

Increasing Risk to Employers from Improperly Classifying Employees as Independent Contractors

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Workers may be classified as employees or independent contractors. However, simply calling a worker an independent contractor is not determinative under the law.

In August 2009, the U.S. Government Accountability Office (GAO) released a detailed report to congressional leaders that culminated in a set of recommendations to address the persistent, widespread problem of employer misclassification of employees as independent contractors. Specifically, the report recommends that the Department of Labor (DOL) and the Internal Revenue Service (IRS) step up enforcement efforts against employers. Therefore, it is particularly important for employers who have classified any workers as independent contractors to carefully review those decisions and, if appropriate, make changes.

While the report recognizes that one of various complex tests are typically used to decide the worker classification question, the applicable test may vary from one jurisdiction to another and depending upon the particular statute involved. Generally, a person is considered an employee if he or she is subject to another's right to control the manner and means of performing the work while independent contractors are individuals who obtain customers on their own to provide services (and who may have other employees working for them) and who are not subject to control over the manner by which they perform their services. Most of the tests use an analysis of multiple factors including, the right to control the means and manner of performance, the mode of payment, the furnishing of material or tools, the control of the premises where the work is to be done and the right of the employer to discharge.

While misclassification of employees as independent contractors itself is not a violation of any federal labor law, it can result in violations of various laws. The DOL, IRS, and the courts will look beyond any agreement between an employer and worker to the real relationship in place. For example, employers who misclassify employees as independent contractors are often cited by the DOL for violating the



record keeping, minimum wage and overtime pay requirements in the Fair Labor Standards Act (FLSA). In addition, employers are generally required to withhold income taxes from paychecks to employees, to withhold and pay Social Security and Medicare taxes for employees, and to pay unemployment taxes on wages to employees. Employers generally are not subject to these obligations with respect to payments to independent contractors. When employers wrongly classify employees as independent contractors, they expose themselves to liability not only for the unpaid employer portion of Social Security and Medicare tax for each employee, but also for a portion of the income tax withholding that should have been taken from each employee's paycheck and the employee share of the Social Security (FICA) tax. When multiple employees in similar positions are wrongly classified, the potential liability to a single employer can quickly become very large.

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This article is not intended as legal advice. You should consult with an attorney for individual advice regarding your own situation.

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