

# Worker Misclassification: Deficit Reducing Opportunity or Employer Nightmare?

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# Use of Contingent Workers or Outsourcing Continues to Increase

- Reduces costs
- Allows company to focus on “core competencies”
- Allows for flexibility
- Maintains competitiveness



# Misconception

- Classifying a worker as an independent contractor, hiring workers through a third-party or retaining a third party to provide outsourced services, relieves a company of any obligations related to the employment relationship including federal and state tax and labor laws

**Independent Contractor**



**Or Employee**

# Fact

- Such classifications and relationships if properly structured MIGHT place the burden of compliance and liability on another party, but in many cases an employer will still be responsible OR jointly liable with another party



# What's the Big Deal?

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- Underpayment of federal and state payroll taxes
- Includes Medicare, Social Security and unemployment compensation insurance taxes
- Workman's Compensation premiums
- 7 to 15% of workers misclassified as independent contractors
- Federal lost tax revenue of 3 to \$5 billion PER YEAR

# What's the Big Deal?

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- Title VII of Civil Rights Act of 1964 (race, color, religion, sex, national origin)
- Americans with Disabilities Act (disability)
- Fair Labor Standards Act (minimum wage/overtime)
- National Labor Relations Act /Wagner Act (union membership, protected concerted activity)
- Immigration Reform and Control Act of 1986 (I-9 Form)

# What's the Big Deal?

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- Family Medical Leave Act (unpaid leave)
- Equal Pay Act (equal pay)
- Age Discrimination in Employment Act (age discrimination)
- WARN Act (mass layoffs/plant closing notice)
- State and local laws/ordinances
  - Example - TCA Section 50-1-304

# Federal Government View

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- Many employees misclassified
- Need more investigators/auditors
- Added revenue from this activity in current budget





# Federal Government View

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- Portraying employees as independent contractors circumvents:
  - Minimum wage (FLSA)
  - Overtime (FLSA)
  - Anti-discrimination laws (Title VII)
  - No workers' compensation
  - No benefits
  - No unemployment insurance

# Federal Government View

- Oh, and independent contractors cannot form/join unions under NRLB



# Potential Costs to the Employer of Misclassification

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- Back taxes, many flavors (income withholding, Social Security, Medicare, additional Medicare, federal unemployment)
- Back wages, usually for three years, doubled, with attorney's fees
- Fines and penalties
- Interest
- Other employment related benefits (accrued vacation and sick leave, health insurance, stock options, 401(k), retirement)

# Historical Issue

- Viscaino v. Microsoft 1996 class action \$97m settlement after 10 years of litigation
- Fed-X Ground ('We are not in the small package delivery business...'), DHL, Sears, others



# So, who is an employee?



# Lack of Clear Consistent Statutory Definition of Employee

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- Well, that depends...
- Almost every federal statute referenced has its own definition of “employee” and rules for interpreting the employee/employer relationship

# Employee/Employer Relationship for Federal Tax Purposes

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- History
  - As enacted Social Security Act had no definition of “employee”
  - Treasury Regulations outlined “economic realities test”, Supreme Court followed, Congress overturned
  - IRC Section 3121 (d) “...any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee...”.

# Employee/Employer Relationship for Federal Tax Purposes

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- History (continued)
  - Revenue Act of 1978 [Section 530(b)] prohibits Treasury regulation or Revenue Rulings clarifying the employment status of individuals for the purpose of employment taxes by the Department of Treasury, (including the Internal Revenue Service), with respect to the employment status of any individual for the purposes of employment taxes



# “Common Law Test” for Worker Status for Federal Employment Taxes

- *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992)
- Employees versus independent contractor is question of fact



# Twenty Factor Test-Revenue Ruling 87-41

- Instructions
- Order or sequence set
- Training
- Periodic payment
- Integration
- Furnishing tools/materials
- Services personally render
- Significant investment
- Hiring, supervising and paying assistants
- Continuing relationship
- More than one relationship
- Payment of expenses
- Set hours of work
- Profit or loss
- Full-time
- Available to general public
- Right to discharge
- Right to terminate
- Work done on the premises
- Reports

# Bottom Line / Classification

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- Depending on the applicable law, there are many varying definitions of “employee”
- Regardless, they are very similar and employer control is prime
- Every situation is a “case-by-case” analysis, and this creates uncertainty, and therefore, risk

# Joint Employers

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# Title VII / Discrimination

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- Joint liability if two businesses have the right to exercise control of the worker's employment
- Contingent workers must be counted for coverage thresholds (15 for Title VII and ADA, 20 for ADEA)

# Example

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- An assembler who was hired to a temporary agency to work on a clients assembly-line sexually harassed as a coworker. Temporary agency and the client will have joint liability. Who should answer the Charge of Discrimination when the harassed coworker files it with the EEOC?

# Fair Labor Standards Act

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- Where the employee performs work which simultaneously benefits two or more employers, or works for more than two employers during the work week, a joint employment relationship generally will be considered to exist.
- If temporary agency refuses to pay overtime to its employees who are working at client's location, the temporary agency and client will be jointly liable for overtime payments.

# Family Medical Leave Act

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- Only the “primary employer” is responsible for giving FMLA notices, approving leads and maintaining benefits
- The primary employer has primary responsibility for job restoration
- The secondary employer must allow a temporary employee returning from leave to continue working at the client site, even if that means bumping another temporary worker
- Both employers can be liable for interference with exercise of rights



# Occupational Safety and Health Act

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- Both employer and client companies are jointly liable
- However, whoever controls the workplace is primarily liable



# Immigration Reform and Control Act (I-9)

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- “In the case of an independent contractor or contract labor or services, the term employer shall mean independent contractor or contractor *and not the person or entity using the contract labor.*” (8 CFR §274a.1(g))
- BUT... any person who uses a contract to obtain the services of an alien knowing that the alien is unauthorized to perform labor or services shall be considered to have hired the alien (8 CFR §274a.5)

# Example – Walmart

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- Government raid involving wiretaps revealed that executives were aware of subcontractors using illegal building custodians.
- “We are satisfied that this is being settled as a civil matter,” Walmart spokesman Mona Williams said. “Despite a long, thorough and high-profile investigation, the government has not charged anyone at Walmart with wrongdoing.”

The Headline Story Read...

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# Walmart Settles Illegal Immigrant Case for \$11M

\* A record fine at the time in a civil immigration case

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- So, how do I avoid these problems and minimize my risk?



# Section 530 Revenue Act of 1978/Safe Harbor

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- Safe harbor / no retroactive reclassification of independent contractors as employees if:
  - Employer has consistently treated the workers (and similarly situated workers) as independent contractors,
  - Employer has complied with Form 1099 reporting requirements for tax year at issue, and
  - Employer had a reasonable basis for treating the workers as independent contractors.

# IRS Options

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- Voluntary Classification Settlement Program (VCSP)
  - Originally released in Announcement 2011-64; modified in Announcement 2012-45, Internal Revenue Bulletin 2012 – 51
- Classification Settlement Program (CSP)
  - Internal Revenue Manual 4.23.6
  - Integral with Section 530

# Minimizing Liability Exposure

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- Use 20 factor test
- Review published job descriptions
- Make sure they are current, accurate, and describe the essential functions of the job
- Be careful of use of the word “employee” with respect to independent contractors, especially in company provided documentation, etc.
- Document independent contractor relationship
- Reference 1099 in any agreement



# Minimizing Liability Exposure

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- Do not employ temporary employees for long-term assignments
- Carefully select reputable and solvent contingent worker provider firms
- Ask firms under consideration to provide references to verify financial stability
- Verify E-Verify use or compliance with Tennessee Lawful Employment Act by third parties providing independent contractors (it's the law!)

# Minimizing Liability Exposure

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- Written agreement
  - Statement of work
  - Compliance with laws
  - Indemnity and defense obligations, if breach
  - Reference agency's policies regarding workplace behavior, etc.
  - Confidentiality, same as employees
  - Avoid language regarding control, and means and methods

# Insurance

- Are agency employees covered by policy (yours and theirs?)
- Certificate of Insurance with Employers' Liability and Statutory Workers' Compensation Coverage



# Employment Issues

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- Furnish the workers with copies of any equal employment opportunity, sexual harassment, and grievance policies
- Treat any complaint of discrimination from such workers like a regular employee's complaint by investigating promptly, and if necessary, taking corrective action
- Notify and coordinate with agency

# Employment Issues

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- Do not make discriminatory requests of a contingent worker provider
- Requesting that temporary employees assigned to the company be of a certain gender or national origin
- Requesting that an agency remove an outsourced worker from an assignment because he or she has a disability

# Payroll

- Accurately report all overtime to the temporary or leasing firm
- Promptly look into any complaints that the temporary or leasing firm is not paying the employees properly



# Danger Area

- Employers that issue W-2's and 1099's for similar services, or that issue 1099's for work traditionally performed by employees, may be subject to close scrutiny by the IRS

OMB No. 1545-0115

**2013**

Miscellaneous  
Income

Form 1099-MISC

4 Federal income tax withheld  
\$

6 Medical and health care payments

**Copy A**  
For  
Internal Revenue  
Service Center

File with Form 1096.

# New Legislation?

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- Payroll Fraud and Prevention Act
  - Written classification notice to all employees
    - Failure to give notice heavy fines even if classification is correct, or no independent contractors
    - Presumption that no notice means misclassification
- Elimination of Section 530 of Revenue Act of 1978 Safe Harbor



# Questions?





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