

Department of Labor Looking to Crack Down on Independent Contractor Misclassification

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To reduce costs, employers have turned to independent contractors to perform traditional staff functions. Unlike employees, independent contractors generally do not qualify for benefits and employers of independent contractors are not liable for Federal Insurance Contributions Act (“FICA”) contributions, Federal Unemployment Tax Act (“FUTA”) contributions, state unemployment contributions, workers’ compensation premiums, or overtime.

Experts believe numerous employers wrongly classify employees as independent contractors. One study concluded that employers illegally passed off 3.4 million employees as independent contractors, while the Department of Labor (“DOL”) estimates that up to 30 percent of employers misclassify employees. Ohio Attorney General Richard Cordray estimates that 92,500 workers are misclassified in Ohio, which costs the state up to \$35 million a year in unemployment insurance taxes, up to \$103 million in workers’ compensation premiums and up to \$223 million in income tax revenue. “It’s a very significant problem,” Cordray recently stated in *The New York Times*.

Recent Developments

Facing record budget deficits, many government agencies have started aggressively pursuing employers that misclassify regular employees as independent contractors. President Obama recently proposed a \$25 million DOL “Misclassification Initiative,” targeting the misclassification of employees as

independent contractors. The Initiative would provide 100 additional DOL enforcement agents and increase states’ capacities to address misclassification. This follows a joint proposal by the DOL and the Department of the Treasury to enhance both agencies’ authority to penalize employers that misclassify employees.

Similarly, Delaware and Maryland recently imposed new penalties on employers that knowingly misclassify workers as independent contractors. Similar legislation has been introduced in Pennsylvania. In Ohio, Attorney General Cordray announced a collaboration between his office and the Ohio Department of Job and Family Services, Ohio Department of Taxation, and Ohio Bureau of Workers’ Compensation (“BWC”) to target employers that misclassify employees as independent contractors.

With the Attorney General’s attention focused on the costs of employee misclassification, Ohio employers that misclassify employees risk significant taxes, fines, penalties, and increased workers compensation premiums. In addition, misclassified employees have brought multi-million dollar class-action lawsuits against employers for failure to pay proper wages and overtime.

Employee or Independent Contractor?

The existence of an independent contractor agreement, by itself, does not create an independent contractor

relationship where an employer-employee relationship actually exists. Rather, multiple factors determine whether a worker is an independent contractor, and different factors are considered by different agencies. For tax purposes, the Internal Revenue Service considers which party has control over the work being performed. For wage-and-hour purposes, courts and the DOL analyze the “economic realities,” which focus on whether the worker is an employee or in business for

himself, and the Ohio BWC employs its own 20-factor test.

With increased scrutiny of purported independent contractor relationships, employers should re-evaluate their worker classifications. Such a review could reduce the risk of costly taxes, fines, and penalties for employers in the event they have misclassified their employees as independent contractors.

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