Exhibit A-April 21, 2014 DOL Letter to MODES

David Randall Jenkins

Available at: https://works.bepress.com/perfect_and_beautiful_woman/35/
Exhibit A

April 21, 2014 Letter
from
United States Department of Labor
to
Missouri Department of Labor & Industrial Relations
Regarding
Missouri House Bill 1642
Mr. Ryan McKenna  
Director  
Missouri Department of Labor and Industrial Relations  
421 East Dunklin Street  
P.O. Box 504  
Jefferson City, Missouri 65102  

Dear Director McKenna:  

We have reviewed Missouri House Bill (HB) 1642, as passed by the House, for conformity to Federal unemployment compensation (UC) law. HB 1642 would amend the UC law to provide that certain services would be presumed to be excluded from coverage under the state UC law. This raises an issue with the required coverage provisions of the Federal Unemployment Tax Act (FUTA) and the “methods of administration” requirement in the Social Security Act (SSA). It may also raise an experience rating issue. A discussion follows.

HB 1642 provides that any funds paid to a limited liability company (LLC), corporation, or entity formed under the applicable assumed name certificate statute organized under chapter 347; funds paid to an individual who holds a state or local license to provide service to multiple customers and whose services to the customers are different than the service provided by the customer to others; and funds use to pay for services provided by a licensed attorney shall be legally presumed, absent conclusive evidence to the contrary, to be a payment for service as an independent contractor and not for employment.

Section 3304(a)(6)(A), FUTA, requires, as a condition for employers in a state to receive credit against the Federal tax, that state law provide that UC be payable based on services performed for state and local governmental entities, federally recognized Indian tribes, and certain nonprofit organizations. Specifically, Section 3304(a)(6)(A), FUTA, requires coverage of services to which Section 3309(a)(1), FUTA, applies, “in the same amount, on the same terms, and subject to the same conditions as compensation payable on the basis of other service subject to such law.” Section 3309(a)(1), FUTA, applies to services excluded from the term “employment” solely by reason of either Section 3306(c)(7) or (8), FUTA. These sections apply to services performed for state and local governmental entities, certain nonprofit organizations, and Indian tribes. There are specific exceptions to this coverage requirement that are not relevant here.

Section 3306(i), FUTA, references the definition of an employee in Section 3121(d) of the Internal Revenue Code (IRC) of 1986. Section 3121(d)(2), IRC, specifies that employee means “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.” Regulations implementing Section 3306(i), FUTA, are found at 26 C.F.R. 31.3306(i)-1. These regulations specify that an individual is an employee if the relationship between the individual and the person for whom services are performed has the legal relationship of employer and employee:
Generally such a relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the results to be accomplished by the work but also as to the details and means by which that result is accomplished.

The regulations explain that “it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if [the employer] has the right to do so.” Concerning independent contractors, the regulations are not permissive; if an employer-employee relationship exists, “it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.” Thus the basic determinant of whether or not service is performed by an independent contractor is the right of direction and control, whether or not it is exercised.

This exclusion of coverage in HB 1642 creates two issues with Federal law. First, certain individuals would be presumed to be independent contractors regardless of the Federal common law test. As a result, their services would not be covered under Section 3304(a)(6)(A), FUTA. Section 3121(d), IRC, includes “any officer of a corporation” in the term “employee.” Thus, if the individual performs services as an officer of the corporation, the individual would be statutorily classified as an employee, and the services performed by the individual would be subject to the FUTA tax. For individuals who are not corporate officers, in the event that there is the right of direction and control of the services performed by the individual or LLC described in the bill, and the employer is a nonprofit organization that is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code, or an Indian tribe, the services must be covered. In the event that the service of the LLC; or of an individual providing services for a customer that is different than the services provided by the customer; or of licensed attorneys, are not ones for which coverage is required, no issue would be raised, but if the IRS determined that an employer-employee relationship exists, the employer would be liable for the full FUTA tax of 6.0% without benefit of any credit as no state contributions would have been paid on the services.

The fact that the bill would provide that the presumption of exclusion from coverage is rebuttable if conclusive evidence is presented to the contrary does not resolve this issue. Common law employees who are denied UC, and who do not rebut (that is, appeal) the presumption, would be denied coverage. Further, common law employees would be required to refute the presumption with conclusive evidence. Neither the presumption nor the refutations are elements of the common law test.

An additional issue is raised under Section 303(a)(1), SSA. This section requires, as a condition of receiving administrative grants for the UC program, that the law of such state includes provision for-

(1) Such methods of administration . . . as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due.
In the case of the rebuttable presumption provision, an individual would have to successfully overcome the presumption of independent contractor status. Placing the burden of proving coverage on an individual is not a “method of administration” for insuring full payment of UC when due. The burden for assuring the coverage requirements of Section 3304(a)(6)(A), FUTA, is met would be transferred from the state to the individual. Again, the UC agency must make a coverage determination and may not transfer this responsibility onto others.

HB 1642 would require that the Department of Labor and Industrial Relations (DLIR) afford employers the same relief afforded to employers under Section 530 of the Internal Revenue Code (IRC) of 1986, as amended. Section 530 of the IRC is the “safe harbor” provision. However, the safe harbor provision is solely a tax relief provision. It does not amend the definition of “employee” under Section 3306(i), FUTA, which determines the scope of the mandatory coverage requirement of Section 3304(a)(6)(A), FUTA, for purposes of determining an employer–employee relationship. Internal Revenue Service Revenue Procedure 85-18, published on April 1, 1985, clearly states that the safe harbor provision does not change the status of these workers from employees to being self-employed. Specifically, Section 3.08 of the Revenue Procedure, states:

Section 530 does not change in any way the status, liabilities, and rights of the worker whose status is at issue. Section 530(a)(1) terminates the liability of the employer for the employment taxes but has no effect on the workers. It does not convert individuals from the status of employee to the status of self-employed. [Emphasis added.]

Therefore, Missouri UC law may not offer the same relief as provided in Section 530, since this would deny UC coverage when such services are performed in an employment relationship for state and local governmental entities; certain nonprofit organizations and federally recognized Indian tribes. The denial of coverage in these circumstances raise a conformity issue because services performed in an employment relationship for these entities are required to be covered. For service performed in an employment relationship for employers other than state and local governmental entities, certain nonprofit organizations or Indian tribes, the exclusion of such services from coverage would have negative tax implications for the entity for whom such service is performed since no contributions would have been paid into the state UC fund, and therefore no credit may be taken against the FUTA tax.

Section 3303(a)(1), FUTA, requires, as a condition for employers in a state to receive the additional credit against the Federal tax, that state law provide that:

no reduced rate of contributions to a pooled fund is permitted to a person (or group of persons) having individuals in his (or their) employ except on the basis of his (or their) experience with respect to unemployment or other factors bearing a direct relation to unemployment risk . . .

If the application of the safe harbor provision would relieve employers of liability for state UC taxes even though services are required to be covered under the state UC law, this would “forgive” the back taxes of employers where there was coverage. If the issue is “forgiving”
taxes otherwise due, then we would raise an experience rating issue since the forgiveness of taxes otherwise due results in the assignment of a zero tax rate on those services which has the result of providing a reduced rate of tax on a basis not related to the experience of the employer.

HB 1642 also provides that any pending investigation as to whether services were performed in an employment relation would be cancelled pending the DLR adopting a rule on employee status following rulemaking procedures. A determination of whether services are covered affects both whether an individual has earned sufficient wage credits to monetarily qualify for UC, and whether an employer is liable for UC taxes. Administrative rule making procedures vary from state to state but they generally take many months to complete. This suspension of an individual’s right to determine his monetary qualification for benefits raises an issue with the “when due” requirements of Federal UC law. As noted above, Section 303(a)(1), SSA, requires, methods of administration reasonably calculated to insure full payment of unemployment compensation when due.

Please contact Steve Scott of your Regional Office, at (312) 596-5439 or scott.steven@dol.gov should you have questions regarding this letter.

Sincerely,

[Signature]

Gay M. Gilbert
Administrator
Office of Unemployment Insurance

cc: Byron Zuidema
   Regional Administrator
   Chicago