



Labor: DOL initiatives to crackdown on employee misclassifications

Penalties for misclassifying employees as independent contractors could be severe

KATHLEEN FUREY MCDONOUGH

In one of the most noteworthy collaborations of 2011, the U.S. Department of Labor (DOL) and the Internal Revenue Service (IRS) announced that they would join forces to combat worker misclassification. Specifically, the merging of resources of these powerful federal agencies is designed to crackdown on instances of employers misclassifying workers as independent contractors as opposed to employees.

Not content to go at it alone, as part of its misclassification initiative, the DOL also has begun entering into agreements with individual states to coordinate enforcement efforts. To date, the DOL has entered into agreements with California, Colorado, Connecticut, Hawaii, Illinois, Maryland, Massachusetts, Minnesota, Missouri, Montana, Utah and Washington.

The collaboration resulted after a recent Government Accountability Office (GAO) report found that the IRS is losing billions of dollars due to misclassification. Similarly, a DOL report claimed that as many as 30 percent of employers misclassify workers. Although the government is investigating misclassifications across all industries, it appears that the construction industry is one of the main targets of investigation.

Given that this initiative is still new, it remains to be seen how the collaboration will operate in practice. However, a review of the various memoranda of understanding between the DOL and IRS, or the DOL and various state agencies illustrates the intent of the partnerships. The efforts are designed to increase communications between the various agencies, create the ability to conduct joint investigations of violations, conduct outreach and/or educational programs about the applicable statutes and encourage referrals of potential violations to the respective agencies.

Whether an individual is an “independent contractor” or an employee depends on several factors including:

- The degree of control exercised by employer over workers
- The workers’ opportunity for profit or loss and their investment in business
- The degree of skill and independent initiative required to perform work
- The permanence or duration of working relationship
- The extent to which work is an integral part of employer’s business

No one of the above factors is controlling; rather, the courts will focus on the level of dependence the individual has on the business. The greater the dependence, the more likely there will be a finding that the individual is an employee.

Employers should be cautious when classifying individuals as “independent contractors,” as misclassifications could be a costly mistake. If workers are found to have been misclassified, the newly deemed employees will be covered by the Fair Labor Standards Act. This means that employees will not only be entitled to regular wages and potential overtime going forward, but the employer could be liable for unpaid wages as well.

The misclassification also could have significant tax consequences if it is determined that the worker was or should have been receiving wages. If an employer failed to withhold income tax on these wages, the penalties could be severe. Employers who believe an individual to be properly classified as an independent contractor are advised to review the assignment carefully, with a close eye on the IRS standards for independent contractor classification.