

Employee classification

How companies can address government efforts to find payroll fraud

INTERVIEWED BY ROGER VOZAR

The Payroll Fraud Prevention Act of 2013, introduced in the Senate last fall, seeks to reduce intentional misclassification of employees as independent contractors.

“It clearly reiterates that it is on the federal government’s radar and that they are concerned about misclassification,” says Brendan Feheley, a director at Kegler, Brown, Hill + Ritter.

IRS and Department of Labor (DOL) officials also are aware that the employer mandate in the Affordable Care Act (ACA) may provide more incentive for businesses to classify workers as independent contractors to avoid providing health insurance.

“It’s going to be a heightened issue in 2015 as it relates to health insurance,” Feheley says. “I think the government is trying to get ahead of the issue and increase penalties for misclassification so it doesn’t look like an attractive option.”

Smart Business spoke with Feheley about employee classification and what businesses should do to ensure legal compliance.

How would the proposed legislation increase penalties for misclassification?

New civil penalties of \$1,100 will be imposed for each affected individual, and \$5,000 for repeated or willful violations. Plus, you would also need to pay for overtime underpayments or other damages related to the misclassification. Also, the Fair Labor Standards Act allows for recovery of attorneys fees for the plaintiff’s lawyer.

You can envision a scenario in which someone not covered by company health insurance has a medical condition and files a claim saying they’re really an employee and have been misclassified and are entitled to coverage, as mandated by the ACA.

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What should businesses be doing regarding classification of workers?

First, look at your industry. If it’s known for using independent contractors — for example anyone using installers, or those in the hotel industry — the DOL has been targeting them. Businesses in these industries may want to take a more conservative approach to classification and make independent contractors part-time employees or seasonal workers.

Companies should audit their workforce and review the independent contractors being used and the work they’re doing. Many times people are initially classified as independent contractors and the relationship evolves so it’s very different from when they first signed on.

How do you determine whether someone is an employee or independent contractor?

There are no absolute rules, but there are tests the various agencies use. The IRS has a 20-factor test, while the DOL’s test has six factors. The few that cross over are the ones that warrant the most attention, and those really go to who has control over what the individual does — setting work hours, determining how the work is done. The more control the company has, the more likely that person is an employee.

Another important factor is whether there

is opportunity for profit or loss for the contractor. A contractor typically can profit by finishing a project in less time, while a person paid an hourly wage is more likely an employee. Independent contractors typically are expected to bring materials they need; if you supply equipment and they’re working in your facilities, you’re closer to having a problem.

Another major consideration is whether the contractor’s activity is vital to your business. A cable installer is not an ancillary part of the business, for example. Last November, the DOL settled with a Kentucky company that paid \$1.5 million in violations relating to misclassification of cable installers.

If you’re using independent contractors, have an agreement that states everyone agrees on that status. Then think about the permanency of the relationship.

Because there are no hard and fast rules, it’s important to pay attention to your industry and how things are done.

Companies that have the hardest time regarding classification are startups, because they don’t have money to bring people on payroll but what those people are doing is very integral to the company’s interests.

Misclassification is not always intentional, but because it is a tax issue the government is taking a closer look and a more skeptical view. ●