Partnership Issues: Employees or Independent Contractors?

Family Child Care Providers in Networks or Systems or Sponsored by Programs

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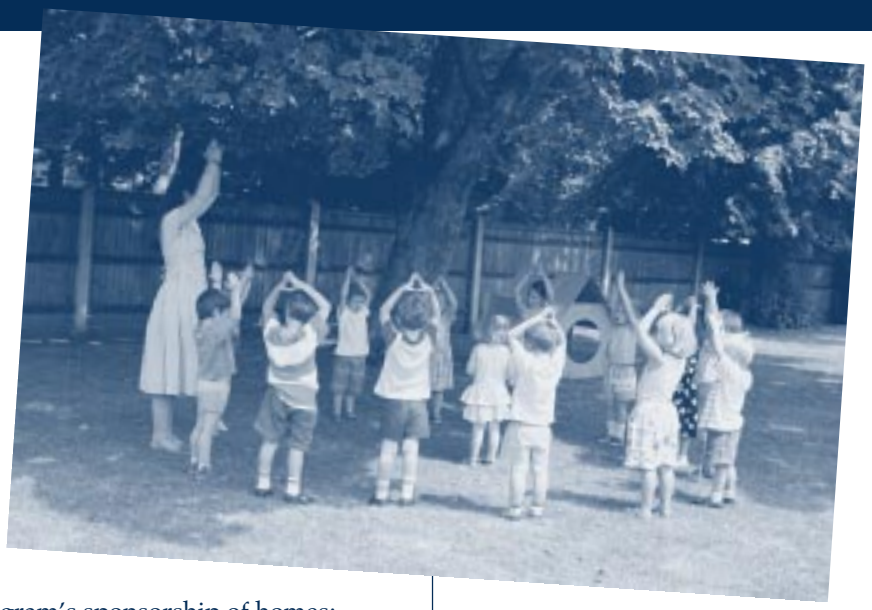

On August 29, 2000, the Head Start Bureau issued proposed regulations which formally recognized the provision of Head Start in family child care settings as a program option. Almost from the inception of Head Start, family child care has been discussed as a possible option. Since Head Start's goal is to design programs to meet community and family needs, family child care has always been attractive. Many parents value its convenience, flexibility, home-like features, and ability to mix age groups (and thereby allow siblings to remain together). In response to this demand, a number of Head Start grantees established family child care homes through innovative demonstration grants and program expansions.

Through the demonstration projects the Bureau identified six primary indicators of quality family child care: the use of licensed homes; very small groups of children, especially when infants and toddlers are enrolled; qualified family child care providers with suitable training and experience; the implementation of a curriculum based on sound child development principles; the integral involvement of parents; and the provision of strong support from the Head Start program to providers, including paid staff to assist the family child care provider as needed and ongoing oversight of the family child care provider by qualified and experienced staff.

Ongoing oversight is important because it always raises a fundamental legal issue when considering family child care networks or systems or a program's sponsorship of homes; namely, are these providers employees or independent contractors? Unless that issue is dealt with, many agencies are reluctant to establish these programs. If providers are found to be employees and have not been treated as such, programs will be hit with penalties for failing to comply with the legal requirements imposed on employers, such as paying unemployment taxes, workers' compensation, and so forth. Consequently, individuals commenting on the proposed regulations have requested that the Head Start Bureau respond to these concerns in its final regulations.

In the meantime this article presents a brief overview of the issues and the current legal landscape. The article first addresses why it even matters how the law characterizes a worker and why the issue is so complicated. Then it discusses the two primary legal issues of concern: (1) Is there an employment relationship? (2) If there is, who is the employer? Finally, it looks at existing case law.

Why does it matter how the law perceives a worker?

When a family child care provider operates completely independently, everyone agrees that the provider is an independent contractor. But as soon as the provider has a relationship with a sponsoring organization, a network, or other system that supports providers and includes certain requirements or oversight, questions arise about whether or not an employment relationship exists. This issue is important because if an employment relationship does exist, the sponsoring entity or the employee or both may be responsible for complying with a variety of federal laws. Some of the primary requirements are as follows:

- Obtaining an employer identification number
- Complying with the federal Fair Labor Standards Act (FLSA)
- Complying with federal tax provisions, including the Federal Insurance Contributions Act (FICA), otherwise known as Medicare and Social Security
- Complying with the Federal Unemployment Tax Act (FUTA)
- Withholding federal income tax
- Applying for the Earned Income Tax Credit (EITC)
- Completing the Employment Eligibility Verification form (INS Form I-9)

(Continued on page 32)

Partnership Issues: Employees or Independent Contractors?

(Continued from page 31)

Under California law employers and employees have additional responsibilities. The primary requirements under state law are as follows:

- Registering as an employer with the Employment Development Department (EDD)
- Paying employer taxes, including State Unemployment Insurance (UI) and Employment Training Tax (ETT)
- Withholding required payments, including State Disability Insurance (SDI) and Personal Income Tax (PIT)
- Withholding payroll taxes
- Withholding income tax
- Contributing to workers' compensation
- Complying with the California Wage and Hour Law

Failure to comply with these laws is costly. In addition to the payment of whatever is owed, many of these laws carry severe civil penalties for violations. Willful violations may also subject one to criminal penalties.

Why is this issue so complicated?

There are three important factors that make the determination of whether there is an employment relationship complicated and difficult. First, many of the legal requirements listed above use different legal standards to determine whether one is an employee or an individual contractor. Although its sounds crazy (and it is not common), it is possible to be considered an employee in one context and an independent contractor in another. For example, courts are more likely to find an individual to be an employee under California's workers' compensation law than under other laws because the primary purpose of the workers' compensation law is to protect injured workers.

Second, the standards that are applied in these cases are not tight, objective standards but, instead, are very loose, subjective determinations. It is also a stretch to call these determinations "standards" because the "standard" used is really a conglomeration of factors, agency opinions, court interpretations, and so forth.

Finally, whether an administrative agency or court determines that someone is an employee is a highly individualized decision based on the specific facts of that person's case. As a result, it is hard to give generalized guidance or develop rules of thumb. Similar cases have resulted in different outcomes with no apparent justification.

When is there an employment relationship?

As indicated above, differing legal standards are used to determine the existence of an employment relationship, depending on which law is being considered. For example, for the purposes of federal employment tax laws, the Internal Revenue Service (IRS) applies a 20-factor test,[1] whereas the FLSA, which is more expansive (easier to be considered an employee), uses a six-factor test. Regardless of which test is employed, there are some factors that are typically considered. These can be grouped into three areas:

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Behavioral control—the right to direct and control how the worker does the task. This right does not actually have to be exercised for an employment relationship to be found; one must simply have the right to exercise control. Those making the determination look at the instructions the business gives the worker and any training given the worker. This factor is the most important consideration in almost all legal tests.

Financial control—the right to control the business aspects of the operation. Agencies and courts look at:

- Whether the worker has unreimbursed business expenses
- What the worker's investment is
- The extent to which the worker makes his or her services available in the relevant market
- How the worker is paid
- The extent to which the worker realizes a profit or incurs a loss

Type of relationship. Agencies and courts look at:

- Whether there is a written contract describing the relationship (Although the written word counts for something, it is not determinative.)
- Whether benefits are provided
- The permanency of the relationship
- The extent to which services performed by the worker are a key aspect of the regular business of the company

Who is the employer?

Under some of the employment laws, there may be a finding of joint employment. One of these laws is the FLSA. Therefore, once agencies or courts determine that an employment relationship exists and that the FLSA governs, they must also determine who the employer is. When child care subsidies are paid to family child care providers who are a part of networks or systems, the entities that need to be evaluated for their possible employer status are the payment agency (whether

[1]Versions of this 20-factor test are widely available; one source of value is the IRS Training Materials on worker classification, which is used by IRS employees to determine whether individuals are employees or independent contractors. While the training material does not carry the force of law, it is instructive. It can be obtained electronically at *<http://www.irs.ustreas.gov/prod/bus_info/training.html>*.

(Continued on page 33)

Partnership Issues: Employees or Independent Contractors?

(Continued from page 32)

public or private), the state or locality, and possibly the parents. In cases of joint employment, all the employers are responsible for ensuring that legal obligations are met.

What are the precedents in case law?

Not surprisingly, few cases deal directly with whether family child care providers that operate as a part of networks or systems are to be considered employees or independent contractors. And, as discussed previously, when such cases exist, it is difficult to generalize from them because either they occur in a different legal context or they involve different facts. The most recent cases in this area have applied the National Labor Relations Act (NLRA—the primary law governing unionizing) to family child care providers who are a part of networks or systems. Independent contractors have no protection under the NLRA.

The National Labor Relations Board (NLRB), which makes the rulings that implement the provisions of the NLRA, has found at least twice that family child care systems operating in New York were made up of independent family child care providers and that these providers were not employees of the sponsoring agency. In *Cardinal McCloskey Children's and Family Services,* 298 NLRB 55 (1990), the providers were found to be independent contractors despite the existence of numerous factors that suggested that they were employees, such as working set hours, serving only referred children, being furnished with toys and equipment, having to attend mandatory training, being closely monitored to ensure compliance with regulations, and having extensive suggestions made regarding the operation of their homes. The key to this decision appears to be that despite all the monitoring and supervision, the regional director found that most of the monitoring was done according to regulations required by the subsidizing agency rather than by the sponsoring agency. It is interesting to note that this finding was made despite the recognition that the homes received more visits than were required by the subsidizing agency and that providers were required to make alternative arrangements for children in their care in the event of provider illness or vacation and to notify the sponsoring agency, although the subsidizing agency did not require this.

By contrast, a 1980 decision by the NLRB had found that providers *were* employees because they were required to meet many controls imposed by the employer independent of any governmental regulations.

Conclusion

There are no easy answers to these issues. From a policy perspective, some people are eager to ensure that protective employment laws benefit family child care providers who clearly are not operating on their own. Those taking this position believe that such providers are running businesses that are controlled by others down to the small details and see few differences between these providers and child care center staff.

Others are concerned about the cost that a finding of employment would cause, particularly in subsidy situations in which the subsidies provided are insufficient to cover all the costs that accompany employment. Still others believe that providers working in their own homes are too independent to be considered employees, regardless of the requirements they must meet to participate in a network or system. The Head Start Bureau may provide some guidance in the future on these issues with respect to Head Start programs under federal law in response to the comments submitted about its proposed regulations.

However, that still leaves open continuing concerns about how Head Start programs utilizing the family child care option will be treated under state laws and how family child care networks or systems operating outside of Head Start will be treated under state *and* federal laws. Because these networks or systems may operate under different standards (unlike Head Start, which uses a uniform standard throughout the country), and the cases may come up in different legal contexts (unemployment, workers' compensation, etc.), we may continue to get different outcomes. It is important for any network or system considering the development of such a program to obtain legal counsel to review the cases that do exist. In that way programs can develop operating policies and procedures in accordance with the outcome they wish to attain—as employees or as independent contractors.