Insights, News & Events

THE PARTY'S OVER

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Many dealerships treat their dealer trade drivers (DX drivers, auction drivers, hikers, etc.) as "contract labor" or "independent contractors," paying them a lump sum for their services and withholding no taxes. Some dealerships also pay regular employees an additional lump sum to perform special work outside their normal work hours, such as cleaning or painting the service drive, performing "catch up" filing or even dealer trades. The dealership treats this work as "contract work" and reports the payments on a Form 1099 thus, having a single individual receive both a W-2 and a Form 1099 from the same employer.

While dealerships have seldom had problems with these practices in the past, that is likely to change. Here's why.

THE PLAYING FIELD

When a business treats an individual as an "independent contractor," it reduces its costs in several ways: It does not pay unemployment taxes or workers' compensation insurance. It does not pay the employer portion of FICA. It can also ignore minimum wage and overtime laws and it does not provide expensive employee benefits like health insurance and vacation. Finally, it does not have to withhold state and federal taxes on their compensation.

The individual who is treated as an "independent contractor" can also benefit because no taxes are withheld, although he or she is still required to pay federal and state income tax on the Form 1099 earnings and must contribute the full 15.3% social security tax (which is normally split between an employer and an employee).

However, experience shows that many “independent contractors” fail to pay any taxes at all on these earnings.

So while employers and their “independent contractors” may both benefit from the arrangement, there is one big loser: government. When an employer does not withhold taxes and “independent contractors” do not pay taxes on their earnings, the state and federal governments lose the employment tax and income tax revenue. The U.S. Department of Labor has estimated that as many as 30% of businesses misclassify some of their employees as independent contractors. The Obama Administration estimates that it can recapture billions in lost tax revenue over the next ten years just by cracking down on the misuse of “independent contractor” status. As a result, a bill entitled “The Employee Misclassification Act” was introduced in both Houses of Congress this year and is designed to target this abuse. DOL has also announced a $25,000,000 Employee Misclassification initiative, operated in conjunction with the IRS, which is designed to detect and deter inappropriate classification of individuals in the workplace.

And the federal government is not alone in this crackdown. A number of states have passed, or are actively considering, tough new laws requiring employers to justify their classification of “independent contractors” or face significant fines and penalties. In addition, plaintiff attorneys have been filing class action lawsuits challenging the classification of many groups of employees, including FedEx drivers, pharmaceutical sales reps and even strippers, seeking to prove they are not “independent contractors,” but rather “employees” who are entitled to overtime pay and other employment benefits.

DO YOU HAVE MISCLASSIFIED WORKERS?

How does an employer know if an individual is an “employee” or an “independent contractor”? To some extent, it depends on the forum you are in and who is asking the question. For example, the IRS uses one standard, while the DOL’s Wage-Hour Division uses another. State workers’ compensation boards and unemployment compensation commissions may use still other standards and tests. So let’s examine how the two most important agencies resolve the question.

THE IRS TEST

The IRS uses a “common law” analysis, which involves examining the degree of control

and independence in the relationship in three areas:

- Behavioral: does the company control or have the right to control what the worker does and how the worker does his or her job?
- Financial: are the business aspects of the worker's job controlled by the payer? (These include things like how the worker is paid, whether expenses are reimbursed, and who provides tools/supplies.)
- Type of Relationship: are there written contracts or employee-type benefits (e.g., pension plan, insurance, vacation pay)? Will the relationship continue and is the work performed a key aspect to the business?

As far back as 1955, the IRS issued a ruling classifying "car shuttlers" as employees and

not independent contractors. The shuttler drove cars to the dealership's place of business from outside the city and drove cars to auction from the dealer's place of business. For these services he received a fixed sum. All the services were performed in the dealer's name and even though the shuttler also performed the work for another dealer, he was an employee because of the employer's control.

In 1973, a federal appellate court ruled against Avis in its claim that car shuttlers were independent contractors citing a number of factors, including that the individual: 1) had no investment in his job; 2) was reimbursed for all costs; 3) had no ability to make a profit from the management of his skills; and 4) was basically unskilled. Even though some workers were transients, the Court found that the "totality of circumstances" justified their being treated as employees.

THE DOL TEST

The minimum wage and overtime laws apply only to "employees" and not "independent

contractors." Therefore, in determining coverage, the DOL's Wage-Hour Division will examine a number of different factors in deciding whether, as a matter of economic reality, the individuals are economically dependent on the business to which they render services, similar to the factors cited in the Avis case. These factors include:

- the degree of control exercised by the alleged employer;
- the extent of the relative investments of the supposed employee and the employer;
- the degree to which the "employee's" opportunity for profit or loss is determined by the "employer";
- the skill and initiative required in performing the job;

- the permanency of the relationship; and
- whether the service rendered is integral to the employer's business.

SOME DEALERSHIP EXAMPLES

The following examples illustrate how these factors might be applied to two different individuals commonly seen around dealerships: a dealer trade driver and a "dent and ding" man.

Dealer trade drivers are often retired individuals who are called in to move cars on an "as needed" basis. Because the dealership decides if and when they will be called, tells them when and where to go and what to do, it is clear that the dealership exercises close control over them. The drivers have no tools and make no investment in their "business." The drivers are normally paid a set amount determined by the dealership and are reimbursed for any expenses, thus limiting their ability to increase profits. The job requires minimal skills. The relationship is ongoing, perhaps for several years, suggesting an employment relationship. Finally, the work is necessary to the performance of the employer's business. In all likelihood, both the IRS and the DOL will find dealer trade drivers to be "employees."

There are a few areas where dealer trade drivers are provided by an outside company and payments are made to that company rather than to the drivers themselves. In that case, the drivers would be the employees of the referring company and not the dealership. But the dealership would likely be a "co-employer" who could be held responsible if the referring company fails to comply with the employment laws. Remember, too, that it's important that all of the wages paid them are accurately reported.

The dent repair men often provide services to a number of different dealers. They normally have attended some form of training and have specialized tools and skills. They are usually paid a set amount per job rather than by the hour, and so can increase their income by doing more work during the day. They are free to do the work any time they wish so long as the work is done by the agreed-upon completion date. They can, if they choose, hire others to assist them. The relationship is a temporary one and may last only a few days. In most cases, they would be considered to be "independent contractors" and not "employees."

On the other hand, there are situations where dent repair men provide services to a group of affiliated dealerships and do not work for dealerships outside the group. They maintain a work space at one of the dealerships where they report every morning, and may even be reimbursed for materials and expenses. Those factors would suggest "employee" status.

OUR ADVICE

Just as Tom Hanks once said, “There is no crying in baseball,” our advice is to assume that “There are no independent contractors at dealerships.” If you have someone who performs services for you when you call them, who reports to the dealership on a regular basis, or who performs services that are essential to the operation of the business, they likely are your “employees” regardless of what you call them. They also may be entitled to minimum wage and overtime and you are likely legally obligated to withhold taxes from their compensation.

Remember, the fact that you have not had problems in the past is no guarantee that you will not be audited or sued tomorrow. The dealership’s liability includes overtime and workers’ compensation claims, claims for coverage under the health plan (as those plans usually cover “employees” who work a specified number of hours per week) and claims for retirement plan benefits. Also, if the worker has failed to pay federal and state income taxes on his earnings , the dealership will be liable for the amount that should have been withheld, plus interest and penalties.

Therefore, we recommend that dealerships review each individual who receives a Form 1099 and carefully examine whether the IRS and DOL standards are satisfied. It they are not clear cut cases, you should treat them as employees. If they work part-time, be sure to determine whether or not they are eligible for health plan or retirement plan benefits and any other programs in which employees participate.

If you have a question about a particular individual at your dealership or if you are not sure how these tests would be applied, please call any Fisher Phillips office and ask to speak to a member of the Dealership Practice Group. We can help.