

## Obama Bill to Close Safe Harbor Provisions in Section 530: The Proposed Impact on the Motor Carrier Industry and Current Status of the Law

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### I. INTRODUCTION

In the midst of the political season, the transportation industry is focusing its attention on Senator Barack Obama. But the attention is not only focused on his Presidential candidacy, but also on his proposed bill that would

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eliminate the safe harbor provisions of Section 530.<sup>1</sup> As the law stands, Section 530 of the Revenue Act of 1978 permits employers to seek relief by avoiding the harsh penalties for reclassifying an independent contractor as an employee.<sup>2</sup> The bill, the Independent Contractor Proper Classification Act of 2007 (hereinafter "Classification Act"),<sup>3</sup> would eliminate the protections afforded under Section 530 and expose employers to lawsuits initiated by employees for allegedly misclassifying them as independent contractors.<sup>4</sup> This Article addresses the potential impact of Senator Obama's bill on the employer, particularly in the context of the motor carrier industry, as well as the current framework to assess the motor carriers' classification of owner-operators as an independent contractors.<sup>5</sup>

At this point, the Classification Act has only been introduced to the Senate and is not yet law.<sup>6</sup> Nonetheless, motor carriers and employers should be vigilant on the status of this bill, as its passage would have a significant impact on the viability of owner-operators as independent contractors.

## II. THE INCOMING AND OUTGOING TIDES OF TAX WITHHOLDINGS

The consequences that flow from the classification of an individual as employee or independent contractor are significant, to both employer and the misclassified individual. For the employer or motor carrier, classifying an individual as an employee requires the employer to withhold Federal Insurance Contributions Act<sup>7</sup> (FICA) taxes, Federal Unemployment Tax Act<sup>8</sup> (FUTA) taxes, and federal income tax from an employee's wages.<sup>9</sup> The employer must

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1. Independent Classification Act of 2007, S. 2044, 110th Cong. § 2 (2007) (hereinafter "Classification Act").

2. Revenue Act of 1978, Pub. L. No. 95-600, § 530, 92 Stat. 2763, 2885-86 (1978) (codified as amended at 26 U.S.C. §§ 3401, 3101 (2008)).

3. Classification Act, *supra* note 1.

4. *Id.* § 2.

5. The term independent contractor is used to include owner-operators in this Article. However, motor carriers should consult their state's statutory definition of owner-operator, if applicable, as the term owner-operator varies from state to state and may provide guidance on whether owner-operator services constitute "employment" or are considered independently contacted work. *E.g.* 2007 Kansas Laws Ch. 80 (S.B. 235); Kan. Stat. Ann. § 44-703(i)(4)(Y) (amending the Kansas Employment Security Law and providing when owner-operator services do not constitute employment). The author would like to acknowledge Mr. Bob Alderson, who drafted the legislation to the above noted statute, for his assistance with this footnote.

6. GovTrack.us., *Independent Contractor Proper Classification Act of 2007*, <http://www.govtrack.us/congress/bill.xpd?bill=s110-2044> (last visited Feb 18, 2008).

7. 26 U.S.C. §§ 3101-02 (2008).

8. 26 U.S.C. § 3301 (2008).

9. 26 U.S.C. § 3402(a) (2008). The act of classifying an individual as an employee affects the employers' tax obligations as well. ROBERT MCCALLUM, WORKERS CLASSIFICATION: EMPLOYEE VERSUS INDEPENDENT CONTRACTOR, <http://www.lesourd.com/publications/workerclassification.pdf> (last visited Feb. 16, 2008). Pursuant to sections 3111(a) and 3301(a), employers must pay a share of

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also pay the employer's share of FICA and FUTA taxes when classifying an individual as an employee.<sup>10</sup> If the employer fails to withhold taxes from an employee's wages, the employer will be required to pay the Internal Revenue Service (IRS) "1.5 percent of the wages paid. . .to such employee" and "20 percent of the amount [of social security that should have been withheld for the employee]."<sup>11</sup> The employer is required to pay this amount and other tax assessments for years,<sup>12</sup> regardless of any intentional wrongdoing, unless the employer obtains relief under the safe harbor provisions of Section 530.<sup>13</sup>

Conversely, if the employer willfully fails to pay taxes, the employer will be required to pay twice the amount of taxes and Social Security otherwise required by 26 U.S.C. 3509(a).<sup>14</sup> In such cases, the IRS may impose against the employer "a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."<sup>15</sup> With these harsh consequences, employers may think twice before classifying an individual as an independent contractor, particularly if the motives are to avoid the burdens of withholding and paying taxes for employees.

Yet at least one court has concluded that an employer does not willfully evade tax obligations by classifying an individual as an independent contractor, even though the classification is done to avoid "the trouble and expense of withholding taxes from workers' wages. . . ."<sup>16</sup> The court held that when the employer seeks out and relies on the advice of counsel to determine whether an individual qualifies as an employee or independent contractor, and is otherwise compliant with all withholding requirements under the Internal Revenue Code, an employer is not willfully evading his obligations under the law.<sup>17</sup> Nonetheless, such a decision merits careful consideration because

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FICA and FUTA taxes respectively in addition to withholding taxes from the employee's wages. 26 U.S.C. §§ 3111(a), 3301(a) (2008).

10. 26 U.S.C. §§ 3111(a), 3301(a) (2008).

11. 26 U.S.C. § 3509(a) (2008).

12. Pursuant to Section 6501(a) (2008), the IRS may take as long as three years to assess back taxes. McCallum suggests that this period may be longer when an individual has been misclassified as an independent contractor, "since no employment taxes would have been filed, there technically is no statute of limitations for assessment, and the IRS would not be precluded from asserting liabilities for multiple years." McCallum, *supra* note 8, at 9 n.7 (citing 26 U.S.C. § 6501(c)(3) (2008)).

13. Revenue Act of 1978, Pub. L. No. 95-600, § 530, 92 Stat. 2763, 2885-86 (1978) (codified as amended at 26 U.S.C. §§ 3401, 3101 (2008)).

14. 26 U.S.C. § 3509(b) (2008).

15. 26 U.S.C. § 6672(a) (2008). Another harsh consequence that follows from the willful evasion of tax obligations is that an employer loses the right to collect tax refunds on assessed taxes. Fred R. Esser, P.C. v. United States, 750 F. Supp. 421, 423 (D. Ariz. 1990).

16. Crowd Mgmt. Services, Inc. v. United States, 889 F. Supp. 1313, 1318 (D. Or. 1995).

17. *Id.* The court also noted that the employer "was conscientious in meeting the reporting requirements for his workers." *Id.* Specifically, "[h]e withheld income taxes for those workers characterized as employees and filed 1099's for all independent contractors, even those whose wages were negligible." *Id.*

misclassifying an employee as an independent contractor can cost the employer millions of dollars.<sup>18</sup>

Although the impact of misclassification on the employer is evident, the impact on the misclassified person may also be costly. For example, if an employee is mistakenly classified as an independent contractor, the employee is responsible for any income tax deficiency that he or she may owe as a result of the misclassification.<sup>19</sup> Additional taxes (or fees) may be imposed as well, including taxes for the employee's failure to file tax returns during the period they were classified as an independent contractor.<sup>20</sup> Aside from the imposition of taxes, misclassified independent contractors may have also been deprived benefits otherwise available to employees, such as health benefits, medical leave, workers compensation, retirement benefits, overtime pay, and stock options.<sup>21</sup> Such consequences are the impetus for Senator Obama's Classification Act.<sup>22</sup>

By treating the "employee" as an independent contractor, employers may cut costs as much as thirty percent, Obama reports.<sup>23</sup>

With the consequences of misclassification presenting difficult struggles to both employers and misclassified independent contractors, there is no doubt that the need to provide tax relief on both sides is essential. How that relief is provided is where the safe harbor provisions of Section 530 and Classification Act come into consideration.

### III. SECTION 530: SAFE HARBORS FOR MOTOR CARRIERS

#### A. STEP ONE: IS THE MOTOR CARRIER ELIGIBLE FOR RELIEF?

As a preliminary matter, Section 530 does not apply to employees.<sup>24</sup> The purpose of Section 530 is to protect businesses from insurmountable tax assessments (and inevitably going out of business).<sup>25</sup> In the motor carrier

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18. James C. Hardman, *Administrative Bulls in the Delicate China Shop of Motor Carrier Operations – Revisited*, 18 *TRANSP. L.J.* 115, 117 (1989).

19. *Escandon v. Comm'r of Internal Revenue*, T.C. Memo. 2007-128, 2007 WL 1475267 (U.S. Tax Ct. 2007).

20. 26 U.S.C. § 6651(a)(1)-(3) (2008).

21. McCallum, *supra* note 8, at 4 (noting the "collateral consequences involved in reclassifying...[an independent contractor] as an employee."); *see also* Sen. Barack Obama & Sen. Dick Durbin, *Tax Loophole Hurts Misclassified Workers*, *CHICAGO SUN TIMES*, Sept. 15, 2007, at 16. See Rule 16.1

22. Obama, *supra* note 20, at 16.

23. *Id.*

24. *Ahmed v. United States*, 147 F.3d 791, 797 (8th Cir. 1998).

25. *Nu-Look Design, Inc. v. Comm'n of Internal Revenue*, 356 F.3d 290, 292 (3rd Cir. 2004); *see also In re Arndt*, 201 B.R. 853 (M.D. Fla. 1996) (providing that the purpose of Section 530 "was created by Congress to provide a 'safe harbor' to employers who had misclassified their employees as

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industry, Section 530 is especially critical because of the motor carriers' reliance on owner-operators. To ensure that motor carriers and other valuable industries are able to stay in business, Section 530 of the Revenue Act of 1978 offers relief to employers who owe federal taxes because they have misclassified individuals as independent contractors.<sup>26</sup> Thus, in cases where an individual is actually an employee and not an independent contractor,<sup>27</sup> Section 530 allows the motor carrier to treat the individual as an independent contractor to avoid the tax consequences of misclassification, but only if the following requirements are met:

- (1) the taxpayer must file requisite federal tax returns (including information returns) on a basis consistent with the tax payer's treatment of the individuals in question as independent contractors (the reporting consistency requirement);
- (2) the taxpayer must treat all persons holding substantially similar positions as independent contractors (the substantive consistency requirement); and
- (3) the taxpayer must have a reasonable basis for treating the individuals in question as independent contractors (the reasonable basis requirement).<sup>28</sup>

The first requirement is fairly straightforward. To meet this requirement, the motor carrier must show that *all* federal tax forms submitted were those forms required to be submitted for an independent contractor.<sup>29</sup> In other words, the motor carrier cannot have submitted any form treating the individual as an employee to qualify for relief under Section 530.<sup>30</sup>

The second requirement, however, "requires an examination of all the facts and circumstances, including particularly the activities and functions performed by the individuals."<sup>31</sup> This analysis becomes complex, particularly

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independent contractors in good faith.").

26. The protections of Section 530 extend only to FICA and FUTA tax assessments, and not federal income tax. JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO WORKER CLASSIFICATION FOR FEDERAL TAX PURPOSES (JCX-26-07), May 7, 2007, available at <http://www.house.gov/jct/x-26-07.pdf>. (hereinafter "Present Law For Federal Tax Purposes").

As such, the employee cannot rely on the employer's Section 530 defense, but must make an independent assessment on whether he or she is an employee or independent contractor based on traditional common law test. *Id.*

27. To determine whether an individual is an employee or independent contractor involves an assessment of several considerations, "but is essentially made by examining the [employer's] right to control how, when, and where the person performs services." Internal Revenue Service, U.S. Dept. of Treasury, *Frequently Asked Tax Questions and Answers*, <http://www.irs.gov/faqs/faq-kw54.html> (last visited Feb. 17, 2008).

28. *Greco v. United States*, 380 F. Supp.2d 598, 615 (M.D. Pa. 2005) (Rev. Rul. 87-41, 1987-C.B. 296) (emphasis added); see also *Hardman*, *supra* note 17, at 118 (setting out the three requirements that an employer must meet to continue treating the individual as an independent contractor).

29. Rev. Rul. 87-41, 1987-C.B. 296; Revenue Act of 1978, Pub. L. No. 95-600, § 530(a)(1)(B).

30. Rev. Rul. 87-41, 1987-C.B. 296.

31. *Id.* However, "[d]ifferences in the positions held by the respective individuals that result from the taxpayer's treatment of one individual as an employee and the other individual as other than an

in cases where motor carriers employ drivers and hire independent contractors to perform substantially similar positions.<sup>32</sup> In *McLaine v. United States*, for example, plaintiff's employee drivers and independent contractors both "haul[ed] freight; . . . receive[d] their job assignments from plaintiff's dispatchers on a daily basis; . . . submit[ted] driver's logs and bills of lading; and . . . haul[ed] the freight in trailers provided by plaintiff bearing the name 'Warren C. Sauers.'"<sup>33</sup> Despite these similarities, the court determined that there was sufficient evidence to determine that the independent contractors and employees did not share a substantially similar position. The court noted in particular that the independent contractors "could choose what loads to haul[,] . . . had their own offices or advertised their services to others and . . . could take advances on their pay."<sup>34</sup>

The final requirement under Section 530 requires the motor carrier to have a reasonable basis for treating the individual as an independent contractor before obtaining relief.<sup>35</sup> The third prong also involves the consideration of several factors. Pursuant to Section 530, a motor carrier may establish a reasonable basis for treating an employee as an independent contractor by relying on:

- (A) judicial precedent, published rulings, technical advice with respect to the tax payer, or a letter ruling to the tax payer;
- (B) a past IRS audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

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employee . . . are to be disregarded in determining whether the individuals hold substantially similar positions." *Id.* For instance, the fact that employee takes part in a "qualified pension plan or health plan" and the independent contractor does not should not have any bearing on whether the independent contractor and employee share a "substantially similar positio[n]." *Id.*

32. *McLaine v. United States*, 1999 WL 164930, at \*4 (W.D. Pa. 1999).

33. *Id.*

34. *Id.*; See also *Halfhill v. United States*, 927 F. Supp. 171, 176 (W.D. Pa. 1996). In *Halfhill*, the court held that the plaintiff's employees and independent contractors did *not* share substantially similar positions, and therefore, that the plaintiff did not qualify for Section 530 relief. *Id.* Specifically, the court found that:

[The] plaintiff treated his only driver, Halfhill, as an employee in 1978 and 1979, but from 1982 through 1990, plaintiff treated all the individuals who drove HT's trucks, including Halfhill, as independent contractors. The type of work performed by Halfhill in the 1970's, however, was substantially similar to the work performed by all of the drivers in the 1980's; these individuals drove HT's trucks, negotiated with carriers regarding the leasing of HT's vehicles, and were paid a percentage of what HT's trucks actually earned. Thus, because plaintiff has inconsistently labeled individuals who performed similar job functions, he is not entitled to § 530's shelter.

*Id.* (emphasis in original).

35. Revenue Act of 1978, Pub. L. No. 95-600, at § 530(a)(1)(B)(2).

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(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.<sup>36</sup>

In applying the reasonable basis prong, courts have clung to Congress's mandate that the "reasonable basis" test is to be "construed liberally in favor of taxpayers."<sup>37</sup> Beyond this basic guideline, courts have construed the provisions of reasonable basis with varying degrees. For example, some courts have construed provision (A) to permit employers to rely on certified public accountants and attorneys as "technical advice with respect to the tax payer,"<sup>38</sup> while other courts have required a further showing of reasonable reliance.<sup>39</sup>

Even though provision (B) appears to be fairly straightforward, there is discord between courts reviewing Section 530 claims and the IRS's interpretation of provision (B). For example, the Fifth Circuit permits a taxpayer to rely on his prior audit to obtain relief under Section 530, even though the audit was for a business in a completely different industry than the business subject to the tax assessments.<sup>40</sup> The IRS clearly rejects this holding. In *Lambert*, the IRS argued that Lambert could not "use an audit conducted within one industry to provide a [safe harbor] governing employees in another industry."<sup>41</sup> In rejecting the IRS's argument, the court held that "[t]he relationship of the taxpayer to his workers is the most important element of the § 530(a)(2)(B) analysis," and not the substance of the work performed by the independent contractor.<sup>42</sup> As such, the court should look to the "terms of control, supervision, pay and demands" of the employer's and individual's relationship, rather than the substance of the work completed.<sup>43</sup> This analysis is favorable to the motor carrier industry, particularly where a trucking company performs several services in carrying out its operations. Nonetheless, this is only one jurisdiction's interpretation of provision (B) and other courts may not adopt the Fifth Circuit's approach.

In turning to provision (C), courts have developed several theories for what constitutes a "long-standing recognized practice of a significant segment of the industry." For example, the Second Circuit held that provision (C) "cannot plausibly be understood to require uniformity of practice," but rather, that "[t]he plain language of § 530 makes clear that . . . a taxpayer must prove

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36. *Id.* at § 530(a)(2)(A)-(C).

37. *Gen. Inv. Corp. v. United States*, 823 F.2d 337, 340 (9th Cir. 1987) (quoting H.R.Rep. No. 1748, 95th Cong., 2d Sess. 5, 1978-3 C.B. (Vol. 1) 629, 633).

38. Pub. L. No. 95-600, at §530(a)(2)(B); *Smoky Mountain Secrets, Inc. v. United States*, 910 F. Supp. 1316, 1324 (E.D. Tenn. 1995).

39. *Arndt*, 201 B.R. at 860; *Vorsheck v. Comm'n of Internal Revenue*, 933 F.2d 757, 759 (9th Cir. 1991).

40. *Lambert's Nursery and Landscaping, Inc. v. United States*, 894 F.2d 154, 157 (5th Cir. 1990).

41. *Id.*

42. *Id.*

43. *Id.* at 156.

that a significant segment of the industry follows a particular practice - not that every segment of the industry follows that practice.”<sup>44</sup> While the Second Circuit still leaves the question of what constitutes a significant segment, at least one court has confined significant segment to a narrower margin.<sup>45</sup> The court held that significant segment can be less than half of the overall industry.<sup>46</sup> To provide further guidance on the issue, Congress established the Small Business Job Protection Act of 1996,<sup>47</sup> which effectively supplements Section 530 by adding the following:

[I]n no event shall the significant segment requirement of subparagraph (C) thereof be construed to require a reasonable showing of the practice of more than 25 percent of the industry (determined by not taking into account the taxpayer), and . . . in applying the long-standing recognized practice requirement of subparagraph (C) thereof—

(i) such requirement shall not be construed as requiring the practice to have continued for more than 10 years, and

(ii) a practice shall not fail to be treated as long-standing merely because such practice began after 1978.<sup>48</sup>

Based on this amendment, an employer’s showing of a significant segment of the industry can be accomplished with less than twenty-five percent of the industry following the employer’s same practice. This is indeed a favorable reading for trucking companies, particularly if courts decide to group motor carrier operations into a single industry – rather than recognizing the individual areas of motor carrier operations – such as moving and storage, hauling of perishables goods, and so on – because anything over twenty-five percent could require a large number of trucking companies to constitute a significant segment.

Lastly, it should be noted that some courts have developed a fourth prong under the reasonable basis determination.<sup>49</sup> These courts have held that the common law rules as to what constitutes a “reasonable basis” may be used to find that a motor carrier reasonably relied on the provisions of Section 530.<sup>50</sup> Whether a reasonable basis exists under this analysis depends on the facts and circumstances of each case and whether the reasonable basis was made in good

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44. 303 W. 42nd St. Enter., Inc. v. Internal Revenue Service, 181 F.3d 272, 276-77 (2d Cir. 1999) (quoting *Springfield v. United States*, 88 F.3d 750, 754 (9th Cir. 1996)).

45. *In re Bentley*, No. 93-30510, 1994 WL 171200, at \*4 (Bankr. E.D. Tenn. Feb. 25, 1994).

46. *Id.*

47. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, at 1766 (appearing in notes to 26 U.S.C.A. § 3401 (2005)).

48. *Id.*

49. *E.g.*, *Select Rehab, Inc. v. United States*, 205 F. Supp. 2d 376 (M.D. Pa. 2002).

50. *Critical Care Register Nursing, Inc. v. United States*, 776 F. Supp. 1025, 1028 (E.D. Pa. 1991).

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faith.<sup>51</sup> Not all jurisdictions have adopted this fourth prong and as such, reliance on showing some other reasonable basis should be reviewed in light of the jurisdiction controlling the motor carrier's case.

As demonstrated from the discussion above, the application of Section 530 cannot be riddled down or put into a basic formula. The application of Section 530 requires a thoughtful analysis of the language and interpretations of Section 530 in the motor carrier's controlling jurisdiction to the facts of each case. As such, motor carriers should consult with their attorneys *before* classifying the individual as an independent contractor to prospectively avoid the consequences of misclassification, or if faced with a misclassification challenge, to determine their likelihood of success under Section 530.

**B. STEP TWO: WHAT RELIEF MAY THE MOTOR CARRIER OBTAIN?**

First, the employer or motor carrier may seek relief from the IRS before having to step through courtroom doors. Under the Classification Settlement Program (CSP), the motor carrier has the option of turning directly to the IRS to resolve their case with a standard settlement agreement.<sup>52</sup> The CSP essentially consists of "a series of graduated settlement offers."<sup>53</sup> In a nutshell, if

- (1) [T]he business meets the Section 530 *reporting* requirement but either clearly doesn't meet the consistency requirement or clearly cannot meet the reasonable basis test, the offer will be a full employment tax assessment for the one tax year under examination.<sup>54</sup>
- (2) [T]he business meets the Section 530 *reporting* requirement and has a colorable argument that it meets the *consistency* requirement and the *reasonable basis test*, the offer will be an assessment of 25% of the employment tax liability for the audit year.<sup>55</sup>

This is a valuable remedy if it does not appear that the motor carrier will be able to prevail under a Section 530 defense. Although the CSP program does not offer the motor carrier the same relief as Section 530, CSP does allow the motor carrier to avoid the full assessment of fines and back taxes otherwise imposed for misclassifying employees.<sup>56</sup>

On the other hand, if the motor carrier is able to establish a *prima facie* case for relief under Section 530, the burden shifts to the government to show

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51. *Id.*

52. 33A AM. JUR. 2D *Federal Taxation* § 9167 (2008).

53. *Id.*

54. *Id.* (emphasis added).

55. *Id.* (emphasis added).

56. *Id.*

that the motor carrier is not entitled to relief.<sup>57</sup> If the government fails to meet its burden, the motor carrier will be entitled to relief under Section 530 and will be exempted from owing back taxes for misclassifying the “independent contractor” as an “employee.”<sup>58</sup> In either situation, whether the motor carrier utilizes the CSP provisions or prevails under a Section 530 defense, the motor carrier will at least have some relief against the assessment of significant fines and back taxes.

#### IV. THROWING OUT A LIFE LINE TO “EMPLOYEES”: THE PURPOSE OF OBAMA’S CLASSIFICATION ACT

The purposes of Section 530 and the Classification Act are aimed in two completely different directions. Section 530 provides relief to employers facing significant tax assessments for misclassifying, in good faith, employees as independent contractors.<sup>59</sup> The Classification Act, if enacted, would provide relief to workers who have been labeled independent contractors and want to seek the benefits of employee status.<sup>60</sup> Assuming the full text of the bill is passed, the Classification Act would seriously weaken the protections afforded to employers and thus, the “motor carrier employer” under Section 530.

As an initial matter, it should be noted that the Classification Act does not eliminate Section 530, but *would* subject motor carriers to a host of challenges.<sup>61</sup> First, the Classification Act allows “any individual who performs services for a taxpayer” to file a petition against the taxpayer (or employer) for the taxpayer’s reliance on Section 530 in classifying the individual as an independent contractor.<sup>62</sup> Upon the filing of a petition, the Secretary of Treasury would determine, based on a set of procedures

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57. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, at 1766 (appearing in notes to 26 U.S.C.A. § 3401 (2005)). For authority holding the employer to a different standard, see *Boles Trucking, Inc. v. United States*, 77 F.3d 236 (8th Cir. 1996) and *Dains v. United States*, 149 F.3d 1182, 1998 WL 385470, at \*7-8 (6th Cir. 1998) (unpublished opinion). In *Boles Trucking, Inc.*, the court found that,

Under the clear text of the statute, ‘reasonable basis’ is what must be proved by the taxpayer—it is not an expression regarding the level of proof or quantum of evidence. Congress’s silence as to an altered burden must be taken as meaning the traditional burdens apply, i.e., a taxpayer’s reasonable basis must be proved by a preponderance of evidence.

77 F.3d at 240 (emphasis in original).

58. *Crew One Prod., Inc. v. Tenn.*, 149 S.W.3d 89 (Tenn. Ct. App. 2004).

59. *Nu-Look Design, Inc. v. Comm’n of Internal Revenue*, 356 F.3d 290, 292 (3rd Cir. 2004).

60. Joseph Z. Fleming, *Airline and Railroad Labor and Employment Law*, SN008 A.L.I. - A.B.A. 1073, 1081 (2007).

61. Classification Act, *supra* note 1, at § 3(f)(1).

62. *Id.* Taxpayer in this context is the employer.

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“established by the Secretary of Treasury,” whether the motor carrier had misclassified the individual as an employee.<sup>63</sup>

If the Secretary of Treasury determines that the motor carrier has misclassified the individual, the Secretary of Treasury may “award expenses, including expert witness fees and reasonable attorney’s fees” and “such expenses against the taxpayer [motor carrier]. . . on behalf of such individual.”<sup>64</sup> Moreover, the Classification Act mandates that upon the finding of a misclassification, that the Secretary of Treasury:

- (1) if necessary, perform an employment tax audit of such taxpayer;
- (2) inform the Department of Labor about such misclassification;
- (3) notify the individual of any eligibility for the refund of self-employment taxes under chapter 2 of the Internal Revenue Code of 1986; and
- (4) apply the provisions of [26 U.S.C. 3509, “Determination of employer’s liability for certain employment taxes”] and direct the taxpayer to take affirmative action to abate the violation.<sup>65</sup>

In essence, the Classification Act would subject the motor carrier to an administrative action by *any* individual who may have performed business for the motor carrier. The administrative action would be on a set of procedures promulgated by the government in its own tribunal and upon a finding of misclassification, subject the motor carrier not only to attorney fees and fines, but also, the full amount of federal taxes owed to the IRS. However, the Classification Act does not end there. In confronting an individual’s challenge, the Classification Act eliminates the motor carrier’s ability to rely on a long-standing industry practice for the basis of claiming the protections under Section 530.<sup>66</sup> As such, a motor carrier’s ability to show a reasonable basis for classifying an individual as an independent contractor will be limited to reliance on judicial precedent and technical advice or a prior IRS tax audit under the first and second prongs of Section 530.<sup>67</sup>

The Classification Act also imposes administrative requirements on motor carriers. First, motor carriers will be required to notify individuals hired as independent contractors that their status as an independent contractor deprives them of certain labor and employment benefits.<sup>68</sup> The motor carrier must also

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63. *Id.* (emphasis added).

64. *Id.*; GovTrack.us., *supra* note 5.

65. Classification Act, *supra* note 1, at § 3(g)(1)-(4).

66. *Id.* at § 2(b)(2).

67. Revenue Act of 1978, Pub. L. No. 95-600, § 530(a)(2)(A)-(B), 92 Stat. 2763, 2885 (1978) (codified as amended at 26 U.S.C. §§ 3401, 3101 (2008)).

68. Classification Act, *supra* note 1, at § 5(b). The employers will not be responsible for developing the information to provide notice to independent contractors. Rather, “Secretary of the Treasury and the Secretary of Labor shall develop model materials for providing such notice.” *Id.*

notify these individuals of the federal tax obligations as an independent contractor and that if the individual wants to challenge their status as an independent contractor, they have a right to do so.<sup>69</sup> If the independent contractor does challenge his or her classification, the motor carrier is not permitted to take any action against the independent contractor which could be viewed as retaliation.<sup>70</sup> Rather, the motor carrier must assist in the challenge by maintaining records of all “independent contractors retained by the [motor carrier], including [the] name, address, Social Security number and Federal tax identification number” for a minimum of three years.<sup>71</sup>

Finally, the Classification Act would authorize the IRS to issue “regulations and revenue rulings”<sup>72</sup> that are currently prohibited under Section 530 and otherwise disseminate information about the impact of misclassified individuals between the government branches.<sup>73</sup> By allowing the IRS to issue regulations and revenue rulings, the Classification Act will enable the IRS to establish a body of precedent that, while beneficial to clarify disputes surrounding employee versus independent contractor disputes, could be potentially geared toward the IRS’s goals in collecting taxes.<sup>74</sup> To the motor

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69. *Id.*

70. *Id.* at § 3(f)(3)(A).

No taxpayer may discharge an individual, refuse to contract with an individual, or otherwise discriminate against an individual with respect to compensation, terms, conditions, or privileges of the services provided by the individual because the individual (or any designated representative or attorney on behalf of such individual) filed a petition [challenging the individual's tax classification].

71. *Id.* at § 5(c).

72. *Id.* at § 2(b).

73. *Id.* at § 4. The Secretary of the Treasury and the Department of Labor will be required to issue annual reports on the impact of misclassifications, including,

- (1) information on the number and type of enforcement actions against, and audits of, employers who have misclassified workers,
- (2) relief obtained as a result of such actions against, and audits of, employers who have misclassified workers,
- (3) an overall estimate of the number of employers misclassifying workers, the number of workers affected, and the industries involved,
- (4) the impact of such misclassification on the Federal tax system, and
- (5) the aggregate number of worker misclassification cases with respect to which each Secretary has provided information to the other Secretary and the outcome of actions taken, if any, by each Secretary in each worker misclassification case with respect to which the Secretary has received such information.

*Id.* These reports will be shared between the departments and used to bring enforcement actions against “industries in which worker misclassification is present.” *Id.* at § 4(b)(1)(A), (B).

74. Senator Obama reports that “[a] 2006 study of misclassified employees in Illinois found \$53.7 million loss of unemployment insurance taxes and a \$149 million to \$250 million loss of income tax.” Obama, *supra* note 20. Looking at these bare figures, the IRS’s incentive to promulgate rulings that

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carrier industry, the Classification Act could have a devastating impact because the area of employment classification would essentially become a highly regulated area. Reports issued by the Secretary of the Treasury may portray motor carrier companies as “out to get the little people” when in effect, such companies consist of hardworking owner-operators that the Classification Act is purporting to protect.<sup>75</sup>

**V. THE CURRENT STATUS OF THE CLASSIFICATION ACT**

Fortunately, the Classification Act is early in the legislative process.<sup>76</sup> The Classification Act must still be debated before the Senate Finance Committee, passed by the House of Representatives and Senate, and signed by the President before becoming law.<sup>77</sup> The likelihood of the Classification Act becoming law is slight, as “[s]uch laws . . . are not designed to achieve a cohesive frame-work for resolving labor and employment problems. Rather, they are intended to respond to, and protect, interested groups – including legislators who need to respond to their constituencies.”<sup>78</sup> This statement is particularly true in light of Senator Obama’s competitive Presidential campaign. Just seven days after the Classification Act’s introduction, an article written in the Chicago-Sun Times praised the introduction of the bill, stating “Chicago workers and ethical employers should be thanking Barack Obama and Dick Durbin for their introduction of the Independent Contractor Proper Classification Act of 2007.”<sup>79</sup> The article challenges, at least implicitly, the protections afforded to employers under Section 530.<sup>80</sup> According to the author, Section 530 allows employer’s to “avoid payroll taxes

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favor tax collection – without regard to the employer’s reliance on the independent contractor, owner-operator market, is readily apparent.

75. Classification Act, *supra* note 1, at § 4.

76. GovTrack.us., *supra* note 5. The Classification Act was introduced by Senators Obama, Durbin, Kennedy, and Murray on September 12, 2007. Classification Act, *supra* note 1. “Introduced bills go first to committees that deliberate, investigate, and revise them before they go to general debate.” GovTrack.us., *supra* note 5. In this case, the Classification Act has been assigned to the Senate Finance Committee. *Id.* “The majority of bills never make it out of committee.” *Id.*

77. “Introduced bills go first to committees that deliberate, investigate, and revise them before they go to general debate.” GovTrack.us., *supra* note 5. In this case, the Classification Act has been assigned to the Senate Finance Committee. *Id.* Even assuming the Senate Finance Committee sends the Classification Act to the House of Representatives, the bill “may undergo significant changes in markup session.” *Id.* Employers (and their counsel) should also “[k]eep in mind that sometimes the text of one bill is incorporated into another bill,” and therefore may not have been abandoned, despite the fact that the original bill was not further pursued. *Id.*

78. Fleming, *supra* note 59, at 1081.

79. Kim Bobo, *Workers Need Protection*, CHICAGO SUN-TIMES, Sept. 19, 2007, at 38. Senator Obama’s bill has gained support from AFL-CIO, Change to Win, the National Employment Project, and “business associations representing the interests of more than 200,000 construction employees.” Obama, *supra* note 20

80. Bobo, *supra* note 78.

and workers compensation,” “steal benefits and protections from workers,” and “steal taxes from the public that could go to schools or mass transit.”<sup>81</sup> Without knowing the current status of the law, a large majority of the working population could be moved to side with Senator Obama, and perhaps not only for his proposal of his Classification Act, but for other protections he may provide as our county’s potential President.

The current status of the law however, is far from allowing employers to merely skip down the halls of the IRS and classify their employees as independent contractors as they please. As discussed above, Section 530 has a complex three part test that employers must pass before they may rely on the safe harbor provisions of Section 530. Moreover, the purpose in passing Section 530 was not to provide a loop-hole for “employers” to avoid payroll taxes or steal benefits from employees, but rather to “alleviate what was perceived as overly zealous pursuit and assessment of taxes and penalties against employers who had, in good faith, misclassified their employees as independent contractors.”<sup>82</sup>

While it is unfortunate that some employers may abuse Section 530 to escape their tax obligations, the purpose and design of Section 530 is far from promoting or fostering tax evasion. Also, employees and the public must not forget that harsh consequences befall employers for their willful attempt to evade taxes,<sup>83</sup> and that the provisions of Section 530 only allow employer’s to seek relief for back FICA and FUTA taxes.<sup>84</sup> The employers must either seek relief elsewhere, or pay over any back state and federal income taxes owed as a result of misclassification.

Viewing Section 530 in conjunction with the entire federal and state tax framework reveals that the current status of the law offers a great deal of protection to businesses, particularly in the motor carrier-independent contractor market, and should be maintained rather than eliminated. And while authorities view the proposal of the Classification Act as an attempt to rally political support for Senator Obama’s constituency at this point, it is nonetheless a serious affront to Section 530’s provisions and motor carriers and their counsel should keep a watchful eye out as it progress through the legislative process.

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81. *Id.*

82. Ahmed, 147 F.3d at 796.

83. *See, e.g.*, 26 U.S.C. § 3509(a) (2008).

84. Present Law for Federal Tax Purposes, *supra* note 25.