

## Misclassification of Employees As Independent Contractors: Employers Beware

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What do AT&T, FedEx, JPMorgan Chase & Co., Staples, UPS, Wal-Mart, and Wildflower Bread Co., have in common? They have all faced multi-million dollar lawsuits accusing them of misclassifying employees as independent contractors.

How does a worker's classification as an employee or independent contractor affect the worker and the company she works for? Unlike employees, independent contractors are *not* entitled to overtime pay, family and medical leave, or employer-sponsored benefits such as health insurance, retirement plan contributions, stock options, and worker's compensation insurance. In addition, employers are not required to pay employment taxes with respect to compensation paid to independent contractors. Classifying workers as independent contractors, therefore, can do a lot for a company's bottom line.

But the cost of misclassification can be steep. What's good for a company's bottom line may shortchange an employee out of valuable wages and benefits. It may also shortchange the government out of valuable tax revenue. And ultimately, misclassification may cost an employer millions of dollars in fines, penalties, and attorneys' fees.

According to the Department of Labor (DOL), up to 30 percent of employers are misclassifying employees. The result of this misclassification? According to the Government Accountability Office, \$4.7 billion per year in unpaid income taxes.

To address this problem, the DOL recently proposed a \$25 million "Employee Misclassification Initiative" to target employers who misclassify employees as independent contractors. The initiative includes a request for:

- \$12 million and 90 new investigators to investigate employers in industries with a history of misclassification, including construction, child care, home health care, grocery stores, janitorial, business services, poultry and meatprocessing, and landscaping;
- \$1.6 million and 10 additional attorneys to pursue misclassification litigation;
- \$11.25 million and 2 employees for competitive grants to states to reward the states that are most successful at prosecuting employers that misclassify employees; and
- \$150,000 to allow OSHA inspectors to identify potential employee misclassification and share information with the DOL.

The Internal Revenue Service (IRS) is also increasing its efforts at uncovering and penalizing misclassification. In February 2010, the IRS began audits of 6,000 randomly selected

employers. One of the objectives: determining whether employers are misclassifying employees as independent contractors to avoid payment of taxes.

There's also new federal legislation in the works. One piece of proposed legislation, the Employee Misclassification Prevention Act, would impose penalties on employers that misclassify employees as follows: \$1,100 per employee for first-time violators and up to \$5,000 per employee for repeat violators.

Given the increased scrutiny of independent contractor relationships, now is the time for employers to review their worker classifications and develop a program designed to ensure that the employer is complying with applicable labor and tax laws. Such measures could reduce the risk of fines, penalties, and attorneys' fees for employers that may have misclassified their employees.