

## CHARLOTTE BUSINESS JOURNAL

Friday, October 10, 2008

# How you classify workers is a key business decision

Charlotte Business Journal - by [Chip Dillman](#) Guest Columnist

With an environment marked by increasing costs and enhanced competition for jobs, construction companies may be tempted to classify workers as independent contractors instead of employees.

The cost savings for making this classification can be substantial, providing unscrupulous employers with a significant cost advantage against their law-abiding competitors.

By classifying a worker as an independent contractor, a construction company can avoid a multitude of payroll and unemployment taxes, health-care costs and employee benefits.

Additional cost savings stem from the administrative burden of filing and remitting those taxes — that's borne by the worker instead of the employer. Workers improperly classified as independent contractors are further penalized by having to pay higher Social Security taxes.

They're generally ineligible to participate in employee-benefit programs such as profit-sharing and health-care plans. The classification blocks them from workplace protections such as workers' compensation coverage, minimum-wage and overtime protections, and family and medical leave enjoyed by employees.

The determination of the employment status of an individual worker is based on the relationship between the worker and the construction company. The courts have considered many factors in determining the proper classification of a worker. These factors fall into three main categories:

- Behavioral control. A construction company would exhibit behavioral control over a worker if it has the right to direct and control the worker on such things as when, where and how to work, what tools or equipment to use, where to purchase supplies and services, and the work-order sequence to follow for a particular job.
- Financial control. The company would exhibit financial control over a worker if can regulate the availability of the worker to perform similar services for other construction companies in the marketplace and the ability of the worker to realize a profit or loss for work performed. Is the worker paid hourly for all work performed, or is the worker paid a pre-established fee, regardless of the time incurred on the job?
- Type of relationship. This includes whether there are written contracts between the parties, receipt of employee-type benefits by the worker and the permanency of the relationship.

The proper classification of workers is critical and may not always be clear cut. Construction companies that are unsure of the proper classification of an individual or group of workers can find guidance in Internal Revenue Service form SS-8.

The misclassification of workers cuts costs for companies but lowers government revenue.

A study by **PricewaterhouseCoopers** estimates the federal government lost about \$35 billion in unpaid taxes between 1996 and 2004 due to worker misclassification. Recently, members of Congress have proposed two bills to close this tax gap by amending existing laws.

The Employee Misclassification Prevention Act of 2008 (H.R. 6111), now in the House Ways and Means Committee, would amend the Fair Labor Standards Act. It would require employers to keep records on a worker's classification, notify the worker in writing of his classification and inform him of the right to challenge the classification.

Employers must inform workers about the U.S. Department of Labor's Web site, which contains information about workers' rights under the law.

Additionally, information sharing between Labor and the IRS on misclassification cases would be allowed, and targeted audits of employers in industries that frequently misclassify workers would be required.

The act would also impose a fine of \$10,000 per violation for an employer who "repeatedly or willfully" misclassified workers. If an employer's misclassification of a worker results in violations of the FLSA's requirements governing maximum hours or minimum wage, the worker would be entitled to recovery at double his liquidated damages.

The additional record-keeping requirement provides an audit trail to government auditors and will make it easier for them to identify misclassified workers. Companies in the construction industry can expect more audits and more focus by government auditors on this

issue. Owners must be certain they are properly classifying their workers, or any potential short-term cost savings will be wiped out by fines, penalties and interest.

The Taxpayer Responsibility, Accountability, and Consistency Act (H.R. 5804), also in the House Ways and Means Committee, would amend the Internal Revenue Code with a new section.

Section 3511 would replace Section 530 and include new rules pertaining to the classification of workers as independent contractors. Section 3511 would limit the basis under which an employer could reasonably determine that a worker is an independent contractor.

The new language would also shift the burden of proof regarding a worker's classification to the taxpayer from the IRS.

This bill would also allow workers to petition the IRS for a review of their classification and would prohibit retaliation against a worker for doing so. The bill would increase the penalties associated with filing incomplete or incorrect tax return information, whether intentional or unintentional.

H.R. 5804 would also require the Treasury Department to issue an annual report on worker misclassification. The report would include information on the number and type of enforcement actions against employers found to be misclassifying workers, among other findings.

The improper classification of workers has been an issue for many years and, as the proposed legislation indicates, this practice is likely to result in severe consequences for employers in the near future.

Should these bills fail to be passed into law, other similar legislation is on the horizon.

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