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Use of Alternative Staffing Arrangements During These Uncertain Times Could Mean Increased Risks For Employers

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Confidence in the U.S. economy remains low. Total private-sector employment in June 2010 was below employment levels in December 2007 and employers still appear reluctant to add regular full-time workers. Instead, they are using all sorts of alternative staffing arrangements to avoid what they perceive to be their obligations to regular, full-time employees. However, the converging trends of increased use of these alternative arrangements and substantially increased government enforcement may actually create more risks for employers.

Statistical Trends

A look behind recent Labor Department's employment statistics reveals the extent of employer reluctance to hire regular, full-time employees. Here are a just few telling statistics:

- The private sector gained a modest 83,000 jobs in June, 2010, but at least 21,000 (25%) of those jobs were with temporary staffing companies;
- The private sector gained only 41,000 jobs in May, 2010, but at least 31,000 (75%) of those jobs were with temporary staffing companies;
- Employment with temporary staffing agencies grew by 369,000 since September, 2009; and,
- As of June, 2010, 8.6 million workers were employed part-time either because of reduced hours or because they were unable to find full-time employment.

These statistics show the sluggish growth in the private sector of regular full-time jobs and the relatively robust trend towards the use of workers from temporary staffing companies.

In addition to using temporary staffing agencies, employers are increasingly turning to other alternative staffing arrangements. These alternative arrangements go by a variety of different names: "contract labor," the oxymoronic "contract employees,"

"freelancers," or "independent contractors." Professional Employer Organizations ("PEO") are yet another option.

Some of the reasons behind this trend could be that employers do not want to add new workers until they understand exactly what they will need to do to comply with the sweeping new federal healthcare law. Or, they simply may not have confidence that they can sustain their growth and are unwilling to add their own full-time employees. These arrangements also provide flexibility and administrative advantages.

Problems With Misclassification

Misclassification can lead to a variety of serious legal consequences. An illustrative few include the potential for such things as liability for failing to withhold and to pay the employer's share of payroll taxes; exposure for failing to include the individuals in employee-benefits plans; the tax-disqualification of retirement plans; and back-wages, add-on damages, and penalties for failing to comply with wage-hour requirements. Moreover, proposals are in the works that are designed both to uncover misclassification and to impose even heavier penalties upon transgressors.

Increased Enforcement Activities

While employers are stepping up their use of these alternative arrangements, the federal government and many state and local governments are increasing their enforcement efforts to catch employers who misclassify workers as independent contractors. Both the U.S. Department of Labor (DOL) and the Internal Revenue Service (IRS) have already announced specific enforcement initiatives in this area.

> For example, in its 2011 Budget Report, the DOL wrote:
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> > Individuals wrongly classified as independent contractors are denied access to critical benefits and protections to which they may be entitled as regular employees. Worker misclassification also generates substantial losses to the Treasury and the Social Security, Medicare and Unemployment Insurance Trust Funds. To address this problem, the FY 2011 Budget includes a joint Labor-Treasury initiative to strengthen and coordinate Federal and State efforts to enforce statutory prohibitions, identify, and deter misclassification of employees as independent contractors.

DOL plans to spend $12 million and to dedicate almost 100 new employees to investigations and enforcement activities by its Wage and Hour Division. It proposes to allocate another $11 million to grants to encourage states to focus upon misclassification issues and it will "reward" states showing the most success. The U.S. Solicitor of Labor would receive resources aimed at both increased litigation and additional efforts coordinated with those of the states.

These increased enforcement activities include mutually-supportive state and federal audits of "problem industries,", litigation against "major employers that cross state

lines," and increased cooperation among and training of enforcement agents. Industries that should expect particular attention include business services, construction, childcare, grocery stores, home healthcare, janitorial services, landscaping, and poultry and meat processing.

At the same time, the IRS started a three-year plan, beginning this year, to conduct random audits of more than 6,000 businesses to determine if they are misclassifying workers as independent contractors. The IRS estimates that the revenue flowing from these audits will be about $7 billion.

Federal Legislation

To further address the trend toward misclassifying workers as independent contractors, Congress is considering passage of the "Employee Misclassification Prevention Act" (H.R. 5107 and S. 3254). This bill would amend the Fair Labor Standards Act (FLSA) to require organizations to keep records of and provide various notices to employees and non-employees who perform labor or services for remuneration. It also provides for targeted audits of "certain industries with frequent incidence of misclassifying employees as non-employees, as determined by the Secretary of Labor." The bill further prohibits "fail[ing] to accurately classify an individual as an employee"; authorizes penalties of up to $1,100 for each individual who was the subject of violation; and authorizes per-person penalties of up to $5,000 for repeated or willful violations.

State Enforcement Activities

State governments are also ratcheting-up enforcement. Colorado, Illinois, Maryland, Massachusetts, New Jersey, and New Mexico have passed laws targeting the construction industry.

Other examples include Nebraska's recently-enacted penalties for misclassification in both the construction and transportation sectors and the Connecticut legislature's passing of increasingly stringent misclassification assessments. A task-force-spurred New York effort has recovered millions in back wages and unpaid taxes and resulted in an "employment fraud hotline" and website. Iowa established an inter-agency Independent Contractor Reform Task Force, adopted online-reporting methods for workers who believe that they have been misclassified, and is pursuing penalties, fines, back-tax collection, and even criminal charges for intentional misclassification.

Suggestions For Employers

With the substantial uptick in enforcement activities and private litigation, employers need to be very careful when using these alternative staffing arrangements. For example, employers who use independent contractors must make sure that the workers are correctly classified under all of the applicable laws. When in doubt, the most conservative approach is to treat workers as "employees" (regardless of whether they are part-time, seasonal, contingent, temporary or something other than regular full-time) and to pay them in accordance with the applicable wage and hour laws; withhold applicable state and federal taxes; pay Social Security taxes for

them; provide workers' compensation and unemployment insurance and other benefits as required.

Employers must make sure to properly document their relationships, whether with their employees or with an independent contractor, temporary staffing agency, labor broker or PEO. Any documentation should correctly state the relationship of the parties and their respective obligations. Ideally, employers should include tough indemnity language in these documents. Employers should be especially careful to avoid using off-the-shelf agreements that do not reflect the actual facts present in a given situation. Employers should also make sure that their benefits-related documents or employee handbooks properly spell out the criteria for eligibility and level of benefits.

Employers should be aware that using a temporary agency or a PEO instead of independent contractors may not necessarily shield them from liability. In this regard, employers should understand the concepts of "joint employment," "primary" versus "secondary" employers, "enterprise coverage" and other complicated and fact-intensive standards used under the myriad of applicable employment, benefit, tax, workers' compensation, safety and related laws.

Over time, employers need to periodically re-analyze their use of these alternative staffing arrangements and modify them as appropriate for their businesses and in light of any enforcement or legislative changes.

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