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(IN)DEPENDENT CONTRACTORS: COMBATTING EMPLOYEE MISCLASSIFICATION IN TITLE 26

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ABSTRACT

This comment addresses the use of 26 U.S.C. § 7434 as an alternative remedy for individuals who are misclassified by their employers as independent contractors for federal tax purposes. Historically, misclassified employees have used more well-known employment laws such as the Fair Labor Standards Act to sue employers who engage in employee misclassification. 26 U.S.C. § 7434 provides an underutilized, alternative means for misclassified employees to recover damages for wrongful misclassification. Originally enacted in 1996 as part of the Taxpayer Bill of Rights, 26 U.S.C. § 7434 is a tax fraud statute that allows a taxpayer to seek civil damages when another person files a fraudulent information return with respect to payments purported to be made to the taxpayer. However, there is disagreement among federal courts as to whether the statute allows employees who have been misclassified as independent contractors to recover damages from their employer. This comment discusses the practical implications and drawbacks of using the statute as a remedy for misclassified employees. Further, this comment argues that the discord among federal courts should be resolved in favor of employees by allowing individuals who are misclassified to recover under the statute.

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I. INTRODUCTION

The American dream is a belief that every citizen of the United States should have the opportunity to work hard, improve their circumstances, and create a better life for themselves.[1] The modern concept of the American dream is based, in large part, on a cooperative relationship between workers and their employers. In exchange for their efforts, workers are afforded some basic guarantees like economic stability, workplace protections, and a social safety net.[2] These traditional notions of work in the United States are constantly evolving and one of the foremost drivers of that change is employee misclassification by corporations seeking to reduce their labor costs.[3] Employee misclassification occurs when a worker who should be considered an employee of a business and receive a W-2 form to file their tax returns, is instead treated as a self-employed, independent contractor and receives a 1099-NEC[4] form for nonemployee compensation.[5] The issue of employee misclassification has become increasingly relevant due to the advent of the modern gig economy. Companies such as Uber, Lyft, DoorDash, and Instacart rely on the labor of independent contractors to operate their businesses.[6] This has resulted in increased scrutiny for businesses who depend on independent contractors and raised the question of whether these businesses are engaging in employee misclassification.[7]

While employers may misclassify their workers as independent contractors for a variety of reasons, one of the primary incentives for employers to misclassify their workers is the reduction in labor costs.[8] Employers who engage in misclassification are able to avoid payroll tax

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1 *See American Dream*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/other/american-dream/ (last visited Mar. 30, 2021).

2 *See Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries*, NAT'L EMP. L. PROJECT (Oct. 26, 2020), https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-workers-federal-state-treasuries-update-october-2020/.

3 *Id.*

4 *See infra* p. 109 (explaining that nonemployee compensation was previously reported using a 1099-MISC form, but beginning in the 2020 tax year, nonemployee compensation is reported using a 1099-NEC form).

5 Françoise Carré, *(In)dependent Contractor Misclassification*, ECON. POL'Y INST. (June 8, 2015), https://www.epi.org/publication/independent-contractor-misclassification/.

6 *See Lauren Feiner, Gig Companies Prepare to Bring Their Fight for Independent Work Nationwide Under a More Skeptical Biden Administration*, CNBC (Mar. 15, 2021), https://www.cnbc.com/2021/02/27/uber-doordash-vs-gig-workers.html.

7 *See* Sean P. Redmond, *Misclassification Mayhem Dashes On*, U.S. CHAMBER OF COMMERCE (June 25, 2020, 12:45 PM), https://www.uschamber.com/article/misclassification-mayhem-dashes.

8 *See Worker Misclassification*, NAT'L. CONF. OF STATE LEGISLATURES, https://www.ncsl.org/research/labor-and-employment/employee-misclassification-resources.aspx (last visited Mar. 3, 2021).

responsibilities typically associated with employees.[9] Employers are responsible for half of the 15.3% payroll tax for Social Security and Medicare under the Federal Insurance Contributions Act, also known as the FICA tax, for their employees.[10] Employers are also responsible for paying the costs associated with the Federal Unemployment Tax, which funds unemployment benefits for employees.[11] Employers who label their workers as independent contractors are not required to pay their share of FICA taxes or Federal Unemployment taxes. Employers may also avoid other costs imposed by state law, such as worker's compensation insurance.[12] In addition, employers who engage in misclassification avoid the compliance costs of the Fair Labor Standards Act (FLSA), which sets standards for wages and overtime premiums.[13] This is due to the fact that independent contractors are not protected under FLSA regulations.[14] Independent contractors also usually lack protection under the Family and Medical Leave Act and Employment Non-Discrimination Act.[15]

Despite the increased controversy surrounding the use of independent contractors, there is very little data on how many employers utilize independent contractors.[16] As a result, is it unknown how many of the 160 million workers in the United States are classified as independent contractors.[17] The most recent data from the Bureau of Labor Statistics estimated that there were approximately 10.6 million independent contractors

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9 *Id.*

10 *Topic No. 751 Social Security and Medicare Withholding Rates*, INTERNAL REVENUE SERV., https://www.irs.gov/taxtopics/tc751 (last visited Mar. 3, 2021).

11 *Federal Unemployment Tax*, INTERNAL REVENUE SERV., https://www.irs.gov/individuals/international-taxpayers/federal-unemployment-tax (last visited Mar. 3, 2021).

12 *Workers' Compensation Laws - State by State Comparison*, NFIB (June 7, 2017), https://www.nfib.com/content/legal-compliance/legal/workers-compensation-laws-state-by-state-comparison-57181/.

13 *See Summary of the Major Laws of the Department of Labor*, U.S. DEP'T. OF LABOR, https://www.dol.gov/general/aboutdol/majorlaws (last visited Mar. 3, 2021); *Misclassification of Employees as Independent Contractors*, U.S. DEP'T. OF LABOR, https://www.dol.gov/agencies/whd/flsa/misclassification (last visited Mar. 3, 2021).

14 29 U.S.C.S. § 203 (LEXIS through Pub. L. No. 117-36).

15 *Family and Medical Leave Act* (FMLA), U.S. DEP'T. OF LABOR, https://www.dol.gov/general/topic/workhours/fmla (last visited Mar. 3, 2021); *see also* Corey Husak, *How U.S. Companies Harm Workers by Making Them Independent Contractors*, WASH. CTR. FOR EQUITABLE GROWTH (July 31, 2019), https://equitablegrowth.org/how-u-s-companies-harm-workers-by-making-them-independent-contractors/ (last visited Mar. 3, 2021).

16 *New Recommendations on Improving Data on Contingent and Alternative Work Arrangements*, U.S. BUREAU OF LABOR STATISTICS (Aug. 10, 2020), https://blogs.bls.gov/blog/tag/independent-contractors/.

17 U.S. DEP'T. OF LABOR, BUREAU OF LABOR STATISTICS, USDL-21-0365, *The Employment Situation – February 2021* (Mar. 05, 2021), https://www.bls.gov/news.release/archives/empsit_03052021.pdf.

in the United States, representing about 6.9% of the entire workforce in 2017.[18] Furthermore, it is unknown how many of the 6.9% of workers were legitimate independent contractors and how many were misclassified.[19] The illicit nature of employee misclassification makes it difficult to calculate the actual scale and magnitude of the problem.[20] However, most estimates show an increase in employee misclassification over the last decade.[21] In 2006, the U.S. Government Accountability Office estimated that the federal government lost $2.72 billion dollars in tax revenue due to employee misclassification.[22] Further, in 2000 the U.S. Department of Labor conducted a study on lost unemployment insurance revenue and found that 30% of the businesses audited had employees misclassified as independent contractors.[23] Misclassification impacts every industry, but the problem is most common in industries where is it most profitable, such as those industries with higher insurance premiums, and industries where it can be easily hidden, such as those industries with scattered work-sites and high turnover rates.[24]

The issue of employment misclassification has a significant impact on the gig worker economy in particular. The gig economy has been defined as "a way of working that is based on people having temporary jobs or doing separate pieces of work, each paid separately, rather than working for an employer."[25] Critics of large corporations who rely on gig workers argue that the companies misuse the independent contractor status to reduce labor costs and gain a competitive advantage.[26] Employee advocacy groups contend that these companies are not engaging in genuine business to business transactions, which the independent contractor status is designed for.[27]

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18 U.S. DEP'T. OF LABOR, BUREAU OF LABOR. STATISTICS., USDL-18-0942, *Contingent and Alternative Employment Arrangements — May 2017* (June 7, 2018), https://www.bls.gov/news.release/pdf/conemp.pdf.

19 Husak, *supra* note 15.

20 Carré, *supra* note 5.

21 Mark Erlich & Terri Gerstein, *Confronting Misclassification and Payroll Fraud: A Survey of State Labor Standards Enforcement Agencies*, HARV. L. SCH., LABOR AND WORKLIFE PROGRAM (2019), https://lwp.law.harvard.edu/files/lwp/files/misclassification.pdf/.

22 U.S. GOV'T ACCOUNTABILITY OFFICE., GAO-09-717, EMPLOYEE MISCLASSIFICATION: IMPROVED COORDINATION, OUTREACH, AND TARGETING COULD BETTER ENSURE DETECTION AND PREVENTION (2009), http://www.gao.gov/products/GAO-09-717.

23 U.S. DEP'T. OF LABOR., INDEPENDENT CONTRACTORS: PREVALENCE AND IMPLICATIONS FOR UNEMPLOYMENT INSURANCE PROGRAMS (2000), http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf.

24 Carré, *supra* note 5.

25 *Gig Economy*, CAMBRIDGE DICTIONARY, https://dictionary.cambridge.org/us/dictionary/english/gig-economy (last visited Mar. 3, 2021).

26 *See* David Weil, *Lots of Employees Get Classified as Contractors. Here's Why It Matters*, HARV. BUS. REV. (July 5, 2017), https://hbr.org/2017/07/lots-of-employees-get-misclassified-as-contractors-heres-why-it-matters.

27 *See Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries*, *supra* note 2.

Several companies including Uber, Lyft, DoorDash, Instacart, and Postmates have fought to protect the independent contractor classification for their workers through nationwide lobbying efforts such as California Proposition 22, a California proposition that exempts the companies from being required to treat their workers as employees.[28] These aggressive lobbying efforts are expected to continue at both the state and federal levels because any adverse regulatory changes would significantly impact the profitability of gig companies.[29]

Employees who are wrongly misclassified by their employers can seek legal recourse in several different ways under federal law. Claims most commonly arise under wage and hour laws such as the Fair Labor Standards Act, the False Claims Act, the Davis-Bacon Act, or the Service Contractor Act.[30] The Fair Labor Standards Act allows employees to recover backpay, overtime, liquidated damages, prejudgment interest, and/or attorneys' fees and costs from their employer for violations of wage and hour provisions.[31] The Davis-Bacon Act and Service Contractor Act allow employees to bring wage and hour violation actions against employers in the context of federal or federally-assisted government contracts.[32] Employees also have the option of filing whistleblower claims under the False Claims Act, which pertains to fraudulent claims made to the federal government that result in a loss.[33] Similarly, the IRS grants monetary awards to whistleblower claims for reports of fraud.[34] However, IRS whistleblower claims are administrative actions and do not require litigation.[35] In conjunction with wage and hour violation actions or whistleblower actions, employees have also been brought under a lesser-known federal tax fraud statute, 26 U.S.C. § 7434.[36]

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28 Megan Rose Dickey, *An Even Bigger Battle for Gig Worker Rights Is on the Horizon*, TECHCRUNCH (Dec. 13, 2020, 10:52 AM), https://techcrunch.com/2020/12/13/an-even-bigger-battle-for-gig-worker-rights-is-on-the-horizon/; CAL. BUS. & PROF. CODE §§ 7448–7467 (Deering, LEXIS through 2021 Legis. Sess.).

29 *See* Erin Mulvaney, *Uber Will Push to Shape Direction of Biden Gig Worker Regulation*, BLOOMBERG LAW (Mar. 13, 2021, 5:31 AM), https://news.bloomberglaw.com/daily-labor-report/uber-will-push-to-shape-direction-of-biden-dols-gig-worker-rule.

30 *See* Edward J. Leyden, *Current Developments in Employment Law 2019 CURRENT EMPLOYMENT AND TAX ISSUES*, SB002 A.L.I.-A.B.A. 341 (2019).

31 29 U.S.C.S. § 216(b) (LEXIS through Pub. L. No. 117-36).

32 *Davis-Bacon and Related Acts*, WAGE & HOUR DIV., U.S. DEP'T. OF LABOR, https://www.dol.gov/agencies/whd/government-contracts/construction (last visited Mar. 3, 2021).

33 *The False Claims Act*, U.S. DEP. OF JUST. (Jan. 14, 2021), https://www.justice.gov/civil/false-claims-act.

34 *Whistleblower Office*, INTERNAL REVENUE SERV., https://www.irs.gov/compliance/whistleblower-informant-award (last visited Mar. 3, 2021).

35 Leyden, *supra* note 30.

36 Leyden, *supra* note 30.

26 U.S.C. § 7434 is a federal statute which allows a taxpayer to recover civil damages from a person who files a fraudulent tax return on their behalf.[37] This note addresses the use of 26 U.S.C. § 7434 as an alternative remedy for employees misclassified as independent contractors. Using the statute in the employee misclassification context is based on the concept that an employer who intentionally files a fraudulent 1099-NEC tax form for independent contractors, instead of a W-2 tax form for employees, has violated the tax fraud provisions of 26 U.S.C. § 7434. There is no uniform answer among the federal courts as to whether a misclassified employee can recover under 26 U.S.C. § 7434.[38] This note aims to simplify the complex intersection of tax law and employee misclassification and describe how the statute can be used as a viable remedy for misclassified employees. This note is divided into two primary sections. The first section addresses the historical background of the statute and how courts have interpreted each required element of the statute. The second section argues that federal courts should adopt a uniform standard which allows misclassified employees to recover damages under the statute and then addresses the major challenges that misclassified employees face when bringing an action.

II. BACKGROUND

26 U.S.C. § 7434 provides that "if any person willfully files a fraudulent information return with respect to payments purported to be made to any other person, such other person may bring a civil action for damages against the person filing such return."[39] The statute also provides that upon a finding of liability, the defendant

> shall be liable to the plaintiff in the amount equal to the greater of $5,000 or the sum of (1) any actual damages sustained by the plaintiff as a proximate result of the filing of the fraudulent information return (including any costs attributable to resolving deficiencies asserted as a result of such filing), (2) the costs of the action, and (3) in the court's discretion, reasonable attorneys' fees.[40]

Federal courts have identified three required elements to create a cause of action under 26 U.S.C. § 7434, which are as follows: (1) the defendant issued an information return; (2) the information return was fraudulent; and

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37 26 U.S.C.S. § 7434 (LEXIS through Pub. L. No. 117-36).

38 Liverett v. Torres Advanced Enter. Sols. LLC, 192 F. Supp. 3d 648, 650 (E.D. Va. 2016) (noting that no federal court of appeals had addressed the ambiguity in 26 U.S.C. § 7434).

39 26 U.S.C.S. § 7434 (LEXIS through Pub. L. No. 117-36).

40 *Id.*

(3) the issuance of the information return was willful.[41] The statute was enacted as part of the Taxpayer Bill of Rights in 1996.[42] The Taxpayer Bill of Rights was enacted by President Bill Clinton in 1996 and contains several provisions "intended to provide increased protection of taxpayer rights in complying with the Internal Revenue Code."[43] 26 U.S.C. § 7434 was included in the Taxpayer Bill of Rights because "[s]ome taxpayers may suffer significant personal loss and inconvenience as the result of the IRS receiving fraudulent information returns, which have been filed by persons intent on either defrauding the IRS of harassing taxpayers."[44] Therefore, 26 U.S.C. § 7434 is essentially a tax fraud statute that allows the taxpayer to file a civil action against any person who has willfully filed a fraudulent information return on the taxpayer's behalf.

The statute has been used increasingly as a means for employees misclassified as independent contractors to sue their employers for tax fraud.[45] The basis for the cause of action lies in the idea that an employer who willfully maintained an employer-employee relationship with a worker but classified the worker as an independent contractor and filed a 1099-NEC return has committed tax fraud. Instead of filing a W-2 return for wages paid to an employee with the IRS, an employer may file a 1099-NEC for non-employee compensation with the IRS. An employer who files a 1099-NEC return rather than a W-2 return for their employee is able to avoid business tax obligations under the FICA Tax (26 U.S.C. § 3301) and the Federal Unemployment Tax Act (26 U.S.C. § 3301).[46]

The issue of whether an employee who is willfully misclassified as an independent contractor can sue their employer under the statute has not been directly addressed by federal appellate courts.[47] Although several U.S. District Courts have addressed whether a misclassified employee can recover under the statute, there are several different interpretations of the statute due

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41 *Liverett*, 192 F. Supp. at 651; Leon v. Tapas & Tintos, Inc., 51 F. Supp. 3d 1290, 1296 (S.D. Fla. 2014); Seijo v. Casa Salsa, Inc., No. 12-60892-Civ, 2013 U.S. Dist. LEXIS 167205, at *23 (S.D. Fla. Nov. 25, 2013); *see also* Pitcher v. Waldman, No. 1:11-cv-148, 2012 U.S. Dist. LEXIS 152087, at *13 (S.D. Ohio Oct. 23, 2012).

42 H.R. REP. NO. 104–506 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158.

43 INTERNAL REV. SERV., DOCUMENT NO. 7394 (REV. 08-96), TAXPAYER BILL OF RIGHTS II, https://www.irs.gov/pub/irs-utl/doc7394.pdf (last visited Mar. 3, 2021).

44 H.R. REP. NO. 104–506, at 40 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158.

45 *See generally* Leyden, *supra* note 30 (describing the use of 26 U.S.C. § 7434 as part of an "Emerging Trend of Using Sanctions for Federal Tax Evasion as Sword in Employment Disputes").

46 Cuellar-Aguilar v. Deggeller Attractions, Inc., 812 F.3d 614, 620 (8th Cir. 2015).

47 *Liverett*, 192 F. Supp. at 650 (stating that "no court of appeals has addressed §7434(a)'s ambiguity").

to the lack of appellate decisions on the issue.[48] Therefore, an employee's recovery under the statute depends on their ability to establish an employment relationship and to establish each element of the cause of action in the relevant jurisdiction.

A. *Employment Relationship*

In order to successfully establish that an employee was wrongly misclassified as an independent contractor, the worker must first prove that an employer-employee relationship existed. Federal courts have established several tests for employer-employee relationships, and determining which test applies depends on the purpose that the classification is being used for.[49] Thus, a worker may be an employee for tax purposes, but not for other purposes. Generally, an individual is an employee for federal employment tax purposes if the individual is an employee under the common law employment relationship factors.[50] Under the common law, an employment relationship "exists when the principal has the right to control and direct the service provider, not only as to the result to be accomplished but also as to the details and means by which that result is accomplished."[51]

To help determine whether the common law employment relationship exists, the IRS has identified twenty factors that may be considered as guidelines when determining whether an employment relationship exists.[52] The twenty factors identified by the IRS focus on specific details in the day-to-day context of work such as training, instructions, hours of work, work location, pay frequency, reimbursement for expenses, significant investment, the right to terminate, and the ability to make a profit or loss.[53] Although courts have employed many of these factors in considering the existence of the common law employment relationship, no single factor or test is determinative.[54]

At least one court has used the economic reality test to determine the existence of an employment relationship when a 26 U.S.C. § 7434 claim was

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48 *See* Hood v. JeJe Enter., 207 F. Supp. 3d 1363, 1378–79 (N.D. Ga. 2016) (describing the different interpretations by U.S. District Courts).

49 *See* Julien M. Mundele, *Not Everything That Glitters Is Gold, Misclassification of Employees: The Blurred Line Between Independent Contractors and Employees Under the Major Classification Tests*, 20 SUFFOLK J. TRIAL & APP. ADV. 253, 267 (2015).

50 I.R.S. Rev. Rul. 87-41, 1987-1 C.B. 296.

51 Atl. Coast Masonry, Inc. v. Comm'r, 104 T.C.M. (CCH) 189 (2012); 26 C.F.R. § 31.3121(d)-1(c)(2) (2021).

52 I.R.S. Rev. Rul. 87-41, *supra* note 50.

53 *Id.*

54 *See* Rutherford Food Corp. v. McComb, 331 U.S. 722, 730 (1947); Ewens & Miller, Inc. v. Comm'r, 117 T.C. 263, 270 (2001).

brought in conjunction with a claim under the Fair Labor Standards Act (FLSA).[55] The economic reality test uses six factors: (1) nature and degree of control of the worker, (2) the worker's opportunity for profit or loss, (3) the worker's investment in equipment or materials, (4) the worker's special skills, (5) the permanency and duration of the relationship, and (6) whether the work is an integral part of the business.[56] The economic reality test is focused on whether the workers are economically dependent on the business.[57] Similar to the common law test, the economic reality test looks at the totality of the circumstances.[58]

Although a worker may be classified as an employee under both the FLSA economic reality test and IRS common law test, it should be noted that the standards are not the same.[59] The distinction between the two tests is significant because misclassified employees who bring FLSA claims and tax claims may need to satisfy both employment tests. Under the FLSA, the notion of employment "is extremely broad - broader than the common law definition of employment and even broader than several other federal employment-related statutes."[60] Therefore, it is feasible that a plaintiff could establish an employment relationship for FLSA claims but fail to establish an employment relationship for other federal employment claims. In addition to traditional employment tests, at least one federal court has used the existence of an employment contract to determine whether an employment relationship existed when a 26 U.S.C. § 7434 claim was brought in conjunction with a state-law breach of contract claim.[61] When evaluating an employment contract in this context, federal courts are required to apply state law rather than federal agency rules.[62] Due to the variations in employment relationship tests, a plaintiff bringing employee misclassification claims should be prepared to satisfy the most narrow employment standard applicable to the case.

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55 Nieman v. Nat'l Claims Adjusters, Inc., 775 F. App'x 622, 622 (11th Cir. 2019).

56 Scantland v. Jeffry Knight, Inc., 721 F.3d 1308, 1311–12 (11th Cir. 2013).

57 *See* Brock v. Mr. W Fireworks, Inc., 814 F.2d 1042, 1043 (5th Cir. 1987).

58 *Id.*

59 Agerbrink v. Model Serv. LLC, 2015 U.S. Dist. LEXIS 145563 at *21 (S.D.N.Y. Oct. 27, 2015); Heath v. Perdue Farms, Inc., 87 F. Supp. 2d 452, 461 (D. Md. 2000).

60 Herman v. Mid-Atlantic Installation Servs., Inc., 164 F. Supp. 2d 667, 671 (D. Md. 2000), *aff'd sub nom*. Chao v. Mid-Atlantic Installation Servs., Inc., 16 F. App'x 104, 104 (4th Cir. 2001).

61 Cuellar-Aguilar v. Deggeller Attractions, Inc., 812 F.3d 614, 618 (8th Cir. 2015).

62 Cordova v. R & A Oysters, Inc., 101 F. Supp. 3d 1192, 1199 (S.D. Ala. 2015) (declining to find that "a federal agency's thoughts on whether a contract exists does or could preclude the existence of a contract under state law").

B. *Information Return Requirement*

In addition to establishing the existence of an employment relationship, the worker must also satisfy each element of the claim. As noted previously, the elements of a claim under 26 U.S.C. § 7434 are (1) the defendant issued an information return; (2) the information return was fraudulent; and (3) the issuance of the information return was willful.[63] In the context of employee misclassification, the first element requiring that a defendant issued an information return, can often be easily satisfied. Prior to the 2020 tax year, nonemployee compensation paid to independent contractors was reported using the 1099-MISC form.[64] In 2020, the IRS updated its forms to require that nonemployee compensation be reported using a 1099-NEC instead of a 1099-MISC form.[65] Both 1099-MISC forms and 1099-NEC forms are classified as information returns under the tax provision 26 U.S.C. § 6041(a) and are incorporated into the definitions found in 26 U.S.C. § 6724(d)(1)(A).[66] In this context, the terms 1099-MISC form and 1099-NEC form are used interchangeably because the form being used by the employer simply depends on the tax year at issue. Thus, an employee who was issued a 1099-MISC prior to the 2020 tax year, or a 1099-NEC form after the 2020 tax year, has satisfied the information return element.

The statute also requires that the information return in question be issued to the person who brings the action in court.[67] While this requirement rarely presents as an issue in standard employee misclassification cases, it can be an issue in some circumstances. In *Baker v. Batmasian*, the U.S. Court of Appeals for the Eleventh Circuit addressed an employee's claims for misclassification under 26 U.S.C. § 7434.[68] The employer in *Baker* required his worker to form a corporation in order to receive compensation.[69] Since the fraudulent information return in question was issued to the corporation rather than the employee directly, the employee was unable to establish a

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63 *See* Liverett v. Torres Advanced Enter. Sols. LLC, 192 F. Supp. 3d 648, 651 (E.D. Va. 2016); Pitcher v. Waldman, No. 1:11-cv-148, 2012 U.S. Dist. LEXIS 152087, at *13 (S.D. Ohio Oct. 23, 2012).

64 *See* Kelly Phillips Erb, *There's A New Tax Form – With Some Changes – For Freelancers & Gig Workers*, FORBES (Sept. 15, 2020, 7:44 PM), https://www.forbes.com/sites/kellyphillipserb/2020/09/15/theres-a-new-tax-formwith-some-changesfor-freelancers—gig-workers/?sh=5787c7b22116.

65 *Instructions for Forms 1099-MISC and 1099-NEC (2020)*, INTERNAL REVENUE SERV., https://www.irs.gov/instructions/i1099msc (last visited Mar. 3, 2021).

66 26 U.S.C.S. § 6041(a) (LEXIS through Pub. L. No. 117-36); 26 U.S.C.S. § 6724(d)(1)(A) (LEXIS through Pub. L. No. 117-36). *See also Pacheco*, 2019 U.S. Dist. LEXIS 90725, at *6.

67 26 U.S.C.S. § 7434 (LEXIS through Pub. L. No. 117-36).

68 Baker v. Batmasian, 730 F. App'x 776, 777 (11th Cir. 2018).

69 *Id.*

claim against the employer.[70] As a result, the dismissal of the employee's claim was affirmed on appeal and the appellate court never reached the issue of whether misclassification established a violation of 26 U.S.C. § 7434.[71] As illustrated by *Baker*, the entity to whom the information return is issued may present an issue in a minority of cases.

C. *Fraudulent Requirement*

The second element of the statute requires that the information return was fraudulent.[72] Generally, courts have found that tax fraud requires evidence of intentional wrongdoing.[73] Tax fraud can consist of "any conduct, the likely effect of which would be to mislead or to conceal."[74] In the context of employee misclassification, there is disagreement among the U.S. District Courts as to whether an employer's willful misclassification of an employee as an independent contractor alone is sufficient to satisfy the fraud requirement.[75] District Court decisions in the Second Circuit,[76] Third Circuit,[77] Fourth Circuit,[78] Seventh Circuit,[79] Ninth Circuit,[80] Tenth Circuit,[81] and Eleventh Circuit[82] have supported the argument that an employer misclassifying their employee for tax return purposes is not, by itself, sufficient to establish fraud. However, there have also been District Court

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70 *Id.* at 780.

71 *Id.* at 777 n.2.

72 *See* Liverett v. Torres Advanced Enter. Sols. LLC, 192 F. Supp. 3d 648, 651 (E.D. Va. 2016); Pitcher v. Waldman, No. 1:11-cv-148, 2012 U.S. Dist. LEXIS 152087, at *14 (S.D. Ohio Oct. 23, 2012).

73 *See* Cavoto v. Hayes, No. 08 C 6957, 2010 U.S. Dist. LEXIS 66017, at *9 (N.D. Ill. July 1, 2010) (quoting Granado v. Comm'r of Internal Revenue, 792 F.2d 91, 92–93 (7th Cir. 1986)).

74 *Id.* at 10.

75 Hood v. JeJe Enter., 207 F. Supp. 3d 1363, 1378–79 (N.D. Ga. 2016) (describing the different interpretations by U.S. District Courts).

76 Pacheco v. Chickpea at 14th St., Inc., No. 18 Civ. 6907 (JMF) (GWG), 2019 U.S. Dist. LEXIS 90725, at *6.

77 Sirin v. Portx, Inc., No. 20-7853 (SRC), 2020 U.S. Dist. LEXIS 196915, at *18–19 (D.N.J. Oct. 22, 2020).

78 Liverett v. Torres Advanced Enter. Sols. LLC, 192 F. Supp. 3d 648, 653 (E.D. Va. 2016); Wagner v. Econ. Rent-A-Car Corp., No. RDB-19-0180, 2020 U.S. Dist. LEXIS 36515, at *8–11 (D. Md. Mar. 3, 2020); Greenwald v. Regency Mgmt. Servs., LLC, 372 F. Supp. 3d 266, 270–71 (D. Md. 2019).

79 Evans v. UPS, No. 19 CV 4818, 2020 U.S. Dist. LEXIS 26903, at *6–7 (N.D. Ill. Feb. 18, 2020); Derolf v. Risinger Bros. Transfer, 259 F. Supp. 3d 876, 885 (C.D. Ill. 2017).

80 Nguyen v. Luong, No. 18-cv-07302-VKD, 2019 U.S. Dist. LEXIS 84654, at *7–8 (N.D. Cal. May 20, 2019).

81 Sanchez v. Front Range Transp., No. 17-cv-00579-RBJ, 2017 U.S. Dist. LEXIS 150069, at *8–10 (D. Colo. Sept. 15, 2017).

82 Tran v. Tran, 239 F. Supp. 3d 1296, 1297 (M.D. Fla. 2017); Sims v. Unation, LLC, 292 F. Supp. 3d 1286, 1299 (M.D. Fla. 2018); Vera v. Challenger Air Corp., No. 16-cv-62354, 2017 U.S. Dist. LEXIS 92199, at *5–6 (S.D. Fla. June 15, 2017).

decisions in the Second Circuit,[83] Eighth Circuit,[84] Ninth Circuit,[85] and Eleventh Circuit[86] disagreeing with that notion and allowing tax fraud claims to proceed based on employment misclassification alone.

The majority of District Courts that have addressed the issue of employee misclassification as tax fraud under 26 U.S.C. § 7434 have held that misclassification alone is not sufficient to state a claim.[87] Rather, these courts have followed the reasoning of *Liverett v. Torres Advanced Enterprise Solutions LLC*, a decision from the Eastern District of Virginia.[88] In *Liverett*, the District Court provided a substantial analysis of the statute and its legislative history.[89] In its decision, the District Court argued that other district courts had overlooked parts of the statutory language and incorrectly interpreted the statute's meaning.[90] Specifically, the court focused on the phrase "with respect to" contained in the broader statute: "If any person willfully files a fraudulent information return *with respect to* payments purported to be made to any other person, such other person may bring a civil action for damages against the person so filing such return."[91] The District Court interpreted the phrase "with respect to" as limiting the scope of "fraudulent" rather than describing the "information return."[92] Under this interpretation, an information return must be fraudulent with respect to the payments listed on the return.[93]

In addition to the statutory language, the court in *Liverett* also relied upon the statute's legislative history and Congress's intent in designing a regulatory scheme to address employment violations.[94] The court referred to

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83 Czerw v. Lafayette Storage & Moving Corp., No. 16-CV-6701-FPG, 2018 WL 5859525, at *3 (W.D.N.Y. Nov. 9, 2018).

84 Shelton v. JS Express, Inc., No. 4:15-cv-00256-SRB, 2015 U.S. Dist. LEXIS 183909, at *3–4 (W.D. Mo. June 29, 2015).

85 Ranko v. Gulf Marine Prods. Co., No. C20-768 TSZ, 2020 U.S. Dist. LEXIS 176961, at *11 (W.D. Wash. Sept. 25, 2020).

86 Seijo v. Casa Salsa, Inc., No. 12-60892-Civ, 2013 WL 6184969, at *7 (S.D. Fla. Nov. 25, 2013); Rivera v. Superior Restoration & Cleaning Serv., Inc., No. 19-61700-CIV, 2020 WL 4501764, at *5 (S.D. Fla. May 20, 2020); Vanderbilt v. Boat Bottom Express Ltd., No. 4:18-CV-10261-JLK, 2019 WL 3323351, at *2 (S.D. Fla. July 24, 2019); Dean v. 1715 Northside Drive, Inc., 224 F. Supp. 3d 1302, 1310–11 (N.D. Ga. 2016).

87 Liverett v. Torres Advanced Enter. Sols. LLC, 192 F. Supp. 3d 648, 653 (E.D. Va. 2016); *Wagner*, 2020 U.S. Dist. LEXIS 36515, at *8–11; Greenwald v. Regency Mgmt. Servs., LLC, 372 F. Supp. 3d 266, 270–71 (D. Md. 2019).

88 *Liverett*, 192 F. Supp. 3d at 648.

89 *Id.* at 651–55.

90 *Id.* at 651.

91 *Id.* at 650; 26 U.S.C.S. § 7434(a) (LEXIS through Pub. L. No. 117-36).

92 *Liverett*, 192 F. Supp. 3d at 652.

93 *Id.*

94 *Id.* at 655.

tax law commentators who have described the statute as being intended to solve the specific policy problem of "malcontents who 'sometimes file fraudulent information returns reporting large amount of income for judges, law enforcement officials, and others who have incurred their wrath.'"[95] The court determined that violations of employment laws do not fall within such a legislative purpose.[96] The court further concluded that Congress created a comprehensive enforcement scheme for violations of federal employment laws under the Fair Labor Standards Act, and enforcement through other state or federal laws is precluded by the Fair Labor Standards Act.[97] As such, the court held that an employee who is misclassified as an independent contractor cannot establish tax fraud unless the amounts listed on the return were fraudulent.[98]

Several district courts have disagreed with the notion that payment amounts must be false for an information return to be fraudulent.[99] These courts have adopted reasoning similar to that found in *Seijo v. Casa Salsa, Inc.*, a decision from the Southern District of Florida. In *Seijo*, the District Court denied summary judgment because Seijo, the employee, had produced sufficient evidence from which a reasonable factfinder could find that her employer, Casa Salsa, violated 26 U.S.C. § 7434 by filing a 1099-MISC for payments made to Seijo despite the fact that she was not an independent contractor.[100] Seijo provided an affidavit of a former employee of Casa Salsa that showed Casa Salsa knew it was misclassifying workers as independent contractors rather than employees and that it was issuing the 1099-MISC forms incorrectly.[101] Accordingly, the court determined that a reasonable factfinder could find that the information return was not merely an error, but rather an intentional wrongdoing.[102]

In *Vanderbilt v. Boat Bottom Express LLC*, the Southern District of Florida reached a similar conclusion by holding an employer liable under 26 U.S.C. § 7434 for misclassification of an employee.[103] The court in

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95 *Id.* at 654 (quoting Jacob L. Todres, Torts, *Tax Reporting, and Preemption: Is There Tort Liability for Incorrect Information Reports?*, 28 J. CORP. L. 259, 281 (2003)).

96 *Id.* at 654–55.

97 *Id.* at 655.

98 *Id.*

99 *See* Seijo v. Casa Salsa, Inc,. 2013 U.S. Dist. LEXIS 167205, at *7 (S.D. Fla. Nov. 25, 2013); Rivera v. Superior Restoration & Cleaning Servs., Inc., No. 19-61700-CIV-MORE, 2020 U.S. Dist. LEXIS 143182, at *5 (S.D. Fla. May 20, 2020); Vanderbilt v. Boat Bottom Express L.L.C., No. 4:18-CV-10261-JLK, 2019 U.S. Dist. LEXIS 123284, at *2 (S.D. Fla. July 24, 2019); Dean v. 1715 Northside Drive, Inc., 224 F. Supp. 3d 1302, 1310 (N.D. Ga. 2016).

100 *Seijo*, 2013 U.S. Dist. LEXIS 167205, at *22.

101 *Id.*

102 *Id.*

103 *Vanderbilt*, 2019 U.S. Dist. LEXIS 123284, at *2.

Vanderbilt specifically relied upon the 1099-MISC form that was issued from the employer to the employee.[104] The 1099-MISC form listed the payments issued as "nonemployee compensation," which the worker argued was evidence of the employer unlawfully giving false information to the IRS by listing the worker as an independent contractor.[105] The court determined that the worker was actually an employee because a verbal agreement existed between the worker and the employer to pay the worker an hourly wage to perform various tasks for the employer.[106] The court concluded that the employer's misclassification was sufficient to find in favor of the employee and award statutory damages under 26 U.S.C. § 7434.[107] The court's holding in *Vanderbilt* illustrates the stark contrast between the varying standards of what courts may consider a fraudulent return.

D. *Willful Requirement*

An employee bringing a claim under 26 U.S.C. § 7434 must prove that the employer who issued the fraudulent information return did so willfully.[108] In the context of criminal tax fraud cases, the Supreme Court has found that willfulness requires that "the law imposed a duty on the defendant, the defendant knew of this duty, and that he voluntarily and intentionally violated that duty."[109] Many federal courts have applied the "voluntarily and intentionally" standard of willfulness in criminal tax fraud cases to claims brought under 26 U.S.C. § 7434.[110] Other courts have interpreted willfulness under 26 U.S.C. § 7434 to require a component of deceitfulness or bad faith also.[111] The added component of deceitfulness or bad faith creates a more stringent standard of willfulness, as opposed to merely voluntarily and intentionally, requiring plaintiffs to show some awareness of the fraudulent

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104 *Id.*

105 *Id.*

106 *Id.*

107 *Id.*

108 *See* 26 U.S.C.S § 7434(a) (LEXIS through Pub. L. No. 117-36).

109 Cheek v. United States, 498 U.S. 192, 201 (1991).

110 *See* Tran v. Tran, 239 F. Supp. 3d 1296, 1298 (M.D. Fla. 2017); Czerw v. Lafayette Storage & Moving Corp., No. 16-CV-6701-FPG, 2018 WL 5859525, at *3 (W.D.N.Y. Nov. 9, 2018); Vandenheede v. Vecchio, 541 F. App'x 577, 580 (6th Cir. 2013); Leon v. Tapas & Tintos, Inc., 51 F. Supp. 3d 1290, 1298 (S.D. Fla. 2014).

111 *See* Nash v. United States, No. 4:02-CV-1725-AGF, 2004 U.S. Dist. LEXIS 27472, at *8 (E.D. Mo. Oct. 12, 2004); Seijo v. Casa Salsa, Inc., No. 12-60892-Civ, 2013 U.S. Dist. LEXIS 167205, at *7 (S.D. Fla. Nov. 25, 2013).

nature of the tax filing.[112] Among federal courts who have addressed 26 U.S.C. § 7434, there is no uniform definition for willfulness or standard by which to prove it.[113]

The willful requirement under the statute is a factually similar inquiry to the fraudulent requirement because they are both tied to the employer's intent.[114] A claim brought under 26 U.S.C. § 7434 alleges fraud, and therefore is subject to the heightened pleading standard created by Rule 9(b) of the Federal Rules of Civil Procedure.[115] As a result, an employee bringing a claim under the statute is required to allege sufficient facts from which a court may infer that the employer intentionally filed the fraudulent tax return.[116] The heightened pleading standard requires more detailed factual allegations and makes it more difficult for a misclassified employee to potentially bring a claim under 26 U.S.C. § 7434.

III. ANALYSIS

An employer who willfully misclassifies their employee as an independent contractor for tax purposes, despite the worker's status as an employee, should be liable for civil damages under 26 U.S.C. § 7434. Employers often have a financial incentive to misclassify their employees because misclassification allows employers to avoid their business tax obligations.[117] An employer's business tax obligations are mandated by law and as a result, an employer who issues a 1099-NEC return to avoid the tax responsibilities associated with W-2 employees violates their legal duties under the Federal Insurance Contributions Act[118] and the Federal Unemployment Tax Act.[119] As a result of the employer's fraudulent conduct, misclassified employees may face additional tax burdens and lack

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112 Nash, 2004 U.S. Dist. LEXIS 27472, at *1 (holding that the Plaintiff in a 26 U.S.C. § 7434 claim failed to provide sufficient evidence of willful conduct on the part of the Defendant because there was no evidence of the Defendant's knowledge of the fraudulent nature of the tax filing in question).

113 *See* Hood v. JeJe Enters.,, 207 F. Supp. 3d 1363, at 1379 (N.D. Ga. 2016) (comparing the differing standards of willfulness among federal courts).

114 *See* Pitcher v. Waldman, No. 1:11-cv-148, 2012 U.S. Dist. LEXIS 152087, at *25 (S.D. Ohio Oct. 23, 2012).

115 S.F. Tech., Inc. v. GlaxoSmithKline LLC, No. 5:10-cv-03248-JF/NJV, 2011 U.S. Dist. LEXIS 33139, at *7 (N.D. Cal. Mar. 16, 2011); FED. R. CIV. P. 9(b).

116 Gidding v. Zurich Am. Ins. Co., No. 15-cv-01176-HSG, 2015 U.S. Dist. LEXIS 15194, at *17 (N.D. Cal. Nov. 9, 2015).

117 Carré, *supra* note 5, at 5.

118 Federal Insurance Contributions Act, 26 U.S.C.S. § 3102 (LEXIS through Pub. L. No. 117-36).

119 Federal Unemployment Tax Act, 26 U.S.C.S. § 3301 (LEXIS through Pub. L. No. 117-36).

employment benefits afforded to employees.[120] Depriving an employee of statutory protections or work-related benefits simply to avoid tax obligations violates the public policy goals behind federal employment and taxation laws. Therefore, a misclassified employee who satisfies each required element of the statute should be able to recover damages. To satisfy each element of the statute in the employment misclassification context, plaintiffs must prove three things. First, the Plaintiff must prove the existence of an employment relationship between the employer and the worker.[121] The Plaintiff must then prove that the 1099-NEC information return issued by the employer constitutes a fraudulent return for purposes of the statute.[122] Lastly, the Plaintiff must prove that the employer acted willfully when the employer filed the fraudulent return.[123]

A. *Proving the Existence of an Employment Relationship*

The existence of an employment relationship is essential to an employee's ability to bring a tax fraud claim for employment misclassification. Evidence of an employment relationship will have a significant impact on the determination of whether an information return was fraudulent, and whether the return was filed willfully. In the tax context, whether an employment relationship exists is determined by common law rules.[124] "Under the common law, an employment relationship exists when the principal has the right to control and direct the service provider, not only as to the result but also as to the details and means by which that result is accomplished."[125] All of the relevant facts and circumstances are considered when determining the existence of an employment relationship, and no one factor is determinative.[126] The importance of each factor ultimately depends on the specific circumstances at issue.[127] As a result, a misclassified employee bringing an action under 26 U.S.C. § 7434 can use any of the IRS

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120 NAT'L. CONF. OF STATE LEGISLATURES, *supra* note 8.

121 *See* 26 U.S.C.S. § 7434(a) (LEXIS through Pub. L. No. 117-36) (establishing the employment relationship is essential to proving that the information return issued to the employee satisfies the "fraudulent" requirement).

122 *See id.* (satisfying the "fraudulent" requirement by proving that the employer classified the employee as an independent contractor despite the employment relationship).

123 *See id.* (satisfying the "willful" requirement by proving that the employer intentionally misclassified the employee).

124 Weber v. Comm'r, 103 T.C. 378, 387 (1994).

125 Atl. Coast Masonry, Inc. v. Comm'r, 104 T.C.M. (CCH) 189, P13–P14 (2012) No. 22515-10, 2012 Tax Ct. Memo LEXIS 232, at *13–14 (T.C. Aug. 13, 2012).

126 Ewens & Miller, Inc. v. Comm'r, 117 T.C. 263, 270 (2001).

127 Mantei v. Mich. Pub. Sch. Emples. Ret. Sys., 663 N.W.2d 486, 494 (Mich. Ct. App. 2003).

common law factors to establish evidence of an employment relationship.[128] However, an employee would be best suited by focusing on the right of the principal to exercise control over the agent. The right of the principal to exercise control over the agent is the most important consideration for determining whether an employer-employee relationship exists.[129] The factors that are used to determine whether an employment relationship exists are highly fact-specific and often create confusion for both employers and employees.[130] As a result, misclassified employers should gather as much evidence as possible relating to factors of employment, and focus on the overarching themes of the various employment relationship tests.

B. *Proving the Fraudulent Nature of Employee Misclassification*

Much of the contention between district courts interpreting 26 U.S.C. § 7434 is regarding whether an employer who has willfully issued a 1099-NEC form rather than a W-2 form to an employee, has filed a fraudulent information return.[131] Appellate courts should resolve this issue in favor of employees and allow an incorrectly issued 1099-NEC form to suffice as a fraudulent return. Several of the district courts who have not allowed misclassification alone to establish a fraudulent return, relied on the reasoning in *Liverett*.[132] The court in *Liverett* relied on several propositions to support its position, mainly (1) the plain language of the statute; (2) the legislative intent of Congress; and (3) the statutory framework for labor violations found in the Fair Labor Standards Act.[133] However, each of these propositions fail to address substantial evidence to the contrary and fail to account for the real-world implications faced by misclassified workers.

26 U.S.C. § 7434 states in relevant part "If any person willfully files a fraudulent information return with respect to payments purported to be made to any other person . . . ."[134] The court in *Liverett* specifically relied on the language "with respect to," arguing that the language modifies the word

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128 *See generally* Rev. Rul. 87-41, 1987-1 C.B. 296.

129 *Weber*, 103 T.C. at 387 (citing Matthews v. Comm'r, 92 T.C. 351, 361 (1989)).

130 Mundele, *supra* note 49, at 270.

131 *See* Hood v. JeJe Enters., 207 F. Supp. 3d at 1378–79 (N.D. Ga. 2016) (describing the different interpretations by U.S. District Courts).

132 *See Wagner*, 2020 U.S. Dist. LEXIS 36515, at *8–10; Greenwald v. Regency Mgmt. Servs., LLC, 372 F. Supp. 3d 266, 270 (D. Md. 2019); Sirin v. Portx, Inc., No. 20-7853 (SRC), 2020 U.S. Dist. LEXIS 196915, at *19 (D.N.J. Oct. 22, 2020)..

133 Liverett v. Torres Advanced Enter. Sols. LLC, 192 F. Supp. 3d 648, 651–55 (E.D. Va. 2016).

134 26 U.S.C.S. § 7434(a) (LEXIS through Pub. L. No. 117-36).

"fraudulent," rather than "information return."[135] The court disagreed with the notion that "with respect to" modified "information return," which would allow a return that is false or misleading in any aspect, to establish fraud.[136] Rather, the court held that the phrase "with respect to" limited the definition of "fraudulent," and as such, an information return was only actionable if the amount of payments purportedly made was false or misleading.[137] In its interpretation, the court noted that statutory interpretation should reference the statute's structure, history, purpose, as well as common sense.[138]

The *Liverett* court's narrow reading of 26 U.S.C. § 7434 contradicts the plain language of the statute and defies common sense. Under this interpretation, an information return purposefully filed by a person with false or misleading information is not fraudulent so long as the numerical amounts on the form are correct. Such an outcome defies the plain language and intent of the statute. More importantly, this interpretation relies on the assumption that a 1099-NEC form, which lists payment amount as the amount of money issued to the worker, is not false or misleading. However, an employer who issues payment to a misclassified employee has failed to withhold federal payroll taxes from the payments. The misclassified employee will also be responsible for the employer's share of FICA taxes. As a result, the payment amounts reflected on the information return are false and misleading by nature. Furthermore, payments issued by an employer using a 1099-NEC form are included as "non-employee compensation," which, by definition, means the payee is not an employee.[139] An employer who is aware that a worker is an employee, but willfully classifies the payments as non-employee compensation, has made false and misleading claims with respect to the payments on the information return.

In addition to the language of the statute, the *Liverett* court also relied on the legislative purpose and history of 26 U.S.C. § 7434.[140] The court first pointed to a House Report describing the legislative history of the statute which stated that the statute was created because "'[s]ome taxpayers may suffer significant personal loss and inconvenience as the result of the IRS receiving fraudulent information returns, which have been filed by persons intent on either defrauding the IRS or harassing taxpayers.'"[141] The court also referenced tax law commentators who stated the statute was specifically

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135 *Liverett*, 192 F. Supp. 3d at 652–55.

136 *Id.* at 650–55.

137 *Id.* at 655.

138 *Id.* at 652.

139 *See* INTERNAL REVENUE SERV., supra note 65.

140 *Liverett*, 192 F. Supp. 3d at 654–55.

141 *Id.* at 653–54 (quoting H.R. REP. NO. 104-506, at 35 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158).

created to address "malcontents who 'sometimes file fraudulent information returns reporting large amounts of income for judges, law enforcement officials, and others who have incurred their wrath.'"[142]

Although workers who have been misclassified by their employers may not be the precise group from which the original policy problem arose, misclassified workers fall entirely within the legislative purpose. The House Report states that the statute was enacted because, at the time, federal law provided "no private cause of action to a taxpayer who is injured because a fraudulent information return has been filed with the IRS asserting that payments have been made to the taxpayer."[143] A worker who has been fraudulently misclassified and issued an incorrect return has suffered both "personal loss" and "inconvenience."[144] Misclassified workers likely face additional payroll taxes and may not be compensated for overtime premiums, both of which constitute direct monetary losses. Employees who are misclassified are greatly inconvenienced in filing their taxes, especially if they are not knowledgeable in income tax law. Furthermore, employers who misclassify workers as independent contractors to avoid their tax responsibilities are defrauding the IRS in order to cut costs.[145] Even if the statute was enacted to prevent strangers from reporting large payments to judges or other law enforcement officials, misclassified employees fall squarely within the congressional intent.

In further support of its argument, the *Liverett* court concluded that a misclassified employee who is issued an incorrect return from their employer is precluded by the Fair Labor Standards Act from recovering.[146] The court held that claims for employee misclassification could not be brought under 26 U.S.C. § 7434 because the FLSA precludes enforcement through other state and federal means.[147] The court in *Liverett* relied on *Kendall v. City of Chesapeake*, a previous decision from the Fourth Circuit, which held that employees who signed settlement agreements with their employer under the FLSA were precluded from making claims under 42 U.S.C. § 1983 against their employer.[148] The *Liverett* court determined that allowing misclassified workers to recover under 26 U.S.C. § 7434 would encroach on the territory of the FLSA, and that the employee could recover sufficient damages under

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142 *Liverett*, 192 F. Supp. 3d at 654 (quoting Jacob L. Todres, *Torts, Tax Reporting, and Preemption: Is There Tort Liability for Incorrect Information Reports?*, 28 J. CORP. L. 259, 281 (2003)).

143 H.R. REP. NO. 104-506, at 35 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158.

144 *Id.* (describing the purpose of 26 U.S.C. § 7434 as aimed at preventing "personal loss" and "inconvenience" for taxpayers); *Liverett*, 192 F. Supp. 3d at 653–54.

145 H.R. REP. NO. 104-506, at 35 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158.

146 *Liverett*, 192 F. Supp. 3d at 655.

147 *Id.*

148 *Id.*; Kendall v. City of Chesapeake, 174 F.3d 437, 442–44 (4th Cir. 1999).

the FLSA to make the employee whole and deter the employer from future violations.[149]

The FLSA does not preclude employees from recovering damages under 26 U.S.C. § 7434. Unlike the employees *in Kendall*, misclassified employees who seek to recover damages under 26 U.S.C. § 7434 are not trying to "circumvent" the "carefully tailored" statutory scheme created in the FLSA.[150] The FLSA's statutory scheme provides redress for overtime and minimum wage violations.[151] Alternatively, 26 U.S.C. § 7434 provides redress for the separate and distinct "personal loss" and "inconvenience" caused by fraudulent information returns filed with the IRS by other persons.[152] The two statutes serve entirely different purposes, and where one may be applicable, the other may not be. 26 U.S.C. § 7434 allows employees to recover damages for fraudulent tax returns filed by their employer,[153] unlike the FLSA, which makes the recovery of damages dependent on whether an overtime or minimum wage violation has occurred.[154] Plaintiffs who establish successful claims under 26 U.S.C. § 7434 can recover the greater of (1) $5,000 or (2) the cost of any actual damages sustained as a result of the fraudulent information return, the costs of the action, and reasonable attorneys' fees.[155] Some courts have also allowed plaintiffs to recover under 26 U.S.C. § 7434, in the absence of any actual damages.[156] Therefore, 26 U.S.C. § 7434 is a unique statutory mechanism because it allows plaintiffs to sue for tax misclassification alone and recover the full costs associated with the fraudulent return, regardless of the existence of wage and hour violations.

In *Tran v. Tran*, the District Court from the Middle District of Florida addressed whether a misclassified employee is precluded from recovering damages for FICA taxes incorrectly paid by the employee.[157] Similar to the FLSA in *Liverett*, the court in *Tran* concluded that a comprehensive statutory

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149 *Liverett*, 192 F. Supp. 3d at 655.

150 *Kendall*, 174 F.3d at 443 (quoting Smith v. Robinson, 468 U.S. 992, 1012 (1984) (stating that the employees had failed to show that Congress intended to allow plaintiffs to "circumvent" the "carefully tailored' statutory scheme created by the FLSA)).

151 *Id.*; 29 U.S.C.S. §§ 206, 207, 216, 217 (LEXIS through Pub. L. No. 117-36).

152 H.R. REP. NO. 104-506, at 35 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158 (describing the purpose of 26 U.S.C. § 7434 as aimed at preventing "personal loss" and "inconvenience" for taxpayers).

153 26 U.S.C.S. § 7434(b) (LEXIS through Pub. L. No. 117-36).

154 29 U.S.C.S. § 216(b) (LEXIS through Pub. L. No. 117-36).

155 26 U.S.C.S. § 7434(b).

156 *See* Czerw v. Lafayette Storage & Moving Corp., No. 16-CV-6701-FPG, 2018 WL 5859525, at *9–10 (W.D.N.Y. Nov. 9, 2018); Cuellar-Aguilar v. Deggeller Attractions, Inc., 812 F.3d 614, 621 (8th Cir. 2015).

157 Tran v. Tran, 239 F. Supp. 3d 1296, 1297 (M.D. Fla. 2017).

scheme exists for the recovery of FICA taxes.[158] In *Tran*, the court stated that a worker could file a form SS-8 with the IRS to obtain a determination of whether the worker is an employee or independent contractor for tax purposes.[159] The court also noted that the worker could file an administrative claim for the FICA taxes incorrectly paid under 26 U.S.C. § 6511.[160] Lastly, the court stated that a worker could also commence an action against the United States to recover the FICA taxes under 28 U.S.C. § 1346(a)(1).[161] The court determined these remedies available to a misclassified employee, represented a comprehensive statutory scheme for recovering FICA taxes, and that the employee was precluded from recovering under 26 U.S.C. § 7434.[162]

None of the remedies addressed by the court in *Tran* constitute a comprehensive statutory scheme that preclude a misclassified employee's recovery under 26 U.S.C. § 7434. To justify its conclusion, the court in *Tran* relied on *McDonald v. Southern Farm Bureau Life Insurance Company*, a case from the Eleventh Circuit which held that FICA did not create a private right of action.[163] The *McDonald* case is clearly distinguishable from a misclassified employee's claim under 26 U.S.C. § 7434. Unlike FICA, 26 U.S.C. § 7434 does quite literally provide taxpayers with a private right of action for fraudulent information returns filed with the IRS.[164] Furthermore, the availability of administrative mechanisms to protect the Plaintiff's interest is not necessarily sufficient to demonstrate that Congress intended to foreclose other statutory remedies, and thus the action is precluded by a comprehensive statutory scheme.[165] The Court in *Tran* relied on two administrative remedies for recovering FICA taxes, obtaining an SS-8 determination from the IRS, and filing an administrative claim for the taxes under 26 U.S.C. § 6511.[166] Both of these remedies are merely administrative mechanisms, that do not show any intent to foreclose recovery under 26 U.S.C. § 7434. The last remedy addressed by the *Tran* court was to initiate an action against the United States for the FICA taxes under 28 U.S.C. §

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158 *Id.* at 1298.

159 *Id.* (quoting McDonald v. S. Farm Bureau Life Ins. Co., 291 F.3d 718, 725 (11th Cir. 2002)).

160 *Id.*; 26 U.S.C.S. § 6511 (LEXIS through Pub. L. No. 117-36).

161 *Tran*, 239 F. Supp. 3d at 1298; 28 U.S.C.S. § 1346(a)(1) (LEXIS through Pub. L. No. 117-36).

162 *Tran*, 239 F. Supp. 3d at 1298–99.

163 McDonald v. S. Farm Bureau Life Ins. Co., 291 F.3d 718, 723 (11th Cir. 2002).

164 *See* 26 U.S.C.S. § 7434(a) (LEXIS through Pub. L. No. 117-36) (stating that taxpayers "may bring a civil action for damages" against the person who filed the fraudulent information return).

165 Golden State Transit Corp. v. Los Angeles, 493 U.S. 103, 106 (1989) (explaining, in the context of 42 U.S.C. § 1983, that "the availability of administrative mechanisms to protect plaintiffs' interests under a particular federal statute is not necessarily sufficient" to show that Congress intended to preclude other remedies).

166 *Tran*, 239 F. Supp. 3d at 1298.

1346(a)(1).[167] However, 28 U.S.C. § 1346(a)(1) is the broad tax statute that allows the recovery of tax payments in U.S. District Courts,[168] not a specific statutory mechanism to recover FICA taxes.[169] As such, a misclassified employee's recovery of FICA taxes under 26 U.S.C. § 7434 is not precluded by other federal statutory schemes.

C. *Proving The Employer's Willful Conduct*

The issue of whether employees can prove that they were misclassified willfully by their employer, is closely intertwined with the employer's awareness of the existence of an employment relationship. To successfully establish that a fraudulent information return was filed willfully, the "pleadings must do more than establish an accounting mistake."[170] Federal courts should adopt a standard of willfulness in the context of 26 U.S.C. § 7434, which requires a voluntary, intentional violation of a legal duty.[171] Federal courts should reject the willfulness standard adopted by some courts which includes an added component of deceitfulness or bad faith.[172] Requiring an added component of deceitfulness or bad faith under the standard of willfulness would be too burdensome for plaintiffs to bring claims under 26 U.S.C. § 7434. The statute is an obscure federal tax statute and requiring proof that the defendant was aware of the legal duty imposed by the statute, would make it extremely difficult to bring claims. Claims brought under the statute are already subject to a greater burden under the heightened pleading standard of Rule 9(b) in the Federal Rules of Civil Procedure.[173]

Misclassified employees bringing claims under 26 U.S.C. § 7434 should be permitted to use circumstantial evidence to prove the employer's willful filing of fraudulent information returns. In *Hood v. JeJe Enterprises, Inc.*, the District Court for the Northern District of Georgia held that circumstantial evidence was permissible to prove an employer's willful filing of a fraudulent

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167 *Id.*

168 28 U.S.C.S. § 1346(a)(1) (LEXIS through Pub. L. No. 117-36).

169 Kendall v. City of Chesapeake, 174 F.3d 437, 442 (4th Cir. 1999).

170 Czerw v. Lafayette Storage & Moving Corp., No. 16-CV-6701-FPG, 2018 WL 5859525, at *8 (W.D.N.Y. Nov. 9, 2018) (quoting Vandenheede v. Vecchio, 541 F. App'x 577, 580 (6th Cir. 2013) (summary order)).

171 *See, e.g.*, *Tran*, 239 F. Supp. at 1298; Czerw, 2018 WL 5859525, at *8; Vandenheede, 541 F. App'x at 580; Leon v. Tapas & Tintos, Inc., 51 F. Supp. 3d 1290, 1298 (S.D. Fla. 2014).

172 *See, e.g.*, Nash v. United States, No. 4:02-CV-1725-AGF, 2004 U.S. Dist. LEXIS 27472, at *8 (E.D. Mo. Oct. 12, 2004); Seijo v. Casa Salsa, Inc., No. 12-60892-Civ, 2013 U.S. Dist. LEXIS 167205, at *25 (S.D. Fla. Nov. 25, 2013).

173 S.F. Tech., Inc. v. GlaxoSmithKline LLC, No. 5:10-cv-03248-JF/NJV, 2011 U.S. Dist. LEXIS 33139, at *7 (N.D. Cal. Mar. 16, 2011); FED. R. CIV. P. 9(b).

return.[174] In its decision, the court referred to the permitted use of circumstantial evidence to prove other forms of fraud.[175] In support of its position, the court cited *Pitcher v. Waldman*, a decision from the Southern District of Ohio.[176] In *Pitcher*, a bench trial was conducted where the District Judge relied on circumstantial evidence to find defendants liable for the willful filing of fraudulent information returns, and the bench order was affirmed on appeal.[177] Similarly, other courts have allowed the use of certain "badges," or indications of fraud, instead of direct evidence to prove tax fraud in other statutory contexts.[178] Due to the lesser-known status of 26 U.S.C. § 7434, and the difficulty in proving state-of-mind for employee misclassification, circumstantial evidence should be permitted to prove willfulness.

The sufficiency of the evidence of an employer's willful conduct will ultimately depend on the specific context of the claim. However, district court decisions provide some indication of what evidence may be sufficient to prove willfulness. In *Dean v. 1715 Northside Drive, Inc.*, the employee brought a claim under 26 U.S.C. § 7434, alleging that the employer intentionally, willfully, and fraudulently misclassified the employee as an independent contractor and filed a 1099-MISC return.[179] The employer challenged the employee's proof of willfulness and in response, the employee provided (1) a letter from the U.S. Department of Labor classifying the businesses' workers as employees rather than independent contractors; (2) an admission by the employer that it never sought legal advice regarding their obligations under the FLSA; and (3) evidence that the employer issued 1099-MISC forms for another employee who commonly served in a position more closely associated with employee status.[180] Based on the evidence provided, the court concluded a reasonable factfinder could find that the employee had satisfied all three elements of the claim.[181]

In comparison, the court in *Seijo* concluded that a reasonable factfinder could find the employer willfully misclassified its employees based on an affidavit from a former employee alleging misclassification alone.[182] In

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174 Hood v. JeJe Enters., 207 F. Supp. 3d 1363, 1380 (N.D. Ga. 2016).

175 *Id.*

176 *Id.*; Pitcher v. Waldman, No. 1:11-CV-148, 2012 U.S. Dist. LEXIS 152087, at *27 (S.D. Ohio Oct. 23, 2012).

177 *Hood*, 207 F. Supp. 3d at 1380; *Pitcher*, 2014 U.S. Dist. LEXIS 42148, at *9.

178 Maciel v. Comm'r, 489 F.3d 1018, 1026 (9th Cir. 2007) (quoting Estate of Trompeter v. Comm'r, 279 F.3d 767, 773 (9th Cir. 2002)).

179 Dean v. 1715 Northside Drive, Inc., 224 F. Supp. 3d 1302, 1310 (N.D. Ga. 2016).

180 *Id.* at 1310–11.

181 *Id.* at 1311.

182 Seijo v. Casa Salsa, Inc., No. 12-60892-Civ, 2013 U.S. Dist. LEXIS 167205, at *24 (S.D. Fla. Nov. 25, 2013).

Vanderbilt, the court relied on an employee's testimony to prove that the employer willfully misclassified its employees.[183] Specifically, the employee testified that she spoke with a CPA who informed her that she was incorrectly classified and should be paid as an employee.[184] The employee shared this information with her employer on two separate occasions but was still misclassified as an independent contractor.[185] The court concluded this testimony was sufficient to find in favor of the employee.[186] These cases demonstrate how the fact-specific inquiry surrounding willfulness may depend on the context of the claim.

IV. CONCLUSION

Employee misclassification has far-reaching consequences for worker rights and economic stability.[187] Although the exact scale of the problem is unknown, it is clear that employee misclassification will remain at the forefront of public policy efforts for large companies seeking to keep their labor costs low.[188] Employees who are misclassified as independent contractors lack many of the benefits and protections afforded to employees, which ultimately puts them at an economic disadvantage in the workforce.[189] Based on the upward trends of employee misclassification, it is evident that current enforcement mechanisms for employment classification standards have not effectively deterred employers from engaging in misclassification.[190]

26 U.S.C. § 7434 provides an underutilized, alternative means for misclassified employees to recover damages for wrongful misclassification. Using the statute in the context of employment misclassification comports with the original legislative intent to eliminate "significant personal loss and inconvenience as the result of the IRS receiving fraudulent information returns, which have been filed by persons intent on either defrauding the IRS of harassing taxpayers."[191] 26 U.S.C. § 7434 can potentially allow misclassified employees to recover statutory damages that otherwise could

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183 Vanderbilt v. Boat Bottom Express LLC, No. 4:18-CV-10261-JLK, 2019 U.S. Dist. LEXIS 123284, at *4–5 (S.D. Fla. July 24, 2019).

184 *Id.* at *4.

185 *Id.* at *4–5.

186 *Id.* at *5.

187 *See* NAT'L EMP. L. PROJECT, *supra* note 2.

188 *See, e.g.*, Mulvaney, *supra* note 29.

189 *See* NAT'L. CONF. OF STATE LEGISLATURES, *supra* note 8.

190 *See* ERLICH & GERSTEIN, *supra* note 21.

191 H.R. REP. NO. 104–506, at 35 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1158.

not be sought under other federal employment statutes, such as the FLSA.[192] Furthermore, 26 U.S.C. § 7434 can potentially deter employers from engaging in tax fraud to reduce labor costs and gain a competitive advantage.[193] Accordingly, federal courts should adopt a uniform interpretation of 26 U.S.C. § 7434 that allows employees to recover damages from their employers while helping combat the issue of employee misclassification.

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192 *See generally* Czerw v. Lafayette Storage & Moving Corp., No. 16-CV-6701-FPG, 2018 WL 5859525, at *9–10 (W.D.N.Y. Nov. 9, 2018); Cuellar-Aguilar v. Deggeller Attractions, Inc., 812 F.3d 614, 621 (8th Cir. 2015).

193 *See* Weil, *supra* note 26 (explaining that "when misclassification is adopted as a business strategy by some companies, it quickly undermines other, more responsible employers who face costs disadvantages arising from compliance with labor standards and responsibilities").