Employee Or Independent Contractor: a Potential Minefield
By: Kelli Kleisinger
kkleisinger@dbllaw.com

Classifying workers as employees or independent contractors has always been a difficult task. But recently the IRS and the Department of Labor have been cracking down on companies that wrongly classify their workers. In *Atlantic Coast Masonry, Inc. v. Commissioner of Internal Revenue*, the Tax Court held that a masonry subcontractor incorrectly classified its workers as independent contractors. Because of its misclassification, the subcontractor failed to withhold payroll taxes and failed to pay employment taxes. Consequently, the subcontractor had to pay $500,000 in taxes and $200,000 in related penalties. How can you avoid this mistake? Let's take a look at how the IRS and courts make this determination.

The IRS looks at three categories, consisting of 11 factors, when classifying workers. The first category looks at the company's behavioral control over the worker. This category considers both how much instruction and how much training the company offers the worker. The second category analyzes the company's financial control over the worker using five factors: (1) the worker's unreimbursed business expenses; (2) the worker's investment in the work; (3) the method of paying the worker; (4) whether the worker's services are available to similar companies; and (5) the worker's opportunity for profit or loss. The final category, called "type of relationship," explores the following factors: (1) the existence of written contracts; (2) the benefits offered the worker; (3) the permanency of the relationship; and (4) whether the work is a key aspect of the company's regular business. You can find more information on these factors at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-(Self-Employed)-or-Employee.

The degree of control is the crucial test for the existence of an employer-employee relationship. The more control the company has the more likely the worker is an employee. In *Atlantic Coast,* the Tax Court found that Atlantic Coast had control over the workers, noting that an employer need not "stand over" the worker to exert control. Atlantic Coast used outside supervisors to manage the job and hire workers. However, Atlantic Coast instructed the workers at the beginning of each project, paid them on a weekly basis, and had final approval of their work.

Other factors also weighed against Atlantic Coast. Its workers did not share in the project's profit or loss. Atlantic Coast compensated the workers as it would employees and had the right to terminate the workers. Further, the laborer's work was integral to Atlantic Coast's business.

The Tax Court gave little weight to which party invested in the work in Atlantic Coast's situation. Both the subcontractor and the workers had an investment in the facilities. The subcontractor purchased the building materials and leased the heavy equipment. But the workers used their own tools.

The only factor that weighed in Atlantic Coast's favor was the transitory nature of the laborers' work. The subcontractor hired the workers for only one job at a time. Once the job was complete, the workers were free to go elsewhere.

The lesson taught by *Atlantic Coast* is clear. Classification of workers is difficult, and misclassification is not worth the risk.