Legislators Target Independent Contractors and Firms That Hire Them – A Threat to the MR Industry and Research Practices

By Howard Fienberg

Independent contractors play an important role in survey and opinion research, whether as field ethnographers, focus group moderators, or general research consultants. More fundamentally, any research participant receiving an incentive could conceivably be considered an independent contractor.

This is why MRA is concerned by legislation in Congress that could jeopardize the part of the tax code that allows for independent contractor relationships. H.R. 3408 and S. 2882 (the "Taxpayer Responsibility, Accountability, and Consistency Act") is sponsored by Rep. Jim McDermott (D-WA-7) and 121 cosponsors in the House of Representatives and Sen. John Kerry (D-WA) and 14 cosponsors in the Senate.

Both bills would eliminate Section 530, the safe harbor provision that allows employers to classify workers as independent contractors rather than employees. These bills would discourage companies from doing business with independent contractors by dramatically reducing the federal employment/tax certainty of treating service providers as independent contractors and materially increasing the penalties for misclassification.

Background: Section 530

Independent contractors do not have income taxes withheld from their pay as regular employees do. Section 530 of the Revenue Act of 1978 is a safe-harbor provision in federal tax law relied upon every day by many companies and self-employed service providers. Section 530 provides both parties to an independent contractor relationship with absolute certainty that such status will be respected by the Internal Revenue Service (IRS).

Section 530 is extremely important to a wide range of businesses. Businesses working with independent contractors do not have to pay Social Security, Medicare and unemployment insurance taxes for those contractors or withhold income taxes from contractors' pay – they only have to report income paid to independent contractors on 1099-MISC forms. They also do not generally have to be concerned about minimum wage, overtime or other labor laws.

As explained by a 2007 report from the Joint Committee on Taxation, "Under present law, the determination of whether a worker is an employee or an independent contractor is generally made under a facts and circumstances test that seeks to determine whether the worker is subject to the control of the service recipient, not only as to the nature of the work performed, but the circumstances under which it is performed."

The certainty provided by Section 530 enables companies and self-employed service providers – the quintessential small business people – to enter into business relationships that they know will be respected for federal employment/tax purposes. A certain and predictable regulatory environment for independent contractors benefits independent contractors, the companies that purchase their services and our nation's economy as a whole.

The Independent Contractor "Tax Gap" and "Tax Loophole"

As long as the income paid an individual is reported on 1099-MISC tax forms, "the federal government shouldn't care whether you perform services as an employee or independent contractor," says Russ Hollrah, executive director of the Coalition to Preserve Independent Contractor Status. "The FICA/SECA tax treatment of both employees and independent contractors is now substantially the same and their respective tax-compliance rates are more or less the same."

Section 530 has rigorous eligibility requirements that are not easily satisfied. And yet, various interest groups and government officials have accused Section 530 of being some kind of "loophole" in the tax code. They also claim that it leads to a "gap" between income paid to contractors and income taxes paid by those contractors. The President's proposed FY 2010 budget went so far as to include the assumption that a federal crackdown on independent contractor status would yield more than $7 billion in tax revenue over a 10 year period.

Rather than creating a "tax gap," Section 530 actually enhances tax compliance by demanding tax reporting compliance as a condition of eligibility. IRS data show 97 percent compliance rate for recipients of Forms 1099, versus 99 percent for those of Forms W-2. Moreover, says Russ Hollrah, most of the "tax gap" for the self-employed comes from the unreported cash economy.

Are Research Participants Employees of Research Companies?

The question may sound absurd, but legal cases arise on a regular basis contesting just that. MRA's General Counsel, LaToya Lang, has assisted multiple members on this issue.

Some participants in research studies receive incentives for participation. Research companies and organizations file 1099 forms as appropriate. However, the court system every year sees

cases where research participants either mistakenly or falsely attempted to claim unemployment insurance. Section 530 is a vital bulwark against similar misunderstandings with the IRS.

Of particular interest to the research profession is the case of Pharmakinetics Laboratory in Maryland. Though the company conducted drug testing, how it worked with and compensated research participants was fundamentally similar. Even though participants had filled out detailed consent forms and specifically acknowledged that they were not employees, the Maryland Department of Economic & Employment Development still contested their status as independent contractors. The company ultimately won the case before the Board of Appeals, 4, but only after the drug testing industry lobbied the state legislature to clarify the law and exempt their research.

Next Steps

MRA has been working with the Coalition to Preserve Independent Contractor Status to keep track of and deter such threats to Section 530. While the status of independent contractors impacts the business of research, it is farther afield from MRA's traditional lobbying concerns. So we need to hear from members of the research profession in the U.S. who: (1) are independent contractors; (2) use independent contractors; or (3) issue 1099 forms to research participants who receive incentives. We need to know where this belongs on our lobbying priority list.

While these bills in Congress are unlikely to be acted upon before the end of the year, we expect them to return in 2011. With the hunt for revenues to combat spiraling budget deficits, and proponents of these bills providing the illusion that they would lead to more tax revenue, we will need to defend independent contractor status for quite a while to come.

Notes

1 The IRS on independent contractors: http://www.irs.gov/taxtopics/tc762.html
2 "U.S. Cracks Down on 'Contractors' as a Tax Dodge." By Steven Greenhouse. The New York Times. Feb. 17, 2010.
3 Report from the Joint Committee on Taxation: http://www.jct.gov/x-26-07.pdf
4 Decision No. 156-EA-94. November 14, 1994.

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