bright-line tests. In large part, determining whether a worker is an employee or an independent contractor involves a subjective analysis, even though the criteria may appear objective. Such a determination often involves analyzing a web of various factors, weighted in a manner that is not prescribed by law. Although some factors are more important than others, precisely how one weighs the various factors falls under one of the many subjective elements of worker status classification.

[\*98] In some cases, the inquiry not only involves whether the worker is an employee or an independent contractor, but a secondary inquiry about the identity of the employer. Assuming the worker is an employee, one can question precisely which company is the employer. Federal laws - both tax laws as well as labor and employment laws - are relevant, as are state laws. State laws, however, vary.

Moreover, the emergence of third-party companies intended to shoulder the employer status must also be considered. Such staffing companies may have employees whom they loan or lease out to other firms. In some cases, there can even be hybrids, where a staffing firm is the employer for a particular worker for employment tax purposes, but not for purposes of employee benefits. Temporary employees, leased employees, and workers provided by contract firms all complicate the jumble of factors to be considered.

Recently, it was reported that Blackwater Worldwide, the scandal-plagued defense contractor, may have misclassified its workers. n6 That story blossomed, provoking considerable Congressional concern over Blackwater and worker classification issues. Senator John Kerry of Massachusetts wrote to Senate Finance Committee Chairs Max Baucus and Chuck Grassley, the U.S. Small Business Administration, and even to the head of Blackwater, Erik Prince. n7 Senators Barack Obama and Richard Durbin drafted a Senate bill to address independent contractor issues n8 and more recently wrote Treasury Secretary Henry Paulson. n9 Much of the concern relates to the loss of tax revenues that hiring independent contractors entails.

Quite apart from tax issues, Blackwater has faced controversy and criticism over the actions of its contractors in Iraq, the deaths of some of its contractors, and the allegedly unprovoked killing of 17 Iraqi civilians in Baghdad in September 2007. n10 In addition, Blackwater now faces queries as to whether its security personnel in Iraq are employees. n11

[\*99]

### III. Blackwater Background

Blackwater Security Consulting LLC ("Blackwater" or "the company"), an affiliate of Blackwater Worldwide, has been

providing private security services to the U.S. government since 2002. n12 Blackwater was founded in 1997, initially envisioned as a basic training facility to support the needs of local and regional law enforcement personnel. n13 According to Blackwater's website, Blackwater's corporate vision extends much further today, "empowering a talented collection of seasoned professionals from a wide range of disciplines, directing them to develop cost-efficient and operationally-effective solutions for the U.S. government and other clientele." n14

Blackwater touts its ability to integrate four core competencies: advanced training, logistics/mobility, technology/innovation, and human/material resources. Blackwater states that it is one of the world's most successful security services corporations, providing creative solutions for the United States government. n15 With respect to human resources, Blackwater asserts that it has a "highly qualified team of experienced professionals, and a thorough understanding how a scarcity of key resources can adversely affect the successful execution of an extended operation." n16

Interestingly, with respect to its personnel, Blackwater's website states that it recruits highly qualified and highly skilled personnel. The discussion continues, stating:

The company looks for people of the utmost caliber; accountability, integrity and respectability are requirements for a Blackwater Worldwide hire ... . Blackwater presently employs a wealth of experts, many of whom have previously served their country in the United States military or law enforcement. Their experience and honorable past service make them the kind of employees Blackwater Worldwide looks for - qualified, skilled, and trustworthy. n17

It is unclear in this discussion if Blackwater is describing solely its own employees or its independent contractors as well. If Blackwater intends its statements to apply to all Blackwater personnel - regardless of their status as independent contractors or employees vis-a-vis Blackwater - this may suggest that Blackwater treats all of its personnel in a similar fashion. That [\*100] could potentially bear on the bona fides of the characterization. However, this point is certainly not expressed on Blackwater's website.

#### IV. Blackwater Contract

In August 2004, Blackwater entered into a Worldwide Personal Protective Services II Contract ("the U.S. Contract") with the U.S. government. n18 The agreement called for Blackwater, along with two other private military contractors, DynCorp and Triple Canopy, to provide security services to the State Department in Iraq. n19

Andrew Howell, Blackwater's general counsel, testified at the House Committee on Oversight and Government Reform's first hearing on Blackwater's activities in Iraq. n20 On March 30, 2007, the IRS sent a Form SS-8 Determination Letter to Blackwater regarding a former security guard who requested clarification from the Internal Revenue Service on his status as employee or independent contractor. n21 The IRS ruled that the guard was truly an employee and not an independent contractor. n22 The Committee sent additional requests for information on May 7, 2007, and May 10, 2007. On May 15, 2007, Blackwater submitted a request for reconsideration. n23

On June 6, 2007, Blackwater executed a "Settlement and Mutual Release Agreement" with the former guard who had requested status clarification, agreed to give him back-pay, and prohibited him from disclosing information about Blackwater. n24 Meanwhile, the Oversight Committee's informational requests sent to Blackwater in May 2007 met resistance. On August 3, 2007, the Oversight Committee issued a subpoena duces tecum to compel Blackwater to provide documents. n25 On October 2, 2007, Erik Prince - Blackwater's founder and chairman, who now heads Blackwater's parent company, The Prince Group - testified before the House Committee on Oversight and Government Reform. n26 The Committee questioned Prince about Blackwater's treatment of its security personnel. n27

[\*101] A few weeks later, on October 22, 2007, Representative Henry Waxman, a Democrat from California and the chairperson of the House Oversight and Government Reform Committee, wrote to Erik Prince, acknowledging the receipt of Blackwater's documents. n28 Waxman requested any further documents or correspondence between Blackwater and federal officials relating to worker classification issues, documents relating to the IRS's March 2007 ruling, documents relating to the nondisclosure agreement, a list of personnel hired as independent contractors with descriptions of their positions, employment data, amounts paid, and amounts withheld and paid to the IRS. n29 Blackwater responded with a brief press release the same day and a lengthier press release on December 3, 2007. n30

#### V. Employees or Independent Contractors?

Blackwater classifies over 500 U.S. workers as employees, including secretaries, paralegals, information-technology professionals, accountants, and landscapers. n31 The company also has workers in other countries, consisting of veterans of specialized military who are hired by Blackwater to work for several months at a time. Blackwater says these workers are subject to the "control, supervision, standards, and protocols of the U.S. government." n32 In contrast to its domestic workers, whom Blackwater treats as employees, Blackwater has always classified its overseas security personnel as independent contractors.

The contract between Blackwater and the State Department requires Blackwater to maintain control over "the training, equipping, and the conduct of its security guards," both before being sent abroad and during their work in a foreign country. n33 The contract requires Blackwater to "establish training facilities, submit detailed training plans, and ensure that all security personnel have 'successfully completed'" a certain number of hours of specialized training before being sent abroad. n34 Furthermore, the company must maintain that level of training throughout each guard's tenure, and the guards are not allowed to use their own training methods. n35

Blackwater must ensure that its security guards follow precise directions, including standard operating procedures and orders issued by the [\*102] State Department. Once in Iraq, the contract requires Blackwater to provide its personnel with logistical support, equipment, and supplies, and additionally prohibits them from "carrying or using their own weapons." n36 Blackwater is further required to provide food, shelter, laundry, and housekeeping services for its guards. n37

In addition to the demanding training and extensive screening of Blackwater security personnel, Blackwater also disciplines its workforce. Blackwater outfits its workers with body armor, uniforms, and boots, and provides them with a handbook as well. n38 If Blackwater personnel fail to follow instructions or commit even minor infractions, such as having bad attitudes or using a bike that does not belong to them, they are fired. n39

Blackwater requires security personnel to sign a service contract, which designates the security personnel as independent contractors. n40 The service contract requires the contractor to pay all taxes and fees due the government, designates travel expenses as taxable income, and provides that no personal expenses will be reimbursed. n41 In addition, the service contract sets the hours of each work day and specifies the contractor's start date, where he reports for duty, where he will be stationed, and how he will be compensated. n42 Blackwater provides equipment, weapons, and transportation, but allows the contractor to bring personal equipment subject to Blackwater's prior approval. n43

The service contract prohibits providing services to any other company without prior written consent from Blackwater. n44 The contract provides that the individual will report directly to Blackwater supervisors, leaders, or the "Customer," and perform duties in accordance with Blackwater's rules and regulations. n45 The contractor is further required to follow Blackwater policies in relation to personal attire and hygiene. n46 The contractor agrees to perform assigned duties until released by the Blackwater supervisor. n47 [\*103] The contract gives Blackwater the right to terminate the contract without notice or cause for "any reason or no reason whatsoever." n48

In early 2007, a Blackwater security guard who worked in Afghanistan in 2005 sought back-pay and requested clarification of his status from an IRS office in Vermont. n49 On March 30, 2007, the IRS ruled he was an employee.

n50 The IRS called Blackwater's "independent contractor" classification "without merit." n51 While this ruling applied only to one security guard, the IRS warned that its ruling might "be applicable to any other individuals engaged by the firm under similar circumstances." n52

The IRS found the actual working relationship determinative, not the written designation of the worker as an "independent contractor." n53 The IRS found several factors pertinent:

- . Blackwater had its personnel sign a written agreement to provide services, and the agreement explained the "type of work and work rotation, and that the worker's services were an essential part of the services that the firm offers its clients";

- . To protect its financial investment, Blackwater retained the rights to "change the worker's methods" and to direct the worker;

- . Blackwater required the worker to personally perform the services for its client;

- . Blackwater paid the worker's travel expenses;

- . Blackwater "performed an evaluation and had the right to suspend the worker" for any procedural violations;

- . The worker followed instructions regarding his assignment from the client;

- . The worker had no opportunity to realize a profit or incur a loss because the worker did not invest capital or assume any risk; and

- . Rather than being engaged in an independent enterprise, the services performed were essential to Blackwater's client who looked to Blackwater to provide a pool of workers with specific skills. n54

Blackwater required the guard who had queried the IRS to sign a nondisclosure agreement before he was given his back-pay and other compensation. n55 The agreement prohibited the guard from "disclosing information about Blackwater to any 'politician' or 'public official.'" n56 Representative Waxman characterized the disclosure agreement as an attempt to conceal [\*104] the IRS ruling and Blackwater's tax evasion from Congress and law enforcement agencies. n57

## VI. IRS SS-8 Procedures

The procedure under which the guard requested the IRS to determine his status began with an IRS Form SS-8. n58 The form is a four-page questionnaire entitled "Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding." n59 Either a worker or a firm may complete a Form SS-8 and initiate the worker status determination. Unlike many other IRS determinations, requesting a determination of worker status with a Form SS-8 does not require paying a fee. n60

The form requires information about the nature of the business, the work performed, and any written agreement between the parties. n61 It probes a wide range of specific factors of control and independence, including but not limited to training, reports, instrumentalities, investment, and compensation. n62 After receiving the form and the information, the IRS assigns a technician to review the facts and apply the law to render a decision.

The IRS technician may require further information from the requestor to make a determination. n63 Moreover, the

IRS technician will seek input from the other party (via another Form SS-8) in an attempt to more clearly view the relationship. There is thus at least some attempt to solicit information from the other side. However, a failure to provide a responding Form SS-8 will not prevent the IRS from issuing a determination in the matter. Instead, the IRS in such a case would make its determination based on the information provided by the requestor.

After applying the law to the facts, the IRS issues a formal determination letter to the firm, with a copy sent to the worker. Such a determination letter is binding upon the IRS with respect to income and employment taxes, but it only applies to the worker or the class of workers for whom the request was made. In some cases, such as for hypothetical worker status determinations, the IRS will only issue a non-binding information letter. n64

A 2004 audit of the SS-8 process found that the three IRS sites processing SS-8s for the fiscal year of 2003 made 5,960 worker status determinations. n65 [\*105] Of the 3,377 determinations made at the two sites that were still operating at the time of the report, 93% ended with the businesses and workers accepting the decision. The remainder became the subject of requests for reconsideration. Only 14 determinations were reversed on reconsideration. n66

The same audit report warned that the IRS was not adequately following up on its own SS-8 determinations. That is, the IRS did not adequately enforce the determinations or check taxpayer compliance. The report cautioned that the SS-8 database was almost unusable to the examiners and clerks, who could only access past determinations with the aid of a computer programmer. The report also found that the IRS did not have adequate procedures for quality review of the determinations. As a result of these shortcomings, the audit found a lack of consistency in reaching determinations. n67

## VII. IRS 20-Factor Definition

The 20 factors the IRS uses to classify workers have remained unchanged for over two decades. n68 These factors reflect important considerations in making the classification decision for federal tax purposes:

1. Instructions. The more instructions given to the worker, the more likely employee status exists.
2. Training. The more training a person receives, the more likely he is an employee.
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. A person who hires, supervises, and pays assistants 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 indicate employment status.
8. Working full-time indicates employment status.
9. Doing work on employer's premises suggests employment status.
10. Performing services in a particular order or sequence set suggests employment status.
11. Oral or written reports to an employer tend to suggest employee status.
- [\*106] 12. Payment by the hour, week, or month suggests employment status.

13. Payment of business and traveling expenses suggests employment status.
14. Furnishing of tools, materials, and other equipment suggests employment status.
15. A worker's significant investment tends to indicate independent contractor status.
16. 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 suggests independent contractor status.
18. Making service available to the general public on a regular and consistent basis suggests independent contractor status.
19. The right to discharge a worker suggests employment status.
20. A worker's right to terminate the relationship without incurring a liability suggests employment status. n69

The IRS's 20-factor test has weathered some controversy over the last decade. Various legislative proposals would have abolished or materially modified the 20-factor test. However, those proposals have met little success. For example, the Independent Contractor Tax Simplification Act was introduced in 1996 n70 to simplify and reduce the 20-factor test to three: 1) a signed contract detailing the relationship as one of an independent contractor; 2) the worker having an investment in the business; and, 3) the worker providing the instrumentalities of the business. This bill, which contained more specific standards in the details, did not pass out of committee. For the most part, it would simply have subsumed the 20 factors into three larger factors.

Interestingly, the IRS itself has acknowledged that additional factors may be important. n71 In fact, an IRS training course (for IRS employees) on worker classification has stated that the primary test affecting worker status is control. n72 IRS trainees are urged to look at several different categories of evidence, which the IRS has divided into three primary areas. Those areas are behavioral control, financial control, and the relationship of the parties.

These broad categories are sometimes viewed as more malleable and therefore potentially more indicative of the real world than the 20 factors enumerated in *Revenue Ruling 87-41*. Regardless of IRS attempts to simplify and group factors, the fact remains that *Revenue Ruling 87-41* is still the law and reflects the IRS's classification methodology. Nonetheless, [\*107] many courts have moved away from express reliance on the IRS's 20 factors to a smaller number of factors grouped together. n73

Although the mention of various tests may sound dizzying, much independent-contractor-versus-employee analysis is almost intuitive, focusing on the extent of control actually exercised or which could be exercised as a matter of right. That is, the legal right to control a worker will usually indicate an employment relationship, even if the employer chooses not to exercise it. Each test seeks to ferret out the work arrangement's details to determine worker status based on traditional indices.

### VIII. Section 530 Relief

We may be coming full circle in worker status controversies. In the 1970s, after the IRS began to reclassify many independent contractors as employees, many employers claimed the IRS was misapplying the rules and that retroactive taxes could be devastating. In response, Congress provided relief in Section 530 of the Revenue Act of 1978. n74 If the IRS reclassifies a worker, it is required by the Internal Revenue Manual n75 to inform the employer of the relief provisions under Section 530.



Section 530 provides that when an employer classifies a worker as an independent contractor and the worker is later reclassified as an employee during an audit, the employer may be sheltered from paying employment taxes. The shelter requires the employer to 1) provide the appropriate tax returns, including information returns; 2) prove that all similar workers were consistently treated as non-employees; and, 3) show a reasonable basis for the classification as an independent contractor. Congress intended Section 530 to be interpreted liberally.

A reasonable basis for independent contractor treatment can be established through any of three methods. Employers may cite precedent from either the IRS or the courts treating similarly situated workers as independent contractors. Similarly, if a past IRS audit failed to question worker characterization, the audit itself equals reasonable basis. Longstanding industry practice is also acceptable as evidence of a reasonable basis. n76

Significantly, once a taxpayer cooperates with the IRS audit and makes a prima facie showing of reasonable basis, the burden shifts to the IRS to show taxpayer disentitlement to relief. In recent years, some observers have suggested that Section 530 relief is too liberal, letting companies off [\*108] the hook based on minimal criteria. Under this view, Section 530 may actually encourage employers to treat workers as independent contractors when they should not be so treated. n77

#### IX. Contracts and Controversies

Blackwater has experience with the independent-contractor-versus-employee issue in multiple disciplines. For example, in one case, Blackwater was sued by the administrators of the estates of four Blackwater workers killed in Iraq. n78 The dispute is an odd one, both substantively and procedurally, and shows the linchpin status that worker status issues can have. The complaint was filed in 2005. n79 The gravamen of the lawsuit is that Blackwater violated its own procedures, rules, and contractual commitments with respect to the conduct of its security operations in Iraq, and that it thereby caused the deaths of these four workers.

Interestingly, the complaint does not appear to hinge on the status of the four decedents as either independent contractors or employees. The lawsuit primarily attacks Blackwater's procedures and conduct, alleging numerous egregious violations of its own contract and protocols. But it also seeks rescission of Blackwater's contract with the decedents based on asserted fraud. Presumably the status of the decedents as common law employees of Blackwater will be an issue and could prove a very important one.

The procedural scuffling in this case has also been interesting. Blackwater first sought removal of the case to federal district court and then sought dismissal. The federal district court first concluded that removal jurisdiction had not been established and that it could not dismiss the case, remanding it back to a North Carolina state court. n80

Blackwater then sought review in the Fourth Circuit Court of Appeals with an ordinary appeal and also with a petition for a writ of mandamus. The Fourth Circuit Court of Appeals rejected Blackwater's contentions, and the U.S. Supreme Court denied certiorari. n81

Thereafter, Blackwater actually sued the families in a rare counterstrike, seeking ten million dollars in damages. Ostensibly, the suit asserts that the families breached their contract with Blackwater by filing the underlying [\*109] lawsuit. n82 One goal of the suit appears to redirect the forum for all of the claims into arbitration, where Blackwater claims it belongs under its contract. n83 Arbitration would presumably be private, as Blackwater suggests sensitive information would come to light in a public forum. Perhaps more importantly, arbitration awards are traditionally more modest than jury verdicts. Although the four families are represented by contingent-fee attorneys in the lawsuit filed by the families, there is no contingent fee arrangement available for defending a suit brought by someone else. n84 Accordingly, a legal defense fund has been established for the families, seeking contributions for defense costs in the action filed by Blackwater. n85

As that drama unfolds, the plain, and by comparison pedestrian, examination of Blackwater's service contract is

nevertheless telling. Blackwater's service contract is an 18-page, single-spaced form that requires the contractor to fill in his name and address on page one and to provide his signature on page 16. n86 It is unclear whether such contracts are negotiable. What is clear is that the contracts contain the following basic provisions:

. The basic duty is to serve as a "security team member, reporting directly to any supervisor as may be designated by [Blackwater] or Customer from time to time."

. 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 the "Duty Station" or such other location directed by Blackwater or its Customer. The worker acknowledges that the geographic location 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, 7 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.

. Blackwater is responsible for economy-class air transportation to and from the Duty Station.

. The worker is responsible for obeying U.S. and local laws, regulations, and customs, and is required to maintain personal attire and hygiene in accordance with Blackwater's or its Customer's policies.

[\*110] . The worker is bound by a confidentiality covenant for the term of the agreement and for five years thereafter.

. The worker is bound not to compete with or solicit other workers during the term of the contract and for 18 months thereafter.

. Blackwater retains the right to terminate the contract "without notice at any time, with or without cause, without advance notice for any reason or no reason whatsoever." The worker is entitled to compensation for services only provided up to the date and hour of discharge.

. The worker can terminate the contract only if Blackwater fails to pay him, and even then, only if that pay is "undisputed." n87

No single contract provision is critical in assessing worker status. An independent contractor controversy is perhaps the quintessential example of a facts-and-circumstances analysis. On a cursory examination, one would assume that the worker is simply required to obey. This may be entirely appropriate and even necessary in the face of wartime hostilities, given the security duties required in troubled spots in the world. The question, however, is whether such military-like action and order-taking can conform to the independent contractor model.

Security consultants are required to take orders from whomever Blackwater appoints, or indeed, from the "Customer." n88 Blackwater and the Customer set all duty hours for personnel. The worker evidently lacks a right to pick and choose which duties to perform. Moreover, the termination provisions are entirely one-sided, with the worker having no rights whatsoever, and Blackwater having unfettered termination rights. n89

The analysis at this stage will be limited to a review of the contract and not the actual conduct between the worker and the company. Even so, it is difficult to read Blackwater's written agreement and to believe it would stand up to scrutiny. That scrutiny could occur in a tax dispute, in a dispute over workers' compensation insurance, in a wrongful death claim, in a respondeat superior tort liability suit, in a labor or employment law dispute, or in any other action involving worker classification.

#### X. Tax Obligations

Blackwater receives more than \$ 460 million a year from the State Department for its security work worldwide. n90 Based on that figure, Representative Waxman's staff estimated Blackwater may have skirted over \$ 30 million in federal taxes. n91 Moreover, that estimate merely covers the period from May 2006 to March 2007, a period between the beginning of the U.S. [\*111] contract with Blackwater and the IRS ruling. This estimate includes unpaid Social Security, Medicare, unemployment, and related taxes. n92

Assuming that Blackwater has continued to treat its workers as independent contractors since the March 2007 ruling, that number is estimated to be almost \$ 50 million in unpaid taxes through September 2007. n93 Presumably, if one were to reach back in time to May 2006 or to reach forward from October 2007 to the current date, the tax savings in question would multiply significantly. Of course, if Blackwater's worker characterization is correct, no taxes are being inappropriately avoided.

Indeed, Blackwater contends it treats its security personnel as independent contractors because its guards prefer this arrangement and because Blackwater finds that "it is a model that works" for them. n94 Blackwater believes its personnel prefer the flexibility an independent contractor relationship provides, allowing them to sign on for a certain period of time and to schedule personal leave when convenient. n95

In a December 3, 2007, press release, Blackwater defended its independent contractor classification for overseas security personnel, arguing that it had complied with federal law. n96 Blackwater states that the treatment of its security personnel falls within Section 530's safe haven. n97 The company claims to have obtained the advice of qualified tax professionals from a large accounting firm and from an unspecified law firm. It has argued that this reliance gives a reasonable basis for designating the security personnel as independent contractors. n98

The Blackwater press release also notes that the Small Business Administration ("SBA") conducted its own independent inquiry into "whether certain Blackwater security workers should be classified as independent contractors" and determined that they were properly classified. n99 The SBA applied its own standards, as well as criteria used by the IRS, to reach its determination. While this argument is helpful, there has long been maddening inconsistency across different bodies of law. n100

[\*112] Blackwater attempted to discredit Representative Waxman's reliance on the March 30, 2007, SS-8 Determination Letter, saying that it was unreliable and had little legal effect. n101 Blackwater argued that these SS-8 determinations may not be used or cited as precedent, are not published, and, as they are not considered an examination, cannot be used to assess employment taxes. n102 Blackwater asserted the Determination Letter was one-sided and written without a full and open adversarial process.

Instead, Blackwater characterized the IRS determination as a mere response to one individual, looking only at the facts provided by that individual. Blackwater also claimed that the SS-8 Determination Letter was replete with "legal and factual errors." n103 According to Blackwater, the IRS technician who wrote the letter did not apply Section 530, did not properly apply the IRS's own training materials, and overlooked relevant case law. n104 The audit of the IRS's SS-8 process did find various problems in that process. n105

#### XI. Congressional Reaction

Senator Kerry, the chair of the Senate Small Business and Entrepreneurship Committee, learned that Blackwater may be relying on the SBA determination for tax reasons and wrote to the SBA on October 23, 2007. n106 In his letter, Senator Kerry called on the SBA to explain its potential involvement and requested notification of any determinations reached by the SBA regarding Blackwater's workers. n107 Senator Kerry also requested that the SBA specify whether those classifications had been made for tax purposes. n108

The SBA responded by explaining its determination made on November 2, 2006, regarding Presidential Airways, a Blackwater affiliate. It found that Blackwater's personnel were not employees "and therefore Presidential Airways did not exceed the applicable size standard." n109 The SBA pointed [\*113] out they used IRS tax criteria in making the determination, but also acknowledged that SBA's size determinations are "solely for purposes of ascertaining eligibility for [its] small business programs" and do not pertain to tax liability matters. n110

Senator Kerry followed up in a November 1, 2007, letter to the SBA, stating that he needed additional information and documentation. n111 Senator Kerry requested both a detailed accounting of the SBA's worker classification ruling and any information not yet provided about size determinations made for any Blackwater affiliates. n112

In an October 26, 2007, letter to Senate Finance Committee Chairs Max Baucus and Charles Grassley, Senator Kerry requested that the Finance Committee investigate Blackwater to ascertain whether Blackwater had misclassified workers to evade taxes. n113 Senator Kerry also sent a letter to Erik Prince of Blackwater, questioning "why Blackwater relied on or referenced an SBA size determination for classifying its workers for tax purposes." He also requested any documents relating to the determination and to Blackwater's classification of workers. n114 Additionally, Senator Kerry requested an explanation of Blackwater's chain of command, and the status of any audit the IRS may be conducting on Blackwater or its affiliates. n115

Senators Obama and Durbin sent a similar request to Treasury Secretary Paulson on October 26, 2007, writing: "It is difficult to fathom how Blackwater employees in Iraq can be considered independent contractors. They are trained by Blackwater, paid by Blackwater, and told whom to guard by Blackwater." n116 The Senators also called on the Treasury Department to reform the Section 530 provision to prevent similar situations from continuing to arise. n117

Obama's and Durbin's letter mentioned the Independent Contractor Proper Classification Act of 2007, S.2044, which the Senators introduced along with Senators Edward Kennedy and Patty Murray in September 2007. n118 The bill would revise procedures for worker classification, primarily focusing on Section 530 of the Revenue Act of 1978. n119 The bill would [\*114] also encourage improved enforcement of existing tax and labor laws related to worker misclassification, strengthen coordination between the Labor and Treasury Departments, improve workers' access to information, and allow workers to question their classifications without employer retaliation. n120

## XII. Industry Standards

Blackwater is the largest private military contractor in Iraq, with over 600 security guards. Triple Canopy and DynCorp only have 73 and 77, respectively. n121 These other two companies also provide security services to the State Department in Iraq and treat their guards as employees. n122 Blackwater, however, classifies its 604 security guards and other personnel in Iraq as independent contractors. n123

Historically, the IRS has held that security guards are employees for federal employment tax purposes. n124 Although not precedential, IRS letter rulings indicate how the IRS may treat similar situations. n125 In Letter Ruling 7843016, the IRS found security guards to be employees because the company exercised overall control over the guards. n126 Regardless of the fact that the company denominated the security guards as independent contractors, [\*115] the IRS found that the company exercised sufficient control over the workers to warrant an employer-employee relationship. n127

In *Letter Ruling 7843016*, the company arranged to provide "security guards to hospitals, hotels, and other

businesses." n128 The Letter Ruling also stated: "Your Firm directs the individual security guards as to which of your clients to go to, to perform their services, pays them for their services, and may terminate their services at any time." n129 Furthermore, the company maintained a "continuing arrangement" with the security guards and had the "final right to determine whether the services" of the security guard were acceptable. n130

In *Letter Ruling 7843016*, the security guards received "specific instructions as to the manner and means of their services from the Firm (or from a senior security guard acting on behalf of the Firm)." n131 The guards' services were "fully integrated into the company's business" n132 and were necessary to the company's function. The guards were essentially full-time workers following the schedule and routine established by the company. The guards "did not hold themselves out as available to perform similar services" outside their agreement with the company. n133 The guards rendered their services personally and did not appoint helpers or assistants. n134

The status of security guards has been examined in other contexts, also. It has been queried under the Fair Labor Standards Act (FLSA). n135 The FLSA applies minimum wage, overtime, equal pay, and child labor protections to employees who are engaged in interstate commerce, involved in producing goods for interstate commerce, or employed by an enterprise engaged in interstate commerce. n136 Employees of private-sector employers, state and local governments, and most federal agencies are all covered. n137

For example, in *Mitchell v. Strickland Transportation Co.*, the security guards' relationship with the company was governed by individual contracts that gave the guards the right to select substitutes when they could not work, and the guards were responsible for paying the substitutes. n138 The Fifth Circuit Court of Appeals still held that the security guards were employees [\*116] in this context. n139 The court reasoned that the guards were employees because they: (1) were not viewed as separate, independent businesses; (2) regularly performed routine tasks that were part of the normal operations of the business; and, (3) often performed tasks similar to those performed by other employees, such as safekeeping cargo. n140

### XIII. History Lesson

The classification of workers can be difficult and consequential. The legal tests and the extent of the laws are vague and serve different purposes. They are also enforced by different agencies, including the IRS, state unemployment and workers' compensation agencies, insurance companies, and the courts. These distinct decision-making bodies each use different criteria, have different reasons for making decisions, and may reach different decisions regarding the same working relationship. The controlling standard for most purposes, however, is the common law right-to-control standard. n141

Given the difficulty in defining control and the right to exercise it, different approaches have evolved. For example, in *United States v. Silk*, the Supreme Court determined that coal unloaders were employees rather than independent contractors, even though they provided some of their own tools and did not work on a regular basis. n142 The Court suggested criteria for determining if an employee is integral to the employer's work, such as whether the worker has an investment in the business and whether the worker can sustain a profit or loss based upon their efforts. n143 These new criteria became part of what is known as the "economic reality" test. n144

Congress was concerned with the economic reality test, as it could include all workers and thus bring them all under the coverage of the Social Security Act. n145 Even in the infancy of Social Security, lawmakers feared that such extensive coverage would bankrupt Social Security. Therefore, in the 1948 Gearhart Resolution, Congress expressed a preference for the common law definition because of its apparent narrower approach. n146 [\*117] However, Congress did not reject the Supreme Court's reasoning that economic factors should be considered in making a determination. n147

Consequently, the courts have long been divided on how to interpret these issues. Even today, there is no single statutory test for determining whether a person is an employee or an independent contractor. The IRS and a variety of

state and federal agencies make their own determinations. Thus consistency is not always possible because agencies use varying criteria. A worker may be classified as an employee for one purpose and as a contractor for another.

In some respects, Blackwater's situation reflects this multidisciplinary inquiry, which interconnects seemingly disparate areas of the law. The SBA found that certain Blackwater personnel were not employees. In defending its decision, the SBA pointed out that its size determinations are solely for purposes of ascertaining eligibility for its small business programs, and are not applicable to tax matters. n148 The IRS could make a different determination of the same workers for tax purposes.

These are consequential decisions. The classification of a worker determines eligibility for federal unemployment, state workers' compensation, and some pension and fringe benefit plans. A worker must be classified as an employee to be eligible to bring a lawsuit under, for example, the Fair Labor Standards Act, Title VII of the Civil Rights Act, the Age Discrimination in Employment Act, and the National Labor Relations Act. n149 These labor laws are not uniform, and an analysis of the facts and circumstances of each case is required.

#### XIV. The Era of Worker Status Litigation and *Vizcaino v. Microsoft*

There has also been an increasing amount of private litigation in which putative independent contractors sue companies claiming they are employees. n150 Although one expects worker status controversies to occur with government taxing or regulatory agencies, worker status controversies also arise in civil litigation between private parties. Moreover, there appears to be an increasing trend of civil litigation brought by workers who are contractually labeled as "independent contractors." In many of these cases, the workers sue their employer expressly seeking reclassification. Some employers [\*118] are startled to learn that a written contract with an independent contractor that clearly identifies the worker as an "independent contractor" may not be respected by the courts.

Indeed, one could argue that a worker who signs a contract stating that he is an independent contractor should be estopped from later claiming that he is, in fact, an employee. However, following the overriding notion that the true relationship of the parties and the true practice between the worker and the company will control the worker status question, mere words in a contract may not prove determinative. In part, this merely reflects that the worker status determination generally must take into account the totality of the situation. Some courts have discounted written contracts even more readily when the facts suggest that they were "adhesion" contracts signed by unsophisticated workers with no bargaining power as to the terms of the contract. Even though a contract may identify a worker as an independent contractor, courts often analyze the facts and circumstances surrounding the relationship. The courts assess the contract's language and the pattern of practice between the worker and the employer to assess the worker's true status. The contract is only one piece of evidence that a court will evaluate to determine whether a worker is an employee or an independent contractor.

Although it was not the first such case, the cornerstone of the modern era of worker status litigation is *Vizcaino v. Microsoft*. n151 In that case, a group of freelance workers sued Microsoft, claiming they, as common law employees, were entitled to various savings benefits under Microsoft's Savings Plus Plan (SPP) and to stock-option benefits under Microsoft's Employee Stock Purchase Plan (ESPP). n152 The freelancers were hired with the distinct understanding that they would not receive the same benefits given to Microsoft's regular employees. n153 They were paid through the accounts-receivable department, instead of the payroll department. n154 They were also paid at a higher hourly rate than comparable regular employees. n155 Microsoft presumably assumed there was no risk of reclassification.

However, in prior years, the IRS examined Microsoft's employment records and determined that Microsoft's freelancers were not independent contractors but employees for withholding and employment tax purposes. n156 Thus Microsoft was required to pay withholding taxes and the employer's portion of the Federal Insurance Contribution Act (FICA) [\*119] tax. n157 In determining that the freelancers were really employees, the IRS concluded that Microsoft either exercised or retained the right to exercise direction over the services performed by the freelancers. n158

Upon learning of the IRS rulings, the freelancers sought various employee benefits including SPP and ESPP benefits. n159 Microsoft denied the freelancers' claims for benefits, taking the position that the freelancers were independent contractors and thus not eligible for employee benefits. n160 Microsoft's plan administrator also reviewed and denied the claims, determining that the freelancers had contractually waived any rights to benefits and that the freelancers were not "regular, full time employees." n161

The district court concluded that the freelancers were not eligible for SPP benefits because the SPP restricted participation to individuals on Microsoft's payroll, and the freelancers were not paid through the payroll department. n162 The district court also concluded that the freelancers were not eligible to participate in the ESPP because the contract between Microsoft and the freelancers clearly stated the freelancers were not eligible to receive benefits. Furthermore, the freelancers had no expectation that they would receive ESPP benefits. n163

The Ninth Circuit reversed and remanded the case, holding that the freelancers were eligible to receive both SPP and ESPP benefits. n164 The SPP provided that each common law employee who was 18 years or older and who was on the United States payroll was eligible to participate in the SPP. n165 The court ruled that the freelancers met these requirements. n166

The court also ruled that by incorporating *Internal Revenue Code Section 423* into the provisions of the ESPP, Microsoft "manifested an objective intent" to make all common law employees, including the freelancers, eligible for participation in the plan. n167 Of importance, Microsoft conceded the freelancers were common law employees and contested their lawsuit on other grounds. The court also noted that Microsoft, as drafter of the SPP, could have easily limited participation in the SPP by using more explicit language in the plan's provisions. n168

[\*120] Vizcaino demonstrates that employers cannot rely entirely upon the labels placed in contracts to designate a worker as an independent contractor. The denomination that a worker is an independent contractor in the contract is not sufficient to establish an independent contractor relationship. n169 The status of the relationship, not the contract, will ultimately control the outcome.

Vizcaino also nicely demonstrates the nearly inevitable interaction between tax controversies and other worker status inquiries. The IRS's reclassification most likely induced the freelancers to make their claim in Vizcaino. A later reclassification controversy may emanate from a simple worker's compensation claim, and one tax-driven dispute over worker status may come on the heels of another. State taxing authorities may follow federal authorities or vice versa. A state employment development audit may incite a direct suit by workers seeking recognition as employees.

Even public agencies are not immune from private litigation resulting from the misclassification of workers. In *Metropolitan Water District of Southern California v. Superior Court of Los Angeles County*, n170 the plaintiffs were workers hired through private labor suppliers to work on long-term projects for the water district. They sought relief to compel the water district to enroll the workers in the California Public Employees Retirement System (CalPERS). The workers had been labeled as "consultants" or "agency temporary employees." n171 The California Supreme Court affirmed the judgment of the lower court, finding that the Public Employee's Retirement Law required the water district to enroll all common law employees, excluding only a few statutorily defined exceptions, into CalPERS. n172

Class action lawsuits involving worker status are becoming more common. For example, in *Estrada v. FedEx Ground*, n173 the plaintiffs were pickup and delivery drivers classified as independent contractors in contracts they signed with FedEx Ground. The plaintiffs sought to be classified as employees, n174 and the court held they were employees. In making this determination, the court found most significant FedEx's right to control and its exercise of that right. n175 The court noted that "the label placed by the [\*121] parties on their relationship is not dispositive, and subterfuges are not countenanced." n176

In *Estrada*, the court stated:

As to whether or not the parties believed they were creating an employer-employee relationship it would seem that the [drivers] thought they were either investing in a 'job' or believed that they would be independent contractors, only to find out by reason of the [company's] controls that they were being treated like employees. n177

Thus a court will not allow an employer to call a worker an "independent contractor" while still subjecting him to the control it exercises over a normal employee.

#### XV. Private Rights of Action

Most of these worker classification suits are brought as claims for employee benefits under state or federal law. In some cases, courts have been reluctant to grant private rights of action where the statute in question does not expressly grant individuals a private right of action on a worker misclassification issue. For example, in *McDonald v. Southern Farm Bureau Life Insurance Company*, n178 the Eleventh Circuit upheld a district court ruling that individuals have no private right of action under FICA to seek damages from their employer resulting from the employer's misclassification of them as employees rather than independent contractors.

This case again illustrates the many reasons why the worker status designation can prove critical. Beginning in 1989, and ending in 1998, Craig McDonald was employed as an insurance agent by Southern Farm Bureau Life Insurance Company. According to his federal class-action lawsuit, Southern Farm Bureau Life erroneously misclassified McDonald as an independent contractor for employment tax purposes. This caused McDonald to be liable for applicable self-employment taxes. n179

McDonald alleged that, even though he and Southern Farm Bureau Life entered a signed agreement labeling him an independent contractor, he was an employee for the following reasons: (1) Southern Farm Bureau Life exercised substantial control over his daily activities - including mandating he keep certain hours of business; (2) Southern Farm Bureau Life Insurance Co. provided him with an office and a staff; and (3) Southern Farm Bureau Life Insurance Co. controlled the circumstances and manner in which McDonald sold its products. n180

[\*122] Southern Farm Bureau Life moved the district court for summary judgment, asserting that no private right of action existed under FICA that would allow McDonald's claim. The district court granted the motion. In explaining its decision, the court cited *Cort v. Ash*, n181 which established a four-part test for "determining whether a private remedy is implicit in a statute not expressly providing one": n182

- (1) Does the statute create a federal right in favor of the plaintiff?
- (2) Is there any indication of legislative intent, explicit or implicit, either to create such a remedy or deny one?
- (3) Is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?
- (4) Is the cause of action one traditionally regulated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? n183

The court went on to say that the pertinent inquiry in applying the Cort analysis to McDonald's claim was "whether Congress intended to create, either expressly or by implication, a private cause of action." n184 It expounded:



Like substantive federal law itself, private rights of action to enforce federal law must be created by Congress. The judicial task is to interpret the statute Congress has passed to determine whether it displays an intent to create not just a private right but also a private remedy. n185

When conducting this analysis, "statutory intent ... is determinative. Without it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute." n186

The court concluded, "An analysis of the Cort factors makes it abundantly clear that no private cause of action might be implied from the language, structure, or legislative history of FICA." n187

Notwithstanding these nuances, there are suggestions that worker status litigation will continue to evolve. If anything, the stakes are likely to increase. Companies facing worker status issues at any level should consider the larger ramifications, since one dispute may serve as a catalyst to another.

[\*123]

#### XVI. Conclusion

Blackwater's fate with respect to its worker classification issues remains uncertain. The IRS may choose to examine other Blackwater employees piecemeal or may investigate the company's entire workforce, both at home and abroad. If the IRS determines that Blackwater's foreign-based security personnel are employees, Blackwater could fight back by requesting a redetermination or a private letter ruling, or by filing an administrative appeal.

Moreover, joining the ranks of ever-growing numbers of private suits on worker characterization issues, Blackwater's security personnel could sue the company, claiming business expense reimbursement, fringe benefits, pension and other qualified plan benefits, or other protections under federal and state labor and employment laws. With the benefit of only a cursory review of Blackwater's service contract, a reasonable initial reaction to Blackwater's situation is that those arguing for employee status - whether that is the government or the workers themselves - may have the better arguments.

In addition, if the on-the-ground experience between Blackwater and its security personnel reflects an even tighter grip of control by Blackwater over the method, manner, and means by which its security personnel operate - that is, if Blackwater actually exerts even more control than its service contract provides - then Blackwater's argument may prove even weaker. Conversely, if Blackwater can demonstrate the kind of professionalism, independence, and end-result discretion that traditionally characterizes an independent contractor, Blackwater could prevail, even with an ambiguous contract possibly suggesting otherwise.

If a dispute over the status of the security guards arises with the IRS rather than with third-party workers, there is an additional protection. As long as Section 530 relief remains available, even if Blackwater loses a battle with the IRS, the consequences may not be too severe. Of course, the pending Independent Contractor Proper Classification Act of 2007, if passed, may make Section 530 relief tougher to obtain. n188 For now, however, Section 530 relief remains an important failsafe with respect to IRS liabilities. n189

[\*124] Perhaps Blackwater can provide dramatic evidence of a lack of control over its security personnel. Perhaps it can show that these workers themselves exercise an enormous degree of independence. Such facts would seem to be squarely at odds with the contracts Blackwater requires the guards to sign, but perhaps Blackwater can nevertheless show that somehow it does not exercise - and somehow it does not even have the legal right to exercise - control.

That will be a tall order, perhaps an impossible mission in view of the contract itself. Moreover, Blackwater may find that its worker status controversies are increasingly multi-jurisdictional and multi-faceted. They can involve the IRS, insurance companies, state and federal labor and employment authorities, private lawsuits with third parties (seeking respondeat superior liability), and private lawsuits with the workers themselves. Even if Blackwater has a better case than a review of its contract suggests, it seems likely to be an expensive and protracted engagement.

**Legal Topics:**

For related research and practice materials, see the following legal topics:

Labor & Employment Law  
Employment Relationships  
Independent Contractors  
Tax Law  
Federal Tax Administration & Procedure  
Tax Credits & Liabilities  
Estimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)  
FUTA Rate of Tax  
Workers' Compensation & SSDI  
Coverage  
Employment Relationships  
Contractors

**FOOTNOTES:**

n1. See Jeremy Scahill, *Blackwater: The Rise of the World's Most Powerful Mercenary Army* (Nation Books 2007).

n2. For examples of Congressional hearings regarding private contracting in the military arena, consult *infra* nn. 20, 26, and accompanying text.

n3. I.R.C. §§3101-3102, 3111 (2007).

n4. *Id.* at § 3301.

n5. *Id.*

n6. Elizabeth Olson, *Auditors Question Blackwater Contracts*, N.Y. Times C5 (Aug. 12, 2008).

n7. Senator John Kerry, *Kerry Requests Finance Investigation of Blackwater*, 2007 Tax Notes Today 209-268 (Oct. 29, 2007); Senator John Kerry, *Kerry Asks SBA for Blackwater Documentation*, 2007 Tax Notes Today 206-246 (Oct. 24, 2007); Senator John Kerry, *Kerry Requests SBA-Related Documentation From Blackwater*, 2007 Tax Notes Today 209-270 (Oct. 29, 2007).

n8. Sen. 2044, Independent Contractor Proper Classification Act of 2007, 110th Cong. (Sept. 12, 2007) (as introduced).

n9. Senators Barack Obama & Richard Durbin, Obama, Durbin Say Blackwater Case Shows Need for Tax Law Reform, 2007 Tax Notes Today 212-229 (Nov. 1, 2007).

n10. Del Quentin Wilber & Karen DeYoung, Justice Dept. Moves Toward Charges Against Contractors in Iraq Shooting, Wash. Post A01 (Aug. 17, 2007).

n11. August Cole, Politics and Economics: Blackwater Assailed on Tax Policy - Firm Calls Iraq Guards Independent Contractors; Waxman Seeks Review, Wall St. J. A14 (Dec. 3, 2007).

n12. Jeremy Scahill, Blackwater: The Rise of the World's Most Powerful Mercenary Army 1, 229 (Nation Books 2007).

n13. Blackwater Worldwide, Company Profile, [http://www.blackwaterusa.com/company\\_profile/company\\_profile.html](http://www.blackwaterusa.com/company_profile/company_profile.html) (last accessed Dec. 22, 2008).

n14. Id.

n15. Id.

n16. Blackwater Worldwide, Human and Material Resources, [http://www.blackwaterusa.com/human\\_resources/HMR\\_resources\\_overview.html](http://www.blackwaterusa.com/human_resources/HMR_resources_overview.html) (last accessed Dec. 22, 2008).

n17. Blackwater Worldwide, Human and Material Resources, Recruit Highly Skilled Personnel,

[http://www.blackwaterusa.com/human resources/HMR Recruit personnel.html](http://www.blackwaterusa.com/human%20resources/HMR%20Recruit%20personnel.html) (last accessed Dec. 22, 2008).

n18. Id.

n19. Rep. Waxman, Waxman Requests Information on Blackwater Tax Evasion, 2007 Tax Notes Today 206-245 (Oct. 24, 2007).

n20. H. R. Comm. on Oversight & Govt. Reform, Iraqi Reconstruction: Reliance on Private Military Contractors and Status Report, 110th Cong. 123 (Feb. 7, 2007).

n21. Id.

n22. Id.

n23. Id.

n24. Waxman, *supra* n. 19.

n25. Id.

n26. H. R. Comm. on Oversight & Govt. Reform, Hearing on Blackwater USA, 110th Cong. 35 (Oct. 2, 2007).

n27. Id.

n28. Waxman, *supra* n. 19.

n29. *Id.*

n30. Blackwater Worldwide, *Blackwater Details Arguments Against Waxman Evasion Allegations*, 2007 *Tax Notes Today* 233-326 (Dec. 4, 2007).

n31. *Id.*

n32. *Id.*

n33. Waxman, *supra* n. 19.

n34. *Id.*

n35. *Id.*

n36. *Id.*

n37. *Id.*

n38. *Id.*

n39. H. R. Comm. on Oversight & Govt. Reform, *supra* n. 26, at 57.

n40. Blackwater Security Consulting, Independent Contractor Service Agreement 1, 2 (unpublished contract, Mar. 16, 2004) (copy on file with U. of Mont. L. Rev.).

n41. *Id.* at 5-6.

n42. *Id.*

n43. *Id.* at 4-5.

n44. *Id.* at 3.

n45. *Id.* at 8.

n46. Blackwater Security Consulting, Independent Contractor Service Agreement 1, 8 (unpublished contract, Mar. 16, 2004) (copy on file with U. of Mont. L. Rev.).

n47. *Id.*

n48. *Id.* at 11.

n49. Dana Hedgpeth, Waxman: Blackwater May Owe Back Taxes, *Wash. Post* D01 (Oct. 23, 2007).

n50. Waxman, *supra* n. 19.

n51. *Id.*

n52. *Id.*

n53. *Id.*

n54. *Id.*

n55. *Id.*

n56. Waxman, *supra* n. 19.

n57. *Id.*

n58. See General Instructions, I.R.S Form SS-8 (last rev. Nov. 2006).

n59. *Id.*

n60. *Id.*

n61. *Id.*

n62. Id.

n63. Id.

n64. General Instructions, I.R.S. Form SS-8 (last rev. Nov. 2006).

n65. Gordon C. Milbourn III, Acting Deputy Inspector General for Audit, U.S. Treasury Department, Final Audit Report - The Program to Determine Worker Status for Federal Tax Purposes Needs Expanded Goals and Increased Operational Oversight (audit # 200330020), reference number 2004-30-055 (Mar. 5, 2004) (available at <http://www.treas.gov/tigta/auditreports/2004reports/200430055fr.html>).

n66. Id.

n67. Id.

n68. *Rev. Rul. 87-41, 1987-1 C.B. 296.*

n69. Id. at 5-8.

n70. Sen. 1610, Independent Contractor Tax Simplification Act of 1996, 104th Cong. (Mar. 13, 1996) (as introduced).

n71. See I.R.S. Employment Tax Handbook, I.R.S. Pub. No. 104, at § 5.81 (2007); see also Independent Contractor or Employee? I.R.S. Pub. Training Materials No. 3320-102, TPDS 842381 (Oct. 30, 1996).



n72. Id.

n73. See *Avis Rent-a-Car Sys., Inc. v. U.S.*, 503 F.2d 423 (2d Cir. 1994); see also *Leb's Enter. Inc. v. U.S.*, 2000 WL 139551 (N.D. Ill. Jan. 26, 2000).

n74. Pub. L. No. 95-600, 92 Stat. 2763 (1978).

n75. See generally I.R.S. Manual, <http://www.irs.gov/irm/> (last accessed Dec. 22, 2008).

n76. *Avis*, 503 F.2d at 429.

n77. Senator Barack Obama, S.2044 Would Reform Independent Contractor Classification, 2007 Tax Notes Today 180-268 (Sep. 17, 2007).

n78. *Nordan v. Blackwater Sec. Consulting, LLC*, 382 F. Supp. 2d 801 (E.D.N.C. 2005).

n79. See Pl.'s Compl., <http://www.blackwatervictims.com/pdfs/Complaint%20File%20Stamped.pdf> (Jan. 5, 2005).

n80. *Nordan*, 382 F. Supp. 2d at 806.

n81. *In re Blackwater Sec. Consulting, LLC*, 460 F.3d 576 (4th Cir. 2006), cert. denied, 127 S. Ct. 1381 (2007).

n82. Frequently Asked Questions, Blackwater Victims Defense Fund, <http://www.blackwatervictims.com/pdfs/FAQs.pdf> (last accessed Dec. 22, 2008).

n83. See Daniel Callahan, Families of American Contractors Slain in Iraq Seek Help from American Public as They Are Attacked by Blackwater, <http://blackwatervictims.com/pdfs/Blackwater%20Victims%20Defense%20Fund.pdf> (June 6, 2007).

n84. Id.

n85. Blackwater Defense Fund Website, <http://www.blackwatervictims.com> (last accessed Dec. 22, 2008).

n86. Blackwater Security Consulting, *supra* n. 40, at 1, 16.

n87. See generally Blackwater Security Consulting, *supra* n. 40.

n88. Id. at 9.

n89. Id. at 11.

n90. Cole, *supra* n. 11.

n91. Waxman, *supra* n. 19.

n92. Id.

n93. Id.

n94. Id.

n95. Id.

n96. Id.

n97. Pub. L. No. 95-600, § 530, *92 Stat. 2763 (1978)* (amended by Pub. L. No. 96-167, § 9, *93 Stat. 1278 (1979)*); Pub. L. No. 96-541, § 1, *94 Stat. 3205 (1980)*; Pub. L. No. 97-248, § 269, *96 Stat. 324 (1982)*; Pub. L. No. 99-514, § 1706, *100 Stat. 2596 (1986)*; Pub. L. No. 104-188, § 1122, *110 Stat. 1900 (1996)* [hereinafter "Section 530"].

n98. Blackwater Worldwide, *supra* n. 30.

n99. Id.

n100. See *McGuiggan v. CPC Intl. Inc.*, *84 F. Supp. 2d 470, 478 (S.D.N.Y. 2000)* (holding that because the test applied under each law - Fair Labor Standards Act and Employee Retirement Income Security Act - differed, the determination under ERISA's common law standard did not preclude hearing of the FLSA claim under the "economic reality" test); *Fredenburg v. Contra Costa Co. Dept. of Health Servs.*, *172 F.3d 1176 (9th Cir. 1999)* (stating that due to the different definitions of disability employed by that state and federal agencies, it is possible to qualify for disability benefits and to satisfy the ADA's definition of a "qualified person with a disability," meaning a person who can perform essential job functions with or without accommodations).

n101. Blackwater Worldwide, *supra* n. 30.

n102. Id.

n103. Id.

n104. Id.

n105. See supra nn. 64-66.

n106. Kerry Requests Finance Investigation of Blackwater, supra n. 7.

n107. Id.

n108. Id.

n109. U.S. Small Business Administration, SBA says Blackwater Determination not Applicable to Tax Matters, 2007 Tax Notes Today 209-269 (Oct. 29, 2007).

n110. Id.

n111. Senator John Kerry, Kerry Questions SBA Concerning Blackwater Contract Deals, 2007 Tax Notes Today 214-242 (Nov. 5, 2007).

n112. Id.

n113. Kerry Requests Finance Investigation of Blackwater, supra n. 7.

n114. Kerry Requests SBA-Related Documentation from Blackwater, *supra* n. 7.

n115. *Id.*

n116. Obama, *supra* n. 9.

n117. *Id.*

n118. S.2044 Would Reform Independent Contractor Classification, *supra* n. 77.

n119. Section 530, *supra* n. 97.

n120. See also Robert W. Wood, Independent Contractor-Versus-Employee Issues Arise in Multiple Contexts, 2007 BNA Daily Tax Rpt. J. 192 (Oct. 4, 2007).

n121. Waxman, *supra* n. 19; Dept. of St., Fact Sheet: WPPSII Contracts Awarded to Blackwater, Triple Canopy, and DynCorp (undated).

n122. Waxman, *supra* n. 19.

n123. *Id.*

n124. See, e.g., *P.L.R. 7611242090A* (Nov. 24, 1976), 1976 PLR LEXIS 248 (security guards for company that sent guards out on different assignments); *P.L.R. 8511041* (Dec. 17, 1984), 1984 PLR LEXIS 268 (security guards that patrolled fairgrounds); *P.L.R. 7747069* (Aug. 26, 1977), 1977 PLR LEXIS 2035 (security guard who patrolled a marina); *P.L.R. 8114021* (Dec. 24, 1980), 1980 PLR LEXIS 6724 (security guards providing

round-the-clock surveillance for various clients' premises); *P.L.R. 9251021* (Sept. 18, 1992), 1992 PLR LEXIS 1966 (security guards for a grocery store); *P.L.R. 8614011* (Dec. 20, 1985), 1985 PLR LEXIS 70 (security guards at construction sites and office buildings); *P.L.R. 8645015* (Aug. 6, 1986), 1986 PLR LEXIS 1826 (security guard at a real estate development); *P.L.R. 9418006* (Jan. 28, 1994), 1994 PLR LEXIS 171 (security guard at an amusement arcade); *P.L.R. 8645060* (Aug. 12, 1986), 1986 PLR LEXIS 1781 and *P.L.R. 8623036* (Mar. 11, 1986), 1986 PLR LEXIS 3964 (security guard of property subdivision); *P.L.R. 8338110* (June 22, 1983), 1983 PLR LEXIS 3087 (security guard at automobile dealership); *P.L.R. 8401014* (Sept. 26, 1983), 1983 PLR LEXIS 1429 (security guard at coal mine); *P.L.R. 7948006* (Aug. 15, 1979), 1979 PLR LEXIS 5270 (security guard at furniture store); *P.L.R. 8130018* (Apr. 20, 1981), 1981 PLR LEXIS 3849 (security guards at ski resort); *P.L.R. 9140032* (June 28, 1991), 1991 PLR LEXIS 1424 (security guard at public school); *P.L.R. 8902021* (Oct. 14, 1988) 1988 PLR LEXIS 3104 (security guard at mental health center). These rulings involve workers who were both hired by a security company that provides security services to various businesses and then were sent out to different premises by the security company, as well as security guards who were hired directly by the company that required the on-site security services.

n125. I.R.C. § 6110(k)(3) (1976).

n126. *P.L.R. 7843016* (July 25, 1978), 1978 PLR LEXIS 2649.

n127. Id.

n128. Id.

n129. Id.

n130. Id.

n131. Id.

n132. *P.L.R. 7843016* (July 25, 1978).

n133. *Id.*

n134. *Id.*

n135. 29 U.S.C. §§201-219 (2008).

n136. *Id.*

n137. 29 U.S.C. §§203, 206, 207, 212.

n138. *Mitchell v. Strickland Transp. Co.*, 228 F.2d 124 (5th Cir. 1955).

n139. *Id. at 128.*

n140. *Id. at 127.*

n141. See e.g. *S.G. Borello & Sons, Inc. v. Dept. of Indus. Rel.*, 48 Cal. Rptr. 3d 341 (Cal. 1989) (California's Borello standard); *Rev. Rul. 87-41, 1987-1 C.B. 296* (IRS 20-Factor Test); Robert W. Wood, *Legal Guide to Independent Contractor Status* (4th ed., Tax Institute 2007) (state-level ABC tests).

n142. *U.S. v. Silk*, 331 U.S. 704 (1947).

n143. *Id. at 716-718.*

n144. *Id.*

n145. Pub. L. No. 80-655, 62 *Stat.* 438 (1948).

n146. *Id.*

n147. *Id.*

n148. Waxman, *supra* n. 19.

n149. See generally Fair Labor Standards Act, 29 *U.S.C.* §§201-219; Title VII of the Civil Rights Act, 42 *U.S.C.* §§2000(e)-2000(e)(17); Age Discrimination in Employment Act, 29 *U.S.C.* §§621-634; National Labor Relations Act, 29 *U.S.C.* §§151-169.

n150. See Tracey A. Cullen, The Independent Contractor Snarl, *Newsltr. of N.Y. Empl. Law Ltr.* (June 6, 2008) (available at <http://www.hrhero.com/hl/060608-lead-independent.html>).

n151. *Vizcaino v. Microsoft*, 97 *F.3d* 1187 (9th Cir. 1996), reh'g en banc granted, 105 *F.3d* 1334 (9th Cir. 1997), cert. denied, 522 *U.S.* 1098 (1998).

n152. *Id.* at 1189.

n153. *Id.* at 1190.



n154. *Id.*

n155. *Id. at 1202.*

n156. *Id. at 1190.*

n157. *Vizcaino, 97 F.3d at 1190.*

n158. *Id. at 1191.*

n159. *Id.*

n160. *Id.*

n161. *Id.*

n162. *Id. at 1192.*

n163. *Vizcaino, 97 F.3d at 1192.*

n164. *Id. at 1200.*

n165. *Id. at 1192.*

n166. *Id. at 1196.*

n167. *Id. at 1197.*

n168. *Id. at 1196.*

n169. See *S.G. Borello & Sons, Inc.*, 48 Cal. 3d at 349 (holding that cucumber farm laborers contractually classified as "independent contractors" were, in fact, common-law employees covered under California's Worker's Compensation Act).

n170. *Metro. Water Dist. of S. Cal. v. Super. Ct. of L.A. Co.*, 84 P.3d 966 (Cal. 2004).

n171. *Id. at 969.*

n172. *Id. at 977.*

n173. *Estrada v. FedEx Ground Package Sys., Inc.* 64 Cal. Rptr. 3d 327 (Cal. App. 2007).

n174. *Id.*

n175. *Id. at 4.*

n176. *Id. at 22.*

n177. *Id.* at 21.

n178. *McDonald v. S. Farm Bureau Life Ins. Co.*, 291 F.3d 718 (11th Cir. 2002).

n179. *Id.* at 721.

n180. *Id.*

n181. *Cort v. Ash*, 422 U.S. 66 (1975).

n182. *McDonald*, 291 F.3d at 722.

n183. *Id.*

n184. *Id.* at 723.

n185. *Id.*

n186. *Id.* at 720.

n187. *Id.*

n188. *Sen. 2044, Independent Contractor Proper Classification Act of 2007, supra n. 8.*

n189. See e.g. *Peno Trucking, Inc. v. Commr.*, 2008 WL 4463765 (6th Cir. 2008) regarding: (1) the IRS's reclassification of truck drivers as employees; and (2) the Tax Court's determination that the company was not entitled to relief under Section 530 of the Revenue Act of 1978. The Tax Court evaluated the drivers' status using the seven factors enunciated in *Weber v. Commr.*, 60 F.3d 1104, 1110 (4th Cir. 1995). The court found all seven of the factors weighed in favor of classifying the truck drivers as employees. Thus, the Court of Appeals affirmed the Tax Court's reclassification of the drivers. The second issue was whether the company had a reasonable belief. Here, although there were state workers' compensation rulings that two of the company's drivers were independent contractors for purposes of workers' compensation, the Tax Court found the company did not have a reasonable basis for its treatment. Overturning the Tax Court on this point, the Sixth Circuit noted that the state agencies employed a 20-factor common-law test virtually identical to the test used by the IRS. Therefore, the Court of Appeals found the company could reasonably rely on those determinations.