

Expect Increased Scrutiny of “Independent Contractors”

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Satchel Paige said "Don't look back, something may be gaining on you." Whether or not that's good advice in general, you should periodically "look back" on your decisions as to whether individuals who provide services to your business are "independent contractors" or "employees."

The IRS recently announced an intensified audit program designed to identify businesses that are misclassifying employees as independent contractors. The IRS is also coordinating with state officials and the United States Department of Labor to detect misclassification. President Obama's budget proposal includes funds for a joint IRS/Department of Labor program to detect misclassification. The government estimates that detecting misclassification could increase government revenue by \$7 billion over the next 10 years.

Pending federal bills would, if passed, substantially narrow the "safe harbors" for independent contractor status currently available under Section 530 of the Revenue Act of 1978. Among other changes, the bills would eliminate the Section 530 provision that allows an employer to classify an individual as an independent contractor based on "industry practice."

Even if you're not audited by the IRS, the "misclassification" issue can be raised in an unemployment compensation claim, a workers' compensation claim, a wage-hour complaint or in an IRS filing by a current or former "independent contractor." The IRS has a form, Form SS-8, that an individual can file asking the IRS to determine whether that individual is an independent contractor or employee.

Don't think it can happen to your company? Class action lawsuits are currently pending against FedEx and other large employers, claiming that they have misclassified employees as independent contractors.

If a person you treat as an independent contractor is determined to be an employee, you may be liable for failure to pay minimum wage and overtime, failure to pay state and federal unemployment taxes, failure to provide workers' compensation insurance, failure to pay employer FICA and Medicare contributions and failure to withhold income taxes and employee FICA/Medicare contributions. These liabilities can be very significant.

There are various listings of "factors" to decide whether an individual is an independent contractor or an employee. The factors currently used by the IRS are listed at

<http://www.irs.gov/publications/p15a/index.html> and
<http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>.

The U.S. Department of Labor, Wage and Hour Division, has its own rules for determining employee status and lists the following factors as important:

- The extent to which the services rendered are an integral part of the principal's business.
- The permanency of the relationship.
- The amount of the alleged contractor's investment in facilities and equipment.
- The nature and degree of control by the principal.
- The alleged contractor's opportunities for profit and loss.
- The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
- The degree of independent business organization and operation.

Under Michigan's workers' compensation law, an individual is considered an employee who must be covered by workers' compensation insurance if that person performs service in the course of your business and "does not maintain a separate business, does not hold himself or herself out to and render service to the public, and is not an employer subject to this [workers' compensation] act."

Some businesses are under the impression that if an individual forms a corporation and the employer engages the corporation, there is no "misclassification" risk. That is not correct. Government agencies will "look through" the entity to determine the "true relationship" with the individual. In fact, this is one of the issues on which the IRS is expected to concentrate in its current program to detect misclassification.

The bottom line is that now is a good time to reassess any "borderline" relationships that may pose risk for your business in this area. If you have any questions, please feel free to contact any member of our Labor and Employment Practice Group.