



## She's Not My Employee . . . Is She?? Classification Challenges on the Rise

by John T. Landwehr and Carrie L. Sponseller

Historically, the United States' workforce has been comprised of long-term employees who received long-term benefits or pensions. In the last few decades, however, the composition of the American workforce has changed significantly. The use of independent contractors by small businesses reached an all time high in 2009. A "contingent workforce" of independent contractors and other non-traditional workers has emerged, creating classification headaches for businesses large and small. Federal and state independent contractor classification challenges are on the rise. Recent studies suggest there is considerable untapped tax revenue at stake for states and the federal government resulting from the misclassification of employees as independent contractors. The Internal Revenue Service has entered into information sharing agreements with more than 30 states to combat misclassification of independent contractors. A recent report from the Ohio Attorney General speculates that misclassification of the "underground economy" in Ohio costs the State approximately \$100,000,000 in payments for unemployment compensation, \$510,000,000 in workers' compensation premiums and more than \$180,000,000 in forgone income tax revenues. Ohio is likely to join the handful of states that have already passed new legislation to crack down on misclassification in an effort to raise much needed revenue; federal legislation is also on the horizon. Now, more than ever, misclassifying independent contractors as employees can be a costly mistake for businesses.

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While the Independent Contractor Proper Classification Act of 2007, introduced by then-Senator Obama, was placed on the back burner while the battle over healthcare reform rages, a similar bill, The Taxpayer Responsibility, Accountability and Consistency Act of 2009 (TRACA), was introduced on July 30, 2009. TRACA aims to repeal the safe harbor provisions in Section 530 of the Internal Revenue Code, making it far more difficult for businesses to avoid employment tax liability for misclassifying employees as independent contractors. TRACA also contains a procedure by which workers can petition for a determination of their status for employment tax purposes and significantly increases fines for misclassification.

There are certainly legitimate reasons and considerable economic advantages to using independent contractors. Foremost among them, businesses eliminate the cost of benefits and payroll taxes and often do not have to purchase new equipment or office space for contractors. Despite these advantages, businesses should use caution when classifying a worker as an independent contractor rather than an employee. No bright line test exists to determine whether an individual should be classified as an employee rather than an independent contractor; however, the Department of Labor, Internal Revenue Service and courts all ask similar questions, including:

- Can the worker make a profit or suffer a loss as a result of the work performed?
- Does the worker supply or have an investment in the tools and facilities used to perform the work?
- Does the worker perform services to more than one company at a time or offer services to the general public?
- Does the company instruct the worker regarding how, when and where to work?
- Does the company train the worker to perform the job in a particular manner?
- Is there an ongoing relationship between the worker and the company?
- Does the company set the worker's hours?
- Can the company fire the worker?
- Can the worker quit at any time without incurring liability?

The key concept is *control*. The greater control the business exercises over the worker, the more likely he or she should be classified as an employee rather than an independent contractor.

Now is an optimal time for businesses to take a closer look at their staffing classifications and scrutinize the duties each worker actually performs - not the position title or description in contracts. Tips for keeping contractors truly "independent" include:

- Do not issue employee ID badges, keys or business cards to independent contractors.
- Develop written agreements outlining the scope and duration of contractors' engagement. Such agreements should incorporate the safe harbor provisions currently included in the Internal Revenue Code.
- Require contractors to submit invoices for services performed and issue 1099 forms using the contractors' tax identification numbers, not their social security numbers.
- Require contractors to supply their own workers' compensation and liability insurance.
- Do not permit contractors to enroll in any employer sponsored benefit.
- Require contractors to supply their own equipment and tools.

- Do not provide contractors with employee handbooks or manuals. Rules and policies applicable to contractors should be incorporated in the written agreements.
- Maintain separate files for each contractor, including copies of the written agreement, 1099 forms and proof of insurance.

When in doubt, companies are encouraged to seek legal counsel to determine whether their classification of workers will withstand legal scrutiny.



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