

dbbr

DAILY BUSINESS REVIEW

JUSTICE WATCH John Pacenti

Feds get tough on misclassifying workers



'Tis the season for the temporarily employed. But businesses better not get on the naughty list at the Internal Revenue Service. There is a crackdown on the misclassification of employees as independent contractors so businesses can avoid paying Social Security, Medicare and unemployment taxes.

The Labor Department estimates 30 percent of companies misclassify their workers.

States have joined in because public treasuries are running low on funds.

The IRS is offering a settlement program to noncomplying businesses that voluntarily come forward. But employment attorneys say this could result in an uptick in wage-and-hour lawsuits since independent contractors don't get overtime.

SEE COLUMN, PAGE A3

JUSTICE WATCH John Pacenti

FEDS GET TOUGHER ON MISCLASSIFYING WORKERS

As the economy sputters and workers take what they can get in the job market, some find themselves classified as independent contractors even if they're doing the same job as salaried employees.

These workers have little or no rights. They can't join a union. If they get laid off, they can't get unemployment benefits. They have no health insurance. Their companies don't have to contribute to Social Security, Medicare or unemployment taxes.

But the Internal Revenue Service is cracking down on the misclassification of workers by employers. It has offered businesses the same deal they offered tax scofflaws with secret offshore accounts: come in and fall on your sword, and you'll get an audit-free deal with discounted penalties.

"South Florida is rife with employers who try to take shortcuts. This should be a wake-up call to them," said attorney **Mark Neuberger**, who is of counsel for **Foley & Lardner** in Miami.

Legislation in Congress has been proposed to force businesses to keep more meticulous records of how their employees are paid. And the IRS and the Labor Department are sharing information with some states to pursue employers that misclassify workers.

Why the concern? Money. Misclassification costs the U.S. government \$54 billion in underpaid employment taxes and



J. ALBERT DIAZ

Attorney Mark Neuberger called the federal crackdown a wake-up call. "South Florida is rife with employers who try to take shortcuts," he said.

\$15 billion in unpaid FICA and unemployment taxes, according to a 2009 study by the Treasury Department's inspector general. State coffers also take a hit on unemployment compensation, which is paid through a payroll tax.

"Part of the issue is the downturn in economy. There has been a lot of revenue not going into the system," said attorney **Margaret Mevers**, a partner at **Lydecker**

Diaz in Miami.

Independent contractors receive 1099 forms from their vendors and are required to report their income to the IRS. But studies have shown about 30 percent of the time they do not. Even in Florida, where there is no state income tax, companies are required to contribute to the unemployment compensation

SEE JUSTICE WATCH, PAGE A4

JUSTICE WATCH: Microsoft settled lawsuit for \$97 million

fund. The state has asked employers to cough up more money this year to keep the jobless fund liquid.

Attorneys whose jobs are to defend companies say Labor Department and IRS rules on employee classification are murky, and it is easy for well-intentioned companies to break federal or state rules.

However, the poor economy has been an enticement for businesses to classify workers as independent contractors to save on overtime and benefits.

"Why this has become such a hot issue is that the practice has expanded — and there are statistics to back this up — across the whole country," Neuberger said. "Florida has definitely ramped up its enforcement."

For Fort Lauderdale employment attorney Donna Ballman, the federal crackdown couldn't come soon enough.

"These employers are getting more creative. A lot of times they call workers independent contractors because they don't want to pay them overtime and they don't want to pay the taxes," said Ballman, who represents workers on numerous issues. "It's been increasing since this nasty recession started."

Now that the holiday season is here, there are plenty of temporary jobs available. But businesses better be careful not to get on the IRS's naughty list. Just because holiday mall elves are seasonal workers doesn't mean they can be classified as independent contractors.

How employers can determine if a worker should be classified as an employee or independent contractor:

Behavioral: Does the company control or have the right to control what the workers do and how they do their jobs?

Financial: Are the business aspects of the jobs controlled by the payer, such as expense reimbursement and payment for tools or supplies?

Type of relationship: Are there written contracts or employee-type benefits such as a pension plan, insurance or vacation pay? Will the relationship continue, and is the work a key aspect of the business?

Source: Internal Revenue Service

Employers "believe that short temporal period is an excuse to make them an independent contractor. But if you look at the factors that you analyze, time is really little or no influence on it," said Neuberger, who represents businesses on labor issues. "It's what they are doing and who exercise control."

FORGET DISCRETION

The Labor Department has a 20-question litmus test to determine how employers classify workers. Still, making a determination can be troublesome, said attorney Truth Fisher, a labor and employment defense lawyer and partner at Gordon & Rees in Miami.

"One of the biggest misconceptions employers make is that classifying an individual as an employee or an independent contractor is discretionary," she said. "Simply having an independent contractor agreement even when signed and agreed to by the worker is not enough to properly classify the worker as an independent contractor."

Neuberger said federal and state classification rules often are not similar. He said he had a client in Pennsylvania who was complying with the federal standard but not the state standard.

"The rules of what is an independent contractor and what is an employee are very murky," he said. "It's very difficult to comply with even if you are well-intentioned."



Fisher

Two examples of misclassification can be found in trucking and journalism. Freelance journalists are basically independent contractors who generally work from home, set their own hours and take only needed direction on assignments. But if the worker is given a desk, a boss and assignments, that status no longer applies.

Truckers who own their rigs are among the most misclassified employees, Neuberger said. Some truly operate as independent contractors, bidding for loads and routes. But in 2009, New York sued FedEx, claiming it had misclassified its drivers as independents. Massachusetts and Montana settled with FedEx after threatening to sue for \$3 million and \$2.3 million, respectively.

IF IT QUACKS LIKE A DUCK ...

The basic question is: who is the boss? If employees set their own hours and pick their jobs, that's an independent contractor. If someone else does that, check the employee column.

"Control is really what it is all about," said Robin Symons, who is also a partner at Gordon & Rees in Miami. "If you tell them when to show, what they should do and how they should do it, they are more likely considered an employee."

Microsoft got in trouble with programmers when it listed a group as independent contractors even though it performed work similar to salaried employees. The group sued and won a \$97 million settlement in 2000.

Mevers said she has a client who got in trouble by classifying new workers as independent contractors during a probationary period and later hiring them as employees. She said the workers filed wage-and-hour claims for their probationary time when they weren't paid overtime.

She said federal and state agencies are sharing information on misclassification. A lot of violations are caught when employees seek unemployment benefits or workers' compensation. "The trend you are seeing is that the agencies more liberally are seeing these individuals as employees, both on the unemployment side and on the compensation side," Mevers said.

Ballman said workers can fill out a

"These employers are getting more creative. A lot of times they call workers independent contractors because they don't want to pay them overtime and they don't want to pay the taxes."

DONNA BALLMAN
EMPLOYMENT ATTORNEY

SS-8 form with the IRS if they believe they have been misclassified. "Filling out this form also likely makes them a protected whistle-blower, so they're protected from retaliation," she said.

SETTLEMENT OFFER

Companies that misclassified workers can participate in the Voluntary Classification Settlement Program announced by the IRS in September. Employers qualify if they are not under audit and have filed all the required 1099s for their independent contractors for the last three years.

Under the program, the business will pay 10 percent of the employment tax liability due on compensation paid for the latest tax year. The employer will not be liable for any interest and penalties and will not be subject to an employment tax audit on the classification of workers being reclassified under the program for previous years.

But it doesn't absolve all sins. Workers can still sue for unpaid overtime. The Labor Department and the Equal Employment Opportunity Commission also are looking for workers with misclassification complaints for potential class actions, Symons said.

She runs a hotline for employers to ask compliance questions and said the hotline has been flooded with calls about classification.

Wage-and-hour lawsuits are the scourge of the federal docket. She fears the same may occur with the misclassification issue.

"The government is trying to protect people from being exploited and unfairly treated," Symons said. "That sounds great, but in application the efforts of these agencies are subject to being exploited by the cynical."

John Pacenti can be reached at jpacenti@alm.com or at (305) 347-6638.



Symons