

## **BEWARE: THE USE OF INDEPENDENT CONTACTORS**

The risks have never been higher

*By Mark A. Stein*

For decades, there have been issues with businesses trying to understand what is and what is not permissible as it relates to classifying workers as independent contractors. In this economy, federal and state governments are looking for revenue wherever they can. It's clear taxing authorities believe this issue could be a pot of gold, with estimates of lost tax revenue in the billions of dollars each year.

Here are a few factual headlines:

- The IRS has committed to spend millions more investigating what they call "worker misclassification" (i.e. calling someone an "independent contractor" when the government considers them your "employee").
- More and more states are going after this issue too, with California having just passed the most onerous law on this subject ever.
- If you are found to have misclassified workers, the taxes, fines and interest could literally put you out of business; and your risk is not limited to the government, with lawsuits becoming more common from workers claiming the company they worked for should have treated them like employees.

Before you allow your blood pressure to rise, we suggest you follow this easy 2- step diagnostic:

Step 1: Do you issue a large dollar volume (let's say millions of dollars) on IRS form 1099 each year to individuals? If you answered "yes", read on and then go to Step 2. Smaller amounts do not mean you're complying with the law, but government officials and potential lawsuits will likely target places where they can find the most money. Remember, when you're issuing all those 1099's, you're providing a copy to the government, so they can easily figure out whom to go after. Issuing 1099s to entities (such as Corporations, LLCs, etc.) is NOT protection against worker misclassification claims, but paying large amounts of 1099s to individuals is certainly more of a red flag.

Step 2: If you do issue a large dollar volume on form 1099 to various people, then it's time to examine the true nature of the relationship you have with these workers you're paying. How would you fare with this sample of questions designed to determine if a worker would be considered your employee (and NOT an independent contractor)?

- Do your workers receive payments based on a project price, as opposed to being paid weekly, biweekly, and monthly?
- Do your workers have significant investments in providing the work for you (such as investments in equipment, tools, materials, etc.)?
- Are your workers able to realize a profit or loss by providing their work?
- Do your workers advertise their services to the public (such as through a website or marketing materials) and are they regularly providing work to others?
- Are you required to use these workers for a certain period of time under some sort of services agreement?

- Is the work being done by these people disconnected or unrelated to the way your company makes money?

If you answered "no" to several of these questions, you may want to read more of this article to learn about the latest developments on this issue.

#### The IRS' new settlement program.

Late September 2011, the IRS announced a new [Voluntary Classification Settlement Program](#), where companies that sign up for the program can be relieved of all past federal liability on this issue in exchange for paying what amounts to about 1% of the total paid to misclassified workers for the most recent year. Given the magnitude of exposure many companies have on this front, considering this program is a worthwhile exercise. The IRS says it won't share information about which companies opt into this program with state governments. Of course, companies that opt into the program need to be sure they don't continue to commit misclassification offenses. At the same time the IRS publicized this new program, the agency made it clear they would be putting significant new resources to work going after companies the agency believes may have misclassification issues. If investigated, your odds are not good. Reportedly, over 70% of the investigations end up with a determination that contractors examined should have been treated as employees. The [GAO has a lot to say](#) about this topic, given it estimates billions of dollars in uncollected revenue. Though various government agencies have historically failed to effectively collaborate, on this matter, the IRS and Department of Labor are partnering to leverage off each other's resources and databases.

#### More and more states are jumping on the bandwagon.

Here are just a few examples.

California's enacted its [new Senate Bill #459](#) in October 2011. Under this law, in addition to previous penalties, the state's Labor and Workforce Development Agency can fine you for "willfully misclassifying" an employee from \$5,000 to \$15,000 per violation and up to \$25,000 per violation if you commit a "pattern of practice" of willfully misclassifying workers. The law goes so far as to require offenders to post a prominent public notice on a company website or worksite for one year, a modern day scarlet letter. In addition, consultants or professionals working for a company that advise the company to use independent status to avoid an employer relationship can also be held liable for misclassification of workers.

Massachusetts enacted Independent Contractor Law, M.G.L. c. 149, §148B (the "MICL") in 1990, but for many years this law went somewhat unnoticed. The MICL was amended in 2004 and people started paying attention. As amended, the law now presumes that an individual performing any service is an employee. Willful violations here can result in fines up to \$25,000 or imprisonment for up to one year for a first offense, and fines up to \$50,000 or imprisonment for up to two years for subsequent violations. Non-willful violations carry lesser fines and shorter prison terms. In addition to government action, workers may file civil actions for themselves and others similarly situated seeking treble (i.e. triple) damages, attorneys' fees and costs.

Fines, penalties, interest and lost litigation could literally put you out of business.

If workers of yours were deemed to have been your employees, you can be held liable for various taxes that both you and the worker should have paid, plus associated interest and penalties. When you compile years of violations, many companies are sitting with millions of dollars of off-balance sheet liabilities. Businesses with any plans to sell or go public might especially want to study this issue to avoid having it pop up during important negotiations or government filings. Remember that beyond government exposure, more cases are being filed where workers band together to litigate against the company they worked for. [FedEx](#) and [UPS](#), for example, have both settled cases involving worker misclassification, where damages total in the millions of dollars.

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Given economic conditions and the rising costs of doing business, it's not surprising that many companies have relied more and more on the use of independent contractors in recent years. Wanting to avoid employer taxes and other benefit costs is understandable, but the regulatory climate has changed. It's important to understand your risks and make well-informed decisions.

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