taxnotes®

state

Volume 96, Number 6 ■ May 11, 2020

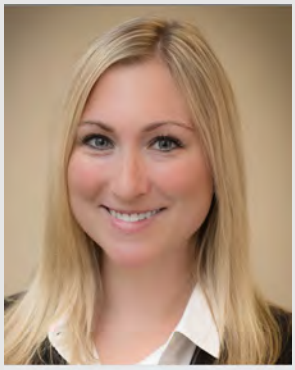
Employers Beware: Pennsylvania Supreme Court Expands Reach of UC Tax

by Jennifer Karpchuk

Reprinted from *Tax Notes State*, May 11, 2020, p. 769

Employers Beware: Pennsylvania Supreme Court Expands Reach of UC Tax

by Jennifer Karpchuk



Jennifer Karpchuk

Jennifer Karpchuk is a shareholder with Chamberlain, Hrdlicka, White, Williams & Aughtry in Philadelphia and is co-chair of the firm's state and local tax practice.

In this installment of Pennsylvania's SALT Shaker, Karpchuk examines where Pennsylvania's unemployment compensation law stands in light of a recent state supreme court case.

The Pennsylvania Supreme Court was recently asked to clarify the definition of employment under the state's unemployment compensation (UC) law, and its holding could increase the amount of UC tax that employers must contribute and collect from employees.

In *A Special Touch v. Department of Labor & Indus.*,[1] the supreme court was asked to discern the meaning of the phrase "customarily engaged" in the UC law. The relevant statutory provision provides:

> Services performed by an individual for wages shall be deemed to be employment subject to this act, unless and until it is shown to the satisfaction of the department that — . . . (b) as to such services such individual is customarily engaged in an independently established trade, occupation, profession or business. 43 P.S. [section] 753(l)(2)(B).

The taxpayer posited that the phrase simply required that one be capable of being involved in an independently established trade, occupation, profession, or business. Conversely, the Department of Labor and Industry, Office of Unemployment Compensation Tax Services (Department) argued that the phrase required that an individual be involved in an independently established trade, occupation, profession, or business in actuality.

A Special Touch was a salon offering nail, skin, massage, and permanent cosmetic services. Under an audit, the Department issued a notice of assessment to the salon indicating that it owed UC contributions because the office determined that 10 of its workers had been misclassified as independent contractors rather than employees.

The court's analysis began by examining the dictionary definitions of customarily and engaged. *Black's Law Dictionary* defines "customarily" to mean "usually, habitually, according to the customs; general practice or usual order of things; regularly." It defines "engage" to mean "to employ or involve one's self; to take part in; to embark on." Viewed together, the court found the terms to be "unambiguous in requiring a putative employer to show that an individual is actually involved in an independent trade, occupation, profession, or business in order to establish that the individual is self-employed under the second prong of Subsection (4)(l)(2)(B)."

The salon argued that the workers were independent contractors based on several facts, including that they could largely dictate their own schedule, and that the nail technicians were required to provide their own supplies and

[1] No. 30 MAP 2019; No. 1181 C.D. 2016 (Apr. 22, 2020).

equipment and maintain their own professional licenses. Also, some of the workers worked outside the salon. Although the court acknowledged that many of the workers performed work outside the salon, it found that none were providing their nail or cleaning services as a part of their own business or for other businesses. Further, there was no indication that the individuals were holding themselves out as having their own businesses or that they were actually involved in an independently established business. Based on those facts, the court concluded that the evidence was insufficient to support a finding that the 10 individuals were "customarily engaged" in an independently established trade or business.

The court acknowledged the difficulty in applying its ruling in practice. It noted that "customarily engaged" does not mandate that an individual actually provides his/her services to either the putative employer or third parties, as long as it is demonstrated that the individual is in some way actually involved in an independently established trade or business. One thing the court pointed to as supportive of the fact that an individual was holding himself/herself out to perform services for others was the use of business cards or other forms of advertising, even if the individual was not performing those services during a time period at issue. The court added that it agreed "with the notion that an individual can be an independent contractor who 'is simply satisfied working for a single client or at a single location' depending on the circumstances." The court's discussion of the facts and circumstances to be analyzed highlights the complexity in the requisite factual analysis.

Finally, while the court recognized that its holding imposed a burden upon employers, it weighed that burden against the risk that if it accepted the taxpayer's position, too many employers would avoid paying UC taxes on workers who were not truly independent contractors. The court found that the potential for the latter was more harmful than an added burden on the employer.

Employers subject to the UC law have a twofold responsibility: They must both (1) contribute and (2) withhold UC tax from employees, based on total payments for services performed in covered employment. The court's expanded view of what constitutes a covered employee necessarily expands the base subject to the UC tax. Notably, its decision does not alter the classification of workers for federal, state, or local tax purposes because the UC law maintains a separate and distinct test for classifying employees. Nevertheless, the dichotomy between the UC law and the tax law means that an employer may be required to pay and withhold the UC tax for those who are not treated as employees for other taxes.

Further, the analysis of whether a person qualifies under subsection 4(l)(2)(B) depends on multiple statutory factors, of which the customarily engaged requirement is merely one. Thus, the independent contractor analysis necessitates a highly fact-intensive inquiry. Because of the court's expanded view of employee for purposes of the UC tax, employers should take a fresh look at their classification of independent contractors in Pennsylvania to ensure compliance with the UC law. ■