Employer/Employee vs. Contractor Status in RESPECT Program

Issue

At issue is the classification of workers paid through the RESPECT of Florida program. Specifically, are RESPECT funded workers to be classified as employees, receiving W-2's, having taxes withheld and employers paying employer taxes; can workers be classified as contractors, receiving 1099's; or, can they be considered as "trainees"?

Background

An Employment Center referring to their workers who are producing commodities as "trainees," states the individuals served are part of their "sheltered workshop training program," appearing to be referencing Revenue Ruling 65-165 (Attachment 1). Many of these workers have been in the workshop in various commodity production roles for periods exceeding the referenced 16 week training period but are moved to different stations or jobs that are considered to be new training experiences.

Another Employment Center fulfilling service contracts refers to their workers as "contractors" and references IRS Publication 501, "Exemptions, Standard Deduction and Filing Information," as the basis for the worker's classification as contractors rather than employees. Upon review of this publication, we note it is a guideline for taxpayers in determining personal exemptions and deductions for dependents with disabilities who work in sheltered workshops. The publication is not directed to Employers and therefore should not be used in determining an Employment Center's Employer / Employee relationship. Further, most service contract pricing packages reflect the assumption that all employees earn at least minimum wage for hours worked and that employer payroll taxes are funded.

It is the position of Florida ARF d/b/a RESPECT of Florida that individuals placed into work through the RESPECT program are employees, and the involved Employment Centers are employers within this relationship. Chapter 413.032, F.S., indicates: *The purpose of the RESPECT program is to further the policy of the state to encourage and assist blind and other severely handicapped individuals to achieve maximum personal independence through useful, productive, and gainful employment by assuring an expanded and constant market for their commodities and services, thereby enhancing their dignity and capacity for self-support and minimizing their dependence on welfare and need for costly institutionalization.* Further, Chapter 413.033 (4)(c), F.S., states: *Qualified nonprofit agency for other severely handicapped means an agency that during the fiscal year* ***employs*** *blind or other severely handicapped individuals for not less than 75 percent of the person-hours of direct labor required for the production or provision of the commodities or services.*

A summary of an Internal Revenue Service Memorandum, dated September 25, 1997 (Attachment 2) and referencing Revenue Ruling 65-165, supports the conclusion that individuals placed in RESPECT funded jobs are employees. The memorandum states:

"Many businesses misclassify workers in a sheltered workshop as independent contractors when they really are employees. Revenue Ruling 65-165 discusses the treatment of such workers in each of the following categories:

- Individuals in training in a rehabilitation program designed to prepare them for placement in private industry. The intent of the training, which averages 16 weeks in length, is to accustom the individual to industrial working conditions. These individuals are not employees of the workshop for federal employment tax purposes while they are being trained.

- Regular workshop employees who have completed training and are capable of performing one or more jobs in the sheltered workshop temporarily if awaiting placement in private industry or permanently if unable to compete in regular industry. These individuals are paid by the workshop that provides working conditions and pay scales comparable to those in private industry, fixes working hours and production schedules so an employment relationship is intended. The trained workers in the workshop are employees for federal employment tax purposes.

- Individuals working at home that are incapable of working in the workshop that are able to produce salable articles and may sell them wherever they please. These individuals are not considered employees as no employer-employee relationship exists under the usual common law rules."

An excerpt from an IRS Memorandum regarding the status as employees or contractors in sheltered workshops states:

- The rulings further conclude that long-term, indefinite duration work programs, in which disabled individuals perform certain services for remuneration in a sheltered workshop program, most closely resemble the situation described in Class 2 of the revenue ruling. Disabled individuals typically remain in these types of work programs for many years either because they are incapable of working outside the protective environment of the sheltered workshop, because no suitable jobs are available *in* the community, or because the individual voluntarily chooses to remain in the sheltered workshop. Accordingly, the rulings held that disabled individuals who participate in such work programs are employees.

  (http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Tax-Benefits-for-Businesses-Who-Have-Employees-with-Disabilities)

Conclusion

Florida ARF d/b/a RESPECT of Florida manages RESPECT as an employment program and opines the employee / employer relationship begins as soon as an individual is hired. Individuals working on RESPECT commodities and / or service contracts must be considered employees for purposes of Federal Income Tax, FICA (Employee and Employer Tax), Unemployment Tax, and Worker's Compensation Coverage. The intent of the program is to create real job opportunities for individuals with disabilities and this position must be honored.

Attachment 1

Tax Benefits for Businesses Who Have Employees with Disabilities

Businesses accommodating people with disabilities may qualify for some of the following tax credits and deductions. More detailed information may be found in the IRS publications referenced.

Disabled Access Credit

The Disabled Access Credit provides a non-refundable credit for small businesses that incur expenditures for the purpose of providing access to persons with disabilities. An eligible small business is one that that earned $1 million or less or had no more than 30 full time employees in the previous year; they may take the credit each and every year they incur access expenditures. Refer to Form 8826, Disabled Access Credit (PDF), for information about eligible expenditures.

Barrier Removal Tax Deduction

The Architectural Barrier Removal Tax Deduction encourages businesses of any size to remove architectural and transportation barriers to the mobility of persons with disabilities and the elderly. Businesses may claim a deduction of up to $15,000 a year for qualified expenses for items that normally must be capitalized. Businesses claim the deduction by listing it as a separate expense on their income tax return. Also, businesses may use the Disabled Tax Credit and the architectural/transportation tax deduction together in the same tax year, if the expenses meet the requirements of both sections. To use both, the deduction is equal to the difference between the total expenditures and the amount of the credit claimed.

Work Opportunity Credit

The Work Opportunity Credit provides eligible employers with a tax credit up to 40 percent of the first $6,000 of first-year wages of a new employee if the employee is part of a "targeted group." An employee with a disability is one of the targeted groups for the Work Opportunity Credit, provided the appropriate government agencies have certified the employee as disabled. The credit is available to the employer once the employee has worked for at least 120 hours or 90 days. Employers claim the credit on Form 5884, Work Opportunity Credit (PDF).

Expanded Tax Credit for Hiring Unemployed Veterans

The work opportunity credit has been expanded to provide employers with new incentives to hire certain unemployed veterans.

On November 21, 2011, the President signed into law the VOW to Hire Heroes Act of 2011. This new law provides an expanded work opportunity tax credit to businesses that hire eligible unemployed veterans and for the first time also makes part of the credit available to tax-exempt organizations. Businesses claim the credit as part of the general business credit, and tax-exempt organizations claim it against their payroll tax liability. The credit is available for eligible unemployed veterans who begin work on or after November 22, 2011, and before January 1, 2013.

For more information on claiming this credit, go to the Expanded Work Opportunity Tax Credit Available for Hiring Qualified Veterans. Get the latest information about Form 5884, Work Opportunity Credit, and its instructions, and Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit.

Classification of Workers in Sheltered Workshops

Many businesses misclassify workers in a sheltered workshop as independent contractors when they really are employees. Revenue Ruling 65-165 discusses the treatment of such workers in each of the following categories:

- Individuals in training in a rehabilitation program designed to prepare them for placement in private industry. The intent of the training, which averages 16 weeks in length, is to accustom the individual to industrial working conditions. These individuals are not employees of the workshop for federal employment tax purposes while they are being trained.

- Regular workshop employees who have completed training and are capable of performing one or more jobs in the sheltered workshop temporarily if awaiting placement in private industry or permanently if unable to compete in regular industry. These individuals are paid by the workshop that provides working conditions and pay scales comparable to those in private industry, fixes working hours and production schedules so an employment relationship is intended. The trained workers in the workshop are employees for federal employment tax purposes.

- Individuals working at home that are incapable of working in the workshop that are able to produce salable articles and may sell them wherever they please. These individuals are not considered employees as no employer-employee relationship exists under the usual common law rules.

Additional information about these business topics concerning accommodations for individuals with disabilities are in:

- Publication 535, Business Expenses
- Publication 954,Tax Incentives for Distressed Communities
- Form 8826, Disabled Access Credit (PDF)
- Form 5884, Work Opportunity Credit (PDF)
- Form 3800, General Business Credit (PDF)
- Instructions to Form 3800
- Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit (PDF)
- Instructions for Form 8850

There is also a wide array of tax benefits available to persons with disabilities, ranging from standard deductions and exemptions to business and itemized deductions to credits. Information about these issues is in Publication 3966, Living and Working with Disabilities (PDF).

Attachment 2

Internal Revenue Service

memorandum

SEP 25 1997

date:

to: Tom Burger, Director Office for Employment Tax Administration and Compliance

from: Assistant Chief Counsel Employee Benefits and Exempt Organizations CC:EBEO

subiect: Employment Tax Status of Disabled Workers

During the past several years, the question of whether disabled individuals who participate in sheltered workshop programs and other training/work programs operated by rehabilitation facilities are employees has received a great deal of attention. This office has received a number of ruling requests over the past few years and we understand that a number of similar cases are pending in various districts throughout the country. In order to inform Service personnel of the position that the National Office is taking in its cases, we are 'providing the following information concerning the rulings issued by this office.

After careful and diligent consideration, the National Office has recently begun to respond to requests for private letter rulings and technical advice concerning the federal employment tax status of disabled individuals who perform services in sheltered workshop programs operated by rehabilitation facilities. Rulings recently issued by the National Office focus on a strict application of Revenue Ruling 65-165, 1965-1 C.B. 446 to the facts in each particular case.

Revenue Ruling 65-165 describes three situations involving blind individuals who performed services in sheltered workshop programs. The ruling holds that the blind individuals are not employees in two out of the three situations described because the control and direction exercised over them is for the purpose of rehabilitation and therapy and no employment relationship is intended. The ruling holds that the other group of individuals, with whom an employment relationship is intended and for whom the sheltered workshop organization provides working conditions, pay scales, and employee benefits comparable to those available in private industry, are employees.

The key in determining the status of disabled individuals is to determine whether the facts in a particular case most closely resemble the situation described in Class 1 (not employees) or Class 2 (employees) of Rev. Rul. 65-165. Class 3 described in the revenue ruling concerns disabled individuals who are incapable of working in the workshop but who are capable of producing saleable articles at home. The National Office has not been asked to rule on this type of situation.'

PMTA:00171

Tom Burger, Director Office for Employment Tax Administration and Compliance

Recent rulings have concluded that short-term, finite duration evaluation or training programs, typically averaging several weeks to several months in length, that are intended to assess a disabled individual's needs, abilities and skills and/or to train the individual for placement in some type of work program within the rehabilitation facility or for competitive employment in the community, most closely resemble the situation described in Class 1 of the revenue ruling.. In the revenue ruling, this period averaged 16 weeks in length. Accordingly, the rulings held that disabled individuals who participate in such programs are not employees.

The rulings further conclude that long-term, indefinite duration work programs, in which disabled individuals perform certain services for remuneration in a sheltered workshop program, most closely resemble the situation described in Class 2 of the revenue ruling. Disabled individuals typically remain in these types of work programs for many years either because they are incapable of working outside the protective environment of the sheltered workshop, because no suitable jobs are available *in* the community, or because the individual voluntarily chooses to remain in the sheltered workshop. Accordingly, the rulings held that disabled individuals who participate in such work programs are employees.

We hope this information is helpful to Service personnel. Please keep in mind that section 6110(j) (3) of the Internal Revenue Code provides that written determinations (i.e. private letter rulings, technical advice memorandum, or determination letters) may not be used or cited as precedent. Service personnel who are interested in obtaining additional information may contact the Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622-6050.