



Labor & Employment Alert June 2010

Get Ready for the Audits: Worker Misclassification High DOL-IRS Priority

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Do you work with a significant number of independent contractors? Or at least, do you *think* or *hope* they are independent contractors? You'd better find out for sure! The United States Department of Labor, in their FY 2011 budget (October 1, 2010-September 30, 2011) has tipped its hand on enforcement priorities for next year. And it and the IRS are planning to come after companies who misclassify employees as independent contractors.

The DOL budget includes a new multi-agency **Misclassification Initiative** that will strengthen and coordinate Federal and State efforts to enforce labor violations that result from the misclassification of employees as "independent contractors" and to stop such violations in the future. The DOL is requesting \$12.0 million and 90 full time employees to support field investigations, which the DOL plans will result in an additional **4,700 investigations**. These investigations will be directed to industries with misclassification characteristics, such as construction, child care, home health care, grocery stores, janitorial, business services, poultry and meat processing and landscaping.

The DOL is pursuing this initiative for two obvious reasons:

- (1) misclassified workers are not eligible for benefits, such as health insurance and pension participation; and
- (2) misclassified workers (and their employers) do not pay FICA, FUTA or Social Security taxes, thus depriving the Treasury of much needed funds.

The DOL budget request also includes \$11.25 million and 2 FTE for grants to states to increase their capacity to focus on misclassification and reward the States that are most successful at detecting and prosecuting employers that fail to pay their fair share of taxes due to misclassification. For instance, Massachusetts has recently become aggressive in enforcing misclassification both generally and in the context of its universal health care law. Massachusetts could theoretically use the DOL grant to step up enforcement efforts in this area.



The Solicitor of Labor has requested \$1.6 million and 10 FTE to pursue misclassification litigation, including multi-State litigation to coordinate enforcement with States. This signals increased DOL litigation, most likely in either ERISA or Wage and Hour suits against employers.

In addition, the budget proposes legislation to ensure the proper classification of employees by: (1) *shifting the burden of proof to employers* to demonstrate that their employees are classified correctly, (2) closing the loophole created by Section 530 of the Revenue Act of 1978 (which allowed employers to avoid responsibility for misclassification as long as they have a “reasonable basis” for incorrectly classifying the employee), and (3) making *misclassification a violation of the Fair Labor Standards Act*, with appropriate penalties. This would result in misclassification issues potentially subjecting an employer to double or triple damages and attorney’s fees.

With this in mind, you should perform your own internal review of your independent contractor relationships to make sure you have not incorrectly classified employees.

Unfortunately, the test for determining whether a worker is an employee or independent contractor varies depending on the context of the test- the IRS test is different from the DOL test, which is different still from state tests, including state departments of revenue, workers compensation, or unemployment administrations. However, most if not all the various tests have common questions that can at least give you an idea of whether there may be a problem- and spur consultation with your labor and employment counsel:

- Are the workers providing services which are an integral part of your business? For example, if you are a car dealership, are the workers selling cars or mopping the floors at night? The former is probably an employee.
- Are the workers permanent or temporary (hired for a specific job, then moving on to another job)?
- Do the workers use your facilities and equipment, or invest in their own?
- Do you supervise the workers closely, or do they control the means and methods of their own work?
- Can the workers make more money by controlling the efficiency of their own work?
- Are the workers competing in an open market against other firms for your business (like a bidding process)?



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- Do the workers work for an independently organized (such as a corporation or LLC) business?
- Who handles the worker's business expenses?
- Do the workers work for you and other businesses, or you exclusively?
- Do you give the workers a 1099 or W-4 for their work? Are they paid hourly, via salary, or on a piecework or contract basis?
- Do you have a written employment or independent contractor contract with the workers?
- What if any benefits or insurance coverage do you maintain for the workers?
- Do you train the workers, or do they train themselves?

These questions are just a sample of the issues you must confront in conducting your review. It's a daunting task- but better to discover any classification errors yourself and put a corrective plan into action than have the DOL or IRS do so for you.

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If you have any questions or concerns about worker misclassification, please contact Katherine A. Hesse or the attorney assigned to your account at (617) 479-5000.

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