CURBING WORKER MISCLASSIFICATION IN VERMONT: PROPOSED STATE ACTIONS TO IMPROVE A NATIONAL PROBLEM

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INTRODUCTION

Worker classification as an employee versus an independent contractor matters primarily because modern policy makers attach importance to the age-old distinction. Dating to feudal England, common law has shielded employers from vicarious liability for a narrow group of independent trades, like blacksmiths.[1] Over the past century, U.S. lawmakers have vastly expanded the implications of classification, creating numerous tax requirements and labor protections for employees, but not for independent contractors.[2] The resulting modern federal and state laws create a complexity in accurately determining an appropriate worker status and often incentivize improper selection.

In most instances, worker classification is not controversial; however, seventy years ago the U.S. Supreme Court recognized that "[f]ew problems in the law have given greater variety of application and conflict in results than the cases arising in the borderland between what is clearly an employer-employee relationship and what is clearly one of independent, entrepreneurial dealing."[3] The challenge today is no easier. Misclassification affects an estimated 10% to 30% of U.S. firms, denying misclassified workers critical benefits and protections, placing properly classifying businesses at a competitive disadvantage, and costing governments billions in unpaid taxes.[4] Many predict the problem will only

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1. *See* Richard R. Carlson, *Why the Law Still Can't Tell an Employee When it Sees One and How it Ought to Stop Trying*, 22 BERKELEY J. EMP. & LAB. L. 295, 302–04 (2001) (discussing pre-industrial origins of worker classification).

2. *See infra* Part I.A–B (outlining the tax implications for employees and independent contractors).

3. NLRB v. Hearst Publ'ns, Inc., 322 U.S. 111, 121 (1944), *overruled in part by* Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992).

4. OFFICE OF THE VICE PRESIDENT, ANNUAL REPORT OF THE WHITE HOUSE TASK FORCE ON THE MIDDLE CLASS 22 (2010) [hereinafter *White House Task Force Report*]. Vermont estimates 10%–14% of Vermont employers misclassify their employees. 2008–2009 PROGRESS REPORT OF THE WORKERS' COMPENSATION EMPLOYEE CLASSIFICATION, CODING, AND FRAUD ENFORCEMENT TASK

get worse as misclassification is especially pervasive in industries anticipated to drive job-growth, including construction, home healthcare, food preparation, and hospitality.[5]

This Article does not suggest a solution, but instead proposes actions the State of Vermont can take to ease the process of properly identifying worker status and discourage intentional misclassification. As discussed below, nearly all states have recently addressed misclassification, and while this Article focuses on Vermont, the analysis and recommendations can be useful in creating strategies in other states.[6] Therefore, Part I provides background by examining the tension between the incentives for electing a worker status and government approaches to reviewing an operating status. Part I concludes that employers, and sometimes workers, have an incentive to misclassify, made easier by the confusing and conflicting government tests complicating ex ante analysis. Part II discusses four actions states have taken to curb misclassification and concludes that Vermont should continue to assess and increase deterrents, better educate employers and workers, and consolidate state tests while rejecting a pre-certification approach. A brief conclusion follows.

I. "CHOOSING" WORKER STATUS

In practice, an employer and worker operate under an agreed worker status. However, worker status is subject to government challenge as law, not contract, defines when a worker is an employee or independent contractor.[7] Therefore, the employer and worker must evaluate potential government review ex ante to anticipate a proper classification. In this

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FORCE 2 (2009) [hereinafter *2008–2009 Progress Report*], *available at* http://www.nh.gov/nhworkers/documents/vt_08-09_rpt.pdf.

5. *See White House Task Force Report supra* note 4, at 22; Daniel Lippman, *Where Job Growth Will Come Over This Decade*, WALL ST. J. (Sept. 14, 2013), http://online.wsj.com/news/articles/SB10001424127887324463604579040891474392908; Anne Fisher, *The Future of Work: When Gen X Runs the Show*, TIME MAG. (May 14, 2009), http://content.time.com/time/specials/packages/article/0,28804,1898024_1898023_1898086,00.html (predicting independent contractors will make up 40% of the U.S. workforce by 2019).

6. Vermont is an ideal case study. *See infra* Part II. Additionally, at the time of writing, one party controls the executive branch and a super majority in both legislative houses, making enactment a real possibility. *See* Anne Galloway, *Dems Sweep All But One Statewide Seat, Hold "Supermajority" in House, Senate*, VTDIGGER.ORG (Nov. 7, 2012, 4:53 AM), http://vtdigger.org/2012/11/07/shumlin-brock/.

7. *See Independent Contractor (Self-Employed) or Employee,* IRS (June 26, 2014), http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee (providing guidance for determining whether a worker's status is an employee or independent contractor).

Article, the term "misclassification" describes all instances where government review would disagree with a worker's operating status. The term does not distinguish between intentional or accidental misclassification.

The purpose of Part I is to illustrate the uncertainty an employer and worker face in evaluating the proper status ex ante, and in that uncertainty, the incentives to choose incorrectly. First, Subpart (A) examines employer and worker incentives for electing a worker status, as well as government interests in proper classification. Second, Subpart (B) examines government tests used to review the selected status, which significantly complicate ex ante analysis.

A. Incentives for Choosing a Worker Status

Employers and workers must initially select the nature of their relationship, a decision with a variety of tax and labor consequences. Understanding the effect of worker classification can enable two sophisticated parties to tailor burdens and benefits, or one sophisticated party to take advantage of the unwitting other. Each interest has subtle and often significant exceptions, but the general overview below is sufficient to grasp the complexity of the competing state, employer, and worker interests. This Subpart groups employment status considerations into two broad factors: the direct financial costs through payroll taxes and healthcare, and restrictions on the employer's ability to control workers through labor protections.[8] Each is discussed in turn.

1. Taxes—Direct financial costs

The largest direct financial costs associated with worker classification are payroll taxes, consisting of income tax withholding, Federal Insurance Contributions Act (FICA) taxes, workers' compensation insurance, and unemployment insurance.[9] Additionally, the Affordable Care Act (ACA)

8. These categories are not intended to be all-inclusive but address the relevant themes of this Article: tax and labor. Other considerations include employer vicarious liability and workers' intellectual property rights.

9. *See, e.g.*, *How to Budget and Bill OWEB for Employee Actual Payroll Costs (Project Management and In-House Personnel)*, *available at* http://www.oregon.gov/OWEB/forms/employee_payroll_budgetingandbilling_instructions.pdf (last visited Nov. 11, 2014) (providing instructions related to managing costs associated with worker classification in Oregon).

imposes health insurance responsibilities on certain employees.[10] These financial costs are immediate and apparent, appearing on every paycheck, and directly affecting employer costs and worker income. For example, classifying a worker as an independent contractor instead of an employee may save between 20% and 40% of labor costs, creating a powerful employer incentive for worker misclassification.[11] The major financial considerations are discussed in turn.

Income Tax Withholding: Employers have two income tax related duties for employees that do not apply to independent contractors. First, an employer must report an employee's annual compensation to the Social Security Administration and IRS on Form W-2.[12] Second, employers must usually withhold a portion of an employee's wages and transfer the funds to the appropriate federal, state, or local taxing authority.[13] The employee indirectly calculates the withholding amount by estimating year-end tax liability on an IRS Form W-4.[14] The employer withholds and transfers the needed portion from each paycheck to satisfy the employee's estimated liability.[15] Any underpayment is due at year-end; an overpaid amount is returned.[16] This system is referred to as pay-as-you-earn (PAYE).[17]

The government interests in employer withholding and reporting are timing and compliance. PAYE provides a more regular flow of government revenue than annual payments and enables workers to gradually pay down their tax bill to avoid a large year-end payment.[18] When combined, employer reporting and PAYE significantly increase taxpayer compliance.[19]

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10. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified in scattered sections of 26 and 42 U.S.C.).

11. Jenna Amato Moran, *Independent Contractor or Employee? Misclassification of Workers and Its Effect on the State*, 28 BUFF. PUB. INT. L.J. 105, 121 (2010). "Labor costs" may include non-payroll tax factors such as paid leave or matching retirement savings.

12. IRS, GENERAL INSTRUCTIONS FOR FORMS W-2 AND W-3, at 4 (2014) [hereinafter *IRS W2–3*], *available at* http://www.irs.gov/pub/irs-pdf/iw2w3.pdf.

13. *See, e.g.*, I.R.C. § 3402(a)(1) (2012).

14. IRS, FORM W-4 (2014), *available at* http://www.irs.gov/pub/irs-pdf/fw4.pdf.

15. I.R.C. § 3102 (2012).

16. *Id.* § 31.

17. *See* Piroska Soos, *Self-Employed Evasion and Tax Withholding: A Comprehensive Study and Analysis of the Issues*, 24 U.C. DAVIS L. REV. 107, 125 (1990) (detailing the PAYE system).

18. *See* Koenraad van der Heeden, *The Pay-As-You-Earn Tax on Wages*, *in* 2 TAX LAW DESIGN AND DRAFTING ch.15:18 (Victor Thuronyi ed. 1998), *available at* https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch15.pdf (describing issues that can occur from improper use of the PAYE system).

19. *See* IRS, TAX GAP FOR TAX YEAR 2006, at 1–2 (Jan. 6, 2012), *available at* http://www.irs.ustreas.gov/pub/newsroom/overview_tax_gap_2006.pdf ("[T]he net misreporting percentage . . . for amounts subject to substantial information reporting and withholding is 1%; for amounts subject to substantial information reporting but no withholding, it is 8%; and for amounts

For employers, employee income tax withholding is facially cost neutral, since the amounts withheld, reported, and transferred belong to the employee.[20] However, the administrative burden of collecting, maintaining, and transferring documents and taxes, or the financial costs of outsourcing the burden to a payroll service may incentivize some employers to favor independent contractor classification.

Most tax compliant workers likely benefit from employer withholdings since it reduces the employee's need to save for larger periodic bills.[21] Furthermore, employees are rather free to determine withholding amounts on their W-4s. However, some savvy workers may also prefer independent contractor status to avoid reporting and maximize deductions. First, employers report employee wages to the IRS but need not necessarily report amounts paid to independent contractors.[22] Employees seeking to underreport their income, and by extension their tax liability, may prefer this arrangement.[23] Second, an employee may deduct limited unreimbursed expenses, like equipment or a home office, but only if the amount added to other deductions, like mortgage and child care, exceeds the standard deduction.[24] Independent contractors have added flexibility in deducting expenses, which reduces the income before taking the full standard deduction.[25]

For example, suppose a married worker with no other deductions earned $20,000 for a year's work, but spends $10,000 on necessary equipment. An employee may be able to deduct these items but the amount

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subject to little or no information reporting, such as business income, it is 56%."); *see also* Soos, *supra* note 17, at 126 ("[W]ithholding has probably done more to increase the tax-collecting power of central governments than any other one tax measure at any time in history.") (internal quotations omitted).

20. *Payroll Deduction IRAs for Small Businesses*, U.S. DEP'T OF LABOR, http://www.dol.gov/ebsa/publications/PayrollDedIRAs.html (last visited Nov. 12, 2014).

21. *Id.*

22. IRS, 2015 INSTRUCTIONS FOR FORM 1099-MISC 6–7, *available at* http://www.irs.gov/pub/irs-pdf/i1099msc.pdf (last visited Nov. 12, 2014) (imposing a reporting requirement through a four-part test).

23. *See* Theodore Black et al., *Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation* (IRS Research, Analysis & Statistics Working Paper, 2012), *available at* http://www.irs.gov/pub/irs-soi/06rastg12workppr.pdf (noting the large gap for information that is not reported); IRS, FORM W-9 (2013), *available at* http://www.irs.gov/pub/irs-pdf/fw9.pdf (last visited Nov. 12, 2014).

24. *See* IRS, 2013 INSTRUCTIONS FOR SCHEDULE A: FORM 1040 (2013) [hereinafter *Instructions*], *available at* http://www.irs.gov/pub/irs-pdf/i1040sca.pdf (last visited Nov. 12, 2014) (discussing deductions in excess of the standard deduction).

25. IRS, 2013 INSTRUCTIONS FOR SCHEDULE C: PROFIT OR LOSS FROM BUSINESS (2013), *available at* http://www.irs.gov/pub/irs-pdf/i1040sc.pdf (last visited Nov. 12, 2014).

is less than the 2013 standard deduction of $12,200.[26] Therefore, the employee would wisely apply only the standard deduction and lose the expense deductions. Alternatively, a worker paid as an independent contractor is granted more flexibility in deductible items. The independent contractor would deduct the expenses directly from their income, then deduct the standard deduction from the remainder. The result is a lower taxable income under independent contractor status.

Thus, independent contractor classification can reduce employer administrative costs and potentially reduce worker tax payments through self-reporting and directly deducting work-related expenses against income, but at a cost to the government of reduced compliance.

Federal Insurance Contribution Act (FICA):[27] FICA taxes, which fund Social Security and Medicare, are withheld from employee paychecks.[28] In 2014, the employee pays 6.2% of their first $117,000 of income for Social Security and 1.45% of all wages for Medicare.[29] Additionally, an employer matches the employee's Social Security and Medicare contribution.[30]

Independent contractors are still responsible for Social Security and Medicare contributions. Since they are both their own employer and employee, they pay the entire amount.[31] This 15.3% tax on the first $117,000 and 2.9% on all additional income is called the self-employment tax.[32] Therefore, classifying a worker as an independent contractor shifts the employer's matching contributions to the worker, reducing the employer's payroll costs and possibly incentivizing employers to classify workers as independent contractors. However, sophisticated workers may reduce FICA taxes by classifying income as profits instead of wages, or by

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26. *See Instructions*, *supra* note 24 at A-11 (discussing employee deductions); IRS, IRS PUBLICATION 501: EXEMPTIONS, STANDARD DEDUCTION, AND FILING INFORMATION 26 (2013), *available at* http://www.irs.gov/pub/irs-pdf/p501.pdf (last visited Nov. 12, 2014) (discussing the standard deduction).

27. 26 U.S.C. § 21 (2012); I.R.C. § 3102 (2012).

28. *Employer and Employee Responsibilities—Employment Tax Enforcement*, IRS, http://www.irs.gov/uac/Employer-and-Employee-Responsibilities---Employment-Tax-Enforcement (last updated Feb. 12, 2014).

29. *Topic 751—Social Security and Medicare Withholding Rates*, IRS [hereinafter *IRS Form*], http://www.irs.gov/taxtopics/tc751.html (last updated July 16, 2014).

30. *Id.*

31. *Self-Employment Tax (Social Security and Medicare Taxes)*, IRS [hereinafter *IRS Self-employment Tax*], http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Self-Employment-Tax-Social-Security-and-Medicare-Taxes (last updated Sept. 5, 2014).

32. *Id.*

maximizing deductions.[33] Most workers, especially unsophisticated or low-wage workers, probably suffer from this shifted tax liability.

Workers' Compensation & Unemployment Insurance: Workers' compensation provides predetermined guaranteed payments to workers for work related injuries while providing employers immunity to tort suits. States regulate most workers' compensation programs, and most state programs require employers to obtain workers' compensation insurance for employees through private insurers.[34] Rates average about 1.4% of wages, but vary between states and industries and increase for companies with a history of past claims.[35]

Unemployment insurance is a jointly administered federal and state program that aims to provide temporary financial assistance to workers who become unemployed through no fault of their own.[36] Federal premiums average 0.1% of wages, and state premiums average about 0.8% of subject wages, but vary widely.[37] Unlike workers' compensation, which usually utilizes private insurers, the state administers unemployment compensation.[38]

Together, workers' compensation premiums, state unemployment premiums, and federal unemployment premiums average about 2.3% of worker wages.[39] Employers are responsible for the entire amount for each employee, but not each independent contractor, creating a financial incentive toward independent contractor classification. Unlike Social Security, the financial cost is not shifted to the employee, as many states

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33. *See id.* (discussing income tax withholding).

34. *See Division of Federal Employees' Compensation (DFEC)*, U.S. DEP'T OF LABOR, http://www.dol.gov/owcp/dfec/ (last visited Nov. 12, 2014) (noting the federal government covers federal employees and certain major industries).

35. *Employer Costs for Employee Compensation for the Region —December 2013*, BUREAU OF LABOR STATISTICS (Mar. 26, 2013), http://www.bls.gov/ro2/ececne.htm; *see, e.g.*, *Rates for Workers' Compensation*, WASH. STATE DEP'T. OF LABOR & INDUS., http://www.lni.wa.gov/claimsins/insurance/ratesrisk/check/rateshistory/ (last visited Nov. 12, 2014) ("While there will be no overall rate increase in 2013, individual employers may see their rates go up or down, depending on their recent claims history and changes in the frequency and cost of claims in their industry.")

36. *See* I.R.C. §§ 3301–3305 (2012) (outlining requirements and regulations for receiving unemployment compensation).

37. *Employer Costs for Employee Compensation for the Regions—December 2013*, *supra* note 35; *see also State Unemployment Tax Rates 2008–2014*, TAX POLICY CENTER, http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=541 (last visited Nov. 12, 2014) (charting state rates and the amount of wages subject to tax).

38. *Employer Costs for Employee Compensation for the Regions—December 2013*, *supra* note 35.

39. *Id.*

allow single-member businesses to avoid premiums.[40] But avoiding workers' compensation comes with a catch for both employees and employers. Employees lose the right to guaranteed injury compensation. Employers no longer necessarily have protection against suits in which a worker is injured as a result of employer negligence.

Health Insurance: Congress has placed other financial and administrative responsibilities on employees, most recently regarding healthcare. The ACA[41] requires firms with fifty or more full-time workers to provide health plans to qualified workers or pay a penalty.[42] To date, no known agency or judge has addressed the law's application to independent contractors. However, only employees are likely to count in meeting the fifty-worker threshold and coming under the health plan requirements.[43] Many suggest employers may be tempted to classify workers as independent contractors to avoid the ACA mandate.[44]

In sum, worker classification has a direct financial impact on both the employer and worker. For the worker, classification as an independent contractor has the potential advantage of avoiding tax withholding and IRS income reporting. However, this classification negatively shifts FICA tax liability, while removing unemployment insurance, workers' compensation, and potentially employer health insurance. The employer incentive is greater, allowing savings on administrative income tax withholding costs, FICA taxes, unemployment insurance, workers' compensation insurance, and potentially health insurance. Thus, direct financial costs can provide a

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40. *See, e.g.*, VT DEP'T. OF LABOR, EMPLOYER INFORMATION MANUAL: A GUIDE TO VERMONT'S UNEMPLOYMENT INSURANCE PROGRAM 1, 2, 4–6, *available at* http://labor.vermont.gov/wordpress/wp-content/uploads/A-26.pdf (last visited Nov. 12, 2014) (noting payments to owners of some businesses may not be considered wages for unemployment insurance purposes).

41. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified in scattered sections of 26 and 42 U.S.C.).

42. I.R.C. § 4980H(a) (2012). "Full-time employee" is further defined in MIREILLE KHOURY, DETERMINING FULL-TIME EMPLOYEES FOR PURPOSES OF SHARED RESPONSIBILITY FOR EMPLOYERS REGARDING HEALTH COVERAGE (§ 4980H) 1, 4, *available at* http://www.irs.gov/pub/irs-drop/n-12-58.pdf (last visited Nov. 12, 2014).

43. *See, e.g.,* Robert W. Wood, *Avoiding Obamacare with Independent Contractors*, FORBES (Sept. 27, 2013, 1:45 AM), http://www.forbes.com/sites/robertwood/2013/09/27/avoiding-obamacare-with-independent-contractors-2/ (discussing the effects of independent contractors on the Affordable Care Act). The Court may review classification under the common law right to control test, as imposed in ERISA cases. *See* Michael Newman, *Who is an Employee and Who is an Independent Contractor Under the Employer Mandate Provisions of the Affordable Care Act (ObamaCare)?*, JDSUPRA BUS. ADVISOR (Feb. 27, 2013), http://www.jdsupra.com/legalnews/who-is-an-employee-and-who-is-an-indepen-86372/ (tracing the definition of "employer" and "employee" to ERISA definitions).

44. *See, e.g.*, Newman, *supra* note 43.

significant influence on worker classification, especially by incentivizing employers to utilize independent contractors.

2. Labor—Restrictions on the freedom to control workers

Federal and state laws impose potentially significant restrictions on an employer's ability to control an employee, restrictions not imposed on independent contractors. Some have direct financial costs, while others restrict the ability to freely select workers.

Worker status can affect employability. Employers are substantively prohibited from "knowingly" hiring employees or contracting with independent contractors unauthorized to work in the United States, but only have an administrative duty to verify, retain, and submit documents to the IRS for employees.[45] No similar administrative duty exists for independent contractors.[46] Therefore, either party may prefer independent contractor status to avoid disqualifying a working relationship.

The federal government also provides numerous protections to employees. For example, the federal Fair Labor Standards Act (FLSA)[47] requires a $7.25 per hour minimum wage, overtime pay, and child labor; the Family Medical Leave Act (FMLA)[48] protects an employee's job from medical-related absences, including child birth and family member care; the Employment Retirement Income Security Act (ERISA)[49] establishes minimum standards for private employer pension funds; the Occupational Safety and Health Act (OSHA)[50] regulates minimum safety standards between employers and employees; Title VII of the Civil Rights Act of 1964[51] limits discrimination based on race, color, religion, sex, or national origin; the Americans with Disabilities Act (ADA)[52] prohibits some employment discrimination based on disability; and the Age Discrimination in Employment Act (ADEA)[53] prohibits employment discrimination for individuals at least 40 years of age. These laws do not apply to independent contractors.

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45. 8 U.S.C. § 1324a(A)(1), (4) (2012).

46. *Do I Need to Use Form I-9?*, U.S. CITIZENSHIP & IMMIGRATION SERV'S, http://www.uscis.gov/i-9-central/complete-correct-form-i-9/who-needs-use-form-i-9/do-i-need-use-form-i-9 (last visited Nov. 12, 2014).

47. Fair Labor Standards Act, 29 U.S.C. § 206 (2012).

48. *Id.* § 2601.

49. *Id.* § 1001.

50. *Id.* § 651.

51. 42 U.S.C. § 2000(e) (2012).

52. *Id.* § 12101.

53. 29 U.S.C. §§ 621–634 (2012).

Some states extend benefits beyond federal protections where possible.[54] Vermont requires a higher minimum wage,[55] extends family medical leave protections to employees of smaller businesses,[56] and prohibits discrimination based on sexual orientation, gender identity, place of birth, or physical or mental condition.[57] Federal law does not recognize some state employee protections, like Vermont's protection of an employee's right to disclose wages to coworkers[58] or its prohibition on polygraphs.[59] Like federal labor laws, state protections do not extend to independent contractors.

Some employers may utilize independent contractors to avoid labor restrictions on the individual worker, allowing the employer to negotiate the terms of employment more freely. But, since each law only applies to employers with a defined number of employees,[60] employers may use an independent contractor classification to avoid labor restrictions on their entire workforce. The chart on the following page illustrates the minimum number of employees required for several federal and Vermont labor protections.

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54. Some federal labor laws, like the FMLA, create a national minimum standard or "floor," and while State law cannot reduce the standard, it can provide additional protections. Other federal laws, like ERISA, preempt all state laws relating to the subject. *See* Heather A. Suve, Note, *State-Legislated Family Leave: The FMLA's Panacea or ERISA's Scourge?*, 73 WASH. U. L.Q. 665, 665–75 (1995) (discussing the effects of ERISA and FMLA on states' attempts to provide medical or family benefits for the workforce).

55. VT. STAT. ANN. tit. 21, § 384 (2009) (establishing a $7.25 minimum wage in 2007 and a 5% increase per year). The 2014 Vermont minimum wage is $8.73 and the federal minimum wage was $7.25. *Id.*; Fair Labor Standards Act, 29 U.S.C. §§ 201–219 (2006); *see also* VT DEP'T OF LABOR, NOTICE MINIMUM WAGE, WH-11 (Feb. 2014), *available at* http://labor.vermont.gov/wordpress/wp-content/uploads/WH-11-Minimum-Wage-Rate-20141.pdf (providing Vermont's minimum wage change from 2011 to 2014).

56. The FMLA applies only to businesses with 50 or more employees. 29 U.S.C. § 2611(2)(b)(ii) (2006). The Vermont Parent and Family Leave Act, extends parent leave to businesses of ten employees and family leave to businesses of fifteen employees. VT. STAT. ANN. tit. 21, § 471(1) (2011).

57. VT. STAT. ANN. tit. 21, § 495 (Supp. 2013).

58. *Id.*

59. *Id.* § 494.

60. Generally, daily, weekly, or annual work hours or geographic conditions further define "employees." *See, e.g.*, 42 U.S.C. § 12111(5) (2012) (applying the ADA to employers who in part have "15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year"); 29 U.S.C § 2611(2)(B)(ii) (2012) (excluding FMLA coverage for employers who have fewer than 50 full-time employees within a seventy-five mile radius of a worksite).

Table 1: Federal and Vermont Labor Protections Compared

Labor Protection	Federal Law	Min. # of Employees	Vermont Law	Min. # of Employees
Wage & Hour	FLSA	1[61]	Vermont Wage & Hour program	2[62]
Family/Sick Leave	FMLA	50[63]	Parent and Family Leave Act	Parental: 10 Family: 15[64]
Race, Sex, Religion, etc.	Title VII	15[65]	Fair Employment Practices Act (FEPA)	1[66]
Disability	ADA	15[67]	FEPA	1[68]
Age	ADEA	20[69]	FEPA	1[70]

In sum, the numerous restrictions on an employer's ability to hire and control the terms of employment provide employers, and in very limited instances workers, additional potential incentives to classify workers as independent contractors.

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61. 29 U.S.C. § 203 (defining an employer as including "any person acting directly or indirectly in the interest of *an* employer in relation to an employee") (emphasis added).

62. VT. STAT. ANN. tit. 21, § 382 (2009) (stating that coverage under the statute applies to employers with two or more employees); *see also* VT. DEP'T OF LABOR, A SUMMARY OF VERMONT WAGE AND HOUR LAWS 1 (2009), *available at* http://labor.vermont.gov/wordpress/wp-content/uploads/WH-13-Wage-and-Hour-Laws-20092.pdf (describing Vermont wage laws as a "program" and explaining qualifications).

63. 29 U.S.C. § 2611(2)(B)(ii) (2006) (stating that an employee at a worksite is not eligible under the statute if their employer has less than 50 employees within a seventy-five mile radius of the worksite).

64. VT. STAT. ANN. tit. 21, § 471(1) (2011) (stating that for the purposes of parental leave the term "employer" is defined as a person who has ten or more employees that work at least thirty hours per week and that for the purposes of family leave the term "employer" is defined as a person who has fifteen or more employees that work at least thirty hours per week).

65. 42 U.S.C. § 2000e(b) (2006) (defining employer as a person who employs fifteen or more employees).

66. VT. STAT. ANN. tit. 21, § 495d(1) (defining an employer as a person who employs one or more individuals).

67. 42 U.S.C. § 12111(5) (defining an employer as a person who employs fifteen or more employees).

68. VT. STAT. ANN. tit. 21, § 495d(1) (defining an employer as a person who employs one or more individuals).

69. 29 U.S.C. § 630(b) (2012) (defining employer as a person who employs twenty or more employees).

70. VT. STAT. ANN. tit. 21, § 495d(1) (defining an employer as a person who employs one or more individuals).

B. Government Review—Legal Distinctions Between an Employee and Independent Contractor

Laws establish the relationship between an employer and worker.[71] But despite the numerous state and federal laws relying on the distinction between employees and independent contractors, clear definitions are rarely provided.[72] Instead, agencies and reviewing courts rely on a number of balancing tests to determine worker status, creating a situation in which a worker could be an independent contractor for some purposes and an employee for others.[73] Some federal laws apply different tests, creating a horizontal conflict. Additionally, some related federal and state laws apply different tests, creating a vertical conflict. This Article briefly[74] discusses the various tests in terms of their expansiveness, where more expansive tests classify more workers as employees. The reference chart on the following page is instructive throughout this Subpart.

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71. *See, e.g.*, 26 C.F.R. § 31.3121(d)-1(a)(3) (2014) (stating that "if [an employer/employee] relationship exists, it is of no consequence that the employee is designated a[n] . . . independent contractor, or the like" for federal tax purposes).

72. *See, e.g.*, Americans with Disabilities Act of 1990, 42 U.S.C. § 12111(4) (2012) (defining employee as "an individual employed by an employer"); Clackamas Gastroenterology Assocs. v. Wells, 538 U.S. 440, 444 (2003) (finding that the definition provided by the ADA is a "'mere nominal'" definition). The IRS provides statutory guidance for some positions, including some real estate agents or direct sellers for all federal tax purposes, full-time insurance salespersons for social security tax and employee benefits, and other salespersons for social security tax purposes only. *See* I.R.C. §§ 3508, 3121(d)(3)(B), (D), 7701(a)(20) (2012).

73. *See* Mitchell H. Rubinstein, *Employees, Employers, and Quasi-Employers: An Analysis of Employees and Employers who Operate in the Borderlands Between an Employer-and-Employee Relationship*, 14 U. PA. J. BUS. L. 605, 628 n.120 (2012) (citing, amongst others, BWI Taxi Mgmt, No. 5-RC-4836874, 2010 WL 4836874, at *9 n. 15 (N.L.R.B. Reg. Dir. Sept. 16, 2010) (stating that the petitioner received a letter saying he was an independent contractor under the Equal Employment Opportunity Commission but was considered an employee under the NLRA)); Seattle Opera v. NLRB, 292 F.3d 757, 763–64 (D.C. Cir. 2002) (holding that the individual was an employee even though he was treated as an independent contractor for tax purposes in that he did not receive a W-2 tax form).

74. The histories and application of the various tests are thoroughly discussed elsewhere. *See* Rubinstein, *supra* note 73, at 605–29; Moran, *supra* note 11, at 107–09. For the purposes of this Article, a brief overview is sufficient to establish a framework for evaluating reforms, as discussed in Part II.

Table 2: Laws Governing Private Sector Employment in Vermont

	Federal				Vermont			
	Law	**Enforce-ment Agency**	**Test**	**Relation to State Law**	**Law**	**Enforce-ment Agency**	**Test**	**Relation to Federal Law**
Tax	IRC	Treasury, IRS	Expanded Common Law	N/A	Title 32	Vermont Dept. of Tax	Expanded Common Law	N/A, but states often draw on federal info
Workers' Compensation	N/A	N/A	N/A	N/A	Title 29, Ch. 9	VDOL, WC Division	Two-part Test	N/A
Unemployment Insurance	N/A	N/A	N/A	N/A	Title 29, Ch. 17	VDOL, UI Division	ABC test	N/A
Wage & Hour	FLSA	DOL	Economic Realities	National Floor	Vermont Wage & Hour Program	VDOL, Wage & Hour Division	Economic Realities	Exceeds
Family/Sick Leave	FMLA	DOL	Economic Realities	National Floor	Parent & Family Leave Act	AG, Civil Rights Division	Common Law or Economic Realities	Exceeds
Discrimination	Title VII	DOL, EEOC	Circuit Split Common Law (2d) or Economic Realities	National Floor	Fair Employ-ment Practices Act (FEPA)	AG, Civil Rights Division	Common Law or Economic Realities	Exceeds
Disability	ADA	DOL, EEOC	Common Law "right to control"	National Floor	FEPA	AG, Civil Rights Division	Common Law "right to control"	Exceeds
Age	ADEA	DOL, EEOC	Common Law "right to control"	National Floor	FEPA	AG, Civil Rights Division	Common Law "right to control"	Exceeds
IP Rights	Various	Private Action	Common Law "right to control"	Preempts	N/A	N/A	N/A	Preempted
Insurance	ERISA	DOL	Common Law "right to control"	Preempts	N/A	N/A	N/A	Preempted
Unionization	NLRA	NLRB	Expanded Common Law	Preempts	N/A	N/A	N/A	Preempted

Federal Law Tests: Federal law distinguishes between employees and independent contractors in numerous tax and labor laws, but applies at least three distinct tests, plus variations, to determine worker status. The common law "right to control" test is presumed where Congress used the

term "employee" without defining it.[75] The test predates modern tax and labor policies, and can be traced to feudal agency law and vicarious liability through *respondeat superior*.[76] Common law analysis weighs twelve factors, although the list is non-exhaustive and no one factor is determinative.[77] The traditional common law test is used in cases involving intellectual property rights,[78] ERISA,[79] and the ADA,[80] and to ADEA cases in the Second Circuit.[81]

The common law test is the least expansive federal test, allowing the most flexibility for utilizing independent contractor status. All other federal

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75. Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 321 (1992); *but see* KENNETH G. DAU-SCHMIDT, ROBERT N. COVINGTON & MATTHEW W. FINKIN, LEGAL PROTECTION FOR THE INDIVIDUAL EMPLOYEE 42 (4th ed. 2011) (arguing the economic realities test applies by default).

76. *See* Rubinstein, *supra* note 73, at 610 & n.11; RESTATEMENT (THIRD) OF AGENCY § 7.07(3)(a) (2006) ("[A]n employee is an agent whose principle controls or has the right to control the manner and means of the agent's performance of work").

77. *See, e.g.*, Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 751 (1989).

> In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party. No one of these factors is determinative.

Id. (citations omitted); *see also* RESTATEMENT (SECOND) OF AGENCY § 220(2) (describing the twelve-part non-exclusive factors).

78. *Reid*, 490 U.S. at 730. Intellectual property rights in a "work made for hire" belong to the employer, absent a written agreement to the contrary. There are two types of work made for hire: (1) an employee work prepared within the scope of employment, or (2) a specially commissioned work (i.e., independent contractor), commissioned in writing and satisfying one of nine statutorily enumerated categories. *See* 17 U.S.C. § 101 (2012) (enumerating the types of works that can be included as "'work made for hire'"); Jon M. Garon & Elaine D. Ziff, *The Work Made for Hire Doctrine Revisited: Startup and Technology Employees and the Use of Contracts in a Hiring Relationship*, 12 MINN. J. L. SCI. & TECH. 489, 489–95 (2011) (discussing the work made for hire doctrine in the modern employment relationship).

79. *Darden*, 503 U.S. at 321. The Employee Retirement Income Security Act (ERISA) is a federal law that sets minimum standards for private sector pension plans. *The Employee Retirement Income Security Act (ERISA)*, U.S. DEP'T OF LABOR, http://www.dol.gov/compliance/laws/comp-erisa.htm (last visited Nov. 12, 2014).

80. Johnson v. City of Saline, 151 F.3d 564, 568 (6th Cir. 1998); Foresta v. Centerlight Capital Mgmt., L.L.C., 379 F. Appx. 44, 45–46 (2d Cir. 2010).

81. Frankel v. Bally Inc., 987 F.2d 86, 91 (2d Cir. 1993); Halpert v. Manhattan Apartments, Inc., 580 F.3d 86, 88 n.1 (2d Cir. 2009).

tests add additional considerations, including the two common law variations.

The National Labor Relations Board (NLRB) has traditionally applied the common law right to control test,[82] but is arguably shifting emphasis. In *FedEx Home Delivery v. NLRB*,[83] the D.C. Circuit recognized a "subtle refinement" from focusing on the right to control the work, to focusing on whether the worker had a significant opportunity for gain or loss.[84] The court indicated that a focus on the opportunity for gain or loss better captures the essence of employment relationships and provides an easier method of distinguishing employees from independent contractors.[85] *Fedex Home Delivery* probably does not indicate the emergence of a new common law entrepreneurial control test, but instead indicates the NLRB will now consider the control of gain or loss as an addition to the common law factors.[86]

The IRS uses a second common law variation. Historically, the IRS used an expanded twenty-factor common law test variation.[87] The test also considered full-time work requirements, worker investments, the worker's ability to realize gains or losses, and the rights to discharge other workers or terminate the relationship without incurring liability.[88] The twenty factors remain relevant, but are now reorganized into three non-exhaustive categories.[89] "Behavioral Control" factors look to whether the worker has a right to direct and control when, where, and how the work is accomplished.[90] "Financial Control" factors look to whether the business

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82. *See, e.g.*, The Arizona Republic, 349 N.L.R.B. No. 95, 1042 (2007) (describing the common law right to control test), *overruled by* FedEx Home Delivery, 361 N.L.R.B. No 55 (2014); Roadway Package Sys., Inc., 326 N.L.R.B. No. 72, 850 (1998) (stating that common law of agency is the standard for determining worker status).

83. 563 F.3d 492 (D.C. Cir. 2009).

84. *Id.* at 497.

85. *Id*.

86. *See* Lancaster Symphony Orchestra, 357 N.L.R.B. No. 152, 4 (2011) (listing entrepreneurial opportunity as a common law factor in determining worker status).

87. Rev. Rul. 87-41, 1987-1 C.B. 296. The IRS is expressly required to apply the common law test to distinguish employees from independent contractors for social security. I.R.C. § 3121(d). The IRS has applied the common law test even where no definition is provided. *See* JOINT COMM. ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO WORKER CLASSIFICATION FOR FEDERAL TAX PURPOSES (May 7, 2007), *available at* http://www.irs.gov/pub/irs-utl/x-26-07.pdf (commenting on the I.R.C. § 3401 failure to define "employee" for employer withholding obligations).

88. Rev. Rul. 87-41, 1987-1 C.B. 296.

89. IRS, INDEPENDENT CONTRACTOR OR EMPLOYEE? TRAINING MATERIALS 2–7 (1996), *available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee.

90. IRS, INDEPENDENT CONTRACTOR OR EMPLOYEE, NO. 1779 (2012) [hereinafter *IRS No. 1179*], *available at* www.irs.gov/pub/irs-pdf/p1779.pdf; IRS, PUBLICATION 15-A: EMPLOYER'S

has the right to control business aspects of the worker's job, like pay structure, reimbursements, the extent of worker investment, and opportunity for profit or loss.[91] "Relationship of the Parties" factors look to how the parties perceive their relationship, including an examination of contracts, permanency, and benefits.[92] Thus, the IRS is not merely focused on the common law right to control, but considers a more expansive list of factors.

The Court has expressly applied a separate "economic realities test" for examining whether a worker is covered by the FLSA.[93] While the Court failed to thoroughly explain the test, lower courts have indicated it focuses on "whether the employee, as a matter of economic reality, is dependent upon the business to which he renders service."[94] The Fifth Circuit has adopted a five-part test examining: (1) employer control; (2) worker investment; (3) opportunity for worker profit or loss; (4) required skill; and (5) the permanency of the relationship.[95] Thus, in what was "originally developed to be more expansive than the common law test,"[96] the economic realities test incorporates and expands on the common law right to control test and the financial interests recognized by the NRLB and IRS. Aside from FLSA analysis, the economic realities test is used for FMLA[97] and Title VII[98] claims in many circuits. Some circuits, but not the Second Circuit, apply the test to the ADEA.[99]

SUPPLEMENTAL TAX GUIDE 7–8 (2013) [hereinafter *Supplemental Tax Guide*], *available at* http://www.irs.gov/pub/irs-pdf/p15a.pdf.

91. *IRS No. 1179*, *supra* note 90; *Supplemental Tax Guide*, *supra* note 90, at 7–8.

92. *IRS No. 1179*, *supra* note 90; *Supplemental Tax Guide*, *supra* note 90, at 7–8.

93. Tony and Susan Alamo Found. v. Sec'y of Labor, 471 U.S. 290, 291 (1985) (stating "[t]he test of employment under the [Fair Labor Standards] Act is one of 'economic reality,'" in determining if volunteers were covered by the FLSA).

94. Nowlin v. Resolution Trust Corp., 33 F.3d 498, 505 (5th Cir. 1994).

95. Hopkins v. Cornerstone Am., 545 F.3d 338, 343 (5th Cir. 2008); *see also* Schultz v. Capital Int'l Sec., Inc., 466 F.3d 298, 304–05 (4th Cir. 2006) (adding a sixth factor, the degree to which the service rendered is an integral part of the employer's business).

96. Rubinstein, *supra* note 73, at 626, n.108; *see also* Moran, *supra* note 11, at 117–19 (arguing the economic realities test provides a broader definition of employee than the common law or expanded NLRB tests and is similar to the hybrid DOL tests).

97. Susan N. Houseman, *A Report on Temporary Help, On-Call, Direct-Hire Temporary, Leased, Contract Company, and Independent Contractor Employment in the United States*, U.S. DEP'T OF LABOR (1999), http://www.dol.gov/oasam/programs/history/herman/reports/futurework/conference/staffing/9.1_contractors.htm#1.

98. Cuddeback v. Fla. Bd. of Educ., 381 F.3d 1230, 1234 (11th Cir. 2004). Applying the economic realities test to Title VII still varies. *Compare* Knight v. United Farm Bureau Mut. Ins. Co., 950 F.2d 377, 378–79 (7th Cir. 1991) (considering a five factor economic realities test), *with* Spirides v. Reinhardt, 613 F.2d 826, 832 (D.C. Cir. 1979) (considering an eleven factor economic realities test that more closely resembles the hybrid test approach). The Second Circuit has traditionally applied the common law test. *See* Frankel v. Bally Inc., 987 F.2d 86, 91 (2d Cir. 1993) More recently the Second Circuit looked for an employment relationship (i.e. economic reality) as a prerequisite for common law

Another approach to Title VII cases is a combination of the common law right to control test and the economic realities test.[100] Under this "hybrid test," the primary focus is on the right to control the worker, including the ability to hire and fire, supervise, and dictate the worker's schedule. However, courts also consider the economic realities including pay structure, tax withholdings, benefits, and terms of employment.[101] The hybrid test is considered a middle-ground approach,[102] but has not been adopted in the Second Circuit.[103]

Thus, federal law applies at least three distinct tests to determine worker status: the least expansive common law right to control test and its variations, the middle-ground hybrid test, and the most expansive economic realities test. The applicable test depends on both the implicated federal law and jurisdiction, and with respect to Vermont, the Second Circuit declines to apply the hybrid test.

State Law Tests: The relationship of federal and state worker classification laws vary depending on subject matter. There are four relationships relevant to this topic. First, some federal laws preempt state law, leaving states no ability to independently regulate the subject matter.[104] Examples include intellectual property rights,[105] ERISA,[106] and unionization.[107] Second, some federal laws establish a national floor, allowing states to impose additional restrictions.[108] Examples include wage

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analysis. Gulino v. N.Y. State Educ. Dep't, 460 F.3d 361, 371–72 (2d Cir. 2006). Therefore, while not expressly applied, the Second Circuit trend appears to lean toward applying the economic realities test in Title VII cases. *Id*.

99. EEOC v. N. Knox Sch. Corp., 154 F.3d 744, 747 (7th Cir. 1998). *But see Frankel*, 987 F.2d at 91 (applying the common law test); Halpert v. Manhattan Apartments, Inc., 580 F.3d 86, 88 n.1 (2d Cir. 2009) (applying the common law test).

100. *See* Muhammad v. Dallas Cnty. Cmty. Supervision, 479 F.3d 377, 380 (5th Cir. 2007) (quoting Deal v. State Farm Cnty. Mut. Ins. Co. of Tex., 5 F.3d 117, 118–19 (5th Cir. 1993)) ("To determine whether an employment relationship exists within the meaning of Title VII, 'we apply a 'hybrid economic realities/common law control test.'"").

101. *Deal*, 5 F.3d at 118–19.

102. Rubinstein, *supra* note 73, at 626.

103. The Second Circuit has rejected the hybrid test, as applied in other circuits, in favor of the common law right to control test or economic realities test in Title VII cases. *See Frankel*, 987 F.2d at 91 (applying the common law test).

104. *See* Suve, *supra* note 54, at 665–75 (noting ERISA and FMLA preempt state law).

105. Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 731 (1989).

106. *See* Suve, *supra* note 54, at 668 (noting that federal preemption is used in ERISA to promote consistency).

107. Legal Info. Inst., *Labor*, WEX, http://www.law.cornell.edu/wex/labor (last visited Nov. 15, 2014).

108. *See* Rubinstein, *supra* note 73, at 611.

and hour[109] and anti-discrimination laws.[110] Many states with corresponding state laws adopt the related federal test. Third, federal and state income taxes are distinctly separate areas of law, although states often utilize federal tax law for simplicity.[111] Many states, including Vermont, defer to the IRS common law variation test for determining worker status.[112] Fourth, unemployment and workers' compensation are largely state regulated without corresponding federal laws.[113] Therefore, states must choose a test, causing significant variations among the states.

Many state laws, including workers' compensation and unemployment insurance, use one of the federal tests,[114] but states have developed a number of additional tests to determine worker status under state law. The "ABC" test is an often-used common law test variation. As applied by the Vermont Department of Labor's Unemployment Insurance Division, the ABC test imposes a rebuttable presumption of employee status until the employer demonstrates that: (A) the worker is free from control or direction, both by contract and in fact; (B) the service performed is either outside the usual course of business or outside all places of the enterprise business; and (C) such worker is customarily engaged in an independently established trade, occupation, profession or business.[115] Other states apply a "modified" ABC test to alter or eliminate one of the three requirements.[116]

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109. *See* Fair Labor Standards Act, 29 U.S.C. § 207 (2012) (providing maximum working hour requirements).

110. 42 U.S.C. § 2000e(b) (2012).

111. *See, e.g.*, *2013 Vermont Income Tax Return, Form IN-111*, Line 10 (2013), *available at* http://www.state.vt.us/tax/pdf.word.excel/forms/income/2013/2013IN-111-fillin.pdf (requiring Vermont income tax filers to report their adjusted gross income, as reported on Federal Form 1040-Line 37).

112. *See e.g.*, *Business FAQs*, VA. DEP'T. OF TAXATION (last updated Aug. 7, 2013), http://www.tax.virginia.gov/site.cfm?alias=BusinessFAQ ("Virginia law conforms to the provisions of federal law with respect to whether an employer-employee relationship exists between parties.").

113. *See infra* Part I.A.1 (noting that workers' compensation is often regulated by states).

114. For example, Alabama uses the common law test to determine worker status under state unemployment insurance and workers' compensation laws. State Dep't of Indus. Relations v. Montgomery Baptist Hosp. Inc., 359 So. 2d 410, 412 (Ala. Civ. App. 1978) (unemployment insurance); Hooker Constr., Inc. v. Walker, 825 So. 2d 838, 843 (Ala. Civ. App. 2001) (workers' compensation).

115. *See, e.g.*, VT. STAT. ANN. tit. 21, § 1301(6)(B)(i)–(iii) (2009) (noting workers will be qualified as employees save certain exceptions); Fleece on Earth v. Dep't of Empl't and Training, 923 A.2d 594, 597 (Vt. 2007) (holding that Fleece on Earth failed to meet two of the three prongs of the ABC test).

116. *See Independent Contractor Central Unit*, MONT. DEP'T. OF LABOR AND INDUST., http://erd.dli.mt.gov/work-comp-regulations/montana-contractor/independent-contractor (last visited Nov. 15, 2014) [hereinafter *IC Central Unit*] (applying the AB test, which eliminates the portion regarding if the service was performed outside the usual course of business); MD. CODE ANN., LAB. & EMPL. § 8-205 (2009) (modifying (B) to require work outside the usual course of business for whom the work is performed or performed outside of any place of business the person for whom the work is performed).

The ABC test is intended to be more expansive than the IRS common law test,[117] but the exact relation to other federal tests is unclear. The presumption of employee status is unique to state law, but the ABC test does not consider any economic factors in determining whether the presumption is rebutted. Therefore, the ABC test is probably more expansive than the common law test, but in a different manner than the economic realities test.

Several states have developed other unique tests. For example, Washington workers' compensation laws apply a six-factor test to demonstrate no employment relationship, while Wisconsin workers' compensation laws require independent contractors to satisfy a nine-factor test.[118] Vermont uses a hybrid two-part test to assess worker status for workers' compensation.[119] The agency and reviewing court first apply the common law right to control test. An employment relationship is presumed if the employer has a right to control the work.[120] Otherwise, the "nature of the business" test evaluates if an employee normally conducts the work or if the work is performed as an integral part of the employer's regular business.[121] This restrictive two-part test is intended to prevent employers from "doing through independent contractors what they would otherwise do through their direct employees."[122]

Thus, properly assessing worker classification requires identifying applicable federal and state laws, then applying a number of federal tests that vary between circuits and another set of state law tests that vary among states. For example, a Vermont employer or worker assessing the relationship would apply at least six tests, including: (1) the common law right to work test for ERISA, intellectual property, federal ADA, ADEA, and Vermont Fair Employment Practices Act (FEPA) purposes; (2) an expanded common law test for federal and state tax purposes; (3) the common law test variation also assessing the ability to realize profits or

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117. *Who is an Employee vs. Independent Contractor?*, VT. DEP'T OF LABOR, http://labor.vermont.gov/unemployment-insurance/employers/who-is-an-employee-vs-independent-contractor/ (last visited Nov. 15, 2014).

118. WASH. REV. CODE § 51.08.195 (2013); WISC. STAT. § 102.07(8)(b) (2014).

119. *Misclassification*, VT. DEP'T OF LABOR, http://labor.vermont.gov/workers-compensation/misclassification/ (last visited Nov. 15, 2014); Forcier v. LaBranch Lumber Co. and Simon's Chipping Inc., No. 04-02WC, 2002 WL 1343862, at *7 (Vt. Dep't Lab. Ind. April 2, 2002).

120. *See Misclassification*, *supra* note 119 (noting criteria used to determine whether an employer controls the work).

121. *Id*.

122. *See* Falconer v. Cameron, 561 A.2d 1357, 1358 (Vt. 1989) (quoting King v. Snide, 479 A.2d 752, 755 (1984)) (discussing 21 V.S.A. § 601(3), the workers' compensation statute credited with the two-part test).

losses for NLRB unionization purposes; (4) the economic realities test to assess federal FLSA, FMLA, Title VII, and related Vermont laws; (5) the ABC test to assess unemployment insurance; and (6) a two-part hybrid test to assess state workers' compensation laws. No test provides a bright line determination, favoring the less predictable balancing of numerous potential factors. As aptly summarized by one academic, "the definitional status of employees. . . . is in a complete state of disarray . . . ."[123]

II. RECOMMENDED VERMONT APPROACH

The first Part discussed the most significant factors contributing to misclassification, the complexity of choosing an appropriate worker status ex ante, and how misclassification incentivizes workers to operate under an incorrect status. This Part focuses on ways to reduce or "curb" misclassification. Some degree of federal action is needed to address misclassification, as federal law underlies most worker classification issues. Since significant federal action is not foreseeable, many states have acted where possible, with varying degrees of success. After briefly reviewing recent federal and state reform efforts, this Part recommends specific actions for the State of Vermont, focusing on increasing enforcement and easing compliance.

Beginning in 2008, President Obama's election and the financial crisis renewed federal and state efforts to curb misclassification. At the federal level, then-Senator Obama favored increasing federal efforts to detect and penalize businesses that widely worked with misclassified workers to better ensure tax compliance and labor protections, an idea that received little traction in Congress.[124] As President, Mr. Obama was able to exert executive influence over the Department of Labor (DOL) and the Department of the Treasury (Treasury) departments to increasingly target misclassification.[125] Further federal legislative remedies have largely stalled.[126]

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123. Rubinstein, *supra* note 73, at 606.

124. Independent Contractor Proper Classification Act of 2007, S. 2044, 110th Cong. (2007) (Senator Obama was the lead sponsor of S. 2044, which never left committee).

125. *Compare* UNIVERSITY OF MAINE, STRETCHING THE LAW II: THE MISCLASSIFICATION OF EMPLOYEES AS INDEPENDENT CONTRACTORS 3 (2009), http://umaine.edu/ble/files/2011/01/Stretching.pdf (stating that DOL under Bush viewed misclassification as "not in itself a violation of the" FLSA making enforcement optional) *with White House Task Force Report*, *supra* note 4, at 22–23 (discussing DOL efforts under Obama to identify and prevent misclassification).

126. *See infra* Part II.A (discussing two proposed bills that were never enacted).

At the state level, the 2008 financial crisis threatened state mandates to balance their budgets.[127] Specific to worker classification, the financial crisis left many people without work, and nearly twice as many people filed unemployment claims in 2009 as in prior years.[128] The demand devastated state unemployment funds, forcing most states to accept federal stimulus loans to maintain fund solvency.[129] For example, in 2010, Vermont borrowed $77.7 million from the federal government for the unemployment insurance fund, an amount fully repaid in 2013.[130] Vermont, like many states, viewed curbing misclassification as one method to recapture lost premiums.[131] Thus, federal efforts were motivated by perceived income tax and labor protection abuses, whereas state efforts were motivated by unemployment compensation premiums.

Post-2008 reforms have limits. The reaches of executive actions limit federal reforms, while federal law and preemption limit state reforms. But both federal and state reforms have similarities that can be instructive to future Vermont reforms. First, Vermont and the federal government have increased, and should continue to increase, enforcement efforts through detection and penalties to encourage greater status selection consideration, incentivize caution, and target intentional misclassification. Second, both either have or should attempt to ease compliance through education, test consolidation, and independent contractor pre-certification. Each of these strategies is discussed in turn, followed by specific recommendations for further Vermont action.

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127. *Sen. John Cornyn Says 49 States Have a Balanced Budget Amendment in Their State Constitutions*, POLITIFACT TEXAS (Dec. 25, 2010, 6:00 AM), http://www.politifact.com/texas/statements/2010/dec/25/john-cornyn/sen-john-cornyn-says-49-states-have-balanced-budge/ (noting all states but Vermont have some constitutional or statutory balanced budget requirements, while questioning the validity of three state requirements).

128. CONG. BUDGET OFFICE, UNEMPLOYMENT INSURANCE IN THE WAKE OF THE RECENT RECESSION (2012), *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/11-28-UnemploymentInsurance_0.pdf.

129. Jake Gravom, *2008 Financial Crisis Impacts Still Hurting States*, USA TODAY (Sept. 15, 2013, 2:20 PM), http://www.usatoday.com/story/money/business/2013/09/14/impact-on-states-of-2008-financial-crisis/2812691/.

130. Press Release, Governor Peter Shumlin, Governor Shumlin Announces Early Payment of UI Trust Fund Loan (July 1, 2013), *available at* http://governor.vermont.gov/newsroom-gov-shumlin-UI-trust-fund-repaid. As of November 13, 2014, nine states have not repaid their loans. *Title XII Advance Activities Schedule*, TREASURY DIRECT, https://www.treasurydirect.gov/govt/reports/TFMP/TFMP_advactivitiessched.htm (last updated Nov. 13, 2014) (chart noting current state general debts).

131. *See, e.g.*, VT. DEP'T OF LABOR, UNEMPLOYMENT INSURANCE TRUST FUND REPORT, 1–2 (Jan. 31, 2014), *available at* http://www.leg.state.vt.us/reports/2014ExternalReports/296784.pdf (noting other efforts including increasing the taxable wage base).

A. Increased Enforcement

The federal and Vermont governments have adopted similar methods to deter misclassification, especially regarding those who intentionally misclassify. In a utilitarian sense, intentional misclassification occurs where the expected benefit outweighs the risk of detection and punishment.[132] Therefore, both the federal government and Vermont have increased enforcement efforts and attempted to increase penalties.

At the federal level, President Obama's 2009 Middle Class Task Force, led by Vice President Biden, identified misclassification as "a key issue," initially prompting the DOL, Treasury, and seven states to begin sharing misclassification information and coordinating enforcement.[133] At the end of 2013, fifteen states had entered into the agreement.[134] The administration added 740 new DOL enforcement positions by 2010, returning to 2001 levels,[135] and secured a $14 million FY2013 budget increase for state grants and increased DOL personnel in the Wage and Hour Division to investigate misclassification.[136] Additionally, President Obama has attempted to incentivize misclassifying employers to come into compliance through the 2011 Voluntary Classification Settlement Program (VCSP), which allows non-audited employers to self-report past misclassification in exchange for reduced back tax liability.[137] Thus, post-2008 federal executive branch

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132. JOSHUA DRESSLER, UNDERSTANDING CRIMINAL LAW 14 (LexisNexis 5th ed., 2009).

133. *White House Task Force Report, supra* note 4, at 22–23; News Release, U.S. Dep't of Labor, Labor Secretary, IRS Commissioner Sign Memorandum of Understanding to Improve Agencies' Coordination on Employee Misclassification Compliance and Education (Sept. 19, 2011), *available at* http://www.dol.gov/opa/media/press/whd/WHD20111373.htm.

134. News Release, U.S. Dep't of Labor, US Labor Department Signs Agreement with NY Labor Department and NY Attorney General's Office to Reduce Misclassification of Employees (Nov. 18, 2013), *available at* http://www.dol.gov/opa/media/press/whd/WHD20132180.htm. Several states with large workforces have signed the agreement, including California, New York, and Illinois, as well as states with small workforces including Utah and Montana. *See* Wage and Hour Division, *Employee Misclassification as Independent Contractors*, U.S. DEP'T OF LABOR, http://www.dol.gov/whd/workers/misclassification/ (last visited Nov. 15, 2014).

135. *White House Task Force Report*, *supra* note 4, at 21–23.

136. EXEC. OFFICE OF THE PRESIDENT OF THE U.S., OFFICE OF MGMT. AND BUDGET, FISCAL YEAR 2013 BUDGET OF THE U.S. GOVERNMENT 146 (2012), *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf (noting $10 million for state grants and $4 million for DOL enforcement personnel).

137. Announcement, IRS, Voluntary Classification Settlement Program (Sept. 21, 2011), *available at* http://www.irs.gov/pub/irs-drop/a-11-64.pdf (amended and clarified through Announcements 2012-45 and 2013-13). The VCSP was designed as an expansion of the existing Classification Settlement Program (CSP), which provided similar incentives to settle disputes early in the administrative process. *Id.* It remains unclear if the IRS would share a VCSP disclosure with DOL or participating state agencies.

enforcement actions include increased detection efforts and creating pathways for misclassifying employers to voluntarily become compliant.

Congress has proposed, but not yet enacted, additional efforts to detect misclassification and increase penalties. Addressing labor issues, the Employee Misclassification Prevention Act (EMPA), introduced in 2008, 2010, and 2011, sought to amend the FLSA to impose recordkeeping requirements on non-employees, make misclassification a federal offense, and impose additional fines.[138] Addressing tax issues, the Fair Playing Field Act (FPFA), introduced in 2010 and 2012, sought to close a safe harbor tax provision and authorize the IRS to issue guidance to clarify worker status for federal tax purposes.[139] No bills made it out of committee, but both the EMPA and FPFA are considered possible starting points for future bipartisan legislation.[140]

At the state level, Vermont increased detection and penalties most notably in the 2011–2012 biennium. In an effort to increase detection, the state funded additional workers' compensation fund investigators, directed the Vermont Department of Labor (VDOL) to create and maintain an online employee misclassification reporting system, and directed the Agency of Administration to coordinate misclassification detection efforts across agencies and departments.[141] The state has been reluctant to further increase enforcement personnel, citing the diminishing return caused by increased salaries.[142] However, better information sharing could increase investigator efficiency with little added expense. And while the legislature has authorized VDOL to share misclassification information obtained through

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138. H.R. 3178, 112th Cong. (2011); H.R. 5107, 111th Cong. (2010); S. 3254, 111th Cong. (2010); H.R. 6111, 110th Cong. (2008). The Payroll Fraud Prevention Act of 2011 sought similar changes. S. 770, 112th Cong. (2011).

139. S. 2145, 112th Cong. (2012); H.R. 4123, 112th Cong. (2012); H.R. 6128, 111th Cong. (2010). The IRS provides a safe harbor for some employer misclassification where there is a reasonable basis for treating the worker as an independent contractor, the employer has consistently treated the worker as an independent contractor, and the position is not substantially similar to any employee positions. I.R.C. § 3401 (2012).

140. *See* Richard Reibstein et. al., *Obama 2.0 and Independent Contractor Misclassification: The Next Four Years of Federal Legislative and Regulatory Activity*, INDEP. CONTRACTOR COMPLIANCE (Nov. 26, 2012), http://independentcontractorcompliance.com/2012/11/26/obama-2-0-and-independent-contractor-misclassification-the-next-four-years-of-federal-legislative-and-regulatory-activity (noting the failures of these two bills and outlining bills that would enjoy "bipartisan support").

141. 2010 Vt. Acts & Resolves No. 142, §§ 1, 7, 13.

142. Kevin J. Kelley, *"Independent Contractor" or Employee? The Difference Could Mean $2.6 Million for the State's Unemployment Fund*, SEVEN DAYS (Dec. 2, 2009), http://www.sevendaysvt.com/vermont/independent-contractor-or-employee-the-difference-could-mean-26-million-for-the-states-unemployment-fund/Content?oid=2138913.

unemployment insurance records with relevant state or federal agencies,[143] the state has not yet entered into an information-sharing agreement with the federal and other state governments. Vermont should reconsider joining DOL, IRS, and neighboring states in an information-sharing agreement, as it could ease detecting violators and enable joint investigations, which could be especially relevant to misclassifying multi-state employers.[144]

Vermont has also increased the consequences of detecting workers' compensation misclassification by prohibiting violating employers from obtaining state contracts for three years, requiring the Agency of Administration to publish a list of violating employers on its website, and increasing criminal misclassification penalties that potentially continue against successor businesses.[145] The penalties could be substantial, including a $15,000 fine for some willful misclassification.[146] Vermont also established a process allowing VDOL to issue stop-work orders, notably used against a state senator's misclassifying company in 2011.[147] Data is not yet available to assess the effectiveness of Vermont's increased enforcement actions, but periodic review is advisable to ensure appropriate personnel and penalties. Furthermore, if effective, Vermont should consider adjusting personnel and penalties beyond workers' compensation laws.

In sum, the federal government and Vermont are making efforts to increase the likelihood of detecting a misclassified worker, and Vermont has increased the consequences for deliberate misclassification. Both efforts are likely to help deter further intentional misclassification. However, Vermont should continue to increase enforcement efforts. State detection efforts will likely benefit from better information sharing with the federal government and neighboring states. State deterrent efforts will likely benefit from periodic personnel and penalty reevaluation and adjustment, and increased penalties for misclassification beyond state workers' compensation laws.

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143. 2011 Vt. Acts & Resolves No. 50, §7.

144. *See* U.S. Dep't of Labor, *supra* note 133 (noting information agreement between federal government and seven other states).

145. 2010 Vt. Acts & Resolves No. 142, §§ 3, 5, 5a, 5b.

146. *Id.* § 2. California notably increased criminal penalties, which range from $5,000 to $25,000 per violation for willful misclassification. *See* CAL. LAB. CODE §§ 226.8, 2753 (West 2014).

147. 2010 Vt. Acts & Resolves No. 142, § 3; Anne Galloway, *Digger Tidbits*, VTDIGGER.ORG (Mar. 8, 2011), http://vtdigger.org/2011/03/08/digger-tidbits-march-8/.

B. Ease Compliance

Increased federal and state efforts to detect and penalize misclassification may curb some misclassification, but is unlikely to solve the problem completely. Inevitably, some well-intentioned employers and workers will inaccurately agree to operate as independent contractors. This "unintentional misclassification" could result from an inability to access information or comprehend the multiple state and federal tests.

Some agencies have taken the relatively simple first step of providing clear and easily accessible guidelines. For example, the VDOL website provides plain-English explanations and links to the relevant independent contractor tests for workers' compensation and unemployment insurance.[148] But evaluating proper classification requires evaluating laws enforced by many other state and federal agencies. The VDOL site notes the IRS applies a different test, but fails to discuss other federal or state laws, including VDOL's own Wage and Hour program.[149] Other Vermont enforcement agencies, like the Civil Rights Unit, Vermont Human Rights Commission (VHRC), and Vermont Department of Tax simply do not address worker status on their websites.

The state could relatively easily increase awareness for those seeking compliance by expanding VDOL's easily accessible guidelines to all state laws relating to worker status. Each enforcement agency should provide clear descriptions of the affected state laws, tests applied, and links to other state and federal agencies. Providing accurate, thorough, and easily accessible information is the low hanging fruit in curbing unintentional misclassification.

However, even if an employer and worker could easily access classification information, the numerous state tests and their relationship with federal tests remain confusing. States have experimented with two approaches to ease compliance: consolidating tests and pre-certification. Vermont has considered but not adopted either approach.[150]

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148. *Misclassification–Independent Contractor vs. Employee*, VT. DEP'T OF LABOR (Nov. 1, 2010), http://labor.vermont.gov/wordpress/wp-content/uploads/Misclassification-final-Nov-1-web-2.pdf. The site addresses workers' compensation and unemployment insurance but fails to address how worker status effects other VDOL programs including wage and hour compliance or worker safety.

149. *See Misclassification*, *supra* note 119 (unemployment insurance); *Who is an Employee vs. Independent Contractor?*, *supra* note 117 (discussing conflicts between the ABC test and the IRS independent contractor test).

150. H.170, 2013–14 Gen. Sess. (Vt. 2013) (as introduced) (single definition for unemployment and workers' compensation); H.177, 2013–14 Gen. Sess. (Vt. 2013) (as introduced) (pre-certification of independent contractors).

1. Consolidating tests

Consolidating tests aims to reduce horizontal conflicts between worker status laws, simplifying ex ante analysis. As discussed in Part I, Vermont employers and workers must assess six different tests in evaluating worker status. The four federal tests and two additional state tests create horizontal federal conflicts, horizontal state conflicts, and vertical conflicts between federal and state tests. The simplest example of consolidating tests would be to eliminate one test, like the Vermont ABC test. Absent the ABC test, Vermont employers and workers would evaluate only five tests, somewhat simplifying analysis. But consolidating tests provides a larger opportunity to eliminate multiple tests.

Consolidating to a single federal test would eliminate all federal horizontal conflicts, and a single state test would replace all state horizontal conflicts. A single test, applied to all laws distinguishing between worker status, and adopted by the federal and all state governments, would eliminate all horizontal and vertical conflicts, significantly reducing the confusion associated with applying different tests to different laws. Employers and workers would still need to apply the test properly, but the debate about which test to adopt would be a secondary issue. A universally adopted test simplifies the analysis as to which tests apply.

There are two main arguments against any test consolidation. First, there are legitimate reasons for distinguishing among the various laws. For example, policy makers may view discriminatory labor practices differently than tax collection responsibilities, thus creating a more expansive test for the former. The Court in *NLRB v. Hearst Publications*[151] essentially took this view, recognizing that employment status was relative to the statutory purpose of the law.[152] Lawmakers may indeed find advantages to defining worker status differently for different areas of law, but those advantages must be weighed against the benefit of easy application. As discussed above, the current multi-test approach is unworkable and plagued with misclassification. Most interested parties—employers, workers, and governments—would benefit from increased proper ex ante classification, even at the expense of slightly different over- or under-coverage.[153] After

151. NLRB v. Hearst Publ'ns, 322 U.S. 111 (1944), *overruled in part by* Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992).

152. *Id.* at 129; *see also* Rubinstein, *supra* note 73, at 622–24 (arguing the statutory purpose is a separate federal test).

153. *See* Karen R. Harned, et. al., *Creating a Workable Legal Standard for Defining an Independent Contractor*, 4 J. BUS. ENTREPRENEURSHIP & L. 93, 93–95 (2010) (arguing the benefit of clarity to businesses).

all, under-expansiveness already affects workers at an estimated 10%–30% of misclassifying U.S. firms and 10%–14% of Vermont firms.[154] Thus, as long as governments tie tax and labor implications to employment status, the ease of providing one test will usually outweigh the gains of custom tailoring the covered group for each law.

The second set of arguments against consolidating tests addresses skepticism toward change, fearing the unknown future to the disarrayed status quo. For example, some argue changing tests would inevitably abandon existing common law precedent and require worker reclassification.[155] While true, this argument holds little weight, as the current, ongoing state changes abandon existing precedents and force ongoing reevaluation of current classifications. Movement toward one common test would ideally stop continual changes and allow courts to better develop a single body of common law, while clarifying ex ante classification analysis.

But establishing a uniform test across all affected laws is not a practical reality, as the federal and all state governments would need to adopt the same test. There is no indication the federal government is prepared to act, and no modern federal legislation proposes this solution. Absent federal action, states can still benefit from consolidating tests, but must be careful that the attempt to clarify state law does not create greater confusion with federal law.

For example, Montana has eliminated state horizontal test conflict by adopting a single two-part test for all five affected areas of state law: workers' compensation, unemployment, wage and hour, human rights, and tax.[156] Montana's "AB test" evaluates a worker's freedom from control and participation in an independent trade.[157] Thus, the test is more inclusive than the common law test, but unlike the economic realities test, hybrid test, or heightened common law tests, does not examine any aspect of the economic relationship with the employer. From the perspective of easing compliance, Montana's consolidated test illustrates two problems Vermont should avoid.

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154. *White House Task Force Report*, *supra* note 4, at 22; *2008–2009 Progress Report*, *supra* note 4, at 2.

155. *See* Jason M. Goldstein, *Money Under the Bridge: The Worker Misclassification Problem*, 5 FLA. A&M U. L. REV. 107, 120–22 (2009) (describing the possible negative effects that a change in law or policy could have on the worker classification system).

156. *IC Central Unit*, *supra* note 116.

157. *Id.*

First, the state's choice of tests does nothing to consolidate federal tests. Since the AB test provides greater coverage than the common law test, any worker properly classified as an independent contractor under Montana law would presumably also be properly classified under federal laws applying the common law test. However, the same would not be true for any federal law that examines any aspect of the economic relationship. Therefore, relating to federal law, Montana has essentially replaced the common law test with the AB test, but an employer and worker must continue to evaluate the economic realities test, hybrid test, and common law tests for applicable federal laws.

This is a missed opportunity. If Vermont chooses to adopt a single state test, it should adopt the most expansive federal test, the economic realities test. The economic realities test encompasses all factors considered in the other federal tests, establishing significant likelihood that a properly classified independent contractor under this test would also be classified as the same under all federal tests. By adopting the single economic realities test for all implicated state laws, Vermont would provide employers and workers a simplified analysis for selecting proper classification. A worker properly classified as an independent contractor under Vermont law could be fairly certain to receive similar treatment under all federal laws, drastically reducing vertical conflicts. Theoretically, state and federal test application could vary, especially since the tests balance a number of factors, allowing potential variations. The state is not likely to provide absolute certainty about federal law, but adopting the most restrictive federal test would provide a significant step toward simplification.

Furthermore, if Vermont adopted the economic realities test, a worker properly classified as an employee under Vermont law, usually only need follow Vermont's discrimination, wage and hour,[158] and family/sick leave laws, since the Vermont laws exceed the floor established by the corresponding federal laws.[159] Therefore, adopting a statewide economic realities test would eliminate much confusion between federal and state *tests* and between federal and state *laws*, allowing employers and workers

158. Vermont wage and hour laws provide a higher minimum wage than federal law but cover a different group. The federal law covers all workers, but the Vermont law does not apply where an employer has only one employee. Therefore, in a limited instance, employers and workers must still evaluate state and federal law. Vermont could eliminate this problem by applying the state minimum wage to all employees. *Compare* Fair Labor Standards Act, 29 U.S.C. § 206 (2012) (federal minimum wage law), *with* VT. STAT. ANN. tit. 21, § 382 (2011) (Vermont minimum wage law).

159. *See, e.g.*, *supra* Part I.A.2 and Table 2.

to look to only Vermont law in most instances.[160] Not all states are in the same position. Some states lack corresponding federal laws or establish protections that fail to meet the corresponding federal floor.[161] Employers and workers in these states must evaluate a greater mix of state and federal laws.

The second problem with Montana's single statewide test is the creation of an undesirable conflict between state and federal income taxes. Unlike labor laws, federal income tax does not create a national floor, but instead creates a nationwide income tax system. States may but need not implement state income tax systems, which can vary from the federal system.[162] However, for practical reasons, state income tax calculations often rely heavily on federal tax law.[163]

No state test can alleviate an employer's or worker's need to evaluate the IRS's worker status test for federal tax purposes. Therefore, Vermont's choice is between a state tax test that is uniform with other state laws but inconsistent with federal tax law, and a state tax test that is uniform with federal tax law but inconsistent with other state tests. Neither is ideal, but the latter is preferable.

A state that varies from the IRS's expanded common law test could create a situation where a worker files federal taxes under one status and state taxes under another. For example, suppose Vermont adopted the economic realities test for state income tax purposes. A worker could be properly classified as an employee for state tax but an independent contractor for federal tax. The result would force an employer to issue a W-2 for state filing and a 1099 for federal filing, the worker to use different calculations to determine federal and state income, and Vermont to change the filing process from merely accepting the federal adjusted gross income

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160. Notably, employers and workers must still look to federal law for preempting federal laws like ERISA, unionization, and intellectual property. Suve, *supra* note 54.

161. For example, Louisiana, Alabama, Mississippi, Tennessee and South Carolina have no minimum wage laws, while Wyoming, Minnesota, Arkansas, and Georgia set state minimum wage below the federal minimum wage. *Minimum Wage Laws in the States—September 1, 2014*, DEP'T OF LABOR, http://www.dol.gov/whd/minwage/america.htm (last visited Nov. 15, 2014).

162. For example, seven states have no income tax and only two have tax dividends and interest. *State Individual Income Taxes, 2014*, TAX POLICY CENTER (May 28, 2014), http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=406.

163. *See, e.g.*, *2013 Montana Individual Income Tax Return*, Line 7 (2013), *available at* http://revenue.mt.gov/Portals/9/individuals/forms/Form_2_2013.pdf; *2013 Vermont Income Tax Return, Form IN-111,* Line 10 (2013), *available at* http://www.state.vt.us/tax/pdf.word.excel/forms/income/2013/2013IN-111-fillin.pdf (showing that Montana and Vermont income tax calculations start by reporting the federal adjusted gross income).

to actually calculating the state tax due.[164] Thus, Vermont should retain the IRS test for state tax purposes because a variation from the federal tax test likely creates substantial uncertainty, more than negating any gain from a single test.[165]

In sum, consolidating tests could significantly ease proper classification, which is desirable even at the expense of eliminating over- or under-inclusivity between laws. Absent federal action, the best Vermont approach is to adopt one test, the economic realities test, for state unemployment, workers' compensation, wage and hour, family/sick leave, and anti-discrimination laws. However, Vermont should continue to use the IRS test for state income tax purposes to maintain tax consistency, and should continue to defer to preempted federal laws regarding ERISA, unions, and intellectual property. While admittedly failing to achieve universal one-test simplification, and short of federal action, this approach would resolve the greatest confusion between the multiple Vermont and federal tests.

2. Pre-certification

Advocates of pre-certification take a different approach to worker classification. Where consolidating tests aims to make ex ante analysis simpler by reducing the number of applicable tests, pre-certification attempts to address the underlying uncertainty with ex ante analysis. In theory, pre-certification, sometimes called the "check-the-box" approach,[166] allows a worker and employer who intend to operate under independent contractor status to register with the state to ensure appropriate treatment. However, like consolidating tests, pre-certification can produce undesirable outcomes. Montana again provides a useful example.

Montana allows workers to apply for an Independent Contractor Exemption Certificate (ICEC) by documenting ownership of an independent business and certifying they are free from employer control.[167]

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164. *See supra* Part I.A.1 (discussing classification tax implications).

165. Maine adopted a similar approach in 2012, consolidating workers' compensation, unemployment insurance, and wage and hour tests, but maintaining one consistent test for state and federal tax purposes. *See* 2012 Me. Laws 643; *Employment Standard Defining Employee vs. Independent Contractor*, ME. DEP'T OF LABOR, https://maine.gov/labor/misclass/employment_standard.shtml (last visited Nov. 12, 2014) (discussing labor tests); *Worker Misclassification—Understanding the Law*, ME. DEP'T OF LABOR, https://maine.gov/labor/misclass/legal.shtml (last visited Nov. 15, 2014) (discussing tax tests).

166. *See, e.g.*, Goldstein, *supra* note 155, at 122 (discussing the purpose of the "check-the-box" approach).

167. *IC Central Unit*, *supra* note 116.

All five state enforcement agencies—unemployment insurance, workers' compensation, wage and hour, human rights, and tax—recognize the certificate, which is valid for two years.[168] The benefit of operating under a Montana ICEC is the presumption of independent contractor status under state law.[169]

However, Montana's pre-certification presents new problems for both employers and workers. For the employer, pre-certification appears to provide clarity regarding worker status, but instead further complicates analysis. It is important to recognize that the state does not pre-certify and validate an actual working relationship, but instead certifies that the worker, working in a specific occupation under hypothetical conditions, is working as an independent contractor. Therefore, an enforcement agency or worker can still challenge the relationship.[170]

For example, suppose the worker files a state discrimination claim. First, the Montana enforcement agency would examine if the ICEC applied. The agency could ignore the ICEC in worker-status analysis where the worker is engaged in an occupation not listed on the ICEC, where the ICEC is expired, or where the employer did not know of the worker's ICEC upon hire.[171] Second, a state enforcement agency would, for the first time, look to the actual work relationship, applying the state's AB test that focuses on the right to control.[172] Under the AB test, and regardless of an ICEC, clear evidence of a right to control would demonstrate employee status and no evidence would indicate independent contractor status. A valid ICEC would only matter for ambiguous cases, providing the employer with some certainty by placing the burden of proof on the worker. Therefore, an employer seeking the presumption of independent contractor status in a narrow set of instances is required to hire workers with an unexpired ICEC, listing the appropriate occupation and ensuring the employer structures the relationship to prevent employer control.

Of course, the Equal Employment Opportunity Commission (EEOC) would ignore ICEC analysis if the worker brought a parallel federal discrimination claim, instead applying the more inclusive economic realities test. Therefore, since a prudent employer would not rely on ICEC

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168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*; *see also* Bjorgen v. Melotz Trucking, Inc., 2003 MTWCC 32, ¶ 26 (finding an independent contractor exemption inapplicable where the employer did not know the employee possessed one, even in the same occupation).

172. *See IC Central Unit*, *supra* note 155. For more on Montana's AB test, see *supra* Part II.B.1.

analysis in determining worker status, Montana's pre-certification process offers extra employer analysis for very limited additional employer protection.

Montana's pre-certification process also presents potential disadvantages for workers. Pre-certification provides large sophisticated employers an opportunity to structure their business practices to only contract with ICEC-holding workers, forcing interested workers to obtain an ICEC for eligibility. This relationship can be problematic where a large employer has significantly more bargaining power than non-unionized labor, and is partially why worker status is defined by law, not contract.[173]

Vermont has considered, but not adopted, a significantly scaled-back version of Montana's pre-certification law. The Vermont approach would largely avoid the problems created by the Montana plan, but the effects can be better achieved through consolidating tests.

In 2012 and 2014, Vermont bills proposed an online independent contractor registry, altering state worker status tests.[174] The proposed application process is more substantial than Montana's, requiring applicants to provide proof of business registration with the federal and Vermont governments, and affidavits attesting they were free from employer control or pressure to falsely apply.[175] A pre-certification board could seek additional information like proof of multiple employers, past work, equipment ownership, and past tax returns.[176] Like Montana, the Vermont pre-certification proposal examines only a worker's hypothetical working relationship and fails to examine the actual relationship with an employer. However, the Vermont proposed law differs from the Montana law in two other significant ways, resulting in reduced conflicts with other tests and less likelihood for abuse.

First, the Vermont pre-certification proposal would affect fewer state laws in less drastic ways. The proposal only eliminates a statutory presumption of employee status when operating with pre-certification.[177] In Vermont, only state workers' compensation and independent contractor

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173. Goldstein, *supra* note 155, at 115–16, 118.

174. *See* S. 220, Sec. 2–8 (Vt. 2014) (as introduced), http://www.leg.state.vt.us/docs/2014/bills/Intro/S-220.pdf; H. 762, Sec. 21 (Vt. 2012) (as introduced), http://www.leg.state.vt.us/docs/2012/bills/Intro/H-762.pdf. Independent Contractor pre-certification language was stripped from S.220 before passing the Senate. H.762 passed the House but not the Senate.

175. S. 220, Sec. 6, §1803(a) (Vt. 2014) (as introduced), *available at* http://www.leg.state.vt.us/docs/2014/bills/Intro/S-220.pdf.

176. *Id.* Sec. 6, §1803(b).

177. *Id.* Sec. 6, §1804.

laws presume employee status.[178] Neither state law has a corresponding federal law, and neither test is adopted elsewhere in state or federal law.[179] Therefore, unlike Montana, Vermont's proposed pre-certification would only modify existing unique state tests, without creating added conflicts with other state or federal laws.

Second, the Vermont approach limits potential bargaining-power abuses by prohibiting employers from hiring more than one pre-certified independent contractor "to do the same work on a project or at a job site."[180] Therefore, unlike the Montana law, the Vermont law would provide limited benefits to businesses hiring single workers to do single tasks, like website developers.[181]

However, Vermont's proposed pre-certification shares the other inherent limits with Montana's pre-certification—it applies in relatively few instances and is not recognized by federal law. While Vermont's pre-certification proposal may provide limited certainty to employers assessing their workers' compensation and unemployment insurance liabilities, a prudent Vermont employer would not rely on a pre-certification to assess other tax and labor liabilities.

Thus, the proposed Vermont approach simply alters existing state law, creating additional analysis and very limited protection in relatively few instances. At least the approach does not create the additional conflicts found in Montana. However, after two failed attempts to slightly reform state worker status laws, reformers would be better suited focusing on test consolidation. After all, adopting the economic realities test for all state labor, wage and hour, workers' compensation, and unemployment insurance laws would also eliminate any worker status presumption.

CONCLUSION

Federal and state laws that distinguish worker classification without clearly defining the terms have created confusion over proper classification and incentives to misclassify. While thorough reform likely requires federal

178. *See supra* Part I.B for a discussion of Vermont's workers' compensation (Two-Part) and independent contractor (ABC) tests.

179. *See infra* Part II.B.1 for a discussion of conflicting Vermont and federal tests.

180. S. 220, Sec. 6, §1804(b) (Vt. 2014) (as introduced), http://www.leg.state.vt.us/docs/2014/bills/Intro/S-220.pdf.

181. *See* Hilary Niles, *Independent Contractors Seek Clearer Employment Status*, VTDIGGER.ORG (Jan. 22, 2014, 7:23 PM), http://vtdigger.org/2014/01/22/independent-contractors-seek-clearer-employment-status (explaining how redefining "independent contractor" will create more benefits for the state).

action, states are not without options, and Vermont is in a good position to act. First, Vermont should continue to monitor the effects of recently increased enforcement efforts and penalties, modifying both as needed to deter intentional misclassification and incentivize compliance. Second, Vermont should ease compliance by providing clear guidance on which state and federal tests apply and their relationship to each other, and making that information readily available to employers and workers. Third, Vermont should consolidate state tests, adopting the economic realities test for all state labor, wage and hour, workers' compensation, and unemployment insurance laws, while ensuring state tax laws continue to parallel federal tax laws. Fourth, Vermont should not pursue a pre-certification process, but instead reach similar conclusions through consolidating tests without further complicating analysis. This approach will not resolve worker classification problems, but would best enable Vermont to detect and penalize misclassification, while incentivizing and easing proper ex ante classification.