

Labor & Employment Inner Workings



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Worker Classifications:
Employee or Independent Contractor

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Worker Misclassifications

- Worker classified as an “independent contractor” (1099-MISC) *versus* as an “employee” (W-2)
- Employer avoids paying income taxes, FICA, unemployment taxes, workers’ compensation, prevailing wages, etc.

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Worker Misclassifications *cont.*

- Loss of Federal and State Revenue; Contributing to Large Deficits
- Federal Government claims billions are underpaid in income, Social Security and unemployment taxes

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Government Initiatives

- IRS Sharing Information With States
 - 1099 MISC filings
- IRS increasing audits
 - 6000 employers over 3 years
- Task Forces: Michigan and other States
 - Michigan (“Interagency Task Force on Employee Misclassification”)

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What May Trigger An Inquiry Or Audit?

- Worker Files For Unemployment
 - Employer Disputes Eligibility, Claiming Worker is an Independent Contractor
- Review of 1099-MISC filings (IRS data sharing)
- Change in Employee Status/Classification (from W-2 to 1099)
- Worker Complaint

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Determining Proper Classification

- IRS Factors
- State Specific Laws and Tests
 - Often found in unemployment comp or workers' comp laws or regulations

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Determining Proper Classification *cont.*

- State Laws May Establish Test For Determining Employee Status
- Some State Laws Create a Presumption of “Employee” Status

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Determining Proper Classification

- Highly Fact-Based Determinations
- No One Factor Controlling or Dispositive

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Classification Factors

- Primary Consideration: Does the Employer have the **RIGHT TO CONTROL** the worker?

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Classification Factors *cont.*

- General Rule: A worker is an “employee” if the Company has the right to control
 - What will be done (Results), **and**
 - How it will be done (Means)

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Classification Factors *cont.*

- IRS 3 Factor Test
 - Essentially incorporates most elements of the IRS’s prior 20 factor test
 - Three categories
 - **Behavioral**
 - **Financial**
 - **Type of Relationship**

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Classification Factors *cont.*

- **Behavioral**
 - Type of instructions given
 - Degree of instruction
 - Evaluation systems
 - Training

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Classification Factors *cont.*

- **Financial Control**
 - Significant investment
 - Unreimbursed expenses
 - Opportunity for profit or loss
 - Services available to the market
 - Method of payment

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Classification Factors *cont.*

- **Type of Relationship**
 - Written Contracts
 - Employee benefits
 - Permanency of the relationship
 - Services provided as key activity of the business

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Classification Factors *cont.*

Additional factors (from former IRS 20 factor test)

- Who must render services?
- Who supervises work?
- Where is work performed?

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Classification Factors *cont.*

- Who pays for business/travel expenses?
- Who provides tools/materials?
- Right to discharge?
- Right to quit?

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Other Factors Supporting “Employee” Status

- Job Descriptions
- Personnel Files
- Performance Evaluations
- Employee Handbooks

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Other Factors Supporting “Employee Status”

- Worker Receiving Benefits
- Company Equipment (Computer, BlackBerry, Email Address, etc.)
- Employee Directory
- Business Cards

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BEST PRACTICES

- Centralize Worker Classification Decisions
- Be Consistent
- Perform Regular Audits

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BEST PRACTICES cont.

- Classify Workers Performing The Same/Similar Work The Same
- Independent Contractor Should Not Perform The Same Work As Regular Employees.

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BEST PRACTICES cont.

- **Red Flag:** Did the Worker previously provide the same services as an Employee? *E.g.*, retired and brought back as an independent contractor.
- IRS will look at how worker was previously classified and what is the difference, if any, in services provided.

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BEST PRACTICES *cont.*

- Ensure Written Independent Contractor Agreement Is In Place
 - Not Dispositive
- Look to Industry Practice

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BEST PRACTICES *cont.*

- Independent Contractors Should Be Paid Via Invoice
 - Utilize Federal Employer Identification (FIN) Number

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BEST PRACTICES cont.

- Utilize Temporary Help Agencies
- Ensure Temp Agency Agreements provide that Temp Agency will be the employer-of-record, e.g., withholding taxes, unemployment, workers' comp., etc.

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LIABILITY

- Fines, penalties, back-taxes imposed by IRS
- Litigation
 - Class actions
 - Can stem from unemployment or workers' comp claims

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LIABILTY *cont.*

- FLSA
- Workers' Comp
- COBRA
- Civil Rights Laws
- Collective Bargaining Agreements
- Affirmative Action Plans

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LIABILTY *cont.*

- Benefit Implications
- Pension and 401(k) Plans
 - Possible impermissible distributions if employee retires and then rehired as a independent contractor
 - Could affect non-discrimination testing if worker is improperly classified

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LIABILTY *cont.*

- Life/Disability/Welfare Benefit Plan
 - Misclassified worker may claim coverage/benefits
 - May be required to provide benefits on a self-insured basis (person not previously reported to carrier and no premiums paid)

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Thank You!

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