



CONTRACTOR VS. EMPLOYEE

WHEN YOU FAIL TO PROPERLY CLASSIFY WORKERS, THE CONSEQUENCES CAN BE DEVASTATING

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Like cicadas clouding the sky every decade or two, government regulators periodically swarm over businesses, seeking to prohibit companies from classifying certain workers as independent contractors.

Sometimes employers inappropriately treat individuals as contractors in an effort to save costs, such as workers compensation premiums, Social Security and Medicare taxes, income tax withholding and employee benefits. The Great Recession may have prompted more businesses to cut corners where they shouldn't. Now, numerous governmental agencies are stepping up enforcement of existing laws, and more than a dozen states have recently passed laws limiting who can be considered an independent contractor. Even the U.S Congress just got into the act, introducing a bill that would strip away one of the key laws that let businesses legitimately classify certain people as independent contractors.

When you fail to properly treat workers as employees and, instead, classify them as independent contractors the consequences can be devastating. Microsoft, one of the most prominent employers in the country, lost a major lawsuit alleging that the company improperly classified employees as independent contractors. In 2001, Microsoft settled the case by paying almost \$100 million. Countless other companies, large and small, have been besieged by both private lawsuits and government enforcement actions.

Know the Difference

To avoid similar problems, understand that true independent contractors are, in essence, people who run their own businesses. If you are a homebuilder, you might hire an independent contractor to install windows. In a bona fide independent contractor relationship, you would pay the window contractor a lump sum or per unit price, and the contractor would perform the work in accordance with a particular set of plans and specifications. But, other than making sure the contractor complies with those plans and specs and does not interfere with your overall schedule, you wouldn't treat the contractor like an employee. The contractor does not need to show up for your staff meetings, take breaks when you say so and, most importantly, you don't tell the contractor how to do their job.

On the other hand, your window contractor may have several of his or her own workers performing the actual window installations. This window contractor may tell these people when to show up for work, how to do their jobs and also pay them by the hour. If the window contractor tries to treat these workers

as if they are independent contractors, whether to reduce labor costs or avoid providing benefits, that window contractor is taking a risk of breaking the law that is growing ever larger.

Currently, there are many national laws on the books that regulate what you must do for your employees. These federal laws regulate everything from minimum wages and overtime to reasonable accommodation of disabilities, family and medical leave and income tax withholding. Unfortunately, many of these laws have different tests for determining who must be considered an employee versus an independent contractor. Many tests focus on whether you control the manner in which people perform their jobs. At least one major test considers whether workers have the opportunity to profit or lose money depending on how efficiently they work independent contractors have that opportunity, and employees don't. Obviously, if a worker is paid a salary, there is little economic risk borne by this person and under this test, he or she should be treated as an employee. Other tests abound and most consider multiple factors in determining whether someone should be an employee or a contractor. On top of these national requirements, many states have their own rules.

Ratcheting Up the Requirements

Increasingly, states are determining that too many companies are breaking the rules by misclassifying employees as independent contractors. Businesses pay no income tax withholding or unemployment and workers compensation premiums if they hire people as contractors. So these states feel that the rule-breakers are robbing government coffers and also putting compliant businesses at a competitive disadvantage.

As a result, in just the last few years, at least 16 states have passed new laws limiting businesses ability to classify certain workers as independent contractors. These new laws tackle worker misclassification in a variety of ways, from increased education and enforcement to new fines and even criminal prosecution. One recent new law, enacted by Pennsylvania in October 2010, breaks totally new ground. The new Pennsylvania rules hold a company liable for misclassification of workers committed by a completely separate business if the first company hired the second business and knew the second business intended to improperly classify employees as independent contractors.

Overall, states have determined that construction contractors are some of the worst offenders of worker misclassification. As a result, many of the new laws are aimed squarely at the construction industry. One new law, the Fair Play Act, enacted in August 2010 by the state of New York, exemplifies this approach. Under the Fair Play Act, New York imposes rigorous new tests on worker classification in the construction industry. This new law abandons prior legal tests and requires companies to jump multiple hurdles in order to hire any individual as an independent contractor. Moreover, violation of the law can result in not only civil and criminal penalties but even personal liability for company officers and shareholders who knowingly permit a willful violation of these new requirements.

It's Only Getting Worse

If all of these new requirements aren't enough for you, the U.S. Congress is ready to step in and do its part. In September 2010, Sen. John Kerry introduced proposed new legislation, The Fair Playing Field Act of 2010. This act would wipe out a 1978 law that previously allowed many businesses to treat workers as independent contractors. In short, the 1978 law allowed businesses to classify workers as independent contractors if they had a reasonable basis for such classification and had historically

treated those workers as contractors. The proposed new legislation would wipe out this safe harbor and impose additional requirements, increasing the number of workers that must be considered employees. While the recent elections may throw this pending bill into suspended animation, there are still plenty of states standing by, ready to impose rigorous new requirements on the classification of workers.

It's time to sit down with your attorney and review whether you're complying with all of these employment laws both old and new. Plenty of companies have been considering workers as independent contractors in violation of even the old rules. The new requirements add a lot more scrutiny and penalties if you don't follow the law. The bottom line is that employment law has gotten complicated, and you may pay a big price if you don't know and follow the rules.

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