



# Independent Contractor or Employee?

**Misclassification Can Be Costly**

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## The Need for Thoughtful Consideration and Consistent Practice

Recent pressure to recover tax revenue has increased governmental efforts to identify “independent contractors” who are in fact “employees”



# Increased Enforcement

1. IRS and Department of Labor share information and coordinate enforcement efforts
2. States can participate – Michigan's Unemployment Agency opted in and shares information
3. DLEG and Department of Treasury are also increasingly aggressive in their pursuit of misclassifications and resulting monetary obligations



## How will they know?

- A random audit *or*
- A “contractor” responds to tax problems by filing a Form SS-8 with the IRS *or*
- A “contractor” files for Unemployment, Workers’ Compensation, or files a complaint with Michigan Wage & Hour or DOL



# The Financial Risk...

**A determination that the company misclassified an employee is costly**

- Federal Taxes – Unpaid back taxes plus a 1.5% to 3% penalty for failure to withhold
- Social Security and FICA – Employer's FICA plus 20% to 40%, for failure to withhold
- State and Federal Unemployment Tax – Interest and penalties

***but wait...there's more***



## The Financial Risk...part 2

- Workers Compensation - % of wages, plus fines, and no immunity from tort
- DOL – Penalties, fees and back wages including overtime
- Various penalties are higher if a violation is “intentional”
- Cost of defense/representation



# Contractor is an employee?

- **According to the DOL** - a worker is an independent contractor if he or she provides service to the business entity in the course of an “independent occupation” **and** if the business entity controls the results of the work but not the means by which the work is accomplished.



# Is the contractor an employee?

- **If challenged in court, the court will likely consider:**
  1. Any written agreement – note that internal inconsistencies set the stage for an adverse determination.
  2. The “realities” of the relationship between the parties – this examination goes beyond the parties’ written agreement and looks at the relationship under a common “test.”





# Common Tests

- **“Economic Reality Test”** factors include: control of the worker’s duties; payment of wages; right to hire, fire and discipline; and whether the duties to be performed constitute an integral part of the employee’s business.
- **“Right to Control” or “Totality-of-the-Circumstances Test”** - the most important factor being the “employer’s ability to control job performance and employment opportunities of the aggrieved individual.”



# Some courts use the factors reviewed by the IRS

An Employee ...	A Contractor ...
Is directed how to perform tasks, and the Company monitors details or requires reporting	Is not given direction, and the Company is only interested in results
Works exclusively for the Company and is reimbursed for expenses	Provides services to others and is a business experiencing profit or loss
Serves the Company's core business, as do other employees performing the same work	Provides services incidental to the Company's core business
Is provided "tools" or is reimbursed by the Company, which also provides a workplace	Provides own tools and place of work



# Some courts use the factors reviewed by the IRS...part 2

An Employee ...	A Contractor ...
Performs services for an indefinite period of time	Works for a defined period of time or until a project is complete
Performs unskilled work requiring little independent judgment	Performs skilled work requiring independent judgment
Paid by the hour or on a fixed salary	Paid by the job or project
Is paid without invoice; Company sets terms	Makes bid, negotiates terms, and issues invoice



# What to do?

## ○ Immediately

- Call us, or call your accountant
- Gather accurate payee information
- Gather information supporting your position
- Begin accurate reporting to the IRS

## ○ Options

- Amnesty
- Voluntary correction
- Let sleeping dogs lie (e.g., for closed tax years)



# Amnesty

- Voluntary Classification Settlement Program (VCSP)
- <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Voluntary-Classification-Settlement-Program>



# Amnesty

- To be eligible, an applicant must:
  - Consistently have treated the workers in the past as nonemployees;
  - Have filed all required Forms 1099 for the workers for the previous three years;
  - Not currently be under audit by the IRS; and
  - Not currently be under audit by the Department of Labor or a state agency concerning the classification of these workers



# Amnesty

- A participating employer must:
  - Pay 10 percent of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates of section 3509(a) of the Internal Revenue Code.
  - Not be liable for any interest and penalties on the amount; and
  - Not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified under the VCSP for prior years.







# Presenters

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