

# COMPANION TO "PEACE"

*A Guide to Consulting APA's Standard  
Text on Independent Contractor Doctrine  
in Logging and Wood Supply:*

*How To Stay At Peace With Your Government*



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## COMPANION TO "PEACE"

What is the purpose of this booklet?

To guide the reader into APA's more exhaustive treatise on "independent contractor doctrine," How To Stay At Peace With Your Government (271 pages).

Is the Companion a condensation of the big book?

No. It only indexes the main points in "Peace," in order to help the reader find where the detailed discussion and information lie.

What is "independent contractor doctrine"?

Independent contractor doctrine is the body of law which defines what independent contractors are and what their legal rights and responsibilities are. The doctrine is crucial in distinguishing "employees" from "independent contractors" in many legal and business situations.

Why is the subject so important in the forest products business?

Over 95% of all timber harvesting in the United States is performed by independent contractors, and numerous configurations of contracting, subcontracting, and employment are common in the wood supply chain. In order to ensure that both employees and independent contractors enjoy the full rights accorded them under the law, it is important that all parties to harvesting and wood supply contracts understand the law and how it affects them.

What is at stake?

- For employed forest workers: the protections of the Fair Labor Standards Act and OSHA, various federal and state entitlements due employees, and the right to Workers' Compensation insurance coverage.

- For logging contractors: protection from the severe financial penalties associated with misclassifying workers from the IRS, Department of Labor, or a state agency, as well as protection from possible liability as a result of a civil lawsuit.
- For wood procurement people: their company's liability for acts by contractors whose independence is questionable.
- For the whole industry: nurturing fairness and professionalism throughout the wood supply chain by promoting an environment in which rights are recognized and responsibilities complied with.

How to Use this Companion

This brief publication glosses the sections of How To Stay At Peace With Your Government which discuss the criteria and application of independent contractor status determination situations. Each point is flagged with a number or range of numbers in square brackets [ ], indicating the page or pages in Peace in which a fuller discussion may be found.

We strongly recommend obtaining and studying a copy of Peace to deepen your acquaintance with this difficult and often confusing area of business law. An order form for Peace is printed on the inside back cover of this booklet.

Introduction

Federal and state governments administer and enforce various laws relating to employers and employees. An employer has the responsibility for complying with these laws. Sometimes there is confusion about who is an employer, who is an employee, and who is an independent contractor. How To Stay At Peace With Your Government examines these laws, as well as the criteria used to determine whether an independent contractor relationship exists or an employer-employee relationship exists under them [3].

Since different laws arose for various purposes, criteria for establishing independence or employment also vary. Peace comments, "It is possible, legal, and in some cases perfectly acceptable to consider an individual an employee under one statute and an independent contractor under another [198]." The question of status determination is really two-fold: Who is the employer? Under which law [3]?

Although these sets of independent contractor criteria vary, each is designed to establish whether the parties are truly and significantly independent of one another.

Common Law Tests

The oldest, and still the most common, set of criteria for establishing independence is the "common law tests," which are derived from an examination of centuries of case law in England and the United States. They govern status determinations under the federal Internal Revenue Service (Social Security and federal Unemployment Compensation taxes, as well as federal income tax) [5-88], the National Labor Relations Act (governing union certification) [89-119], the various statutes enforced by the Equal Employment Opportunity Commission defining and outlawing various forms of employment discrimination [173-174], and a few state-level Unemployment Compensation laws [199]. The common law tests are also used to determine status under state and federal tort law to settle third-party lawsuits (personal injury or property damage, for example) [261-271].

Other tests, discussed later, are used for status determinations under the Fair Labor Standards Act (governing federal minimum wage laws, overtime, and employment of minors) [121-145], federal and state Occupational Safety and Health Acts [147-159], the federal Migrant and Seasonal Worker Protection Act [161-167], most state Unemployment Compensation laws [195-200], and state laws governing Workers' Compensation insurance [179-194].

Given their broad application, it is unfortunate that the common law tests are not easy to apply. The largest and most detailed section of Peace is devoted to clarifying them [11-79].

The IRS "Twenty Tests"

The common law tests are a set of twenty criteria which the IRS identified following an extensive review of court decisions on independent contractor determination. These twenty criteria are all indicators of whether a relationship is truly independent or whether hidden or overt control factors exist, indicating an employment relationship. Affirmative answers to any of these test questions are held to be indicators of employment [24-25]:

- 1) Integration - Provide services that are integrated into the other party's business? [26-27]
- 2) Employer's Premises - Do their work on the other party's premises? [27-28]
- 3) Continuing Relationship - Have a continuing working relationship with the other party? [28-30]
- 4) General Public - Do not offer services to the general public? [30-31]
- 5) Opportunity for Profit or Loss - Cannot make a profit or suffer a loss? [32-34]
- 6) Significant Investment - Lack a major investment in facilities used to perform the service? [34-37]
- 7) Furnish Tools or Materials - Rely on the other party to furnish the tools or materials? [37-39]
- 8) Pay Business or Travel Expenses - Receive payments for business or travel expenses? [39-41]
- 9) Pay by Unit - Receive payment of regular amounts at set intervals? [41-42]
- 10) Set Hours - Must follow set hours of work? [42-43]
- 11) Full Time Required - Work full time for the other party? [43-44]
- 12) More Than One Firm at a Time - Work for one party at a time? [44-45]
- 13) Personal Service Required - Provide services that must be rendered personally? [45-47]
- 14) Instructions - Must comply with the other party's instructions about the work? [47-49]
- 15) Training - Receive training from or at the direction of the other party? [49]
- 16) Oral or Written Reports - Must submit regular reports to the other party? [49-51]
- 17) Order or Sequence Set - Must do the work in a sequence set by the other party? [51-52]
- 18) Right to Discharge - Can be fired by the other party? [52-53]

- 19) Right to Terminate - May quit work at any time without incurring liability? [53-54]
- 20) Hire, Fire, Pay, and Supervise Others - Hire, supervise, and pay assistants for the other party? [54-55]

Although these twenty test factors were developed internally by the IRS--a federal agency--and do not have the authority of written law, they are a widely accepted interpretation of "unwritten" common law, and judges refer to them frequently in drafting legal opinions, whether in cases involving the IRS or in other situations in which the common law holds sway.

Peace defines each of these tests at length [26-56]. However, it is necessary to stress that gauging the weight or validity of any single one of these tests, or any set number of them, is an exercise grounded in uncertainties. Legal determinations are not simply made because parties to a contract "pass" a majority of these tests. Rather, based on the particular situation under dispute, a judge is likely to weigh some tests more heavily than others and look for strong, rather than borderline, evidence that the relationship passes those tests. Determinations under the common law are rarely based on "technicalities" but on a highly subjective weighing of evidence [20-22].

APA's observation is that the IRS itself tends to place most weight on tests (1) through (5), above, in pursuing legal challenges to independent status [31]. Peace examines published IRS documents and federal court decisions which contribute valuable sidelights on how evidence for and against independence is weighed with respect to the wood supply sector [67-78].

#### Other Indicators

Apart from these twenty tests, APA has identified another eleven indicators which we feel can be introduced as evidence of the degree of independence under the common law [56-63]. We should stress, however, that the IRS--in some cases, explicitly--

does not admit their relevance. These indicators are (a "Yes" answer denotes independence):

- 1) Custom, Longstanding Tradition - Is the relationship customary and of longstanding tradition in the community, area, region? [57-58]
- 2) Price Negotiation - Are prices actively negotiated between the parties? [58]
- 3) Initiative, Judgment, Foresight - Are managerial skills and knowledge required to fulfill the contract requirements successfully? [58-59]
- 4) Written Contract Clauses - Does a written contract accurately spell out the relationship and the obligation of both parties? [59]
- 5) Compliance - Is there evidence of the contractor's compliance with laws and regulations affecting employment of others? [60]
- 6) Accounting Services - Does the contractor use the services of an accountant or bookkeeper in order to comply with employment taxes, insurance, and other business responsibilities? [60]
- 7) Business Structure - Is the contractor's form of business--sole proprietor, partnership, or corporation--indicative of independence? [60-61]
- 8) Tax Reporting - Does the contractor report and pay employment taxes as a business should? [61]
- 9) Labels - Are the terms used by all parties to describe individuals and contract responsibilities appropriate for an independent contractor relationship? [61-62]
- 10) Attitudes - Are the intent and personal opinions of the parties demonstrative of independence? [62]
- 11) Switching - Switching employees to independent status or switching from using an employee to using a contractor to perform the same duties may give the appearance of a "sham" to avoid some of the costs of employment. [62]

The IRS may start off its audit procedure by asking the individual under audit to respond to a set of questions about his or her business--either orally or through a printed questionnaire. Never respond to such questions, orally or in writing, without the assistance of a knowledgeable attorney or tax accountant [63, 80]. And never allow an IRS agent to search through your files for any reason; insist that the agent state exactly what records he or she is seeking, and provide those records and only those records [80]. Peace [80-82] outlines what an IRS employment tax audit is like, as well as the rights of the individual under audit at each stage.

#### Section 530

Since 1978, individuals under employment tax audit by the IRS have had an alternate recourse to the expensive and risky procedure of defending employment status under the common law. This recourse is a legislated "safe harbor," known as Section 530 of the 1978 tax bill. If properly invoked, this safe harbor protects the individual under audit from reclassification, if the independent contractor relationship in question meets all three criteria [14-20]. These criteria are:

- 1) Reasonable Basis - Is the relationship a prevailing industry practice in the region [15-16]?;
- 2) Consistency and Similarity - If there has been any "switching" of employees to independent contractors, or if the individual under audit treats independent contractors and acknowledged employees similarly, the "safe harbor" is unavailable [18];
- 3) Filing Federal Returns - The filing of federal tax returns, including information returns (Form 1099), must be consistent with the claim of independent status [18-19].

Section 530 has been very helpful in reducing unjustified IRS reclassification actions at our industry's expense. Three points should be made, however. First, the IRS agent in all likelihood will not inform you of the existence of this safe harbor; you and your advisor must raise the option. Second, Congress may repeal or modify Section 530 at any time--so it is a good idea, in the long run, to ensure that all independent contract relationships are justified under the common law. Third, Section 530 applies only to IRS employment tax audits--not to income tax or tort law liabilities, not to actions under the National Labor Relations Act, nor to any other of the areas or jurisdictions, other than federal employment taxes, in which the common law applies [20].

Peace also examines several federal income tax questions relevant to logging: the status of "leased employees" [82-83], deductibility of chain saw expense [83-84], deductibility of loggers' travel expense between home and the cutting site [84-85], deductibility of business use vs. personal use of vehicles [85-87], and deductibility of WCI premiums paid by sole proprietors and partners on their own earnings [87].

#### Price Pressure Organizations

Occasionally groups of logging contractors have banded together in hopes of collectively bargaining for a price increase or for other changes in the contract relationship. Because such campaigns are illegal (with severe criminal and civil penalties under antitrust law), contractors must obtain labor union recognition to proceed legally; to do that, they must prove they are employees of one or more of their customers--at least for the purposes of the National Labor Relations Act. This Act is administered by the National Labor Relations Board, which certifies labor unions [89-93]. If certified as a labor union, a group may undertake several activities which are otherwise illegal under antitrust law: negotiate collectively over price ("wages") and organize "strikes" [89].

NLRA certification is based on the common law, and the determination is made on a fast track, with a much narrower opportunity to assemble evidence and prove a case than in IRS or tort law jurisdictions, and the law provides relatively limited opportunities for appealing decisions through the courts [92-93]. Peace reviews several serious attempts by contractors to form price pressure organizations (mostly during the period 1950-1980), together with language from the respective NLRB decisions [94-115]. Peace discusses one unusual attempt in some detail, that of the United Woodcutters Association (dating from 1979 in Mississippi), which featured a broad-issue self-help campaign, a church-oriented support group, and United Farm Workers-style organizational tactics [115-118].

Peace also notes a few attempts to use the antitrust exemptions for "agricultural co-operatives," outlined in the Capper-Volstead Act, as a basis for forming a price-bargaining organization, as an alternative to labor union certification [111-114]. Although the legal basis for defining loggers as "agricultural producers" in this context is very slim, and has never survived a court challenge, a U.S. District Court opinion in a 1977 Michigan case shows that the doctrine has some legal support [113-114]. However, the opportunities for collective action under an agricultural cooperative, as defined by Capper-Volstead, are much more limited than those available to employees bargaining as union members [112].

APA feels that price-pressure organizations tend to arise because of general poor communications and poor relationships between wood purchasers and wood suppliers. A purchaser who is attentive to suppliers' legitimate concerns and communicates expectations clearly can minimize the conditions that lead to such actions [118-119].

### The Doctrine of "Economic Reality"

Following the 1938 passage of the federal Fair Labor Standards Act, which requires payment of the federal minimum wage [121-124] and overtime [124-129] and prohibits child labor if interstate commerce is involved or affected [129-130], federal courts accepted a new, somewhat broader set of status determination criteria for the purposes of the Act: the so-called "economic reality" doctrine. In the 1970s, the federal Occupational Safety and Health Administration, also administered under the U.S. Department of Labor, adopted similar criteria [149-151]. Correctly defining an "employee" is a key issue in both FLSA and OSHA enforcement.

This "economic reality" doctrine downplays somewhat the criterion of "control"--crucial to "common law" determinations--but stresses the "dependence" of the employee on the employer. In the view of this doctrine, an employee is one who as matter of economic reality is dependent on the business which he or she serves. Many of the "common law" tests also indicate employment under the economic reality doctrine, but the weighting and interpretation reflect the differences in the doctrine. The notable departure from the "common law" is the presumption that the source of the money leads to the true "employer"; "deep pockets" tend to be implicated [131]. Peace reviews Department of Labor notices, as well as a court decision, to shed further light on how determinations are made [132-134].

Violations of wage-hour laws and child labor laws under FLSA call for severe penalties [131], so it is important for logging employers to understand and comply with the Act's provisions and for purchasers to evaluate the likelihood of their being named as employers of their wood suppliers (and of employees or subcontractors of these suppliers). The Act defines what "working hours" are [122], what a "work week" is [122], and what records should be kept [123-124]. Peace discusses common misunderstandings in our industry surrounding the payment of

overtime in some detail, including the "eight-man exemption" [126-127, 137-139] and the application of overtime laws to piece-rate payment [127-129, 136-137]. Since 1941, logging has been defined as a "hazardous occupation" under FLSA, and the Act's child-labor provisions prohibit employment of anyone under 18 years of age in almost all logging tasks [129-130].

Peace provides a detailed chronological summary of the development of FLSA policy and APA actions affecting it since 1938 [140-141] and describes the proper use of "written assurance" notices to protect innocent purchasers in the event of FLSA violations by suppliers [139].

#### Migrant and Seasonal Worker Protection Act

Regulations published in 1988 extended the jurisdiction of the Migrant and Seasonal Worker Protection Act to "forestry activities," although this term is understood not to cover "harvesting." [161] MSPA's detailed regulations and paperwork requirements are designed to prevent abuse of itinerant agricultural workers by crew leaders and contractors [161-167]. Its employment status criterion is the doctrine of "economic reality," as used in the Fair Labor Standards Act [164].

#### Status Determinations Under OSHA

The federal Occupational Safety and Health Act of 1971 calls for employers to provide "safe and healthful working conditions" for employees and empowers the Occupational Safety and Health Administration to enforce compliance. Peace summarizes basic employer responsibilities [147-148]. Obviously, for proper enforcement, questions of employee status must be resolved.

Generally, status determinations under OSHA are made through the "economic reality" doctrine, and the OSH Review Commission has stated seven tests which it feels determine status [149]. Court decisions resulting from appeals from the Review Commission's decisions also reinforce the "economic reality" doctrine as holding

sway. However, a 1984 Appeals Court decision explicitly placed emphasis on defining as the employer whoever provides the workplace at which work occurs, and OSHA in Maine has apparently attempted to use this decision to hold forest landowners accountable for OSHA violations by independent contractors on their land [150-151].

In the logging industry, employment status questions under OSHA have so far arisen only in Maine, where enforcement personnel, apparently unilaterally, have more than once adopted novel criteria for defining status [151-152], unjustified by OSH Review Commission precedent. Peace examines two Maine cases from 1987, in which the agency attempted to cite companies which had recently switched from employing woodcutters to contracting out logging operations for violations committed by those contractors [153-156]. Neither attempt was successful, although the agency did prevail in a third case, concerning an ill-advised switching maneuver [156].

Peace [157-159] examines issues bearing on reducing the risk of unwanted inferences of employment with respect to OSHA and whether landowner or purchaser personnel should assist OSHA in locating independent logging contractors for inspection.

#### The Equal Employment Opportunity Law

The Equal Employment Opportunity Commission, empowered under the Civil Rights Act to ensure that terms of employment are based on the employee's (or applicant's) ability and merit, rather than on illegal discrimination, currently holds jurisdiction only over employment relationships under the common law [173]. The Americans with Disabilities Act [173-174], administered under the EEOC, prohibits employers from discriminating against qualified applicants and employees on the basis of disability and provides that employers provide "reasonable accommodation" to employees or applicants with disabilities who are otherwise qualified. ADA only applies to employers with at least 15 employees, and in the

absence of a lengthy legal history, Peace presumes the common law definition of "employee" which governs other areas of EEOC enforcement applies [174].

#### State Workers' Compensation Laws

All fifty states have laws providing for a Workers' Compensation insurance program which requires (or virtually requires) logging employers to purchase insurance to provide no-fault compensation for employees' medical treatment and lost income as a result of injury or death through employment [179-180]. Since logging employees' risk of injury is acknowledged to be quite high, premiums to buy this insurance--calculated as a percentage of payroll--are a significant business expense for employers. In the forest products industry, we have strong financial incentives, not only to reduce accidents and injuries, but (1) to identify logging employers correctly and (2) to ensure that logging employers are maintaining WCI coverage for all employees. Correctly defining "employee" and correctly identifying the "employer" are central to avoiding third-party lawsuits following death of or injury to an uninsured forest worker [180].

Peace [179-194] reviews various problems and issues concerning all Workers' Compensation programs, and some issues specific to the logging industry, such as "vendors to" policies [185-187], in which premium is paid on volume of product produced rather than on payroll. The text also discusses the dilemma of the sole proprietor, who is not required to provide WCI coverage for himself by law, and in some states is not eligible to, yet must satisfy customers that they are insulated from liability for personal injuries he may incur [183-184].

Determinations of employment for Workers' Compensation purposes in most states are very inclusive, being defined by "contractor-under" statutes. The "contractor-under" rule imposes on the general contractor the ultimate liability (sometimes even the primary liability) for all uninsured subcontractors' employees and

for the subcontractors themselves. This rule emphasizes the "integration" test ("provide services that are integrated into the other party's business") from the common law [187]. Requiring proof of WCI coverage from suppliers and contractors is the best method of avoiding liability [188], although vigilance is still required to ensure that such certification reflects realities [204-207].

Workers' Compensation insurers, represented by the National Council on Compensation Insurance, use a set of sixteen questions, many of which are similar to the IRS's common law tests, when auditing insureds to determine whether full premium is being paid. These tests, however, are not relevant in court cases in which employment is at issue [188-189]. Courts and Workers' Compensation boards do their best to make sure that injured workers are covered by somebody's insurance.

In 1990, the state of Wisconsin adopted a nine-point "independent contractor" definition governing WCI status determinations, providing hefty penalties for any uninsured "employer" who defies a state order to shut down [193-194].

#### State Unemployment Compensation Laws

As noted above, federal unemployment tax is levied by the IRS on all employers who have employees as defined under the common law [5]. However, of the state revenue agencies which collect unemployment tax for state programs, only twelve (plus the District of Columbia) rely on the common law in making determinations [199]; the others use some variation on a more rigid set of tests, known as the "ABC test."

For the use of the ABC test, services performed by an individual are generally considered employment unless:

- A) Workers are free from control over performance;

used in Florida: a list of ten tests including several of the IRS's twenty tests along with some others [265-267].

- B) Service is outside the regular course or place of employer's business; and
- C) The worker is customarily in an independent business.

Peace reviews the "Sturdivant Case," in which a consuming mill was found liable for actions of a pulpwood truck driver, under verbal contract to a dealer, in a highway accident resulting in multiple fatalities [267-269]. Since the stakes for plaintiffs and their attorneys are very high in tort cases, and juries' judgments of whether employment status exists are easily clouded by emotion or prejudice, tort actions present very serious exposures for wood consumers. Peace examines several means of reducing such exposures, particularly with respect to highway accidents [269-271].

In most ABC test states, the relationship must meet all three tests, but there are a few exceptions, and in some states the wording of the tests varies from the above [195].

In Wisconsin, for example, the (B) test is dropped, but the (C) test is toughened up; Peace analyzes the Wisconsin test in detail, suggesting five possible paths for compliance [196-199].

Generally, the stakes for misclassification are lower for state unemployment taxes than they are for misclassification in other areas: payment of back taxes, without additional penalties. If an assessment is made, generally because of an individual's claim for unemployment benefits following dismissal, it pays to investigate the fact situation carefully before deciding whether to contest, since losing in court will almost certainly bring the employment status of additional individuals under scrutiny [199].

Personal Injury and Tort Cases

When an action for recovery of damages is launched in the form of a civil suit, determining who is liable to pay any damages awarded may rest on a determination of employment status. An "employer," with the legal right, and sometimes the implied responsibility, to "control" the actions of an "employee" under common law, may be liable, or jointly liable, for some actions of that employee. In both state and federal jurisdictions, the common law is used to determine whether such an employment relationship exists, although each state's common law, deriving from its own body of case law, may vary from others' [265]. Most states, however, use their own standard "restatement" of the common law to simplify determination of status. Peace presents the restatement