

## Misclassified Workers

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In December 2007 the IRS released [Form 8919](#). Beginning in tax year 2007, employees who believe that they have been misclassified as independent contractors by an employer may file Form 8919 with their individual Form 1040. The Form 8919 will include the name of the employer (or employers) for whom services were provided. Tax and human resources professionals expect the IRS will match misclassified employees with the offending employers.

Misclassified workers have been a point of emphasis for the IRS for most of this century. The IRS is concerned that employers are avoiding their employment tax obligations by classifying employees as independent contractors. Many states are also beginning to examine independent contractor relationships. Illinois and Massachusetts have taken action in 2008 to crack down on Independent Contractor abuse.

Although corporate flight department managers who compensate supplemental workers as independent contractors may feel there is a reasonable basis for this practice and justify this as a long-standing recognized practice of a significant segment of the industry, many employers do not realize the ramifications, at both the state and federal level, of misclassifying employees as independent contractors.

Determining what constitutes an independent contractor can be difficult to determine. According to the IRS, anyone who performs services for you is your employee if you have the right to control what will be done. This is so even when you give the employee freedom of action. If you have an employer-employee relationship, it makes no difference how it is labeled. The substance of the relationship, not the label, governs the worker's status. Moreover, you may have to classify a worker as an employee if you have treated any worker holding a substantially similar position as an employee.

Another test, known affectionately as the "ABC Test" and used by many states, requires employers to treat workers as employees **unless each of three** tests are passed:

- A. The worker is *free from control or direction* in the performance of the work under the contract of service and in fact;
- B. The service is performed either outside the usual course of the business for which it is performed, or

The service is performed outside of all places of business of the enterprise for which it is performed; and

- C. The individual is customarily engaged in an independent trade, occupation, profession or business.

When applying these tests to the work performed by supplemental pilots, flight attendants, technicians, and schedulers, the right of the company to control the workers and the components of B above can be a high hurdle. Supplemental pilots, flight attendants, technicians, and schedulers services usually work in the usual course of the business for which the service is performed, and their services *are* performed within the place of business (considering the aircraft as a place of business). Moreover, the company typically has the right to control what will be done by the workers.

Proper classification of employees/independent contractors is important. A company that misclassifies its employees faces exposure on several avenues:

**Tax Penalties:** In December 2007, the IRS assessed FedEx with \$319 Million in fines and penalties for misclassifying its drivers as independent contractors. And that's only for 2002. (FedEx is appealing).

**Litigation:** Misclassified workers often sue their former employers seeking damages for unpaid overtime and benefits.

**Worker's Compensation:** A supplemental worker, who is compensated as an independent contractor and suffers injury or death on the job, may make a legal claim against the service recipient for lost wages, medical expenses, or long-term bodily injury or death benefits, or claim the worker is entitled to Workers' Compensation because the worker is in actuality an employee misclassified as an independent contractor.

**Unemployment Insurance:** An employer may face fines and penalties for failure to pay state unemployment taxes for misclassified employees.

### **How Do I Figure This Out?**

Independent contractors play an important role in our industry and economy, and their use has a place. Employers, however, need to understand the difference between an employee and an independent contractor, and make conscious choices regarding how to classify workers.

- Consider the IRS has no relief provision if you or your predecessor has treated any worker holding a substantially similar position as an employee for any periods beginning after 1977. (IRS Section 530)
- Review your states ABC test.
- Review IRS Publications 15 and 15-A Who Are Employees? Employee or Independent Contractor?
- Consider your supplemental worker/s may file the new IRS Form 8919 and Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding. Consider it likely the IRS will seek to recover the offending employer's share of employment tax for this worker and any other similar worker/s.
- Consult with your legal and tax advisors.

### **Resources**

- [IRS Form 8919: Uncollected Social Security and Medicare Tax on Wages](#)
- [IRS Publication 15: Employer's Tax Guide](#)
- [IRS Publication 15-A: Employer's Supplemental Tax Guide](#)