

EMPLOYEE OR INDEPENDENT CONTRACTOR? WORKER MISCLASSIFICATION INVESTIGATIONS ARE GROWING

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There has been a sharp increase in worker classification cases and investigations by the Department of Labor and the Internal Revenue Service (IRS). The DOL's Wage and Hour Division (WHD) is leading the Fair Labor Standards Act (FLSA) enforcement effort and has been working with the IRS and many states to "combat employee misclassification and to ensure that workers get wages, benefits, and protections to which they are entitled."

Twenty three states have entered into partnerships with the WHD including the Labor Bureau of the New York State Office of Attorney General. Industries impacted thus far include janitorial, temporary help, food service, day care, hospitality and garment industries. Recent state court cases are also on the rise. Some notable cases include FedEx delivery truck drivers (CA appellate court finding they were not independent contractors) and an interesting pending case involving Uber drivers claiming employee status, thus entitling them to receive expense reimbursements including gas and vehicle maintenance, and gratuities.

The WHD notes that in recent years, the employment relationship between workers and businesses receiving the benefits of their labor has "fissured" apart as companies have contracted out activities. This "fissuring" is often accomplished through the use of subcontractors, temporary agencies, labor brokers, franchising, licensing and third-party management, and may lead to misclassification of employees as independent contractors. The concern is that there is a deliberate effort to mislabel certain employees as independent contractors to reduce costs. Regardless of the motivation, determining employee classification status is a gray area where no bright line rule or one-size-fits all test exists to aid businesses and practitioners. Rather, there is an abundance of case law and administrative guidance that outlines the factors that should be considered when making a worker classification determination.

Determining whether workers are employees or independent contractors is an important and ongoing challenge for many businesses. An accurate determination ensures that both workers and businesses can anticipate and comply with many complex employment and tax laws. Employers should review their employment arrangements and make every effort to properly classify workers. If it is determined that an employment misclassification exists, employers may face significant employment, tax and penalty exposure. For federal tax purposes, employers who incorrectly classify employees as independent contractors are responsible for federal withholding taxes, Social Security and Medicare (FICA) and federal unemployment taxes (FUTA). The employers would also be responsible for state tax obligations, and federal and state laws regarding minimum wage, overtime compensation, unemployment insurance and workers compensation.

Best Practices

While the majority of classifications of workers are not challenged by the IRS, that may soon change as a result of the increased investigations and information sharing among the various federal and state agencies. The best protection for employers is to be proactive, and review and test employment arrangements. It is not enough to explicitly describe a worker as an independent contractor in an agreement or rely on a set number of factors to make the worker an employee or independent contractor. Businesses must weigh all of factors and evaluate each arrangement.

WHD and IRS Determination Factors

Both the WHD and IRS utilize tests that consist of many determination factors and no one factor is considered controlling nor is there any bright line checklist to use. The rules have developed over many years from case law as well as through administrative pronouncements. Attached are one-pagers that describe generally the key differences between existing WHD and IRS guidance. Additionally, resources available for both WHD and IRS worker classification analysis are listed below.

WHD	IRS
<ul style="list-style-type: none"> • Administrator's Interpretation No. 2015-1 • Fact Sheet #13 • Fact Sheet #14 • DOL Press Releases: Employee Misclassification 	<ul style="list-style-type: none"> • IRS Publication 15-A • IRS Publication 1779 • Rev. Rul. 87-41 • Treas. Reg. Section 31-3121(d) • IRS FS-2015-21

Takeaways

1. While the standards used by WHD and IRS are different, the analysis and purpose of the underlying worker classification factors have a similar theme – dependence and control. From a practical standpoint, consistency among the various stakeholders (state and federal agencies) is a mutual goal that should aid in enforcement and compliance objectives. Consistency will also help prevent unintended consequences. An example might be a situation whereby a worker is classified as an employee for FLSA purposes and an independent contractor for federal tax purposes. The WHD and the IRS have been sharing information pursuant to a memorandum of understanding since 2011. Thus, businesses and practitioners that review worker classifications should not only separately test for both FLSA and IRS compliance, but consider the underlying purpose and theme of the joint federal agency efforts.

2. Employers and practitioners should exercise a greater degree of diligence in obtaining and reviewing information concerning the nature of the employment arrangement. This can be a very murky gray area and all available information should be requested and reviewed.
3. In light of recent developments, employer positions may be impacted if a potential misclassification is identified. All factors are taken into consideration in determining the probability that a particular position will result in a tax or other liability if challenged. Given the aggressive and growing activities of the enforcement authorities, uncertainty is heightened.
4. In worker classification fact situations that remain unclear, consider filing a Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income tax Withholding with the IRS. There is no fee for this service and response time is usually six months. Likewise, workers who believe they have been misclassified as an independent contractor may file a Form 8919, Uncollected Social Security and Medicare Tax on Wages. This may allow the affected worker to report only their share of Social Security and Medicare taxes rather than self-employment taxes.
5. For employers that had their workers reclassified by the IRS, evaluate whether relief from employment taxes is available under section 530 of the Revenue Act of 1978. The taxpayer must meet certain requirements justifying a reasonable basis for not treating a worker as an employee. Employers who are currently treating their workers as independent contractors may also want to reclassify these workers as employees for future periods under the Voluntary Classification Settlement program.

Click this link to download [IRS Guidance - Employee vs. Independent Contactor](#)

Click this link to download [Department of Labor Guidance - Employee vs. Independent Contractor](#)

For More Information

If you have questions about the information provided in this alert, please contact Mark Baran, Principal of the Tax Practice, by phone at (516) 992-5827 or by email at mbaran@markspaneth.com or any of our [Marks Paneth professionals](#).

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