2023 NAMFS Conference for Mortgage Field Services

Industry Whys

Employee Misclassification

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EMPLOYMENT MISCLASSIFICATION A PRIMER FOR MORTGAGE FIELD SERVICES INDUSTRY

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CONSEQUENCES OF MISCLASSIFICATION

- State administrative agency investigation/exposure
- Federal administrative agency investigation/exposure
- Litigation-class action exposure
- Conflicting adjudicatory standards among regulators/courts
- Underpayment of employment/payroll taxes
- Liquidation of damages
- Heightened public scrutiny

WHAT IS EMPLOYMENT?

"To suffer or permit to work"-Fair Labor Standards Act

Definition is specifically board to cover as many employees as possible

An estimated 10-30% of companies misclassify their workers as independent contractors

Misclassification is pervasive in specific industries, including mortgage field services, which are now the targets of litigation and regulation

IRS 20 FACTOR TEST

Focus on the "right to control"

The greater the control or opportunity to control, the more likely that the relationship be deemed covered employment

Actual exercise of control is not required-only the ability to control the means, as opposed to the outcome of contracted services

THE 20 POINTS
1-10

1. Level of instruction as to when, where and how work is to be performed
2. Amount of training provided
3. Business integration
4. Extent of personal services required
5. Control of assistants
6. Continuity of the relationship
7. Flexibility of scheduling
8. Demand for full-time work
9. Demand for on-site work
10. Demand that work be performed in a particular sequence

THE 20 POINTS
11-20

11. Requirement of status reports
12. Method of payment
13. Payment of business/travel expenses
14. Provision of tools and materials
15. Investment in facilities and equipment
16. Realization of proof or loss
17. Work for multiple enterprises
18. Services held out to the public
19. Control over discharge
20. Right of termination

THE MODERN INTERPRETATION-THREE CATEGORIES

1. Behavioral Control
2. Financial Control
3. Relationship of the Parties

BURDEN OF PROOF

In a misclassification case brought by an entity against the state or federal government, that entity, as plaintiff, assumes the burden of proving that the relationship does not constitute covered employment

Appeals from agency determinations place businesses in the role of plaintiffs.

CONTROL FACTORS

No single factor is controlling.
Even if fewer than 11 factors have been made, the relationship has been deemed covered employment.
Part-time opthalmologists, optometrists and medical photographer determined to be employees. Employer set the fees; services performed on premises using its equipment; employer did billing, scheduling and collections; no evidence of control over medical services but control over operational issues. Held: despite some evidence to the contrary, substantial evidence to support employment determination exists. *Matter of Concourse Opthalmology Associates, 89 A.D.2d 1047 (New York, 1981)*

FACTS & CIRCUMSTANCES TO CONSIDER

- The degree to which the employer controls or directs the manner in which the work is performed.
- Whether the worker's opportunity for profit or loss depends on managerial skill.
- Whether the services are performed on an ongoing basis.
- Whether the services are integral to the employer's business.
- The extent of the worker's investment in equipment or materials.
- The degree to which the worker is engaged primarily for the employer's benefit.
- The absence of independent business judgment.

MORE FACTUAL QUESTIONS

- Does the employer require the individual to follow instructions: when, where and how?
- Does the employer provide on the job training?
- What are the financial ramifications of success or failure?
- Is the relationship reported on Form 1099 or Form W-2?
- Is the contractor a legal entity?
- Does the classification square with how courts have classified similar workers in the past?
- What are the factors re permanence of the relationship?

THE REASONABLE BASIS PRINCIPLE

Traditionally, if you could show a reasonable basis, the IRS would not reclassify-either retrospectively or prospectively!

WARNING: Now, however, prior Revenue Rulings or Private Letter Rulings sought by Form SS-8 are no longer being accorded that weight.

SECTION 530 SAFE HAVENS

An employer may seek Section 530 relief upon voluntary reclassification if 3 statutory requirements are met:

1. Reporting consistency (filing 1099s for the taxable years at issue);
2. Substantive consistency (not having reported same services as covered employment; and
3. Reasonable basis (reliance on a prior audit, judicial precedent or industry practice-not ex post facto justification)
4. ALSO, a taxpayer which does not fulfill the above may still seek relief upon reliance on the advice of counsel/CPA, non-tax federal law, prior audit of a predecessor entity or good faith.

HOWEVER, Section 530 relief does NOT apply to the worker, who may still be liable for the employee's share of FICA, but not self-employment tax.

CONTRACTUAL RELATIONSHIPS

Per the statute of frauds, contracts of less than one year's duration need not be reduced to a writing.

NEVERTHELESS, state departments of labor view the absence of a written agreement as evidence of covered employment AND EVEN WHEN A CONTRACT EXISTS, the terms and provisions are subject to scrutiny.

DRAFTSMANSHIP MATTERS!

One size does not fit all!

If the contractor is not a legal entity, strict scrutiny will apply!

Contracts highlighting independent contractor status are suspect!

Payment terms can be fatal to independent contractor classification!

AUDITS

States now have the ability to target certain industries-"low hanging fruit theory"

Unemployment filings by individuals lead to opportunistic audits

Statute of limitations-once a determination has been issued, the statute is not tolled and delays in final determinations will not vitiate liability.

-Federal SoL is 3 years

-State SoL is 6 years (breach of contract) unless contrary to legislation

CALIFORNIA-AB5

AB5 was signed into law on September 17, 2019 and is the most closely watched piece of employment law legislation in the past decade.

AB5 has altered the landscape of independent contractor relationships.

AB5 codified the result in *Dynamex Operations West Inc. v. Superior Court of Los Angeles (2018),* rejecting the prior multi-factor test outlined in the *Borello* case, which focused on issues of control.

AB5 imposes a legal presumption of employment

AB 5 STANDARD-"THE ABC TEST"

Independent contractor status exists only when all 3 of the following factors are met:

1. The worker is free from control and direction of the hiring entity in connection with performance of the work, both contractually and in fact;
2. The worker performs work outside the usual course of the hiring entity's business; AND
3. The worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed by the worker.

QUESTIONS RAISED BY AB 5

How much control is envisioned by the parties?
How much does location matter? Consider in light of the car service and trucking cases!
What is the worker voluntarily opts to perform services at the hiring entity's location?
Does the worker maintain a business license?
What independent judgment or discretion in performance is involved?
How are rates negotiated?

AB5 EXEMPTIONS

Professionals-doctors, lawyers, accountants, architects, engineers
Investment advisors
Direct-sales salespersons
Commercial fisherman
Travel agents
Photographers
Freelance writers and graphic artists (but not film editors!
Licensed barbers and cosmetologists
Real estate licensees
Private investigators
Bona fide B2B contracts

AB5 PROBLEMS

The existence of a written contract is NOT dispositive!

An entity may not invoke AB5 to reclassify a worker who had been an employee prior to the effective date of July 1, 2020

Any reclassifications of independent contractors as employees may raise red flags of potential liability and result in litigation

AB5 JURISDICTION

Does AB5 apply to CA companies doing business with out-of-state contractors?

Does AB5 apply to an out-of-state business having contractors physically situated in CA? This is a highly relevant issue in mortgage field services!

AB5 PENALTIES

Pursuant to the CA labor code, the penalty for willful misclassification is a minimum of $10,000 and a maximum of $25,000 **for each violation!**

Personal liability may be imposed on officers and directors for AB5 violations.

California's Private Attorney Generals' Act (PAGA) creates opportunistic litigation.

RECENT CASE LAW

In *Vasquez v. Jan-Pro Franchising International, Inc. (2021),* the California Supreme Court, at the request of the United States Court of Appeals for the 9th Circuit, decided the issue of whether *Dynamex*, a case of first impression, applies retroactively, concluding that it did so for reasons including public policy ramifications and holding that there was no reason to depart from the general rule that judicial decisions are given retroactive effect.

CONSEQUENCES

Unionization of certain industries
Effect on contractors who desire to maintain independence
Continued uncertainty
Attempts to thwart enforcement
Public scrutiny of specific industries
Litigation exposure and costs
Politicization of employment law issues

THE WINDS OF EMPLOYMENT LAW

The winds have historically moved from west to east.
AB5 cannot be viewed as limited in import to CA.
Employment law trends are spreading from state to state and cannot be viewed in isolation.
Costs to hiring entities, particularly during troubled economic times can be significant.
Employment litigation has skyrocketed; wage/hour plaintiffs have far greater likelihoods of success than federal civil rights lawsuits against employers
Class action litigation set a new record in 2021—1548 in federal district court.
Litigation trend: ramping up of class actions by worker advocates, increases in settlement sizes, priority on government enforcement litigation by the Biden administration.

LITIGATION CONSEQUENCES

Audits and litigation are the challenges that keep business leaders up at night.

Adverse judgments can bankrupt businesses.

Negotiated resolutions bring the potential for "copy-cat" claims and a domino effect of challenging corporate policies and practices in numerous jurisdictions.

The top 10 employment law settlements in 2020 totaled $1.58 billion with California leading the way.

THE PATCHWORK QUILT

Compliance with a patchwork quilt of workplace laws at the federal, state and local levels will become even more important as the class action bar is posed to pivot off employee-friendly/ramped up business regulation.

The role of the accountant, as the trusted advisor to businesses, to evaluate issues and ensure compliance with workplace laws will become even more important in navigating employment classification issues.

ABOUT JUDGE KRAFT

Ruth B. Kraft, the Chair of Falcon Rappaport's Employment Law Group, is a graduate of the Yale Law School. Her practice is a national one in which she advises business organizations on all facets of employment law including wage/hour disputes, employee misclassification, policies and procedures and compliance. During her time on the bench, she specialized in employment law issues; she now successfully litigates multi-million dollar employment class action lawsuits in the federal and state court systems in a broad range of industries.

She is admitted to practice in the State of New York, a variety of federal district courts and the United States Supreme Court. She is the "Uber-Judge" of the International Business Ethics Case Competition and spent the early part of her career in legal academia. Judge Kraft is a member of the employment law committee of the Federal Bar Council. She has been recognized as a *Super Lawyer* and named as a *Top Lawyer* and *Lawyer of Distinction* in New York.