THE CAPTIVE INSURANCE AGENT—A LAST HURRAH FOR AN INDEPENDENT CONTRACTOR?

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I. INTRODUCTION

It has been a virtual article of faith within the insurance industry that an insurance sales agent is an independent contractor. This position is under attack, and at least with respect to those agents representing a single company, or a number of affiliated non-competing companies, sufficient pressure is being generated that the agent's days as an independent contractor appear numbered. These so-called "captive agents," those agents representing only a limited number of companies, companies which are usually closely related, are increasingly found to be employees rather than independent contractors.

Despite the importance of the issue to a wide segment of the insurance industry, no adequate survey of the law relating to an agent's status exists. This article seeks to provide such a survey.

In a recent addition to its audit procedures, the Internal Revenue Service (IRS) has attempted to assess overall compliance with payroll tax and withholding requirements. As a result, the IRS has sought to reexamine the relationships existing between insurance companies and their sales agents. Though it may seem to bear the brunt, the insurance industry itself has not been singled out for review. Rather, the IRS has targeted some twenty-three general areas for closer scrutiny, with the emphasis largely focused on the so-called "personal service" area.[1] Misery may crave companionship, but this is of little consolation to those in the insurance industry concerned with determining an agent's status. In addition, because of the nature of his product, an insurance agent may be a special case, which further complicates the definitional process.

The reasons for renewed interest by the IRS are twofold. First, the interest follows from a recognition that there are many business areas where the degree of control exercised over individuals is inconsistent with their treatment as independent contractors. Secondly, it is a response to the ever-growing problem of evasion of the employment tax provisions of the *Internal Revenue Code* on the part of both the employee and the employer. It is simply much

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1. INTERNAL REVENUE SERVICE, AUDIT AND INVESTIGATION—EMPLOYMENT TAX PROCEDURES, INTERNAL REVENUE MANUAL 4621.

easier to collect the tax at the source, to tap the fountainhead so to speak, and thus reduce the number of persons responsible for reporting and payment.

The IRS's interest in this area is of recent origin. The earliest directive contained in part IV of the *IRS Manual* dates only from 1972.[2] This attention has not been prompted by recent changes in the industry, for the facts to be gleaned from an industry-wide review of the manner in which insurance sales are conducted would indicate that such operations are not substantially different than those of twenty years ago. Yet the net result of the IRS's scrutiny has been to call into question the traditional categorization of an insurance agent as an independent contractor. Qualification of employee pension and profit sharing plans has been jeopardized by the categorization of an agent as an employee. Wages paid to officers and employees serving more than one corporation in multiple corporate configurations have been caught in the melee and reassigned and assessed accordingly.

The harried employer is already aware of the importance of the issue. For his plea, "Where do I turn?" the obvious answer is to turn to the *Internal Revenue Code* and the broader common law which has developed. What the employer will find is that there is no simple answer. This article is not a cookbook. However, there are certain broad guidelines emerging which can allow an employer to make at least an educated guess.

II. The Internal Revenue Code

Subtitle C of the *Internal Revenue Code*[3] imposes certain requirements which make it necessary that an employer determine whether an individual is an employee or an independent contractor. Three distinct, yet closely related taxes are involved. The Federal Insurance Contributions Act[4] (FICA) and the Federal Unemployment Tax Act[5] (FUTA) impose on every employer a tax on "wages" paid to individuals. These are commonly referred to as "Employment Taxes." The Collection of Income Tax at Source on Wages Act[6] (Withholding) imposes on every employer the requirement that the appropriate income tax be withheld on the "wages" of every employee.

Contained in the language of the *Code* sections relating to these taxes are some very broad initial definitions of the terms which are important factors in determining the agent's status. Section 3121(a) defines "wages" as "all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash . . . ." Section 3306(b) and section 3401(a) employ virtually identical language. "Wages" is a narrower term than "in-

2. *Id.*
3. All textual references herein to the *Internal Revenue Code* refer to the *Internal Revenue Code of 1954, as amended*, 26 U.S.C. section 1 et seq., with reference simply to the "*Code*," the appropriate section or regulation.
4. Int. Rev. Code of 1954, § 3101 et seq.
5. *Id.* § 3301 et seq.
6. *Id.* § 3401 et seq.

come" and the two terms should not be confused. Whether payments are taxable to or deductible by an employee is immaterial in determining whether they are subject to Withholding under section 3401(a).[7]

"Employee," for FICA purposes, includes a full-time life insurance salesman and any individual who, under the usual common law rules applicable in determining an employer-employee relationship, has the status of an employee.[8] The contract of service must contemplate that substantially all of the services will be performed personally by the individual. The term "employee" does not include individuals who have a substantial investment in facilities or whose services are in the nature of a single transaction, not part of a continuing relationship.[9] Section 3306(i) incorporates substantially all of section 3121(d). The *Code*'s definition of "employee" for Withholding purposes is the vaguest of all three sections. Section 3401(c) simply includes employees and elected officials of governmental agencies and officers of a corporation as employees for Withholding purposes.

Further guides for determining an individual's status are found in three substantially similar sections of the regulations: namely, *Treasury Regulation* section 31.3121(d)-1(c) (1960), *Treasury Regulation* section 31.3401(c)-1(d) (1960) and *Treasury Regulation* section 31.3401(c)-1(b) (1960). The latter provides the following exemplary definition:

> (b) Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; *it is sufficient if he has the right to do so.* The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, *if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.*[10]

With two exceptions, the *Code*'s treatment of the employee v. independent contractor paradox as it relates to insurance agents, is similar for FICA, FUTA, and Withholding. Under section 3121(d)(3)(B), "full-time life insurance salesmen" are specifically included as employees for FICA purposes. There are, however, two exceptions. First, the regulations provide that a part-time

7. *See* Royster Co. v. United States, 342 F. Supp. 375 (E.D. Va. 1972).
8. INT. REV. CODE OF 1954, § 3121(d). A number of occupations unrelated to the matter under discussion are also included within the definition of "employee."
9. INT. REV. CODE OF 1954, § 3121(d).
10. Treas. Reg. § 31.3401(c)-1(b) (1960) (emphasis added).

agent or one who works for several companies will not be considered a "full-time life insurance salesman."[11] The regulations further caution:

> The fact that an individual falls within one of the enumerated occupational groups, however, does not make such individual an employee under this paragraph unless (a) the contract of service contemplates that substantially all the services to which the contract relates in the particular designated occupation are to be performed personally by such individual, (b) such individual has no substantial investment in the facilities used in connection with the performance of such services (other than in facilities for transportation) and (c) such services are part of a continuing relationship with the person for whom the services are performed and are not in the nature of a single transaction.[12]

Under section 3306(c)(14), so long as an insurance agent is remunerated *solely* by way of commissions, the agent will not be classified as an employee for FUTA tax purposes. *Compensation* by any means other than commissions jeopardizes this exception.[13]

The definition of "employment" contained in section 3121(b) provides a special trap for related insurance companies who conduct their sales operations through the same sales agent. If the agent is found to be an employee of each related company, each related company would be presented with its own individual FICA tax liability on the account of each employee. Allocation of the agent's salary between related employers would be required and a FICA contribution assessed for the non-exempt portion of each agent's salary from each related employer.[14] Employees are entitled to credit or refund for FICA overpayments which result from employment with more than one employer. Employers, even related corporations, do not receive similar treatment. There is no correlation between the total wages received by an employee and the FICA contributions required of each employer. This has the effect of ballooning the assessments where a multiple corporate configuration has been adopted.

How then is an employer to make a proper determination? No clear guide posts are provided by either the *Code* or the regulations. The *Code* provisions are not integrated. They were written at different times as responses to different problems. Their differences tend more to further complicate matters than lend any clarity to the question at hand.

Improper determination of an individual's status can result in an assessment of the employer of unpaid FICA and FUTA taxes and Withholding as well as the employees' share of FICA taxes, together with IRS's traditional penalty and interest. Abatement of that portion of the assessment relating to

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11. *Id.* § 31.3121(d)-1(d)(3)(ii) (1960).
12. *Id.* § 31.3121(d)-1(d)(4)(i) (1960).
13. *See* Royster Co. v. United States, 342 F. Supp. 375 (E.D. Va. 1972). In *Royster*, the company reimbursed their salesmen for their actual cost of meals. The court held that this was not a wage payment but merely reimbursement for *actual* expenses, in no way connected to the status or salary of the salesmen. *Id.* at 376-77. Thus, this payment was not compensation within the meaning of the applicable tax laws.
14. S.S.T. 154, 1937-1 CUM. BULL. 391.

taxes actually paid by the employee is possible under section 3402(d). However, the fact that the employee has satisfied his liability by reporting his income and paying the appropriate income and self-employment tax does not operate to relieve the employer from liability for penalties or interest on the original amount as assessed.[15] Even this apparent right of set-off is deceptive. The burden of proof is on the employer. Occupations with a high rate of turnover, such as insurance agents, present special problems. Terminated agents are not always available and often unwilling to assist. The IRS will not, and probably cannot with recent concerns over individual privacy, make its records available to a taxpayer seeking to abate an Employment and Withholding tax deficiency.[16]

As a result of the *Code*'s general lack of clarity, refuge is usually sought in the oft-quoted phrase, "each case must be decided on its own merits." This requires a review of the common law, with a particular emphasis placed upon certain factors given heavy weight by the courts.

III. The Common Law

The common law test is easy to articulate, but, in close cases, difficult to apply. In determining whether an individual is an employee for Federal Employment and Withholding tax purposes, federal rather than state law is applicable.[17] State tort cases which have held the principal responsible for the negligent acts of independent contractors are generally predicated upon the doctrine of estoppel or a holding out to the public, and are not particularly helpful. This article seeks to deal with the contractual relationship between the parties and the relationships which develop as a result.[18] The interests of unrelated third parties, usually an important element in most state court cases, are not involved. However, there are federal enactments which have developed their own "federal common law" and which seem applicable at first glance, but which are not. The fact that an individual is an employee under the National Labor Relations Act is not controlling in Employment and Withholding tax cases. The objectives of the two acts are not the same, and it is quite possible that an individual might be regarded as an employee for the purposes of one statute and not the other.[19]

Regardless of the characteristics of a particular case, the overriding element is the question of control. The principal is not required to stand at the individual's elbow and direct his every move; nor does the fact that the

15. Rev. Rul. 577, 1958-2 Cum. Bull. 744.
16. *See* Levine, *Current Factors That Distinguish Between "Employee" and Independent Contractor*, 37 J. Tax. 188 (1972).
17. Dimmitt-Rickhoff-Bayer Real Estate Co. v. Finnegan, 179 F.2d 882, 885 (8th Cir. 1950).
18. *See* Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216, 231 (Ct. Cl. 1965) wherein the court notes the inapplicability of tort cases in the context of determining the contractual relationship of the parties.
19. Nevin, Inc. v. Rothensies, 58 F. Supp. 460, 461 (E.D. Pa. 1945).

employee has occasion to exercise his own cerebellum in the conduct of the employer's business negate the existence of an employment relationship.[20] In pursuit of the middle ground, that grey area in which "control" is difficult to determine, the following factors need to be examined:

A. *Right of Discharge*

In the case of an insurance agent, the effect of the right of the principal to discharge an agent is essentially a two-stage analysis. Initially, the basis upon which the right to discharge may be exercised must be determined. In addition, the effect of the agent's discharge upon his ability to conduct his trade or business may be critical.

While the right to discharge an individual is not itself an indication of the existence of an employment relationship, the basis upon which the principal can exercise the right of termination is fundamental. Even an acknowledged independent contractor can be terminated for failing to achieve the result to be accomplished in the market place.[21] However, the apparent ability to terminate an agent for a failure to adhere to company rules and regulations indicates an employment relationship.[22] An employer's right to terminate for failure to satisfy established sales quotas does not prima facie establish an employer-employee relationship. Termination for failing to achieve the intended result does not convert an independent contractor to an employee merely because he was terminated.[23] Proper structuring of such a right of termination is indicative of a right to enforce the desired result, or to use the *Code*'s language, "the result to be accomplished."

Because of the obvious disparity in bargaining powers between a principal and an individual, an agreement that gives the individual certain bargaining rights on termination supports the individual's status as an independent contractor. In *Hemmerle v. Hobby*,[24] the court relied upon the fact that the contract between principal and agent could not be terminated at the will of either party, but only by mutual agreement. Since the principal was thus deprived of the right of summary discharge, the court found that there was no right on the principal's part to direct and control the conduct of the individual.[25]

The length of notice required prior to termination of an agent's contract may also be an important element. Most agency contracts require only thirty days written notice. The right of summary discharge in certain aggravated situations could be retained, but an extension of the notice period required by

20. Ellison v. Commissioner, 55 T.C. 142, 153 (1970).
21. Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216, 229 (Ct. Cl. 1965).
22. Ellison v. Commissioner, 55 T.C. 142, 154 (1970).
23. Levine, *Current Factors That Distinguish Between "Employee" and Independent Contractor*, 37 J. TAX. 188, 189-90 (1972).
24. 114 F. Supp. 16 (D.N.J. 1953).
25. Hemmerle v. Hobby, 114 F. Supp. 16 (D.N.J. 1953).

the contract may be viewed as reducing the unilateral effect of the agent's discharge.[26]

The ability to terminate without liability can be further indicative of an employment relationship.[27] By this rationale, an insurance agent who is an independent contractor would have a vested interest in renewal commissions.[28] Preservation of just such a vested interest may provide one of the major pitfalls of any attempt to maintain a "captive agent" as an independent contractor. Maintenance of an economic base for the market area to be served by subsequent "captive agents" is an important consideration. A vested interest in renewal commissions on the part of terminated agents could well destroy the economic base of his replacement. Attempts to provide some other interest in lieu of a vested interest in renewal commissions is discussed in later sections.

A final pitfall is presented by the structure of state licensing provisions for insurance agents. Most states employ a "sponsorship" licensing system in the sense that an agent is licensed to sell insurance through a particular company. In a recent revenue ruling, the IRS placed primary reliance on the effect of termination of a real estate sales agent under such a "sponsorship" system. In effect,

> all of the facts and implications of fact in this case should be considered in light of the effect of the legal requirements of the state registration system . . . . [T]he fact that the company's sponsorship is essential to the salespeople's ability to perform in the industry suggests that any factual indications of control over the salespeople should be heavily emphasized in favor of finding an employer-employee relationship. For example, *the termination of a salesperson by the company would have a more profound effect on that person than would ordinarily be the case with respect to an independent contractor.*[29]

The analogy to be drawn in the case of insurance agents may be insurmountable. The potential for control is enhanced by local law requirements which require company sponsorship of the agents for registration and licensing. The termination of a "captive agent" effectively removes him from the market place.

B. *Intent of the Parties*

Determining the intent of the parties is always a very delicate process. In cases involving the employee-independent contractor paradox, it becomes clear that rather than being one of the principal aids in the process of evaluation, intent is only the most subjective element. Intent is a false corridor, and any

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26. Simpson v. Commissioner, 64 T.C. 974, 988 (1975).

27. Security Storage & Van Co. v. United States, 528 F.2d 1166 (4th Cir. 1975). In *Security Storage*, the refusal by the court to instruct the jury that the right to discharge a worker without cause was a factor to be considered in determining whether the worker was an employee or an independent contractor was reversible error.

28. A. Frazier, *Unemployment, FICA and Withholding On Income Taxes of Life Insurance Agents*, 1975 ALIA LEGAL SECTION PROCEEDINGS [hereinafter cited as Frazier].

29. Rev. Rul. 137, 1976-1 CUM. BULL. 11, 13 (emphasis added).

attempt at an evaluation of the parties' intent simply returns the searcher to the substantive elements already under review. In those cases which have dealt with the question of intent, it all too often appears as though the proverbial dog may finally have caught his tail. As an example, in a case dealing with "installers" of aluminum windows, the court viewed the following factors as determinative of the parties' intent: whether the principal had the right to exercise control over the details of the work; whether the principal had the right to discharge the individual; whether the individual had the opportunity for profit or loss from operations; whether the individual had an investment in the tools and facilities of the work; whether the occupation required a high degree of skill or knowledge; whether the relationship was intended to be a permanent one; whether the work was part of the employer's regular business; whether the parties believed they were creating an employer-employee relationship; and what was the method of payment. Intent was one of the elements reviewed by the court. However, that intent had to be supported by the actions and conduct of the parties.[30]

Mere expressions of intent, mere contract verbage, will not serve to make an employee an independent contractor. *Treasury Regulation* section 31.3401(c)-1(e) (1960) provides:

> (e) If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.

However, the written word will not necessarily betray the intent of the parties as that intent is evidenced by their conduct. Even though the contracts, manuals, and other materials appear on their face to establish an employer-employee relationship, this will not be determinative. The courts will examine how the company and its insurance agents interpreted the contract provisions in light of their actual conduct.[31] The courts have at least expressed the thought that concern is not with the contract which the parties could have entered into or a relationship which could have been established. The courts appear concerned with the contract which was entered into and the relationship which was established.[32]

C. *Opportunity for Profit or Loss*

An opportunity of sustaining either a profit or a loss from operations is a strong indication that the individual is an independent contractor. More has to be involved than the incentive derived by an employee in the way of possible salary increases.[33] The opportunity for profit or loss must depend upon the

30. Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).
31. Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,842 (W.D. Okla. 1975).
32. Reserve Nat'l Ins. Co. v. United States, 74-1 U.S. Tax Cas. 84,302, 84,306 (W.D. Okla. 1974).
33. Nevin, Inc. v. Rothensies, 58 F. Supp. 460, 462 (E.D. Pa. 1945).

individual's own efforts, initiative, sales skills, or lack thereof.[34] In *Nevin, Inc. v. Rothensies*,[35] drug store operators, as licensees, were viewed as independent contractors. Considerable control was involved, such as requiring the managers to purchase only from one supplier, but the fundamental element which the court relied upon was the risk of substantial personal loss in the event the business was unsuccessful. The exposure of the licensees involved a good deal more than the mere possibility of a loss of their position. In *Dimmitt-Rickhoff-Bayer Real Estate Co. v. Finnegan*,[36] real estate agents were found to be independent contractors. The salesmen's potential for success was not dependent upon their position, but was entirely dependent upon their own initiative, efforts, skill, and personality.

The apparent analogy between such occupations as real estate salesmen and insurance agents may be one to be relied upon only with care. The built-in controls involved in the process of issuance of an insurance policy are not present in many other occupations. There is no application or underwriting procedure involved in a real estate transaction. However, it is becoming clear that even in the case of insurance sales, if the decisions and efforts of the agent, not those of the employer, determine the success or failure of the agency, the agent will be viewed as an independent contractor.[37]

D. *Degree of Skill or Expertise Involved*

Intertwined with the individual's opportunity for gain or loss is the degree of skill or expertise required by a particular occupation. In the case of an insurance agent, this is a two-part analysis. First, the agent's skill as a salesman, and the effect of that skill on any analysis of his status, must be evaluated. Second, the level of expertise developed by the agent in the business of insurance and its uses must be weighed. Neither good producers nor good planners are automatically designated as independent contractors because of their level of skill or expertise; but, developed skills and expertise are strong indications of a lack of control by the principal of the details and means by which the work is accomplished. In *Illinois Tri-Seal Products, Inc. v. United States*,[38] the court relied upon the fact that the "installers" were skilled in the installation of aluminum windows and doors. Because of their skill, detailed instructions were unnecessary. In Revenue Ruling 70-575,[39] so-called "trade embalmers," engaged only occasionally by funeral homes and hospital morgues, were viewed as independent contractors. Their occupation involved a high degree of skill which by its very nature was not subject to substantial control.

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34. Dimmitt-Rickhoff-Bayer Real Estate Co. v. Finnegan, 179 F.2d 882, 888 (8th Cir. 1950).
35. 58 F. Supp. 460 (E.D. Pa. 1945).
36. 179 F.2d 882 (8th Cir. 1950).
37. Farmers Ins. Co. v. United Farmers Agents Ass'n, 209 N.L.R.B. 177 (1974).
38. 353 F.2d 216 (Ct. Cl. 1965).
39. Rev. Rul. 575, 1970-2 CUM. BULL. 223.

Cases and rulings in this area are not limited to recognized occupations or skills. Local "gypsy chasers," hired randomly to load and unload trucks, have been found to be independent contractors. Some skill was involved in the loading and unloading of trucks, and little, if any, direction was required of the "gypsy chasers" in the conduct of their work. However, too heavy a reliance on those cases dealing with the likes of the "gypsy chasers" may be dangerous. Two factors recognized in all the decisions were the number of separate, independent transactions involved each year, and the difficulty, if not the impossibility, of enforcement and collection by the trucking companies.[40]

Nevertheless, possession of a recognized or established skill is not itself determinative. In Revenue Ruling 75-101,[41] a licensed practical nurse was found to be an employee. The contract of employment contemplated that the services involved were to be performed personally and under the company's name. The employee was issued instructions, paid at a predetermined hourly rate, and was subject to periodic checks by the employer. The fact that the nurse was a trained, skilled worker, who did not require constant supervision, and the fact that the nurse was free to accept or decline any particular assignment was not sufficient to conclude that the nurse was an independent contractor.

State licensing requirements, the increasing complexity of their product, and the ever-changing use of insurance by the public should all support a claim that an insurance agent is highly skilled and possessed of a high degree of expertise. However, no specialized skill, other than the personal charisma required of a good salesman, is necessary for an individual to become an insurance agent. He learns something about the product he is selling, but the occupation of an insurance salesman does not involve the sort of specialized skill required, for example, of chicken sexers[42] or radiologists,[43] which can be applied independent of the principal's business.[44]

E. *Training and Continuing Education*

As shown in section D of this article, expertise may imply a lack of control. However, as has aptly been demonstrated by those cases which have dealt with the role played by company-provided training, the decision to acquire the type of expertise which is to imply such a lack of control must come from the agent and cannot be imposed from above. Company-provided training is not itself detrimental. Almost all insurance companies provide some form of training for new agents, and in fact, the nature of the product offered is such as to require it. The role training plays in the analysis of an agent's status is once again one of degree. Training aimed at familiarizing the new agent

40. Lanigan Storage & Van Co. v. United States, 389 F.2d 337 (6th Cir. 1968); Bonney Motor Express, Inc. v. United States, 206 F. Supp. 22 (E.D. Va. 1962).
41. Rev. Rul. 101, 1975-1 CUM. BULL. 318.
42. Saiki v. United States, 306 F.2d 642 (8th Cir. 1962).
43. Azad v. United States, 388 F.2d 74 (8th Cir. 1968).
44. MFA Mut. Ins. Co. v. United States, 314 F. Supp. 590, 599 (W.D. Mo. 1970).

with the policies sold by the company, the application and underwriting process, and the amount of premium to accompany the application probably poses no threat. The company's concern should not be with the manner, method and style of the agent, but with whether policy costs and coverages were correctly represented to the prospect.[45] However, training which seeks to "train" the agent in the preferred method of sales, which requires the use of "canned" sales presentations and the like, smacks of control and will probably cause the agent to be construed as an employee.[46] The agent must retain the right to devise and utilize his own methods.[47]

Whether emanating from the insurance company licensing him or from independent sources, the established agent can find himself engulfed by programs of continuing education. Continuing education's use by the agent must depend upon the individual's desire for further assistance. Coupling follow-up counseling with company-provided training removes yet another protective shroud from the would-be independent contractor.[48] Requiring the agent to participate in a program of continuing education may be costly.[49]

F. *Investment in Tools and Facilities*

Normally, the employer-employee relationship does not result in a significant investment by the employee in the facilities and tools of his occupation, and thus a significant investment is indicative of a principal-independent contractor relationship. The investment need not be large, but should cover the tools necessary to conduct the trade or occupation.[50] A substantial investment includes equipment and premises as distinguished from education, training, and experience, yet it does not include such incidental tools, instruments, equipment or clothing as are frequently provided by employees.[51]

Some insurance companies leave the matter of provision of office space and other facilities up to the agent, with many such offices set up in the agent's personal residence. Revenue Ruling 64-280[52] states that provision of space, heat, light and power in a personal residence are not considered an investment. Revenue Ruling 64-280 goes on to state that furnishing of a typewriter and related materials for an office does not constitute a substantial investment. The key is whether the equipment or facilities provided by the employee may be used for purposes not related to the occupation. If such items are readily adaptable to other purposes, it is questionable whether they will be viewed as a significant investment.[53] Specifically excluded from consideration is any in-

45. Reserve Nat'l Ins. Co. v. United States, 74-1 U.S. Tax Cas. 84,302, 84,305 (W.D. Okla. 1974).
46. *See* Ellison v. Commissioner, 55 T.C. 142 (1970).
47. Halpern & Lenrow, *When is an Employee an Employee?*, 74 BEST'S REV. 68, 70 (1973).
48. *See* Rev. Rul. 139, 1976-1 CUM. BULL. 16.
49. Ellison v. Commissioner, 55 T.C. 142 (1970).
50. *See* Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).
51. Rev. Rul. 88, 1972-1 CUM. BULL. 319, 320.
52. Rev. Rul. 280, 1964-2 CUM. BULL. 384, 386.
53. Rev. Rul. 88, 1972-1 CUM. BULL. 319, 320.

vestment by the agent in an automobile or other vehicle. Investment in the facilities for transportation is not included within the *Code*'s meaning of a "substantial investment in facilities."[54]

The investment required in an insurance operation is minimal and is obviously vulnerable to the argument that most of the equipment could just as readily be used for other purposes. Further, the largest single investment, an automobile or other vehicle, is specifically excluded by the *Code*. It appears, then, that the significance of the investment of the individual still depends upon the totality of circumstances.[55]

G. *Work Premises*

Proximity is oft-times equated with control. However, geographic isolation alone does not establish an absence of control since control can be accomplished as readily by the mere availability of the principal's personnel for direction.[56] The nature of the insurance business makes it impractical for a company to attempt to control sales personnel on a day to day basis. Insurance agents usually work outside of the business premises, a fact which argues for their status as independent contractors.[57] However, when it is clear that the understanding of the parties is that company rules, in certain situations, will determine directly how things are to be done, no amount of physical distance will be helpful.[58]

Provision of office space alone is not a fatal error provided that an analysis of the other factors would indicate that there is clearly a lack of control on the part of the principal.[59] Usually, but not always, the fact that the principal provides an agent with the necessary equipment, office space, materials, and supplies indicates that the agent is an employee.[60] Both the choice and provision of office space should be the decision of the agent. If the agent chooses to have his own office, furniture and equipment, such should be provided by the agent at his own expense.[61]

H. *Manner of Payment*

As discussed earlier, section 3306(c)(14) provides an exception to the definition of "employee" for insurance agents who are remunerated "solely by way of commission." Even if an insurance agent is an employee under the common law, the employer will not be liable for payment of FUTA taxes where remuneration is solely on a commission basis.

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54. INT. REV. CODE OF 1954, § 3121(d).
55. *See* Ellison v. Commissioner, 55 T.C. 142, 155 (1970).
56. *See* Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216, 230 (Ct. Cl. 1965).
57. *See* Rev. Rul. 288, 1969-1 CUM. BULL. 258.
58. *See* Rev. Rul. 137, 1976-1 CUM. BULL. 11.
59. Rev. Rul. 136, 1976-1 CUM. BULL. 10.
60. *See* NLRB v. Phoenix Mut. Life Ins. Co., 167 F.2d 983 (7th Cir. 1948).
61. *See* Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,838 (W.D. Okla. 1975).

At common law, payment by commission is a strong indication that the individual is an independent contractor, but the term "commission" is perhaps overly restrictive. "Gypsy chasers," "applicators," and "installers," paid on a piece-work basis, have been found to be independent contractors.[62]

The principal problems in clearly applying this element to an analysis of an individual's status are in determining: (a) the status of an individual who receives a set salary for part of the year and receives commissions for the remainder; (b) the treatment to be given the cash value of prizes and awards received by the agent during the year; and (c) the effect of any agent's retirement plan maintained by the company.

1. *Financed Agents*

Almost all insurance companies seek to provide their new agents with some form of financing to assist them in their initial stages of operation. As a general rule, there seems to be little or no way in which those financed agents can be construed as independent contractors and still maintain the basic reason behind the financing agreement. Where the principal seeks to establish a minimum salary or floor for the individual, the agent will be found to be an employee.[63]

The leading case involving financed agents is *MFA Mutual Insurance Co. v. United States*.[64] The court viewed the method of payment as one of the more significant factors in the case. Fixed monthly payments made to agents under an Agent Financing Agreement was not "remuneration solely by way of commission" as required by section 3306(c)(14). If all, or any part of, the remuneration received by an insurance agent was "wages" as defined in section 3306(b), none of the services of the agent for that pay period were excepted.[65] Payment of a guaranteed salary was, therefore, viewed as wholly inconsistent with the relationship of principal-independent contractor.

The determination of whether an insurance agent was remunerated solely by way of commission must be made for each pay period of the calendar year.[66] This position was finally adopted by the IRS in Revenue Ruling 75-81.[67] While section 3306(d) defines a pay period as a period of not more than 31 consecutive days, the IRS had earlier contended in Revenue Ruling 67-44,[68] and Revenue Ruling 71-357[69] that the term "all such service" referred to all such service performed during the calendar year. These rulings have been revoked by Revenue Ruling 75-81. Using a pay-period-by-pay-period ap-

62. Lanigan Storage & Van Co. v. United States, 389 F.2d 337 (6th Cir. 1968); United States v. Thorson, 282 F.2d 157 (1st Cir. 1960); Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).

63. *Cf.* Reliable Life Ins. Co. v. United States, 356 F. Supp. 235 (E.D. Mo. 1973).

64. 314 F. Supp. 590 (W.D. Mo. 1970).

65. Treas. Reg. § 31.3306(c)(14)-1(b) (1960).

66. Reliable Life Ins. Co. v. United States, 356 F. Supp. 235, 238-39 (E.D. Mo. 1973).

67. Rev. Rul. 81, 1975-1 CUM. BULL. 326.

68. Rev. Rul. 44, 1967-1 CUM. BULL. 287.

69. Rev. Rul. 357, 1971-2 CUM. BULL. 353.

proach, it is possible to have the agent be an employee for part of the year and an independent contractor for the remainder.[70]

One possible alternative to treatment of the financed agent as an employee is posed by Revenue Ruling 68-337.[71] Under the usual agent financing agreement, the financed agent has no liability even though earned commissions do not equal the payment received. Revenue Ruling 68-337 held that the payments made under a financing agreement were not wages because they represented an indebtedness to the company on the part of the financed agent. The advances were loans and not wages. They represented an obligation which must be satisified even though the employment was terminated prior to payment. However, the obligation of the financed agent must be genuine and a history of enforcement on the part of the principal must be shown. A consistent pattern of "writing off" any excess amount advanced to terminated agents will cause the payments to be construed as a salary or guaranteed minimum compensation.[72]

2. *Awards, Prizes & Bonuses*

As a further incentive to boost sales, most insurance companies offer special prizes, bonuses or trips for increased sale effort on the part of the agents. In many instances, if the agent is unwilling or unable to take the trip, he is given its cash value. Most of the same rules relating to financed agents apply with respect to treatment of awards, prizes, and bonuses received by the agent during the course of a sales year. Because an individual can now be an employee for a fraction of the year, the present IRS position would make an agent an employee during any month he receives a special bonus. Prizes and their cash value will be considered as remuneration by means other than commission. Consequently, the agent will have to be treated as an employee, at least for FUTA purposes, for those months in which such payments are received.

A special problem may be presented by bonuses received as the result of a sales contest. The agent would be an employee during the month payment was received. However, most sales contests involve extended periods of time, up to and including a year. Whether an agent would be viewed as an employee for each month of the sales contest, under a constructive receipt of income argument, is unclear. However, in *Reserve National Insurance Co. v. United States*,[73] the court viewed such prizes and bonuses as extra commissions for those reaching a certain sales quota.

3. *Benefits and Retirement Programs*

The principal need not withdraw entirely from providing benefit plans, such as group health insurance, to the sales agency force. However, any

70. *See* Reliable Life Ins. Co. v. United States, 356 F. Supp. 235 (E.D. Mo. 1973).
71. Rev. Rul. 337, 1968-1 CUM. BULL. 417.
72. *See* Rev. Rul. 138, 1976-1 CUM. BULL. 13, 15.
73. 74-1 U.S. Tax Cas. 84,302, 84,304 (W.D. Okla. 1974).

benefit plan offered should be one separate and apart from any offered to acknowledged employees. The costs of any benefit plan should not be subsidized by the principal.[74] If contribution by the principal is desired, the model presented in *Standard Life & Accident Insurance Co. v. United States*[75] might prove helpful. Participation was pegged at a certain sales production level. Once an agent's production qualified him to participate, the ratio of the premium paid by the company again depended on sales production; the higher the agent's sales production, the greater the portion of the premium paid by the principal. If an agent's sales production declined, the agent's proportionate premium would increase, or his right to participate would terminate, depending on the amount of the decrease in sales production.[76]

Other benefits, such as vacation and sick pay are traditionally associated with an employee status. In those cases and rulings where the individual was adjudged an independent contractor, such benefits have universally not been available. Many insurance companies provide retirement programs for their agents. While these are many times intended as a substitute for an interest in renewal commissions upon termination, the existence of such a retirement program can be persuasive evidence that the agents are employees.[77] The common conclusion of the foregoing is that compensation of an insurance agent by any means other than commissions jeopardizes his status as an independent contractor.

I. *Reimbursement for Expenses*

The ability to determine the level and type of expenses is indicative of an individual's status as an independent contractor.[78] There should be little or no relationship between the commissions received by the agent and the expenses incurred in his sales operation.[79] Expense allowances paid by the insurance company but tied to sales production have been viewed as simply another means of paying commissions.[80] Outright provision of office space, desk, telephone, stenographic service, stationery, postage, filing cabinets, indemnity bonds, in short, virtually all of the equipment and expenses necessary to run an insurance agency, was one factor relied upon in finding insurance agents employees in *NLRB v. Phoenix Mutual Life Insurance Co.*[81] Non-reimbursement for expenses was found significant in a ruling involving magazine subscription salesmen.[82]

74. *See* Reserve Nat'l Ins. Co. v. United States, 74-1 U.S. Tax Cas. 84,302, 84,305 (W.D. Okla. 1974).
75. 75-1 U.S. Tax Cas. 86,835 (W.D. Okla. 1975).
76. Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,838-39 (W.D. Okla. 1975).
77. NLRB v. Phoenix Mut. Life Ins. Co., 167 F.2d 983 (7th Cir. 1948).
78. Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,837-38 (W.D. Okla. 1975).
79. *See* Reserve Nat'l Ins. Co. v. United States, 74-1 U.S. Tax Cas. 84,302, 84,305 (W.D. Okla. 1974).
80. Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,-839-40 (W.D. Okla. 1975).
81. 167 F.2d 983 (7th Cir. 1948).
82. Rev. Rul. 370, 1971-2 CUM. BULL. 345.

No determination seems to have been made as to whether reimbursement for expenses constitutes remuneration other than by way of commission. If so held, the exemption under section 3306(c)(14) could clearly be jeopardized. Many companies share advertising expenses and even finance their financed agents through agreement with their established agents. These types of payments may be sufficient to jeopardize the exception under section 3306(c)(14).

J. *Determination of Hours and Routine*

While the ability to establish or set one's own work hours and routine implies a lack of control, strange or irregular working hours do not automatically make the individual an independent contractor. The special circumstances of the particular occupation may themselves be controlling. However, an attempt on the part of the principal to establish required work schedules clearly indicates that the individual is an employee.[83] A failure on the part of the principal to require specific business hours clearly leaves the individual free from direction by the principal.[84]

K. *Rules and Regulations*

Whether embodied in contract forms, rate manuals, or handbooks, mandatory rules and regulations are indicative of control.[85] As in all questions of control, the crucial items are first, the degree of direction and second, whether the results or methods are directed. There need not be a total absence of rules or regulations. Special directions can be given to take into account the special nature of a particular "job."[86] However, the insurance industry does not involve the type of job-to-job relationship found in the cases dealing with special by-the-job instructions.

The insurance industry is fraught with special restrictions and requirements. Many of these are statutory or imposed by state regulatory agencies. Every insurance agent is confronted with an immediate body of rules and regulations to which he must conform if he is to maintain his license. Each insurance company has numerous rules and regulations with respect to the process of application for, and issuance of, policies of insurance which the agent must follow.

The mere fact that the insurance company requires their sales agents to conform to regulatory legislation and established customs and practices obligatory upon the industry will no longer, in and of itself, be viewed by the IRS as sufficient evidence of such control of the salesmen's manner and method of performance of their services as to make them employees.[87] However, the effect of implementation of the statutory provisions by the company must be taken into account in evaluating the relationship between the company and its

83. *See* Ellison v. Commissioner, 55 T.C. 142 (1970).
84. *See* Rev. Rul. 446, 1970-2 CUM. BULL. 215, 216.
85. *See* Rev. Rul. 586, 1970-2 CUM. BULL. 223.
86. Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).
87. Rev. Rul. 136, 1976-1 CUM. BULL. 10, 11.

salesmen.[88] Enforcement of company rules can be a different matter. An insurance company's effort to enforce its "field underwriting rules" will not cause the agent to be construed as an employee. Rules of this sort relate to the result to be accomplished. The results v. methods dichotomy set forth in *Treasury Regulation* section 31.3401(c)-1(b) shows that rules and regulations can relate to the final result, but not the manner or method in which that result is achieved.[89]

Most insurance companies also seek to require company approval of all advertising material. These restrictions are usually viewed as an attempt to guard against misrepresentation and have not been found objectionable.[90]

Certain rules and regulations are transgressions in themselves. In Revenue Ruling 70-586,[91] a requirement that a sales agent operate solely under the company's name, whether on stationery, in the telephone directories, or on his office door, was an important factor which caused the agent to be viewed as an employee. In *Ellison*, the insurance company sought to require the use of special audio-visual equipment, the verbatim use of prepared or "canned" sales presentations, and the use of a suggested daily schedule. Through its correspondence and sales meetings, the company continually sought to stress the mandatory nature of the agent's compliance with the company's pronouncements. As a result, the agents were found to be employees.[92] In Revenue Ruling 76-139,[93] the company sought to require the use of a prepared sales presentation, regular working hours, and a follow up on all leads furnished by the company. As a result, the sales agents were held to be employees.

Of the rules and regulations insurance companies usually seek to enforce, many relate either to the handling of claims or to the fulfillment of certain service functions. The relationship of these rules presents a special problem.

1. *Claims Responsibility of Insurance Agents*

Required assistance in the handling of claims puts the insurance agent at the beck and call of the company. Such duties may well require advice, direction, and supervision from the home office. The right to direct the agent to perform certain claims duties has, in fact, been viewed as a reservation by the company of the right to control and direct the individual performing the services.[94]

2. *Service Functions*

Part of any insurance agent's time is consumed by so-called service functions. These can range from matters related to policy service to completely

88. Rev. Rul. 137, 1976-1 CUM. BULL. 11, 13.
89. *See* Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,842 (W.D. Okla. 1975).
90. *Id.* at 86,837.
91. Rev. Rul. 586, 1970-2 CUM. BULL. 223.
92. Ellison v. Commissioner, 55 T.C. 142 (1970).
93. Rev. Rul. 139, 1976-1 CUM. BULL. 16.
94. Holland v. Altmeyer, 60 F. Supp. 954 (D. Minn. 1945).

unrelated matters such as membership service in a related organization. Policy service seems inherent in the occupation and may not be objectionable. Unrelated service functions such as securing membership for an affiliated non-insurance corporation may indicate control. If the two capacities are interrelated, the agents are not acting in two separate and distinct capacities. Interrelated services containing elements establishing the existence of a common law employer-employee relationship can result in the conclusion that all services were performed as an employee. To argue otherwise, the two capacities must be wholly separate.[95]

L. *Reporting Requirements*

Reporting requirements are fatal to the individual's status as an independent contractor. In *MFA Mutual Insurance Co. v. United States*,[96] regular written reports were required of financed agents. Although the company attempted to show that the requirement was only haphazardly applied, the court found that the existence of such a requirement was totally inconsistent with the company's claims that it was disinterested in the details of its financed agents' activities, or that it did not intend to exercise its management powers over how the work was to be conducted.

In *Ellison*, the insurance company required that each agent maintain a "Calls to Clients" book reporting their activities for the week. Every detail of the day was to be recorded ranging from how many sales prospects were contacted to how many times a special audio-visual machine was used. The agents' activities as recorded were reviewed by the company's home office personnel. Agents were counseled if the report revealed such was necessary. This type of reporting requirement was viewed as indicating extensive control on the part of the insurance company, and the agents were found to be employees.[97]

The reports reviewed by the company need not be confined to the traditional forms. A policy of review of an agent's correspondence can certainly be as effective as any required written report. It seems to make no difference that the review was conducted to ascertain whether the company's products were being fairly represented.[98]

M. *Required Attendance at Sales Meetings*

Voluntary attendance at company sales meetings indicates a lack of control by the principal.[99] In *Ellison*, attendance was mandatory. Further, agents were often called upon to make presentations of the company's pre-

95. Rev. Rul. 505, 1958-2 CUM. BULL. 728, 729.
96. 314 F. Supp. 590 (W.D. Mo. 1970).
97. Ellison v. Commissioner, 55 T.C. 142 (1970).
98. Rev. Rul. 138, 1976-1 CUM. BULL. 13.
99. *See* Rev. Rul. 619, 1970-2 CUM. BULL. 228.

packaged sales talks. They were graded on their presentation and in some instances actually prohibited from conducting any further interviews until they were able to correctly imitate the model sales presentation.[100]

The responsibility for the payment of the expenses incurred by the agent in attending a company-sponsored sales meeting need not always lie with the agent. If the sales meeting is called for the purpose of introducing a new company product, expense payments have not been viewed as detrimental.[101]

It appears that agents can be encouraged to attend, but such attendance cannot be mandatory. Nonattendance should not threaten the contract of a good producer and faithful attendance should not save the contract of a poor producer. Such an arrangement should make it appear that the principal is interested solely in the result to be accomplished.[102]

N. *Sales Quotas*

The effect of the ability of the company to impose sales quotas has been clouded by the language employed by the IRS in a number of recent Revenue Rulings.[103] Ample authority exists to support the position that the ability of the company to establish sales quotas for the agents relates to the result to be accomplished in the market place.[104] The court in *Standard Life & Accident Insurance Co. v. United States*[105] adopted this position. The ability of the company to terminate an agent for low production was viewed as demonstrating that the interest of the company was solely in the agent's production. However, the relative comfort provided by the *Standard Life & Accident Insurance Co. v. United States* case is shaken by the repeated emphasis given "sales quotas" in the IRS's latest pronouncements.

In Revenue Ruling 76-137,[106] the company possessed the right to discharge a real estate sales agent for, among other reasons, a failure to sell a minimum amount of property. In Revenue Ruling 76-138,[107] sales quota requirements were not spelled out as such, but were imposed in connection with the guaranteed minimum draw which was provided to agents. Low production dropped the agent from the "draw" program and could lead to his termination. In Revenue Ruling 76-139,[108] real estate sales people were expected to maintain a certain level of sales to retain their employment. In all three rulings the individuals were found to be employees. Thus, although there is existent

100. Ellison v. Commissioner, 55 T.C. 142, 147 (1970).
101. *See* Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,837 (W.D. Okla. 1975).
102. *Id.*
103. *See, e.g.*, Rev. Rul. 137, 1976-1 CUM. BULL. 11; Rev. Rul. 138, 1976-1 CUM. BULL. 13; Rev. Rul. 139, 1976-1 CUM. BULL. 16.
104. Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).
105. 75-1 U.S. Tax Cas. 86,835 (W.D. Okla. 1975).
106. Rev. Rul. 137, 1976-1 CUM. BULL. 11, 12.
107. Rev. Rul. 138, 1976-1 CUM. BULL. 13, 14.
108. Rev. Rul. 139, 1976-1 CUM. BULL. 16.

case law which equates sales quotas with the result to be accomplished in the market place, these recent Revenue Rulings indicate that the IRS has adopted the contrary position and equates sales quotas with control.

O. *Selection and Hiring of Own Assistants*

The right to delegate responsibility is inherent in the status of an independent contractor. Where the individual is free to engage others to assist him, without direction by the principal, such facts indicate that he is an independent contractor.[109]

P. *Selection and Solicitation of Customers*

If the employer furnishes lists of customers and requires the agent to contact them, an employer-employee relationship is indicated.[110] Leads themselves are not damaging. However, the requirement that the individual follow them up is.[111]

Q. *Sales Territories*

As is the case with all of the elements discussed in this article, the importance of an assigned sales territory to any analysis of an agent's status depends upon the relationship which the territorial designation bears to the principal's ability to exercise control over the manner and methods of the agent. The designation by the company of a specific sales territory does not per se establish the type of control necessary to create an employer-employee relationship. When coupled with other factors, such a designation might be a strong indication of control.[112] However, the designation of a specific sales territory is not controlling where it is clear that the designation does not relate to the methods and details of operation or the manner in which the services are to be performed.[113] The absence of an ability on the part of the company to require an agent to canvass any particular sales territory has been viewed as significant.[114] Where it can be shown that any territorial designation was intended only to indicate where the agent was expected to be doing most of his work, the type of restriction necessary to imply control on the part of the principal will not be found.[115]

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109. Rev. Rul. 619, 1970-2 CUM. BULL. 228.
110. Rev. Rul. 176, 1958-1 CUM. BULL. 349, 350.
111. *See* Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,838 (W.D. Okla. 1975).
112. *See* Rev. Rul. 176, 1958-1 CUM. BULL. 349.
113. Rev. Rul. 370, 1971-2 CUM. BULL. 345.
114. Zipser v. Ewing, 197 F.2d 728 (2d Cir. 1952).
115. *See* Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,837 (W.D. Okla. 1975).

R. *Contract Approval*

Of the factors reviewed in the cases and rulings which have sought to determine the status of individuals engaged in a wide variety of occupations, few are as unreliable and have less application to the process of determining an insurance agent's status than the right of the principal to have final approval of contracts and to establish prices. In both instances, the insurance agent, even an "independent" agent who is acknowledged as an independent contractor, has little discretion.

Traditionally, lack of a contract between a principal and the customers served by an individual indicates that the individual is an independent contractor.[116] The ability to negotiate and vary the terms of the contract and the finality of the individual's decision with respect to credit risks and terms of payment are signficant indications that sales contracts are not subject to home office approval.[117] Some discretion no doubt exists in the case of those agents writing for companies who write some of their business on a note basis, but the existence of even slight latitude on the part of an insurance agent would completely undermine the underwriting process and the statistics which furnish the guidelines upon which the underwriting rules are based.

Although fixed prices certainly show a lack of discretion on the part of the agent, the ability of the individual to determine his own margin, set his own profit and set his own risks supports his status as an independent contractor.[118] Furthermore, insurance agents are strictly forbidden by statute or regulation from "rebating" on commission and the established insurance rates are filed with the state insurance commissioners.

Neither factor (final approval of contracts and established prices) should figure heavily in determining an insurance agent's status. With these built-in limitations, the cases and rulings which rely upon the ability of the agent to set contract terms are not particularly helpful.

S. *Exclusivity*

The requirement that the individual work exclusively for the principal indicates control.[119] As noted earlier, one of the important factors relied upon by the court in those cases dealing with the so-called "gypsy chasers" was the fact that a "gypsy chaser" might work at loading and unloading for any number of trucking companies during the course of a year. Although the difficulty of reporting was also a factor, the lack of exclusivity tempered the potential for control.[120]

Performance on a regular basis of similar work for competing companies has been viewed as a signficant indication that the principal did not possess the

116. Rev. Rul. 587, 1970-2 CUM. BULL. 224, 225.
117. Rev. Rul. 619, 1970-2 CUM. BULL. 228.
118. Rev. Rul. 446, 1970-2 CUM. BULL. 215.
119. Rev. Rul. 586, 1970-2 CUM. BULL. 223.
120. Lanigan Storage & Van Co. v. United States, 389 F.2d 337 (6th Cir. 1968).

right to control.[121] Particular occupations, or trade designations, imply that the individual is free to work for any number of competing companies. Such was the case in Revenue Ruling 70-575.[122] "Trade embalmers," a sort of free-lance mortician who worked for any number of funeral homes and hospital morgues, were viewed as independent contractors because they worked for any number of competing companies.

Restrictions on the insurance agent's right to sell competing lines of insurance is the hallmark of the "captive agent." Phoenix Mutual Life Insurance Co. took special pride in the fact that its agents were to work full-time and exclusively for Phoenix Mutual. The source of that pride was an important element in the court's decision which found their agents to be employees.[123]

Some of the earlier cases which dealt with the question of exclusivity relied heavily on the fact that the principal possessed the right to restrict the agent. Thus, in *Ringling Brothers-Barnum & Bailey Combined Shows, Inc. v. Higgins*,[124] the fact that the circus company had the power to restrict or prohibit the appearance of any of its "feature acts" in any other circus, theater or wild west show during the off season, was viewed as an important element of control and the "feature" acts were found to be employees. However, several recent cases dealing with insurance agents tend to discount the mere possession of the power of restriction on the part of the principal and rely instead on the conduct of the parties.[125] If a prohibition against the sale of competing products is not enforced, the parties' conduct, not the contract language, is controlling and the agents are held to be independent contractors. Of further significance in one case was the fact that not only was the prohibition not enforced, but many agents sold competing lines of insurance with the principal's full knowledge.[126] In *Reserve National Insurance Co. v. United States*,[127] the requirement of exclusivity was viewed as intended principally to protect against the misuse of sales leads provided by the company. If an agent was found to be selling for another company, the company stopped furnishing "leads." There was no indication that any agent had been terminated for selling insurance for other companies.[128]

In some cases, the imposition of an exclusive business requirement has not been fatal. In *Nevin, Inc. v. Rothensies*,[129] licensees of a chain of drugstores

121. Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).
122. Rev. Rul. 575, 1970-2 CUM. BULL. 223.
123. NLRB v. Phoenix Mut. Life Ins. Co., 167 F.2d 983 (7th Cir. 1948).
124. 189 F.2d 865, 869 (2d Cir. 1951).
125. *See, e.g.*, Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,836 (W.D. Okla. 1975); Reserve Nat'l Ins. Co. v. United States, 74-1 U.S. Tax Cas. 84,303 (W.D. Okla. 1974).
126. *See* Standard Life & Accident Ins. Co. v. United States, 75-1 U.S. Tax Cas. 86,835, 86,836, 86,842 (W.D. Okla. 1975).
127. 74-1 U.S. Tax Cas. 84,302 (W.D. Okla. 1974).
128. Reserve Nat'l Ins. Co. v. United States, 74-1 U.S. Tax Cas. 84,302, 84,304 (W.D. Okla. 1974).
129. 58 F. Supp. 460, 462 (E.D. Pa. 1945).

were required to purchase their merchandise exclusively from Nevin. The court viewed this arrangement simply as an attempt by Nevin to assure a market for its goods. The licensees benefited from the established name of the principal, and their agreement to purchase all supplies from Nevin was simply part of the consideration given to Nevin in return for Nevin's accumulated good will.

Most name insurance companies rely extensively upon accumulated good will for their local sales success. Any new agent operating without a well-known company's name can have a very difficult time getting established. Whether a comparison exists between this situation and that posed in *Nevin, Inc. v. Rothensies* remains to be seen. What is clear from a review of the cases and rulings is that any attempt to require both exclusivity and to enforce the requirement will cause the agent to be found an employee.

T. *Work is Similar to That of Acknowledged Employees*

Many of the cases and rulings concerned with the status of an individual involve attempts by principals who seek to "cover" deficiencies in their staff by farming out part of the work to various "independent contractors." For the individual to be an independent contractor, factors other than the fact that the individual does not work for the company on a regular basis must be present. If the company has acknowledged employees performing tasks similar to those performed by "independent contractors," there is a good chance that any "independent contractor" will be found to be an employee.[130] The effect of other factors, such as a significant investment in equipment, will not lessen the impact of the fact that acknowledged employees are performing similar work.[131] However, use of employees to undertake jobs which acknowledged independent contractors are unwilling to attempt, will not make the independent contractors employees. The occasional use of employees to perform or complete jobs ordinarily assigned to independent contractors has been viewed as merely a departure from their regular duties.[132]

U. *Permanency of the Relationship*

One element underlying all the factors thus far considered is the intent of the parties with respect to the "permanency" of the relationship they are creating. The IRS contends that an employer-employee relationship is generally one which is intended to continue indefinitely.[133] The paradox is a case where principal and independent contractor have achieved satisfactory results for an extended period of time. This situation existed in *Illinois Tri-Seal Products, Inc. v. United States*[134] in that many of the "installers" had worked

130. Rev. Rul. 442, 1970-2 CUM. BULL. 211.
131. Rev. Rul. 602, 1970-2 CUM. BULL. 226.
132. United States v. Thorson, 282 F.2d 157 (1st Cir. 1960).
133. Frazier, *supra* note 28.
134. 353 F.2d 216 (Ct. Cl. 1965).

at various jobs for Illinois Tri-Seal for a number of years. They remained free to decline any particular job, and often did so without jeopardizing their right to any other jobs. The relationship was on a purely job-to-job basis and the installers were viewed as independent contractors.

A continuing relationship coupled with the integration of the services performed by the agent into the business of the taxpayer may itself be sufficient to cause the agent to be viewed as an employee. In *Smith v. United States*,[135] moving van drivers were held to be employees rather than independent contractors. The drivers had the right to reject a particular job; located and employed their own assistants; chose their routes without consultation with the company; determined their own work schedules; and were responsible for their own expenses. However, the court determined that sufficient control existed to create an employer-employee relationship. It appeared that drivers could be terminated for using the moving vans for their own purposes or for turning down too many jobs. Furthermore, the driver's opportunity for profit or loss was not dependent on his management skill.

Such job-to-job relationship cannot be found with respect to insurance agents. Permanency is an important element of the insurance business.[136] One of the principal problems faced in those cases dealing with financed agents has been the fact that the financing agreement was entered into simply to assist the new agent in overcoming the difficulties inherent in the initial stages of operation as an agent so that a long-term agreement might be entered into.[137]

IV. Conclusion

For every question, there is one answer that is simple, logical, easily applied, and wrong. If one thing is clear from a review of the pertinent cases and rulings, it is that there is no simple, uniform, and easily applied test to determine who is and who is not an independent contractor.[138] What is clear is that any determination as to the status of an individual for employment tax purposes does not involve complex rules of law. Instead, the matter turns on an examination of the facts of a particular case in light of the common law factors which have been discussed in this article. The resulting balance is as subjective as any in the law.

There seems to be no way of determining the weight given by the IRS to any of the individual factors discussed in this article. The presence or absence of any one or more of the factors discussed is not necessarily determinative in a particular case.[139] In addition, the emphasis afforded a particular factor is not always consistent.[140] As has been stated before, each case must be decided on its own special facts.

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135. Smith v. United States, 75-2 U.S. Tax Cas. 88,497 (N.D. Tex. 1975).
136. *See* Ellison v. Commissioner, 55 T.C. 142 (1970).
137. MFA Mut. Ins. Co. v. United States, 314 F. Supp. 590 (W.D. Mo. 1970).
138. NLRB v. Hearst Publications, Inc., 322 U.S. 111, 120-22 (1944).
139. Cape Shore Fish Co. v. United States, 330 F.2d 961, 964-65 (Ct. Cl. 1964).
140. *See* Simpson v. Commissioner, 64 T.C. 974 (1975). In *Simpson*, an insurance agent sought to avoid the imposition of the self-employment tax imposed by I.R.C. section

All of the factors discussed in this article have, at one time or another, appeared to be pivotal and thus, any attempt by this writer to single out the "most important" factors would be counterproductive. It is crucial to note, however, that the importance of the factors discussed lies in their effect on the ability of the company to exercise control over the agent. The key word throughout is control.

1401(a). The court discusses many of the factors to be weighed in determining whether an agent is an employee or an independent contractor. In finding the agent to be an independent contractor, the court noted the following facts:

(1) the agent's contract was terminable for cause or upon three months written notice;
(2) the agent was designated as an independent contractor;
(3) compensation was predominantly in the form of commissions;
(4) the agent maintained his own office;
(5) supplies and equipment were purchased by the agent without reimbursement by the company;
(6) the agent employed his own secretary and determined the terms and conditions of her employment;
(7) the agent was free to solicit customers throughout the state in which he was licensed;
(8) the agent set his own office hours;
(9) the agent took vacations without the company's prior approval;
(10) the agent was not required to attend sales meetings;
(11) sales leads were not provided;
(12) no regular reports were required except policy application reports;
(13) the agent was free to adopt his own methods and style in soliciting insurance.

PUNITIVE DAMAGES: AN UNSETTLED DOCTRINE*

John D. Long†

An important question facing the courts, the insurance industry, and the insuring public is whether liability insurance covers punitive damages. The question, specifically, is whether a liability insurer is obliged to defend its insured against punitive damages claims and to pay resulting punitive awards. A substantial body of case law on the question leaves the issue open.[1] Several distinct and conflicting decision patterns among the jurisdictions where litigation has occurred have increased rather than reduced the uncertainty as to insurability. The insurability of punitive damages has also been discussed at length by numerous commentators who, more often than not, considered the issue in the context of some specific case. On balance, the commentators seem no more in agreement than the courts on whether liability policies should and do cover punitive damages awarded against those insured by such policies.[2]

To make matters still more difficult, the insurance industry itself is divided on the issue.[3] Some insurers take the position that liability policies definitely cover punitive damages arising out of non-intentional injuries unless (1) punitive damages are specifically excluded in the insurance contract or (2) a court with jurisdiction has ruled that such insurance is violative of public policy.

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1. *See* Annot., 20 A.L.R.3d 343 (1968) for a discussion of numerous cases. Many cases directly or indirectly supportive of insurance coverage of punitive damages are not included in the A.L.R.3d annotation. *E.g.*, General Cas. Co. v. Woodby, 238 F.2d 452 (6th Cir. 1956) (as to vicarious liability); State v. Farm Mut. Auto. Ins. Co. v. Hamilton, 326 F. Supp. 931 (D.S.C. 1971); Continental Ins. Co. v. Hancock, 507 S.W.2d 146 (Ky. 1973); Malanga v. Manufacturers Cas. Ins. Co., 28 N.J. 220, 146 A.2d 105 (1958) (as to vicarious liability); Wolff v. General Cas. Co. of America, 68 N.M. 292, 361 P.2d 330 (1961); Svejcara v. Whitman, 82 N.M. 739, 487 P.2d 167 (Ct. App. 1971); Maryland Cas. Co. v. Seidenberg, Civ. No. 7890 (N.M. Dist. Ct. 1970). Two cases squarely in opposition to insurance coverage of punitive damages and not among the A.L.R.3d citations are *Caspersen v. Webber*, 298 Minn. 93, 213 N.W.2d 327 (1973) and *Padavan v. Clemente*, 43 App. Div. 2d 729, 350 N.Y.S.2d 694 (1973). Another case indirectly in opposition is *General Insurance Corp. v. Harris*, 327 S.W.2d 651 (Tex. Civ. App. 1959). Also not included in the A.L.R.3d citations are: a collaterally related case, *Laird v. Nationwide Insurance Co.*, 243 S.C. 388, 134 S.E.2d 206 (1964), where the court ruled that an automobile insurer was not liable under an uninsured motorist (not a liability) coverage for punitive damages the insurer's own insured was entitled to receive from the uninsured motorist; and *Touchette v. Bould*, 324 S.2d 707 (Fla. App. 1975) where the court remanded the case for a new trial on all issues including punitive damages awarded vicariously against the insured employer.

2. A selected bibliography of these commentaries is included as an appendix to this paper.

3. The author reports in a separate paper some of the attitudes and practices of large insurers in regard to third-party punitive damages claims under various liability coverages. "Should Punitive Damages Be Insured," accepted by the *Journal of Risk and Insurance* for publication.