

# Independent Subcontractors

## The Rising Risks of Misclassification

By Phillip M. Perry

*Editor's Note: We've received reports of the IRS cracking down on door dealers who are using independent contractors as technicians. This excellent story, exclusive to Door + Access Systems, presents important facts and tips to help you navigate this important issue.*

Using independent subcontractors as technicians has benefits, but the risks involved have recently escalated. On July 15, 2015, the Wage and Hour Division of the U.S. Department of Labor (DOL) filed an interpretation that in essence announces its intention to step up enforcement actions against employers who, deliberately or not, misclassify workers.



Joerg

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"The DOL is sending a clear message that they are going to be harshly evaluating the status of independent contractors," said Nancy Joerg, a Chicago-area attorney specializing in employment law.

"They are going to strictly interpret their six-part 'economic realities' test to determine if independent contractors are economically dependent on their employers. If they are, then the employers may be in trouble and may be financially in a lot of pain."

### New crackdown

This new initiative seeks to stem the increasing use of independent contractors. "Government agencies at the state and federal levels have

been cracking down on independent contractor misclassification for the last several years," said Dallas employment lawyer Barry Hersh.

Why the new crackdown? "If employees are not classified properly then taxes (Social Security, Medicare, unemployment) are not being correctly withheld," noted Hersh. "The government wants its money. Also, the government wants to ensure that workers are being afforded their rights."

### Multiple threats

If you inadvertently misclassify your workers, you could face what Hersh refers to as "a parade of horrors." For starters, federal agencies may assess fines for failure to withhold taxes or to comply with workers' compensation laws.

Among the costliest penalties are those relating to employee remuneration. Under the federal Fair Labor Standards Act (FLSA), misclassified employees can recover unpaid overtime and minimum wages for the past two or three years, and such wages can be doubled under a penalty called "liquidated damages."

State agencies may levy penalties for failure to collect taxes and to pay into the unemployment insurance coffers. Why? Economic survival.

"Nothing stops independent contractors from applying for state unemployment benefits when their contracts are over," cautioned Joerg. She added that states do not want to pay unemployment benefits when the employer has not been paying into the system. Workers compensation carriers can also demand unpaid premiums.

### A Trojan horse

Furthermore, investigations into unemployment insurance violations can quickly broaden. "Often, an investigation

of one employee's complaint is a 'Trojan horse' that allows the agency to look into a business's employment practices as a whole," said Hersh.

It can all add up. "It can get very expensive not only in terms of dollars, but in emotional distress and in time taken away from running your business to deal with the matter," said Joerg, who has seen penalties climb higher than \$500,000 for egregious cases.

### The "temp" trap

Some small employers might consider new workers as temporary and think that the arrangement creates an independent contractor relationship. But it does not, said Hersh. "Depending on how the business uses those individuals, they may be employees entitled to the same rights and benefits of full time workers."

What determines employment status is largely the degree of control you have over the worker such as requiring them to come to work at a certain time and attend meetings at specified times. Such mandates are more characteristic of an employment status. In contrast, independent contractors usually agree

to complete tasks and then do their work on their own schedules. For other indicators of employment status, see the quiz on page 46.



Hersh

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## How to avoid trouble

### #1. Don't try to mandate employment status.

Employers often ask potential hires to sign documents acknowledging independent contractor status. But such documents do not alone prevail.

“Just because a worker signs an independent contractor agreement does not automatically mean he or she is not an employee,” said Hersh. “Whether the worker is or not is a legal question.” The answer to that legal question involves an analysis of how the employer interacts with the worker.

### #2. Don't copy other employers.

“The fact that competitors may be violating employees’ rights does not make it acceptable for you to make the same mistake,” said Hersh. “Industry practice or custom is not a defense. Moreover, many wage-and-hour investigations are the result of complaints from competitors.”

### #3. Treat your people well.

Whether full time employees or independent contractors, people who are happy at your business will cause fewer problems. “Treating workers with respect can prevent a lot of headaches—legal and otherwise,” said Hersh. “People who feel mistreated will often talk to lawyers.”

### #4. Consider your status under the “safe harbor act.”

“Section 530 of the Internal Revenue (Safe Harbor) Act of 1978 provides a bulletproof vest for companies that can pass a three-part test that will protect them from an IRS legal challenge and from huge IRS assessments,” said Joerg.

To be protected by this legislation you must meet certain conditions. First, have you consistently classified a certain category of worker as an independent contractor? Second, have you a reasonable basis for doing so? Third, have you filed 1099s when required?

## Help, please

Your legal risk can only grow as federal and state agencies pay more attention to worker misclassification. “What used to be a somewhat minor issue for employers has become a huge one,”

said Joerg. “Any employer who uses independent contractors has to have some basic understanding of the law. There is too much risk to do it casually.”

Indeed, the entire field of employment law can be so confusing that outside help should be considered. “There are so many ramifications that I encourage all employers to consult with attorneys who have experience with independent contractor issues,” said Joerg. “This need not be a long consultation, but perhaps an hour on the phone. There is a lot you can do in a short consultation to dramatically lower your risk.”

Above all, don't ignore the issue and hope nothing happens. “I see businesses ‘play ostrich’ by sticking their heads in the sand because an issue is complex,” said Hersh. “But that is perhaps the biggest mistake a business can make. You need to get out in front of the issue in order to avoid problems.” ■



## Quiz: Are You Violating the Law?

Are you breaking the law by classifying employees as independent contractors?

The questions below are based on the U.S. Department of Labor's economic realities test (go to [dol.gov](http://dol.gov) and search for "Fact Sheet 13: Am I an Employee?") and the Internal Revenue Service's Form SS-8 on determination of worker status (see [irs.gov](http://irs.gov) and search for "SS-8").

More "yes" answers increase the chances that someone is in fact an employee and not an independent contractor.

- Must the person follow your instructions as to how work is to be performed?
- Do you dictate that work be done in a certain sequence and require that reports be made of what steps were taken or work accomplished?
- Do you dictate what hours the person works or even require the person spend all the working day on your property?
- Do you furnish the tools used for the work?
- Does the person work only for your business and not offer services to the general public?
- Do you train the person in the work being performed?
- Do you require that the person perform the work personally?
- Are the worker's services critical to the continuation of your business?
- Do you have a continuing relationship with the person?
- Do you make periodic payments by hour, week, or month rather than in a lump sum for a project?
- Do you pay the person's travel or other business expenses?