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Bada-bing: Exotic Dancers, Wages and the IRS

Exotic dancers have received a decided boost from the courts on the issue of whether they should be classified as employees or independent contractors. Their bump in pay came in an employment dispute hailing from Boston, against King Arthur's Lounge, a strip club.

Increasingly, worker status issues are cropping up in civil litigation. For example, if a delivery driver runs over someone while driving as an independent contractor, only the driver is liable. Yet if the driver is determined to be an employee, the employer is *also* liable. The injured party may sue, attacking the *bona fides* of the working relationship as a way to reach the employer's assets.

Sometimes, however, the lawsuit is not brought by a third party but rather by the workers themselves, usually for overtime, employee benefits, etc. Employers often have a particularly hard time understanding how this is possible. After all, in most cases the workers have signed a contract that expressly states they will be treated as independent contractors, foregoing any right to employee benefits.

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Should not a worker be estopped to later deny the validity of a contract, many employers ask? The courts have not seen it that way. In fact, the courts have repeatedly said that one's status as an employee or independent contractor is simply not a matter of contract. It is a legal and factual question. Whatever the parties may have agreed, it does not bind either government agencies or private parties in civil disputes.

Surprisingly, there is no universal test for defining employees. The IRS uses one test, the U.S. Dept. of Labor (and many employment statutes) use another, and most state unemployment insurance authorities use another still. Yet most of the tests are similar.

In large part, the tests focus on the common law right to control the worker. Unfortunately, there is no litmus test for how many or how few factors one needs for one category or the other. That can be maddening, especially to business people who want clear guidance about what they can and cannot do. Some factors are intuitively more important than others, but there is no magic bullet.

The question now is what damages they will receive. The dancers contend that they were not even making the state's required minimum wage of $2.63 per hour. In contrast, club owners say some of the girls earned hundreds of dollars a night.

So, how did these exotic dancers successfully take on their employer and why?

The answer lies in the odd intersection of tax law and employment law. Dancers at King Arthur's sued the proprietor claiming that despite their independent contractor labels, they were really employees. Suing for wages and benefits as a class, the dancers contended they were subjected to orders telling them what to do and how to do it. They earned no salaries or wages, and were required to pony up $35 as rent in order to perform each night.

Yet from the clever club's perspective, these girls were independent entrepreneurs. So you think you can dance? Pay up first. The club structured the arrangement as a business deal, with dancers getting to keep $10 of every $30 for "private dancing'' in secluded booths.

Despite the craftiness of King Arthur's proprietors, however, one of the key features to the court was the integration of the dancers into the club. This integration factor - just how central are the workers to the business of the employer - is another factor that is usually examined in worker status disputes. The club argued unsuccessfully that selling alcohol was its main business. Strip shows, it argued, were merely incidental.

The club even had the temerity to argue that these "independent" dancers merely provided extra entertainment - like televisions at a sports bar. The court disagreed, ruling dancing to be integral to King Arthur's business and granted the dancers' motion for summary judgment on liability.

This is not the first time worker status issues have reached the club dance floor and beyond. There have been a number of disputes between the IRS and companies operating dance theaters, fantasy booths and other venues for adult entertainment.

The clubs are typically being chased for withholding and employment taxes. Generally, dancers pay rent and receive a cut of fees paid to the club. A written contract usually states that they pay their own taxes and work when they want.

Unlike many independent contractors in other lines of business, however, clubs often impose detailed rules and regulations. Some even levy fines for prohibited conduct. Still, such powers may not be strong enough to result in the kind of control that usually spells employee status. And despite the dancers' recent victory against King Arthur's, the clubs often do well in these disputes.

In fact, clubs have prevailed in a number of these cases, upholding the independent status of their dancers. If they can beat the IRS, some nightclubs are emboldened to seek attorney's fees. The government can be forced to fork over the attorney's fees expended by a taxpayer if the IRS' position on a matter is "substantially unjustified."

In *Marlar Inc. v. U.S.*, a court awarded attorney's fees to a nightclub that successfully defended its independent contractor relationship. The court held that the club reasonably relied on industry practice in treating its exotic dancers as "lessees." The government, it found, was not substantially justified in pursuing employment tax claims against the club, so the club won attorney fees.

Even if a company loses a tax case about worker status, the employer can normally find an escape valve by showing, among other things, that it was the industry's "uniform practice" to treat these workers as independent contractors. Other cases suggest the industry practice does not even have to be uniform.

Some have argued that good social policy should single out the adult entertainment industry for tough tax treatment. Whether or not you agree, it is hard to deny the track record of the adult entertainment industry, which, on the whole, has done a good job manipulating the web of factors that differentiate employees from independent contractors. Many other industries are not so lucky.

Indeed, if King Arthur's case is any indication, the adult entertainment industry may have more to fear from direct suits by workers themselves than they do from the IRS. In fact, that may well be true about *most* industries.

It is clear that worker status suits are not going away anytime soon. Given the huge dollars involved, it is no wonder that taxing agencies, insurance companies, third parties - and the workers themselves - are evaluating their respective rights and liabilities. These lawsuits are not merely about employment taxes, although taxes can certainly be one aspect.

The moral, if there is one, relates to clarity and control. If you want to regulate every aspect of what your workers do, you may need to bite the bullet and treat the workers as employees. Conversely, if you want to treat workers as independent contractors, you must be prepared to give them some, well, independence.