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Jack E. Karns

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CURRENT FEDERAL AND STATE CONFLICTS IN THE INDEPENDENT CONTRACTOR VERSUS EMPLOYEE CLASSIFICATION CONTROVERSY

JACK E. KARNS*

I. INTRODUCTION

With business entities attempting to restrict overhead costs and needing to be able to control the number of employees to those absolutely necessary, the issue of whether or not workers are classified as employees or independent contractors has evolved into a major conflict area between taxing authorities and the private sector. The reason for the conflict can be stated quite simply. If a worker is classified as an employee, the employer is required to withhold income, social security, and medicare taxes from the individual's paycheck and to pay these monies over to the government, typically through a monthly bank deposit.¹ On the other hand, if the individual is classified as an independent contractor, he or she is required to conduct a self-assessment of taxes. This is done using the IRS Schedule C for a sole proprietor or it is reflected on IRS Form 1120 or 1120S if the business entity is incorporated.² The independent contractor is then permitted to offset income by deducting business expenses that are "ordinary and necessary," which include wages and other compensation paid to workers.³ The typical employee cannot deduct these expenses

* Professor of Business Law, East Carolina University. LL.M. (Taxation), 1992, Georgetown University; J.D., 1981, Tulane University; M.P.A., M.S., 1974, B.A., 1973, Syracuse University.

1. Trust fund taxes, i.e., employment (Social Security and Medicare) taxes, are usually deposited at a bank in monthly payments. Social Security trust funds are referred to as 941 taxes while the Federal Unemployment Tax (FUTA) is referred to as 940 tax and is usually payable on a one-time basis at the end of each taxable year. Income taxes that are withheld from wages and compensation are not considered "trust fund" taxes and are generally sent via U.S. mail on a quarterly basis to various collection points around the United States.

2. The sole proprietor appends the Schedule C to his or her IFS Form 1040. A corporation that does not elect S status files a Form 1120 while a properly designated S corporation files the Form 1120S.

3. 26 U.S.C. § 162 (1994).

since they belong to the employer, the corporation, or sole proprietorship. Finally, the standard used by the Internal Revenue Service (hereinafter "IRS" or the "Service") may differ from that relied upon by state revenue departments or other federal and state labor and worker protection laws that are aimed primarily at employees and not independent contractors.⁴

For some time, the Internal Revenue Service primarily evaluated the worker classification issue by using what is now referred to as the "twenty common law factor test."⁵ The IRS evaluated any given employment situation with regard to these twenty factors and then by a preponderance of the evidence, rendered a decision that the individual worker was either an employee, or an independent contractor. This approach gave way in 1996 with the introduction by the IRS of its new three-part control test.⁶

Although some of the specific common law factors were explicitly included in the control based test, the emphasis in worker-classification cases now focuses on the issues of behavioral and financial control, as well as the relationship that exists between

4. See *infra* Part II: DEVELOPMENT OF THE CURRENT IRS VIEW, and Part IV: THE NORTH CAROLINA STATE EXPERIENCE.

5. The twenty common law factors for determining worker classification disputes as set forth in Internal Revenue Service Revenue Ruling 87-41 are:

- 1) Instruction,
- 2) Training,
- 3) Integration,
- 4) Services Rendered Personally,
- 5) Hiring, Supervising, and Paying Assistants,
- 6) Continuing Relationship,
- 7) Set Hours of Work,
- 8) Full Time Required,
- 9) Doing Work on Employer's Premises,
- 10) Order or Sequence Set,
- 11) Oral or Written Reports,
- 12) Payment by Hour, Week, Month,
- 13) Payment of Business and/or Traveling Expenses,
- 14) Furnishing of Tools and Materials,
- 15) Significant Investment,
- 16) Realization of Profit or Loss,
- 17) Working for More than One Company,
- 18) Making Services Available to General Public,
- 19) Right to Discharge, and
- 20) Right to Terminate.

6. See *infra* Part II: DEVELOPMENT OF THE CURRENT IRS VIEW.

the business entity and the worker.⁷ In addition, the Small Business Job Protection Act of 1996 (SBJPA)⁸ revitalized the safe harbor allowances of Section 530, which made its first appearance in this controversy as part of the Revenue Act of 1978.⁹ All of this movement by both Congress and the Service was intended to force a more realistic view as to the manner in which employer-worker relationships are manifested in today's workplace.

Part II of this Article outlines the development of the federal IRS worker classification status and attendant issues. Part III introduces some initiatives taken by the IRS in an effort to settle cases with taxpayers. Part IV discusses the federal criminal sanctions that can be imposed on an individual or entity which fails to collect or pay over to the United States Treasury these employment trust fund taxes. In Part V, the status of worker classification in North Carolina is considered relative to cases filed primarily with the Employment Security Commission. Finally, in Part VI, some observations are offered regarding the disparity in worker classification matters at the state and federal level, and commensurately between revenue and regulatory agencies.¹⁰

7. Department of the Treasury, Internal Revenue Service, *Employee or Independent Contractor?*, Feb. 1996, (hereinafter referred to as "IRS Training Material").

8. 26 U.S.C. § 104 (Supp. II 1996).

9. See Commerce Clearinghouse, Standard Federal Tax Reports, Vol. 83, Issue No. 48, Issue No. 36 (Extra Issue), entitled Small Business Job Protection Bill of 1996 (H.R. 3448), Conference Report and Statement of the Managers as Released on August 1, 1996, dated August 3, 1996. (Hereinafter referred to as the "CCH Report"). CCH is a publication service that reviews and interprets new legislation.

10. Throughout this article, reference will be made to the training materials used by the IRS. The IRS promulgates training manuals that are continually updated in order to reflect changes in policy. These manuals are then reviewed by Congress, and further changes are made as needed. In this article, three different IRS training manuals are used. The first manual is a draft of the IRS training manuals dated February 1996. The second manual, a draft dated July 1996, is a revision of the February 1996 manual. The last manual (dated October 1996), which is referred to in the text as the "Classification Training Materials" (CTM), is a culmination of both the February 1996 and July 1996 manuals and the final revisions from Congress, and it reflects the final form of the IRS training materials.

II. DEVELOPMENT OF THE CURRENT IRS VIEW

Prior to the passage of the Small Business Job Protection Act of 1996,¹¹ the Internal Revenue Service, and most state revenue departments, used the "twenty common law factor test"¹² in deciding whether, for tax purposes, an individual was classified as an employee or an independent contractor. These common law factors, although important, have undergone some changes in light of current legislative action and the passage of several statutes, most particularly the Small Business Job Protection Act of 1996.

Section 530, as presented in the Small Business Job Protection Act of 1996, looked carefully at current IRS views relative to job classification issues, as set forth in current IRS training materials on the employee versus independent contractor issue.¹³ Although the current IRS position is set forth in its July 1996 training materials (Final Training Materials)¹⁴, the "twenty common law factor" test found in Revenue Ruling 87-41 was a mainstay of worker classification decisions¹⁵ in audit situations until 1996. With the control oriented changes to Section 530, Congress recognized that there was a growing dispute between the IRS and taxpayers regarding worker classification issues, most especially the application of Section 530 to small businesses.

Congress moved to make certain modifications and clarifications that effectively reversed positions that had been taken in the Final Training Guide by the IRS as it interpreted the Small Business Job Protection Act of 1996 in its ongoing worker classification programs.¹⁶ Most importantly, Congress reversed the decision by the IRS that a determination first had to be made under the "twenty factor common law" test that a worker was an employee, and only then could the applicability of the Section 530 safe harbor be considered.¹⁷

This was, without question, the most important change made to the Final Training Guide and was quickly disseminated to all IRS workers by former Commissioner Richardson. He admon-

11. 26 U.S.C. § 104 (Supp. II 1996).

12. *See supra* note 6.

13. Department of the Treasury, Internal Revenue Service Training Materials on Employee or Independent Contractor, Training 3320-102, July 1996.

14. *Id.*

15. *See supra* note 6 and accompanying text.

16. *See supra* note 14.

17. *See supra* note 10 at 23-26.

ished field examiners that either worker classification, independent contractor or employee, can be a valid and appropriate business choice. Further he stated that Congress had mandated that Section 530 be the beginning point of an examination as to whether or not a worker should be classified as an employee or an independent contractor.¹⁸ This effectively subordinated the twenty factor test to the safe harbor provisions of Section 530, as set forth in the 1996 Act. Section 530 is generally viewed as a safe harbor provision in that it permits a business to seek relief if it meets the requirements set forth within the Section. The Section provides that if the taxpayer has a reasonable basis for not treating workers as employees, then a proper foundation exists for independent contractor status.¹⁹

This reasonable basis can be established by several things: taxpayer reliance on a court case; a ruling issued to the taxpayer by the Internal Revenue Service; a previous audit where the employee-independent contractor status was addressed; a showing that a significant segment of the industry treated such workers as independent contractors and the taxpayer had simply done the same; or that the taxpayer had relied on some other reasonable basis.²⁰ If a reasonable basis does not exist for treating workers as independent contractors, Section 530 does not apply.²¹ This is true whether the business is now defunct, or still ongoing. In addition, if it can be shown that the taxpayer treated some workers as independent contractors and others as employees, yet they all did the same type of work, then Section 530 relief is not available.²² Most importantly, in order to establish reporting consistency Section 530 requires that IRS Form 1099 be filed for each worker unless that particular worker earned less than \$600 for the tax year in question.²³ If the IRS 1099 forms were not filed as required or if the taxpayer selectively filed IRS 1099 forms for some workers but not for others, Section 530 relief is not available.²⁴

18. *See supra* note 10 at 23.

19. *See supra* note 10 at 23-28.

20. Department of the Treasury, Internal Revenue Service, Publication 1976, Sept. 1996, Catalog Number #22927M.

21. *See supra* note 10 at 23-25.

22. *See supra* note 10 at 24-26.

23. *See supra* note 10 at 26.

24. *See supra* note 10 at 25-26.

Under current federal law, taxpayers must be provided with information that summarizes the requirements of Section 530 prior to the beginning of any worker classification examination or audit.²⁵ Typically, Publication 1976 (September 1996) is used for this purpose and is merely given to the taxpayer or appropriate agent. In the new IRS worker Classification Training Materials (CTM)²⁶ which were issued on October 30, 1996, the IRS recognized that a worker may fall under several categories with regard to tax withholding purposes.²⁷ The CTM emphasizes that control of the worker must be evaluated not only with regard to the results to be accomplished by the work, but also relative to the means and details by which the work is accomplished.²⁸

Perhaps more importantly, the CTM states the following regarding the previously recognized twenty factor test: "Over the years, the IRS and Social Security Administration compiled a list of 20 factors used in court decisions to determine the worker status."²⁹ Although these factors were eventually published in revenue ruling form, the twenty factor test is an analytical tool and not the legal test used in determining worker status. The legal test is whether there is a right to direct and control the means and details of the worker.³⁰

The common law factors are not the only ones that may be important. Every piece of information that helps determine the extent to which the business retains the right to control the worker is important. In addition, the relative importance and weight of the common law factors can vary significantly. Information important in helping determine worker status may change over time because business relationships change over time. As a result, some of the common law factors "are no longer [as] relevant as they once were."³¹

Subsequent provisions of the CTM suggest that several of the factors are of little or no importance relative to worker classification,³² while other factors, such as intent and whether or not worker benefits are provided, are of significant importance.³³ In

25. See *supra* note 10 at 26.

26. See *supra* note 11

27. See generally, IRS Training Materials.

28. CTM, at 2-3.

29. IRS Training Materials, Feb. 1996 at 1-3.

30. *Id.*

31. CTM at 2-2, 2-4.

32. IRS Training Materials at 1-31.

33. *Id.* at 2-22, 2-29 and 2-30.

the CTM, the IRS notes that the relevancy of the common law factors must give way to types of information that are most persuasive regarding the issue of control.³⁴ As previously mentioned, this evolved into a test that now focuses on evidence that supports three primary control issues: behavioral control, financial control, and the relationship of the business and the worker.³⁵

The first issue, behavioral control evidence, looks at how the worker receives instructions with regard to performing the work.³⁶ The following issues are considered: a) when to perform the work; b) where to perform the work; c) what tools or equipment to use; d) what workers to hire to assist with the work; e) where to purchase supplies; f) what routines must the worker use; g) what order or sequence must the worker follow; and h) must the worker obtain prior approval before taking action.³⁷ Obviously, the more detailed these instructions become, the more control there is, and the greater the likelihood that the IRS will or can assert that the evidence in this particular category militates toward concluding the individual is an employee and not an independent contractor. It should also be made clear that the CTM states that, even if a business imposes certain rules of instruction, but those same rules are also mandated by governmental agencies or industry governing bodies, those factors should be given little weight with regard to determining or classifying worker status.³⁸

The second issue, financial control evidence, looks at the ability of the employer to direct or control economic aspects of a particular worker's activities because "economic aspects of the relationship between the parties are frequently analyzed in determining worker status."³⁹ Financial control evidence includes: a) significant investment; b) non-reimbursed expenses; c) services available to the relevant market; d) method of payment; and e) opportunity for profit or loss.⁴⁰ The CTM emphasizes that the auditor focus on the economic relationship between the employer and worker.⁴¹ However, the question is not one of economic

34. *Id.* at 1-32.

35. *Id.* at 1-3.

36. *Id.* at 1-8.

37. *Id.*

38. CTM at 2-10, 1-11. *See also*, Rev. Rul. 76-226, 1976-1 C.B. 322.

39. *Id.* at 2-16.

40. IRS Training Materials at 1-16.

41. *Id.*

dependence or independence from the employer, since the worker's economic status is "inappropriate" for analyzing the worker classification issue.⁴²

Finally, the third prong of the control test focuses on the relationship between the business and the worker in accordance with CTM directives.⁴³ The key question here is: how does this relationship reflect the parties' intent with regard to the issue of control?⁴⁴ Actions such as written contracts or filing the IRS Forms W-4 and/or W-2 may be used by the IRS as evidence that there is an intent to create an employer-employee relationship.⁴⁵

The twenty factor test looked at whether or not the individual worker was involved in regular business activity, and yet the CTM states that "the mere fact that a service is desirable, necessary, or even essential to a business does not mean that the service provider is an employee."⁴⁶ In keeping with the policy that many workers must rely on part-time work in a variety of positions, the CTM states that the following factors from Revenue Ruling 87-41 are to be given less importance than they have been in the past: a) part-time versus full-time work; b) working for one business; c) established work hours; and d) whether the work is performed on business premises.⁴⁷

III. IRS SETTLEMENT INITIATIVES

Perhaps the most striking feature of the worker-classification issue in this decade has been the implementation of a number of initiatives to settle this controversy with individual taxpayers.⁴⁸ The Worker Classification Training initiative was an in-house effort by the Service to provide better training opportunities for employees to handle this issue.⁴⁹ A team of instructors held training sessions for nearly one thousand IRS employees around the

42. *Id.* at 2-16. See also, *Nationwide Mutual Worker Classification v. Dardin*, 503 U.S. 318 (1992).

43. IRS Training Materials at 1-24.

44. *Id.*

45. *Id.* at 1-26, 1-27.

46. CTM at 2-18.

47. Rev. Rul. 87-41, 1987-1 C.B. 296 (factors 8, 17, 7 and 9). See *supra* note 6.

48. J. David Mason, *Independent Contractor or Employee: The Continuing Controversy*, *Taxes: The Tax Magazine*, Feb. 1997, at 106.

49. *Id.*

country.⁵⁰ This program was begun in 1996 and was supplemented with new training materials.⁵¹

Another IRS initiative directed more at settling cases with taxpayers was the Classification Settlement Program initiative (CSP)⁵², also begun in 1996 in conjunction with aforementioned training sessions. The purpose of the CSP was to resolve worker classification controversies administratively by permitting a re-evaluation by both the IRS and the taxpayer, changing worker classifications when appropriate, and giving the taxpayer as much Section 530 safe harbor protection as possible.⁵³ More simply, the Service initiative was intended to forgive incorrect classifications whenever possible in order to achieve a higher level of correct classification compliance.

Finally, the IRS also implemented a third initiative aimed at the early referral of employment tax issues. Procedures were provided in IRS Announcement 96-13⁵⁴ to resolve employment tax issues concurrently through the appeals process and the Office of the District Director.⁵⁵ Although not available to all taxpayers, this program has been successful in drawing out an appreciable number of taxpayers interested in reaching an accord with the IRS.

IV. FEDERAL CRIMINAL CHARGES IN EMPLOYMENT TAX CASES

Section 7202 of the Internal Revenue Code (IRC)⁵⁶ essentially provides that any individual who is required to “collect, account for, and pay over any tax imposed by this title” and who fails to do so is guilty of a felony punishable by a fine of not more than ten thousand dollars or a term of imprisonment of not more than five years, or both.⁵⁷ Prosecutions under this statute were very lim-

50. *Id.*

51. *Id.*

52. *Id.* at 107; see also, *WORKER CLASSIFICATION: IRS Continues Classification Settlement Program Indefinitely*, IRS Practice Adviser Report, Apr. 10, 1998, at 143.

53. See generally, Mason, *supra* note 49.

54. Announcements are internal documents used by the IRS for interoffice communications.

55. See Mason, *supra* note 49, at 107.

56. 26 U.S.C. § 7202 (1994).

57. *Id.* Section 7202 provides:

Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties

ited for some time. However, during recent years, the IRS and Department of Justice (DOJ) have not been so reticent about invoking this felony statute.

The primary courtroom issue as to this particular statute centers around whether there has to be either a willful failure to collect the taxes, i.e., a willful failure to withhold the tax from the employee's paycheck, or a failing to account for the taxes along with a willful failure to pay over the tax to the government, or both.⁵⁸ To put this legal issue more simply, when an employer takes the taxes out of an employee's earnings and files an accurate IRS Form 941 without paying over the tax money to the IRS, has § 7202 been violated? There is a split among the Circuit Courts of Appeal with regard to this issue.

In a 1997 case, *United States v. Evangelista*,⁵⁹ the Second Circuit held that irrespective of the filing of an accurate IRS Form 941, § 7202 is violated when the employer is shown to willfully fail to pay the taxes to the government.⁶⁰ This particular holding followed that of a Massachusetts District Court in *United States v. Brennick*⁶¹ in which the court carefully dissected the wording of § 7202.⁶² However, the Ninth Circuit held there must be both a willful failure to account for, as well as a willful failure to pay the tax owed, in order for there to be a violation.⁶³ The Ninth Circuit first ruled on this double willfulness standard in 1957,⁶⁴ and then affirmed its holding in the 1975 case, *United States v. Poll*.⁶⁵

Not too unexpectedly, there is also a split among the Circuits as to the applicable statute of limitations with regard to prosecutions under § 7202. The Second, Third, and Tenth Circuits have held that there is a six-year statute of limitations applicable to § 7202 offenses.⁶⁶ To the contrary, district courts in Massachu-

provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

58. *Id.*

59. 122 F.3d 112 (2d Cir. 1997).

60. *Id.* at 121.

61. 908 F. Supp. 1004 (D. Mass. 1995).

62. *Id.* at 1017.

63. *United States v. Poll*, 521 F.2d 329, 333 (9th Cir. 1975), *see also*, *Wilson v. United States*, 250 F.2d 312, 318 (9th Cir. 1957).

64. *Wilson*, 250 F.2d 312.

65. 521 F.2d 329 (9th Cir. 1975).

66. *United States v. Musacchia*, 900 F.2d 493, 500, (2d Cir. 1990), (*vacated on other grounds*), 955 F.2d 3, (2d Cir. 1991); *Evangelista*, at 119; *United States v.*

setts and in Georgia have ruled that the applicable limitations statute is only three years.⁶⁷ The fact that this disagreement exists is not that remarkable given the variance in analysis brought to this IRC Section by the Second Circuit in *Evangelista*,⁶⁸ and the Ninth Circuit in the *Poll*⁶⁹ case.

In addition, the financial ability or inability to pay over the taxes may be a defense with regard to a rebuttal of the willfulness element since the government must prove:

that at the time payment was due the taxpayer possessed sufficient funds to enable him to meet his obligation or that the lack of sufficient funds on such date was created by (or was the result of) a voluntary and intentional act without justification in view of all the financial circumstances of the taxpayer.⁷⁰

Finally, there is a misdemeanor statute that covers the failure to pay employment taxes.⁷¹ Section 7215 is rarely used in federal prosecutions, even though it is a useful statute in that it does not require that there be proof of willfulness, as is the case with § 7202.⁷² This particular misdemeanor statute is likely to be used in cases where the element of willfulness cannot be established. However, the taxpayer is permitted to defend by establishing that there exists a reasonable basis as to whether or not the law required that the tax be collected, or by demonstrating that her failure to comply with § 7512 was based on circumstances that were beyond her control. Both defenses for this misdemeanor statute are statutory and even though the burden of proof is shifted to the defendant, both have been upheld as constitutional.⁷³

Gollapudi, 130 F.3d 66, 70, (3d Cir. 1997); *United States v. Porth*, 426 F.2d 519, 522 (10th Cir. 1970).

67. *Brennick*, 908 F. Supp. at 1018; *United States v. Block*, 497 F. Supp. 629, 632 (N.D. Ga. 1980).

68. *Evangelista*, at 121.

69. *Poll* at 333.

70. *Evangelista*, at 119, (citing *Poll* at 333).

71. 26 U.S.C. § 7215.

72. *Id.* Section 7215 provides:

Any person who fails to comply with any provision of section 7512(b) [relating to payment of employment taxes into special accounts] shall, in addition to any other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$5,000, or imprisoned not more than one year, or both, together with the costs of prosecution.

73. *United States v. Paulton*, 540 F.2d 886, 891 (8th Cir. 1976). *See also*, *United States v. Erne*, 576 F.2d 212, 215 (9th Cir. 1978) (Proof of willfulness element not required.); *United States v. Randolph*, 588 F.2d 931, 933 (5th Cir.

V. THE NORTH CAROLINA EXPERIENCE

From the perspective of dealing with the North Carolina State Department of Revenue and other State agencies relative to the employee versus independent contractor controversy, practitioners have a unique problem. First of all, the most significant case decided in this particular area was *Hayes v. Elon College*⁷⁴ in 1944. In *Elon College* the Court ruled that the primary indicators as to whether someone should be deemed an independent contractor revolved around whether an individual:

(a) is engaged in an independent business, calling, or occupation; (b) is to have the independent use of his special skill, knowledge, or training in the execution of the work; (c) is doing a specified piece of work at a fixed price or for a lump sum or upon a quantitative basis; (d) is not subject to discharge because he adopts one method of doing the work rather than another; (e) is not in the regular employ of the contracting party; (f) is free to use such assistants as he may think proper; (g) has full control over such assistants; and (h) selects his own time. [citations omitted]⁷⁵

These eight criteria originally arose in a case that involved the Employment Security Commission of North Carolina rather than the North Carolina Department of Revenue, and focused on whether death benefits were owed to an "alleged employee."⁷⁶

At present, there is no recorded case law in which the North Carolina Department of Revenue is a party and which specifically deals with the question of employee versus independent contractor classification. However, since the Employment Security Commission engages in an activity that is comparable to that of the Department of Revenue in making tax assessments, these eight indicators are the most likely starting point in determining this controversy in State tax cases.⁷⁷

Unfortunately, the *Elon College* case is extremely dated and the eight indicators that are included therein are far removed from the more enlightened position taken by the Internal Revenue

1979) (Taxpayer can establish defense by demonstration that failure to comply with § 7512 was due to circumstances beyond his control.) However, the latter defense has been narrowly construed. *United States v. Dreske*, 536 F.2d 188, 195 (7th Cir. 1976).

74. 224 N.C. 11, 29 S.E.2d 137 (1944).

75. *Id.* at 16, 29 S.E.2d at 140.

76. *Id.* at 13, 29 S.E.2d at 138.

77. *See supra* notes 73-74 and related text.

Service in its three part control test.⁷⁸ When representing clients either before the Employment Security Commission or the North Carolina Department of Revenue, practitioners would be well advised to argue that the current federal standard for determining the “employee versus independent contractor classification” is more relevant and applicable because it takes into consideration the manner in which business is done today, rather than fifty years ago.⁷⁹

However, caution requires that the eight factors mentioned above be considered. At a recent Employment Security Commission hearing in which the author represented an employer,⁸⁰ through questioning of the Commission’s investigating officer, it was quickly established that she was not familiar with the federal test. She admitted she had not considered it or the Section 530 safe harbor, and had relied solely on the *Elon College* case factors and her “personal experience” in rendering her opinion.⁸¹ Through extensive cross-examination, it was established that she had not contacted any comparable employers in the areas to ascertain the applicability of the *Elon College* factors on an industry-wide basis.⁸² The Commission ruled in favor of the State’s independent contractor determination. The hearing officer relied on case precedent in making this decision, and noted in his opinion that whoever is the “boss” plays a significant role in determining worker classification controversies.⁸³

The mere fact that *Elon College* continues to be the primary North Carolina case in this area is a poor reflection on State governmental agencies charged with significant tax related decisions which impact the survival and success of small businesses and entrepreneurs.⁸⁴

78. See *supra* notes 36-46 and related text.

79. IRS Training Materials at 1-3.

80. Joseph R. Cronin v. Don Murry Homes, Inc. Appeal of Result of Investigation by Tax Department, Docket No. TX-98- (4).

81. *Id.*

82. *Id.* (Final Opinion).

83. Small business owners are in severe peril in the United States and simply cannot afford to have tax related decisions made based on fifty year old case law with no investigation into current industry practices. In the *Cronin* case, see *supra* note 79, the North Carolina Employment Security Commission attorney and investigating officer did not offer any defense of this practice, other than that it was time honored within the Commission. This rationale is no longer adequate.

84. *Id.*

VI. CONCLUSION

The worker classification controversy is an evolving problem, at least at the federal level. Given the advantages that the government receives when workers are classified as employees and not independent contractors, it is commendable to see the IRS actively involved in developing the new three-part control test.⁸⁵ This initiative is strongly supported by both current IRS Commissioner Rossotti⁸⁶ and former Commissioner Richardson. In fact, former Commissioner Richardson is on record as making it clear to IRS personnel that the use of independent contractors is a legitimate means for employers to conduct work regardless of lost advantage to the government.⁸⁷

At the state level, the problem is much more serious. Various regulatory agencies and revenue departments attempt to "make their own way" through this legal issue.⁸⁸ Unfortunately, in most cases, it is a matter of convenience relative to the collection of taxes rather than a legal issue. North Carolina represents the perfect example of decisions made by bureaucrats in haste and to the detriment of small business owners. State legislatures need to mandate that the IRS classification and settlement initiatives be evaluated in full and adopted, despite the fact that in doing so, long time precedent must die.⁸⁹ In the case of North Carolina, the *Elon College* factors should have been buried long ago.⁹⁰

85. See Part III: IRS SETTLEMENT INITIATIVES.

86. See generally, *IRS ADMINISTRATION: Rossotti Describes Vision of IRS in Address to Corporate Tax Practitioners*, IRS Practice Adviser Report, Apr. 10, 1998, at 144.

87. Mason at 106, n. 41 and accompanying text.

88. The fact that many state revenue departments have not made clear what approach will be taken as to the worker classification question is proof in itself that a greater degree of uniformity is needed.

89. The rationale put forth in the *Elon College* case is simply not current and does not take into consideration the manner in which commerce is conducted today.

90. 224 N.C. 11, 29 S.E.2d 137 (1944). When the IRS is striving to develop new, rational and meaningful reform measures with regard to the independent contractor problem, it is difficult to defend judicial factors based on a fifty-year-old case. See generally, Part IV: THE NORTH CAROLINA EXPERIENCE.