

**From the desk of
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Worker Misclassification Risks

Many businesses employ independent contractors which can be somewhat risky on many levels.

Regulations exist with both the IRS and Department of Labor (DOL) which determine how workers must meet certain criteria that distinguish them from employees.

Get it wrong and you run the risk of having to pay back taxes, penalties, and possible certain civil legal problems and risks.

The Real Risk Comes from Your Workers

Workers do not always understand that being an independent contractor means they cannot file for unemployment or make a workers' compensation claims if they get hurt on the job.

Any filing by a worker for unemployment or a worker's compensation claim, and that worker is not listed as an employee federal and state agencies will initiate immediate investigations and/or audits.

And then there is the risk of a disgruntled worker filing a report. The IRS has Form SS-8 that any worker can submit to request a classification review.

Classification Factors

The classification of a worker as an independent contractor rather than a worker can be exceedingly complex, and depends on the facts and circumstances of each case.

The determination is based on whether the person for whom the services are performed has the right to control how the worker performs the services.

An employee is technically controlled by the employer, managing what their work, how they do it, and when.

For all those who work within your office or premises, that is an employee by government standards, as are many who now work remotely.

An independent contractor may be told what project is needed and when the work is due, but they are in control of the way they go about the work.

An independent contractor handles their own licensing, and permits, and insurance. Lacking any of these items makes the relationship that of employer/employee. The IRS and other government agencies, and insurance companies are aware that employers who mislabel their workers as employees escape the obligation of paying minimum wages, overtime, payroll taxes, worker's compensation, unemployment, Social Security, health benefits, paid leave, and retirement benefits.

There are serious consequences to misclassification of a worker as an independent contractor.

If the worker is determined by the IRS to be an employee the business is liable for the taxes it neglected to withhold in addition to the employee's share plus interest and penalties, in addition to pension costs, and insurances.

The IRS utilizes a 20-factor test which can be found on our website.

The tests are based on common law principles which it has condensed into a three-part test focusing on behavioral control, financial control, and the relationship of the parties.

States, especially California follow the federal tests and have added their own more restrictive rules.

The California Supreme Court adopted a new three-part test to make the determination under California's wage orders which regulate wages, hours and working conditions.

This new "ABC" test requires a company to establish three factors to classify a worker as an independent contractor:

The worker is free from the control and direction of the hirer in connection with the performance of the work both under the contract for the performance of such work and in fact;

- A. The worker performs work that is outside the usual course of the hiring entity's business; and,
- B. The worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed for the hiring entity.

Failing the above ABC Test, a worker is considered under California law to be an employee.

Don't Cross the Legal Line

When contracting with an independent worker you want to be sure to have a legal independent contractor relationship with the worker which is documented with a signed contract.

The best way to protect your business is to have a signed agreement which should be entitled "Independent Contractor Agreement" so there's no question about the intent of the relationship.

The agreement should specify both the work required, and the financial terms.

The contract should specify an end date, or at least tie the end of the contract to the completion of a specific project.

Some of the documentation that should be obtained when contracting with an independent worker is:

- Contractor' license if one is required for the type of work to be performed;
- Proof of insurance, both general liability, and Workmen's Compensation Insurance;
- City or State licenses;
- W-9;

Before any work begins obtain a completed Federal Form W-9 from the contractor, not afterwards as you will not get it.

Be sure to issue the appropriate 1099-MISC forms and file those with the IRS at the appropriate time.

We highly suggest that you consult a labor attorney, as well as your general legal counsel in the preparation of the contracts.

We here at Muffoletto & Company believe that the more informed you are in regards to the rules and regulations that affect you the more we can be of service.

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