



Worker Misclassification Increasingly Dangerous

Employee misclassification usually refers to one of two things. The first is improperly treating a worker as an independent contractor instead of an employee. The second is improperly treating an employee as being exempt from the requirement of premium pay for overtime.

From the government's perspective, misclassifying employees as independent contractors is primarily a tax revenue issue that is handled by government tax collectors. Misclassifying employees to avoid paying overtime is primarily a Department of Labor issue that falls under the authority of the wage and hour division.

The U.S. Treasury Department and the U.S. Department of Labor have now joined forces to implement an employee misclassification initiative. On March 10, 2010, the Secretary of Labor announced that her Department will earmark \$25 million to create a multi-agency program that will entail hiring at least 90 new investigators to expand enforcement efforts. The program will also set aside funds that will be used to reward states that are the most successful or improved at prosecuting employers that fail to pay appropriate taxes due to worker misclassification.

There is nothing new about the perception that workers who should be treated as employees for employment tax purposes are often treated as independent contractors and that the practice results in billions of dollars in lost tax revenue. Historically, however, there has been little cooperation between government agencies that have mutual interests in employee misclassification but for different reasons. The Department of Labor, for example, is concerned with workers getting paid while the IRS is concerned with the government getting paid. Employee misclassification has a lot to do with how much money goes to both the workers and the government. It makes sense that government agencies with similar interests in how workers are classified should cooperate in a joint enforcement effort.

The joint initiative will coordinate efforts not only at the federal level, but also between federal, state and local agencies as well. Some states, such as New York, have already implemented a multi-agency initiative to address the problem of employee misclassification. In less than three years, the New York task force identified more than 30,000 examples of employee misclassification through an aggressive enforcement effort. Now, the Federal government is looking to coordinate efforts with states like New York and also to provide financial incentives for aggressive enforcement.

Whether workers are properly classified is not necessarily a simple determination. The IRS considers up to 20 different factors, no single one of which is determinative, when distinguishing between employees and independent contractors for withholding and employment tax purposes. The difference between exempt and non-exempt employees for purposes of

minimum wage and overtime pay can also entail complicated analysis under Department of Labor regulations. Expert legal and accounting advice is necessary in any situation where an employer may be faced with potential exposure to claims arising out of employee misclassification.

And the exposure can be significant. The State of Illinois has, for example, targeted the construction industry with a law that makes it very difficult for any individual construction worker to be properly classified as an independent contractor. The penalties for misclassification include daily fines, double or triple damages and even criminal sanctions where the first offense is a misdemeanor and subsequent offenses are felonies.

Employers should keep in mind that claims will not necessarily originate in government audits. The most likely source of claims will continue to be from workers. It is not uncommon for workers who were being treated as independent contractors to find out (usually through an attorney) that they should have been treated as employees and that they should have been paid time and a half for overtime. A claim for unpaid overtime wages is bad enough without an ancillary investigation into unpaid employment taxes that may be triggered by the wage claim.

Our current economic environment has left many state and local governments with serious budget deficits. Employers should expect increased scrutiny designed to recover as much tax revenue as possible under the existing laws. State and local tax collectors can now expect enforcement assistance from the Federal government in the form of audits that may start off focusing on wage and hour issues but end up yielding valuable information for the tax collectors.