

## EMPLOYEE/INDEPENDENT CONTRACTOR MISCLASSIFICATION ISSUES

In today's marketplace, members of the workforce generally fall into one of three classifications: *employers*, *employees* and *independent contractors*. Worker misclassification issues have significant impact – for both companies and the workforce alike – in the areas of tax and benefits, wage/hour and anti-discrimination laws and immigration, to name a few. Recently, federal and state agencies have zeroed in on employee/independent contractor classifications in the workplace and have increased their enforcement efforts. As a result, it is important for companies to ensure compliance with federal and state law when classifying their workforces.

- Q – Why the increased scrutiny on employee/independent contract classifications?

A – In a word, "money." As federal and state governments look to shore up their budgets, agencies are tasked with finding ways to increase revenue. The Government Accountability Office estimates that unpaid taxes stemming from employee misclassification may amount to more than \$2.7 billion annually. The U.S. Department of Labor ("DOL") claims that if only one percent of workers were misclassified, the loss in unemployment insurance revenue alone would be \$220 million annually.

- Q – Which agencies are stepping up their enforcement efforts?

A – The IRS and the DOL figure prominently in stepped-up enforcement efforts. The two federal agencies signed a Memorandum of Understanding ("MOU") in September 2011 to work together and share information to reduce the incidence of employee/independent contractor misclassification. Since 2009, the DOL has recovered more than \$29 million in back pay for over 29,000 employees. And the IRS announced an employment tax audit initiative in 2009 whereby the IRS would audit nearly 6,000 employers, selected at random, from 2010 to 2012 for issues involving worker misclassification, fringe benefits and expense reimbursements.

- Q – What's happening at the state level?

A – States are likewise increasing their enforcement efforts on worker misclassification issues, and 14 states (CA, CO, CT, HI, IL, IA, LA, MD, MA, MN, MO, MT, UT and WA) have entered into collaborative MOUs with the DOL. These MOUs enable the participating states to share information and to coordinate enforcement efforts with the DOL in order to ensure that employees receive protections under both state and federal law (e.g., overtime, minimum wage, unemployment insurance). Put plainly, *a misclassification issue at the local unemployment office can now make its way up to the DOL and the IRS, with disastrous consequences.*

- Q – What factors determine if an individual is an employee or an independent contractor?

A – There is no one-size-fits-all test. For federal tax purposes, the IRS looks to three broad categories (behavioral control, financial control and the type of relationship between the parties). For most federal antidiscrimination laws, the courts use a multi-factored test that focuses on whether the employer controls the means and manner of the worker's performance. At the state level (e.g., for unemployment benefits), a variety of state-specific tests are used.

Companies that misclassify their employees and independent contractors – whether intentionally or otherwise – can expect to be hit with steep penalties, monetary damages, retroactive tax liability and increased exposure to employment liability claims and class/collective actions. Because of this increased scrutiny, companies need to ensure that their employee/independent contractor classifications align with federal and state law.

For more information on workforce misclassification issues and their application to your organization, please contact Jonathan Bumgarner at 317.977.1474 or [jbumgarner@hallrender.com](mailto:jbumgarner@hallrender.com) or Dana Stutzman at 317.977.1425 or [dstutzman@hallrender.com](mailto:dstutzman@hallrender.com).