Beware Of Misclassifying Workers As "Independent Contractors"

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If your workforce includes "contract employees," "freelancers", "casual workers", or independent contractors by any other name you should seriously analyze whether such workers should be re-categorized as employees. The risks of not properly classifying workers can be substantial and include having to pay backpay, liquidated damages, unpaid taxes, penalties, interest, accounting and attorneys' fees. In addition to these economic risks, other risks can include interference with on-going operations and harm to an employer's reputation.

The IRS and the U.S. Department of Labor (USDOL) are cracking down on the misclassification of workers as independent contractors. These agencies have entered into agreements with more than 14 states to coordinate enforcement efforts. This government activity is intended to increase collection of taxes and compliance with applicable laws.

USDOL calls its increased enforcement activities its "Misclassification Initiative." USDOL has hired more than 300 new enforcement officers as part of this Initiative. These efforts have produced significant results, including:

- Recovery of more than $2.9 million from a government contractor in Vermont and some of its sub-contractors;
- Recovery of more than $1.3 million from multiple employers in the restaurant industry in Boston;
- A judgment for $1.3 million against a nationwide provider of directory assistance services; and
- A judgment for $1,075,000 against a Kentucky-based cable installer; and
- Recovery of $105,000 from a Texas employer that considered workers independent contractors for their first 90 days with the company;

USDOL claims that in the past two years it has collected almost $10 million in backpay for more than 11,400 workers as part of this initiative. Other USDOL misclassification investigations are underway across the country.

The IRS and many states also increased internal funding to hire enforcement officers and tout similar successes.

In addition to government actions, private misclassification lawsuits are making their way through the nation's courts. Some involve a challenge to non-employee status brought by just one claimant. Others are being pressed by many individuals who join their allegations together in a complaint brought as an FLSA "collective action", as a class action under another law, or as both. Some of these claims will succed, while some won't, but all will require employers to divert time and resources to the battle.

No single test exits for determining whether a worker is an "employee" or an independent contractor. This area of the law is quite tricky because the relevant legal test depends upon which law is being applied. For example, income tax, workers' compensation, unemployment compensation, equal opportunity, wage and hour, labor relations and leave laws all have their own tests for who is an "employee" and who is not. State and federal laws can also differ. It is even possible for a worker to be an "employee" under one law while an "independent contractor" under another law.

Generally speaking, relevant considerations include:

- The extent to which the worker's work is controlled by the alleged employer;
- The extent to which the worker uses entrepreneurial initiative, judgment, or foresight;
- Whether and to what extent the worker has any investment in facilities, equipment, and supplies;
- Whether and to what extent the worker has opportunities for profit or loss;
- Whether the relationship is permanent or temporary and whether it is indefinite or for a specified duration
- Whether and to what extent the work is an integral part of alleged employer's business.

In assessing a particular arrangement, decision-makers consider whether a contractor's work is the same as that done by acknowledged employees, and whether the training, supervision, and oversight exercised over the contractor are the same as those for acknowledged employees. Other pertinent questions might involve whether the alleged employer finances or underwrites the contractor's business purchases.

Whether there is a written agreement characterizing the relationship as one of an independent-contractor is also relevant. However, the existence of an independent-contractor agreement standing alone does not guarantee that this status will be found to exist.

The ultimate determination depends on whether all of the relevant considerations, taken together, reveal that the worker is economically dependent upon the organization for his livelihood and therefore an "employee" instead of a contractor.

In the current legal climate, the best advice for employers is to evaluate whether management can defend treating "contract" workers as being non-employees. When there is any doubt, employers should treat the worker as an employee. This conservative approach will avoid payment of professional fees to defend the classification and eliminate the risk of having penalties assessed because the relationship was misclassified under one of the applicable laws.

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