



2015 Payroll Fact Sheet

Federal Agencies Turn Up the Heat on Worker Classification

The federal government is always on the lookout for businesses that improperly classify workers as independent contractors rather than employees. But the heat was recently turned up even more.

The issue of worker classification has many tax and benefit implications. And it continues to be problematic for employers.

If you incorrectly treat a worker who is actually an employee as an independent contractor, your company could be assessed unpaid payroll taxes plus interest and penalties. It also could be liable for employee benefits that should have been provided but weren't, including significant penalties under federal laws. In addition, businesses with misclassified workers also generally owe taxes and penalties to their states.

During 2015, both the IRS and the U.S. Department of Labor's Wage and Hour Division (WHD) issued communications to employers about employee classification.

The IRS issued a Fact Sheet reminding employers "to correctly determine whether workers are employees or independent contractors." The tax agency and courts generally take the stand that workers are independent contractors if they meet specific criteria focusing on the amount of *control* they have over their jobs.

The WHD, on the other hand, issued an "Administrator's Interpretation" stating that worker classification isn't just about control. Rather, the focus is "whether the worker is economically dependent on the employer or in business for him or herself."

The WHD added that "most workers are employees" under the broad definitions of the Fair Labor Standards Act (FLSA).

The two federal agencies are working together and with states to tackle misclassification.

Many businesses prefer to classify workers as independent contractors to lower costs, even if it means having less control over workers' day-to-day activities. Federal and state government agencies have always cracked down on businesses that classify workers as independent contractors to evade taxes or sidestep providing benefits. Now there's another reason to focus on worker classifications: Employers may treat individuals as independent contractors to avoid health insurance obligations that involve employee headcounts under the Affordable Care Act.

Note: Be aware that a worker or a business can file a form with the IRS to ask for a determination about classification. Disgruntled former workers may file the form to show that a business improperly denied employee benefits by classifying them as independent contractors. Businesses should consult with their tax advisers before filing this form because it may alert the IRS to worker classification issues — and inadvertently trigger an employment tax audit.

Here's the rub for your business: If you incorrectly classify an employee as an independent contractor, your company could be assessed unpaid payroll taxes plus interest and penalties. You also could be liable for employee benefits that should have been provided but weren't, including significant penalties under federal laws.

That doesn't mean that you shouldn't use independent contractors. You just have to be careful to handle the relationships properly. A written contract can help support a worker's independent contractor status. But that's no guarantee.

The determination traditionally boils down to this: A worker is an independent contractor if you have little or no control over the way he or she gets the job done. For example, do you set the hours, provide equipment and require the worker to come to your facilities? These are only some of the questions that need to be asked. The bottom line is that if you provide substantial day-to-day supervision, the worker is probably an employee.

Your Responsibilities

If a worker is an employee, you generally must withhold federal income tax and the employee's share of Social Security and Medicare taxes from his or her wages. Your business must then pay the employer's share of Social Security and Medicare taxes, pay federal unemployment tax, file federal payroll tax returns and follow lots of other burdensome IRS and DOL rules.

You may also have to pay state and local unemployment and worker compensation taxes and comply with more rules and regulations. In addition, employees may be eligible for fringe benefits such as health insurance, retirement plans and paid vacations.

If a worker is an independent contractor and you pay him or her \$600 or more during the year, you must issue a Form 1099-MISC to the individual and the IRS to report what you paid.