



FEDERAL AND STATE GOVERNMENTS TARGET INDEPENDENT CONTRACTOR MISCLASSIFICATION

Many employers who utilize subcontractors and independent contractors will soon face increased scrutiny. As part of the proposed 2011 budget, the Departments of Labor (“DOL”) and Treasury are pursuing a joint proposal. The joint proposal eliminates incentives for employers to misclassify their employees, enhances the ability of both Departments to penalize employers who misclassify, and restores benefits to workers who have been denied them because of misclassification. The proposed budget also includes an additional \$25 million for DOL’s and Treasury’s joint enforcement.

In addition to the \$25 million to create the joint program, DOL’s Wage and Hour Division would receive \$12 million and 90 new investigators to expand these enforcement efforts. In addition, the misclassification initiative would support new, targeted efforts to recoup unpaid payroll taxes through state audits of problem industries supported by federal audits and a \$10.9 million pilot program. The pilot program would reward states that are the most successful or improved at detecting and pursuing employers that fail to pay proper taxes due to worker misclassification. The Internal Revenue Service (“IRS”) has initiated a comprehensive nationwide employment tax examination program to, in part, identify employers that improperly fail to withhold taxes and pay Social Security and Medicare taxes.

Despite the increased scrutiny, utilizing independent contractors is permissible under existing laws and can generate significant costs and tax savings when the relationship is established properly. An independent contractor does not participate in an employee benefit plan and is paid as a Form 1099 individual without employment tax and income tax withholding. However, the costs of misclassification can be high in terms of taxes and penalties.

Unfortunately, the determination of independent contractor depends on the facts and circumstances and there can be no bright line distinction. In fact, the tests vary among the Fair Labor Standards Act, the Internal Revenue Code and the various state statutes.

Nevertheless, there are some things you can do as a general rule to help secure the independent contractor relationship. The first is that an independent contractor agreement is essential. The agreement must provide that the employer neither has the right to exercise, nor does it exercise direction and control over the independent contractor.

A contract alone, however, is not sufficient. Employers with independent contractors should undergo a self-audit with the advice of counsel. A thorough audit should focus on all the facts and circumstances surrounding the independent contractor’s job function and relationship with the company. The audit should focus not only on federal law but also state laws. The results of the audit should assist employers in determining whether the relationship should be reclassified or restructured, or whether another option such as employee leasing or staffing should be considered.

Please call me if you have any questions or would like further information.

Barry A. Furman, Esquire
610.941.2529
bfurman@kaplaw.com
www.kaplaw.com