

Worker Characterization Lessons From Blackwater

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The difference between hiring an independent worker for a one-time project and hiring employees for whom you take payroll deductions may seem straightforward. Unfortunately, the distinction is often difficult to discern. The line between employee and independent contractor can be a fine one, and disputes over misclassification are hardly new.

Late last year, it was reported that Blackwater Worldwide, the scandal-plagued defense contractor, may have misclassified its workers. That story blossomed, provoking considerable congressional concern over Blackwater and worker classification issues. John F. Kerry, D-Mass., Senate Small Business and Entrepreneurship Committee chair and Finance Committee member, wrote to Finance Committee Chair Max Baucus, D-Mont., and ranking minority member Chuck Grassley, R-Iowa, to the U.S. Small Business Administration, and even to the head and founder of Blackwater, Erik Prince.¹ Sens. Barack Obama, D-Ill., and Richard J. Durbin, D-Ill., drafted a Senate bill to address independent contractor issues,² and then they wrote to Treasury Secretary Henry Paulson.³

Quite apart from tax issues, Blackwater has faced controversy and criticism over actions of its contractors in Iraq, the deaths of some of its contractors, and the allegedly unprovoked killing of 17 Iraqi civilians by its

contractors in Baghdad in September 2007. Blackwater now also faces queries regarding whether its security personnel in Iraq are employees.

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. In August 2004, Blackwater entered into a Worldwide Personal Protective Services contract with the U.S. government. The agreement calls for Blackwater, along with two other private military contractors, DynCorp and Triple Canopy, to provide security services to the State Department in Iraq.

Andrew Howell, Blackwater's general counsel, testified at the House Oversight and Government Reform Committee's first hearing on Blackwater's activities in Iraq.⁴ In response to a former security guard who requested IRS clarification of his status (as employee or independent contractor), the IRS on March 30, 2007, sent a Form SS-8 determination letter to Blackwater. The IRS ruled that the guard was an employee. The committee sent additional information requests on May 7, 2007, and May 10, 2007. On May 15, 2007, Blackwater submitted a request for reconsideration.

On June 6, 2007, Blackwater entered into a settlement and mutual release agreement with the former guard who had requested clarification of his status, agreeing to pay him back pay and other compensation, and prohibiting him from disclosing information about Blackwater. Meanwhile, the information requests the Oversight Committee sent to Blackwater in May 2007 met with resistance. On August 3, 2007, the Oversight Committee issued a subpoena to compel Blackwater to provide documents. On October 2, 2007, Prince (who now heads The Prince Group, Blackwater's parent) testified before the Oversight Committee.⁵ Prince was questioned about Blackwater's treatment of its security personnel.

A few weeks later, on October 22, 2007, Rep. Henry A. Waxman, D-Calif., Chair of the Oversight Committee, wrote to Prince, acknowledging the receipt of Blackwater's documents. Waxman requested 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; and a list of personnel

¹See letter from Kerry to Baucus and Grassley, Oct. 26, 2007, *Doc 2007-23978*, 2007 TNT 209-68; letter from Kerry to Steven C. Preston, U.S. Small Business Administration, Oct. 23, 2007, *Doc 2007-23653*, 2007 TNT 206-46; letter from Kerry to Prince, Oct. 26, 2007, *Doc 2007-23977*, 2007 TNT 209-70.

²Independent Contractor Proper Classification Act of 2007, S. 2044.

³See "Obama, Durbin Say Blackwater Case Shows Need for Tax Law Reform," *Doc 2007-24258*, 2007 TNT 212-29.

⁴Testimony of Prince, House Committee on Oversight and Government Reform, "Hearing on Blackwater USA: Private Military Contractor Activity in Iraq and Afghanistan," 110th Cong. (Feb. 7, 2007).

⁵House Committee on Oversight and Government Reform, "Hearing on Blackwater USA: Private Military Contractor Activity in Iraq and Afghanistan," 110th Cong. (Oct. 2, 2007).

hired as independent contractors with descriptions of their positions, employment data, amounts paid, and amounts withheld and paid to the IRS. Blackwater responded with a brief press release the same day and a lengthier press release on December 3, 2007.

Contractors or Independent Contractors?

Blackwater treats over 500 U.S. workers as employees for tax purposes, including secretaries, paralegals, information technology professionals, accountants, and landscapers.⁶ The company also has over 1,000 workers in other countries, specialized military veterans hired by Blackwater to serve several months at a time. Blackwater says these workers are subject to the control, supervision, standards, and protocols of the U.S. government.⁷ 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 training, equipping, and conduct of its security guards both before they are sent abroad and once they are working in a foreign country. The contract requires Blackwater to establish training facilities, submit detailed training plans, and ensure that all security personnel complete a specific number of hours of specialized training before being sent abroad. Furthermore, the company must maintain that level of training throughout the guard's tenure, and security guards are not allowed to use their own training methods.⁸

Blackwater must ensure that its security guards follow precise directions, including standard operating procedures and orders issued by the State Department. Once its personnel are in Iraq, the contract requires Blackwater to provide them with logistical support, equipment, and supplies; and the contract prohibits workers from carrying or using their own weapons. Blackwater is required to provide food, shelter, laundry, and housekeeping services for its guards.⁹

In addition to demanding training and extensive screening of Blackwater security personnel, Blackwater disciplines its workforce. Blackwater provides its workers with all equipment, body armor, uniforms, and boots, as well as a handbook.¹⁰ If Blackwater personnel fail to follow instructions, or commit even minor infractions (such as having a bad attitude or riding a bike that does not belong to them), they are fired.¹¹

⁶See "Blackwater's Model of Using Independent Contractors Is Consistent With Law and Good Practice," Blackwater Press Release, Dec. 3, 2007, *Doc 2007-26545*, 2007 TNT 233-26.

⁷*Id.*

⁸Letter from Waxman to Prince, The Prince Group, Oct. 22, 2007, *Doc 2007-23575*, 2007 TNT 206-45.

⁹*Id.*

¹⁰*Id.*

¹¹Testimony of Prince, House Committee on Oversight and Government Reform, "Hearing on Blackwater USA: Private Military Contractor Activity in Iraq and Afghanistan," 110th Cong. (Oct. 2, 2007).

Blackwater requires its security personnel to sign a service contract¹² that designates them as independent contractors. It 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. The service contract specifies the contractor's start date, where he reports for duty, where he will be stationed, how he will be compensated, and the hours of his workday. Blackwater provides equipment, weapons, and transportation; but the contractor can bring personal equipment with prior approval from Blackwater.

The service contract prohibits the contractor from providing services to any other company while working under the service contract without Blackwater's prior written consent. The contract provides that the individual will report directly to Blackwater supervisors, leaders, or the "Customer" (generally the U.S. government) from time to time, and perform his duties in accordance with Blackwater's rules and regulations. The contractor is required to maintain his personal attire and hygiene in accordance with Blackwater policies. The contractor agrees to perform assigned duties until released by the Blackwater supervisor. The contract gives Blackwater the right to terminate the contract without notice or cause, for any reason (or no reason) whatsoever.

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. On March 30, 2007, the IRS ruled he was an employee. The IRS called Blackwater's classification "without merit."¹³ While this ruling applied to only one security guard, the IRS warned that its ruling "may be applicable to any other individuals engaged by the firm."¹⁴

The IRS found the actual working relationship trumped the mere written agreement designating the worker as an independent contractor.¹⁵ The IRS found several factors to be pertinent, including the following:

- Blackwater had its personnel sign a written agreement to provide services that explained the type of work and work rotation, and that stated the worker's services were essential to the services it offers its clients;
- Blackwater retained the right to change the worker's methods and direct the worker to protect its financial investment;
- 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 violations of its procedures;
- the worker followed instructions regarding his assignment from the client;

¹²Blackwater Security Consulting Independent Contractor Service Agreement.

¹³See *supra* note 8.

¹⁴*Id.*

¹⁵*Id.*

- the worker did not have the opportunity to realize a profit or incur a loss as a result of his services, because the worker did not invest capital or assume any business risk; and
- the worker was not engaged in an independent enterprise; the services performed were essential to Blackwater's client; the client was dependent on Blackwater providing the necessary people with specific skills, and they were a necessary and integral part of Blackwater's business.¹⁶

Blackwater required the guard who queried the IRS to sign a nondisclosure agreement before it paid his back pay and other compensation. This agreement prohibited the guard from disclosing any information about Blackwater to any "politician" or "public official." Waxman characterized this as Blackwater concealing the IRS ruling and its own tax evasion from Congress and law enforcement agencies, preventing the worker who discovered tax evasion from disclosing any information.¹⁷

IRS 20-Factor Definition

The factors the IRS uses to classify workers have remained unchanged for over two decades:¹⁸

1. Instructions. The more instructions that are 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.

The IRS 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 so far met with little success.

Contracts and Controversies

Blackwater has actually had prior experience with the "independent contractor vs. employee" issue in other contexts. For example, in one case, Blackwater was sued by the administrators of the estates of several Blackwater workers murdered in Iraq.¹⁹ The complaint asserted that although these workers performed services under service agreements labeling them independent contractors, they were really employees.

Blackwater's service contract is an 18-page, single-spaced form requiring the contractor to fill in his name and address on page 1 and to sign on page 18. It is not clear how much (if at all) these contracts are negotiable. What is clear is that the contracts contain the following basic provisions:

- the basic job is to be 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 Customer (the worker acknowledges that the geographic location may change at any time);
- the term of the contract is generally three years, although 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;

¹⁶*Id.*

¹⁷*Id.*

¹⁸Rev. Rul. 87-41, 1987-1 C.B. 296.

¹⁹*Nordan v. Blackwater Sec. Consulting, LLC (In re Blackwater Sec. Consulting, LLC)*, 460 F.3d 576 (4th Cir. 2006), cert. denied, 127 Sup. Ct. 1381 (2007).

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- Blackwater is responsible for economy-class air transportation from the point of hire to the Duty Station, and return;
- the worker is responsible for obeying U.S. and local laws and regulations and local customs, and is required to maintain personal attire and hygiene in accordance with Blackwater or Customer policies;
- 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 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); and
- the worker can terminate the contract only if Blackwater fails to pay him, and even then, only if that pay is "undisputed."

Although no one contract provision is critical in assessing worker status, it is hard for me to read this contract without thinking that the worker is simply required to do what he is told. This may be entirely appropriate, even necessary, in the face of wartime hostilities, and given the security duties occurring in troubled spots in the world. The question, of course, is whether such military-like secondment and order taking can jibe with the independent contractor model.

Security consultants are apparently required to take orders from whomever at Blackwater gives them or, indeed, from whomever at the "Customer" gives orders. Duty hours are any time Blackwater or the Customer sets. The worker evidently has no right to pick and choose what duties to perform. Moreover, the termination provisions are entirely one-sided, with the worker having no rights whatsoever, and Blackwater having unfettered termination rights.

My analysis at this stage is limited to reviewing the contract (and not considering the always-critical actual conduct between worker and company). Even so, it is hard not to read Blackwater's form of written agreement (even in an initial and cursory reading) without thinking that this contract would have a difficult time standing up to scrutiny. That scrutiny might come in a tax dispute, a dispute over workers' compensation insurance, a wrongful death claim, a *respondeat superior* tort liability suit, a labor or employment law dispute, etc.

Tax Evasion?

The State Department pays Blackwater more than \$460 million a year for security work around the world.²⁰ Based on that figure, Waxman's staff estimated Blackwater may have skirted over \$30 million in federal taxes for its State Department guards.²¹ Moreover, that esti-

mate covers merely May 2006 to March 2007 (from the contract commencement to the time Blackwater received the IRS ruling). This estimate evidently includes unpaid Social Security, Medicare, unemployment, and related taxes. Assuming that Blackwater has continued its practice of treating its workers as independent contractors since the March 2007 ruling, that number may approach \$50 million in unpaid taxes (through September 2007).²²

Blackwater contends that it treats its security personnel as independent contractors because its guards prefer this arrangement, and because Blackwater finds "it is a model that works" for its personnel.²³ Blackwater believes its personnel prefer the flexibility an independent contractor relationship provides, allowing them to sign on for a specified period and to schedule personal time off when it is convenient for them.²⁴ That may be.

In a December 3, 2007, press release, Blackwater defended its independent contractor classification for its overseas security personnel, asserting compliance with federal law.²⁵ Blackwater states that its treatment of its security personnel falls within section 530's safe haven.²⁶ Blackwater claims to have obtained the advice of qualified tax professionals (a large accounting firm and a law firm) and to rely on that advice, arguing that it has a reasonable basis for designating its security personnel as independent contractors.²⁷

The press release also notes that the Small Business Administration (SBA) conducted its own independent inquiry into whether some Blackwater security workers should be classified as independent contractors, determining that they were properly classified. The SBA applied its own standards, as well as criteria used by the IRS, to come to its determination. Of course, there has long been maddening inconsistency across different bodies of law.

Blackwater attempted to discredit Waxman's reliance on the March 30, 2007, SS-8 determination letter, saying that it was unreliable and had little legal effect. Blackwater argued that these SS-8 determinations may not be used or cited as precedent; are not published; and, because they are not considered an examination, cannot be used to assess employment taxes. The determination letter was one-sided, Blackwater asserted, not the result of a full and open adversarial process, but instead a mere response to one individual, looking only at the facts provided by that individual. The SS-8 determination letter is also full of legal and factual errors, Blackwater claimed. 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.²⁸

²²*Id.*

²³*Id.*

²⁴*See supra* note 5. *See also supra* note 6.

²⁵*See supra* note 6.

²⁶*See* section 530 of the Revenue Act of 1978, P.L. 95-600, 92 Stat. 2763, amended by P.L. 96-167; P.L. 96-541; P.L. 97-248; P.L. 99-514; and P.L. 104-188.

²⁷*See supra* note 6.

²⁸*Id.*

²⁰*See* August Cole, "Blackwater Assailed on Tax Policy," *The Wall Street Journal*, Dec. 3, 2007, at A14.

²¹*See supra* note 8.

Congressional Reaction

Kerry became concerned that Blackwater was relying on the SBA decision for tax purposes, and wrote to the SBA on October 23, 2007.²⁹ In his letter, Kerry called on the SBA to explain its potential involvement, and requested any SBA determinations concerning the classification of Blackwater workers. Kerry also requested clarification of whether the SBA had made such a determination for tax purposes.

The SBA responded, explaining the SBA's November 2, 2006, size determination regarding Presidential Airways, an affiliate of Blackwater. It found that Blackwater personnel were not employees, and therefore that Presidential Airways did not exceed the applicable size standard.³⁰ The SBA pointed out it 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 are not applicable to tax liability matters.

Kerry followed up in a November 1, 2007, letter to the SBA, writing that more information and documentation from the SBA was still needed.³¹ Kerry asked for a detailed accounting of the SBA's worker classification ruling, as well as any information not yet provided to the committee about size determinations made for any Blackwater affiliates.

In an October 26, 2007, letter to Baucus and Grassley, Kerry requested that the Finance Committee investigate Blackwater to determine if it attempted to evade taxes by misclassifying workers.³² The same day, Kerry also sent a letter to Prince questioning why Blackwater relied on or referenced the SBA size determination in classifying its workers for tax purposes, and requesting any documents relating to the determination or Blackwater's classification of workers.³³ Kerry also requested an explanation of the chain of command of Blackwater workers deployed in Iraq and Afghanistan and the status of any IRS audit on Blackwater or any of its companies.

Obama and Durbin sent a similar request to Paulson on October 26, 2007, asking for a full investigation and audit of how Blackwater classifies its workers.³⁴ They wrote, "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." The senators also called on Treasury to reform the section 530 provision to prevent similar situations from continuing to arise.

Their letter mentioned the Independent Contractor Proper Classification Act of 2007, S. 2044, which they

²⁹Letter from Kerry to Preston, Oct. 23, 2007, *Doc 2007-23653*, 2007 TNT 206-46.

³⁰Letter from Preston to Kerry, Oct. 24, 2007, *Doc 2007-23979*, 2007 TNT 209-69.

³¹Letter from Kerry to Preston, Nov. 1, 2007, *Doc 2007-24523*, 2007 TNT 214-42.

³²Letter from Kerry to Baucus and Grassley, Oct. 26, 2007, *Doc 2007-23978*, 2007 TNT 209-68.

³³Letter from Kerry to Prince, Oct. 26, 2007, *Doc 2007-23977*, 2007 TNT 209-70.

³⁴See *supra* note 3.

introduced along with Sens. Edward M. Kennedy, D-Mass., and Patty Murray, D-Wash., in September 2007.³⁵ The bill would revise procedures for worker classification, primarily focusing on section 530 of the Revenue Act of 1978.³⁶ The bill would encourage improved enforcement of existing tax and labor laws related to worker misclassification, strengthen coordination between the Labor and Treasury departments, improve access to information for workers, and establish a worker's right to question his classification without employer retaliation.³⁷

Industry Standards

Blackwater is the largest private military contractor in Iraq, with more than 600 security guards in Iraq, compared with DynCorp's 77 and Triple Canopy's 73.³⁸ DynCorp and Triple Canopy, the two other major private military contractors that provide security services to the State Department in Iraq, treat their guards as employees. Blackwater classifies its 604 security guards (as well as other Blackwater personnel working in Iraq under the Worldwide Personal Protective Services contract) as independent contractors.

Historically, the IRS has held security guards to be employees for federal employment tax purposes.³⁹ Although not precedential, IRS letter rulings are a good indicator of how the IRS might treat similar situations.⁴⁰ In LTR 7843016,⁴¹ the IRS found security guards to be employees because the company exercised overall control over the guards. The IRS gave no weight to the fact

³⁵See "S. 2044 Would Reform Independent Contractor Classification," *Doc 2007-21118*, 2007 TNT 180-68.

³⁶*Supra* note 26.

³⁷See also Wood, "Independent Contractor-Versus-Employee Issues Arise in Multiple Contexts," *BNA Daily Tax Report* vol. 2007, no. 192 (Oct. 4, 2007), p. J-1.

³⁸U.S. Department of State, "Fact Sheet: WPPSII Contracts Awarded to Blackwater, Triple Canopy, and DynCorp."

³⁹See, e.g., LTRs 7611242090A (Nov. 24, 1976) (security guards for company that sent guards out on different assignments); 8511041 (Dec. 17, 1984) (security guards that patrolled fairgrounds); 7747069 (Aug. 26, 1977) (security guard who patrolled a marina); 8114021 (Dec. 24, 1980) (security guards providing round-the-clock surveillance for various clients' premises); 9251021 (Sept. 18, 1992) (security guards for a grocery store); 8614011 (Dec. 20, 1985) (security guards at construction sites and office buildings); 8645015 (Aug. 6, 1986) (security guard at a real estate development); 9418006, 94 TNT 89-46 (Jan. 28, 1994) (security guard at an amusement arcade); 8645060 (Aug. 12, 1986) and 8623036 (Mar. 11, 1986) (security guard of property subdivision); 8338110 (June 22, 1983) (security guard at automobile dealership); 8401014 (Sept. 26, 1983) (security guard at coal mine); 7948006 (Aug. 15, 1979) (security guard at furniture store); 8130018 (Apr. 20, 1981) (security guards at ski resort); 9140032 (June 28, 1991) (security guard at public school); 8902021 (Oct. 14, 1988) (security guard at mental health center). These rulings involve both workers who were hired by a security company that provides security services to various businesses and then were sent out to different premises by the security company and workers who were hired directly by a security company that required on-site security services.

⁴⁰Section 6110(k)(3).

⁴¹July 25, 1978.

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that the security guards were designated as independent contractors by the company. The IRS found that the company exercised control over the security guards to an extent sufficient to establish an employer-employee relationship.

The company that hired the security guards in LTR 7843016 arranged to provide the guards to hospitals, hotels, and other businesses. The company directed individual security guards to particular clients, paid them, and could terminate their services at any time. The company engaged the security guards under a continuing arrangement and had the final right to determine whether or not the services of the individual security guards were satisfactory.

Also, the security guards in LTR 7843016 received instructions from the company (or from a senior security guard acting on behalf of the company) as to the manner and means of performing services. Their services were fully integrated into the company's business and were necessary to the company's operation. Their services were performed on an essentially full-time basis according to the schedule and routine established by the company. The guards did not hold themselves out as available to perform similar services outside their arrangement with the company. The guards rendered their services personally, and did not engage helpers or assistants.

The status of security guards has been examined in other contexts too. It has been queried under the Fair Labor Standards Act.⁴² That act applies minimum wage, overtime, equal pay, and child labor protections to employees engaged in interstate commerce, employees who are involved in producing goods for interstate commerce, or employees who are employed by an enterprise engaged in interstate commerce. Employees of private-sector employers, state and local governments, and most federal agencies are covered.⁴³

In *Mitchell v. Strickland Transportation Co.*,⁴⁴ security guards were held to be employees even though their relationship with the company was governed by individual contracts that gave the guards the right to substitute other individuals and made them responsible for paying the substitute guards. The Fifth Circuit Court of Appeals concluded that the guards were employees because: (1) they were not viewed as separate, independent businesses; (2) they regularly performed routine tasks that were part of the normal operations of the business; and (3) they often performed tasks similar to those performed by other employees, such as logging in truck drivers and safekeeping cargo.

History Lesson

The classification of workers can be difficult and consequential. The laws are vague and serve different purposes. They are enforced by different agencies, including the IRS, state unemployment and workers' compensation agencies, insurance companies, and the courts.

These parties use different criteria, have different reasons for making decisions, and reach different decisions regarding the same working relationship. The controlling standard for most purposes, however, is the common-law right-to-control standard.

Yet, given the problems of defining control and the right to exercise it, different approaches have evolved. For example, in *United States v. Silk*,⁴⁵ 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. The Court suggested criteria for determining if employees are integral to the employer's work, including the investment the workers have in the business and whether they stand to lose or gain from their efforts.⁴⁶ Those new criteria became part of what is known as the economic reality test.

Congress was concerned with this definition of economic reality because it could conceivably include all workers, bringing them under the coverage of the Social Security Act. Even in those early years, there was fear that such übercoverage would bankrupt Social Security. Therefore, in the 1948 Gearhart Resolution,⁴⁷ Congress expressed a preference for the common-law definition because it appeared to be narrower. However, Congress did not reject the Supreme Court's reasoning that economic factors should be considered in making a determination.

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. Consistency is not always possible because the agencies use overlapping but different criteria. A person may be classified as an employee for one purpose and as a contractor for another.

Take, for example, Blackwater's situation. The SBA found that some 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. The IRS could make a different determination of these 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 the Fair Labor Standards Act, Title VII of the Civil Rights Act, the Age Discrimination in Employment Act, the National Labor Relations Act, and others. These labor laws are not uniform, and an analysis of the facts and circumstances of each case is needed. There has also been an increasing

⁴²29 U.S.C. sections 201-219.

⁴³29 U.S.C. sections 203, 206, 207, and 212.

⁴⁴228 F.2d 124 (5th Cir. 1955).

⁴⁵331 U.S. 704 (1947).

⁴⁶*Id.* at 716-718.

⁴⁷62 Stat. 468 (1948).

amount of private litigation, in which workers labeled as independent contractors sue the company claiming they are really employees.

Conclusion

Blackwater's fate with taxing and other agencies over its worker classification issues remains uncertain. The IRS may choose to examine other Blackwater employees piecemeal or investigate the company's entire workforce at home and abroad. If the IRS determines that Blackwater's foreign-based security personnel are employees despite contrary labels, Blackwater could fight back and request a redetermination or a private letter ruling, or take its case to the appellate level.

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 protections under federal and state labor and employment laws. With the benefit of only a cursory review of Blackwater's service contract, a reasonable first reaction to Blackwater's situation is that the government may have the better arguments.

Furthermore, if the on-the-ground experience between Blackwater and its security personnel reflects an even tighter grip by Blackwater on the method, manner, and means by which its security personnel do their work than even Blackwater's ubiquitous service contract suggests, Blackwater's case may be tougher still. Yet, as long as section 530 relief remains available, even if Blackwater loses these battles, the penalty 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.

Ultimately, however, Blackwater may find that increasingly today, 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 my cursory contract review might suggest — and I should stress that Blackwater may well have a credible or even a good case — it seems likely to be an expensive and protracted engagement.

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