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# The Latest in Employer Scams

*By Marc Linder and Larry Norton*

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**I**N JUNE of 1984, a family of migrants — let's call them the Morales family — from Roma in the Rio Grande Valley, travelled up to West Texas in search of work. They had waited until school was out so that their five children, ranging in age from 11 to 18, could also work. This is crucial because the family will earn most of its yearly income during the summer. In Levelland, they hear that there's an employment office outside the town in the tiny community of Pettit. There they are assigned to various farmers to hoe cotton. Although a sign at the employment office says they are entitled to

\$3.35 per hour, the agent in the office tells them they will earn only \$2.50 an hour because that's all the farmers can afford. No longer are they hourly "hoe-hands." They are independent contractors, small entrepreneurs. They have realized the American dream of becoming their own bosses and unfortunately no longer are covered by federal minimum wage laws. Employers, by declaring their employees independent contractors avoid a number of cumbersome and costly requirements including:

- employer's social security tax
- employer's federal income tax
- employer's state unemployment insurance tax
- workers compensation premiums
- statutory minimum wage or overtime payments
- withholding of social security or income tax

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- collective bargaining
- ERISA pension benefits
- safety and health inspections
- race, sex and age discrimination
- sanctions for employment of "unauthorized aliens"

At the peak of the season all seven members of the Morales family work sometimes up to 14 hours a day, seven days a week, on four or five West Texas farms. Even at \$2.50 an hour that amounts to more than \$1,200 a week. For a family with a cash income of only \$5,000 a year, that seems like a lot of money. And with plenty of other families in the area — including illegal aliens — out of work, no one can afford to protest that, by paying them 85 cents an hour below minimum wage, the farmers are short-changing them to the tune of \$400-500 a week.

The story, however, does not end in West Texas. In August the family returns to the Valley in time for their children to begin school. In early 1985 the parents file their tax return. Although they have received no tax documents from the farmers, they scrupulously report all income — after all, they will be entitled to an earned income credit. Two years later the IRS weighs in with some proposed changes.

Although the West Texas farmers did not provide the family any forms, the farmers filed 1099 IRS forms to document their own business expenses.

The IRS has created a computer program — with a two-year time-lag — that matches names of the recipients of such 1099s submitted by businesses with the names of wage earners on W-2s or filers of 1040s. Bingo! The Morales's are the losers. Since they have been employees all their lives, the heads of household have always anticipated their employers deducting the family's share of FICA tax and contributing their own employers' share as well. Now the IRS informs them that they owe an 11.3 percent self-employment social security tax (which for 1987 income is up to 14.1 percent) on their "nonemployee compensation." With two years of interest tacked on, the Morales's are now being dunned for more than \$700 (which they don't have and legally don't owe. In addition, until they pay, the Social Security Administration (SSA) will not credit them with any coverage credits toward their old-age pensions or disability insurance payments.

When they turn to a local legal services office, they discover that the burden is on them to prove that they were employees of the West Texas farmers. In addition to having to file an amended return, they will have to fill out two very long-winded forms in case the IRS or SSA, at some point in the misty future, finds the time to investigate the complaint. Finally, their wage claims, now almost three years old, might be barred by the statute of limitations.

In Texas the most frequent victims of this employer scam are those who can least afford it, seasonal and migrant farmworkers like the Morales family. And recent action by the Legislature, amending the Texas minimum wage law and entitling all farmworkers to \$3.35 an hour, will probably result in more creative measures by which agricultural employers will postpone the day when they too will have to pay workers \$3.35 per hour.

An even more sophisticated system is practiced in pickle sheds in the Valley. Taking a cue from their brethren in Ohio, Michigan and Wisconsin, who have elevated this technique to a philosophy of life, shed operators have devised the following practice. In Hidalgo County one large pickle shed decreed that for the 1987 harvest each family or separate individual harvesting pickles is running an independent

business. Asked to justify this classification, the shed managers argued that "pickers are independent contractors, just like plumbers and we don't tell them what to do."

In fact, the sheds have adopted a method of payment that largely does away with the need for supervision.

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### *Pickle workers in the Valley find themselves turned into "sharecroppers."*

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Pickling cucumbers are priced inversely to their size: the smallest ones are worth most. Thus on a piece rate, pickers are paid more for larger grades, less for smaller ones and nothing for culls. Over time farmers and shed operators realized that on the average this graded piece rate was about half the contract price they received from the picklers. To save supervisory and paperwork costs, they decided simply to pay the workers 50 percent of the proceeds. In effect, the automatic grading machine replaces the straw boss.

Although this arrangement might be lawful (if the workers were guaranteed \$3.35 per hour, regardless of their output), employers give it an illegal twist by taking the further step of calling their pickers "share-croppers." In reality, this employment relationship bears scarcely any resemblance whatsoever to the regime that plantation owners devised to secure a supply of labor in the wake of the emancipation of the slaves after the Civil War. In particular, the pickle pickers share no risk: if for some reason the pickles were not sold or were destroyed before reaching the shed, the workers would still be paid and the farmers shed would bear the loss.

In order to support the fiction of self-employment, the shed requires each family head, as a condition of employment, to apply for a certificate or registration as a crew leader (although by statutory definition someone who works only with his or her own family is not a crew leader). The shed then announces that because the workers are self-employed, they are not entitled to the minimum wage. (Unfortunately many farmworkers already mistakenly believe that when they work "por contrato" — on a piece rate — they are not entitled to minimum wage even when they are employees.) Six members

of what we'll call the Rodriguez family — "sharecropping" in the Hidalgo County operation — wind up with less than the equivalent of \$3.00 per hour each. And that does not include the 3-4 hours that Mr. Rodriguez spends in line every evening waiting for his pickles to be weighed and graded.

The shed management also informs them that since each family is running its own pickle picking business, the shed is not responsible for social security. And of course all the workers are excluded from the unemployment insurance system.

This re-classification is not, as these two examples show, based on any re-organization of production or introduction of new technology. The same worker can undergo this transformation from one day to the next. Rather, this sleight of hand is made possible by Form 1099-MISC. By filing it with the IRS and furnishing a copy to the worker an employer can create the legal basis for eliminating — and shifting to the employees the burden of establishing their entitlement to — the protections and benefits of social legislation.

What is this magical Form 1099-MISC? According to the Internal Revenue Code, businesses must file it if they pay \$600 or more (for services performed) to a person not treated as an employee. How has it come to pass that this Statement for Recipients of Miscellaneous Income, which was once largely reserved for reporting payments of fees to attorneys, accountants and the like, now does standard service for the humblest hewers of wood and drawers of water?

This particular paper scam was made easier by the Revenue Act of 1978. As a result of lobbying by the insurance, real estate, direct sales and other industries, all seeking to avoid intensified efforts by the IRS to insure that such employers pay social security and unemployment insurance taxes, Congress inserted a provision known as Section 530. It was originally supposed to self-destruct after one year but has now been extended indefinitely. Section 530 creates so-called safe havens for employers who have consistently treated employees as independent contractors for employment tax purposes in reasonable reliance, among other things, on a "long-standing recognized practice of a significant segment of the industry." Congress fortified the safe haven by prohibiting the IRS from publishing any regulations or revenue rulings regarding employment status. With the enforce-



ment and compliance arm of the IRS shackled, wave after wave of 1099s has come cascading down upon former employees. Lawyers and CPAs alert

clients to money-saving possibilities and satisfied customers spread the gospel to new disciples.

For more than a decade Congress has been unable to resolve the issue of employee status definitively. Its paraly-

sis has stemmed from the conflicting claims pressed by various industry associations — a debate that has by and large not penetrated popular consciousness. The time has now come for the affected workers to speak up. □

## What Congress Should Do

In Colorado, Governor Roy Romer recently ordered the state's attorney general to investigate and prosecute employers who "knowingly mischaracterize" employees as independent contractors and the U.S. Department of Labor has filed suit against one employer that used the label of "independent contractor" to avoid overtime pay. Though such action — on behalf of workers — by Gov. Bill Clements is unlikely, the Legislature could establish a uniform definition of "employee" that is not subject to manipulation by employers. However, to protect the package of worker benefits that have evolved since the New Deal, Congress will have to act:

1. Congress should establish, for all federal protective social legislation, a uniform definition of "employee" subject to the broadly remedial and humanitarian "economic reality of dependence" test developed by the courts interpreting the Fair Labor Standards Act.

2. Such a definition should include additional categories of so-called statutory employees whose status would not be subject to manipulation by employers. Chief among the vulnerable workers especially in need of such protection are migrant farmworkers.

3. A presumption should be created that all workers — but certainly

all workers whose hourly earnings are in the vicinity of the minimum wage — are employees (as is already done for example by most state unemployment compensation statutes).

4. Congress should repeal Section 530, which creates a safe haven for employers who have treated workers as independent contractors.

5. No employer should be permitted to issue a Form 1099-MISC without prior approval by the IRS. Such approval would be sought by filing the already existing Form SS-8 ("Information for Use in Determining Whether a Worker Is an Employee for Federal Employment Taxes and Income tax Withholding").

M.L.