

Going after employers who misclassify workers

1099 or W-2?

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Sen. Bob Casey, D-Pa. (Photo: AP).

Lawmakers and regulators are signaling that this year may bring a crackdown on employers who misclassify workers as contractors or freelancers, when in fact their tasks are identical to regular employees.

“Misclassification” of workers became a hot issue last year after Georgia-based Hibachi Grill & Supreme Buffet was hit with a \$2 million lawsuit for misclassifying restaurant servers as independent contractors. The U.S. Department of Labor filed several other, similar lawsuits in 2013, under provisions of the Fair Labor Standards Act.

In addition, the [Payroll Fraud Prevention Act of 2013](#) was introduced in November by Sen. Bob Casey, D-Pa. The proposed legislation would require businesses to notify workers of their status as employees or non-employees and doubles the penalties for noncompliance with FLSA. Co-sponsoring the bill were Democratic senators Richard Blumenthal, Sherrod Brown, Al Franken, Tom Harkin and Elizabeth Warren.

Under federal law, an employee's status is determined by the degree of an employer's control over the manner and means of work, not any written agreement.

Advocates of stricter regulation say misclassification occurs when an employer intentionally classifies a worker as an "independent contractor" instead of as an employee to avoid paying taxes and providing employee benefits. Some say the passage of the Patient Protection and Affordable Care Act will give some employers further incentive to keep workers off the books as official employees.

Talk about new legislative and regulatory measures concerning misclassification arises at a time when the number of freelance and contract workers has been rising steadily. The issue of determining who is a legitimate employee has become more pressing for employers in a range of industries.

Although some question how widespread misclassification really is, the DOL says that since 2012, it has collected \$18.2 million in penalties linked to misclassification of more than 19,000 workers in the U.S.

“Employers — even those who diligently try to follow the amorphous standards for who is an employee — should be looking over their shoulders,” wrote Robert Wood, a San Francisco-based tax lawyer, in an [article for Forbes](#). Wood and others say government regulators see misclassification not only as a labor issue but a tax issue, because companies don’t withhold taxes on contractors, making it much more difficult for the IRS to collect such taxes.

Increased burdens

Some observers are skeptical about the push, though. “It’s certainly not a new concept, “ says Washington-based attorney Ilyse Wolens Schuman, co-chair of the Workplace Policy Institute and author of an [employment law blog](#) for Littler Mendelson. “There seems to be an ongoing effort by legislators and regulators to assume there is a rampart misclassification problem when the facts don’t seem to bear that out.”

Schuman questions the need for the additional regulatory burdens that employers would face with new legislation. “This could result in enormous new administrative costs and penalties on employers,” she said. “There would be a new avenue for liability for employers, along with new, onerous record-keeping obligations.”

A race to the bottom

Those in favor of stricter rules on misclassification say they are protecting not only workers, but companies who already play by the rules.

At a Senate hearing on the Casey bill in the fall, Catherine K. Ruckelshaus from the National Employment Law Project testified that companies that misclassify workers save approximately 30 percent in labor costs. “(Misclassification) hurts law-abiding employers who treat their workers as employees but who cannot compete with those who perpetrate fraud. This has resulted in a race to the bottom and rewards cheaters,” she said.

The same hearing featured small-business leaders who called for stricter rules on misclassification.

Daniel Odom, chief operating officer for Odom Construction Systems in Knoxville, Tenn., noted that companies caught misclassifying workers in his state have paid fines that were significantly less than what they saved by engaging in the practice. “The bad news for us is that violating the law has become an established business plan,” he said. “The profitability of breaking the law, fueled by reduced opportunities due to the recession, creates the danger of phasing out law-abiding businesses.”

Change coming in 2014?

Experts have mixed opinions about whether the Casey bill has much of a chance for passage this year.

“The reality is that with a divided Congress and a legislative logjam, I don’t see this bill becoming law in this Congress,” Schuman said. She added that she is more concerned about the DOL expanding regulations about misclassification of workers on its own, effectively bypassing Congress.

Marjorie Elizabeth Wood, a historian and labor rights advocate who wrote an [op/ed piece](#) in the New York Times in support of the Casey bill, is more optimistic about legislative action. She said that the recent attention paid to economic inequality could boost the bill's chances. "With mid-term elections on the horizon, both sides of the political aisle will look to enhance their populist credentials," she said. "Payroll fraud legislation could have a very good chance of passage in this climate as an issue that doesn't dramatically expand workers' rights but rather guarantees the protections employees already have."

Wood urged employers to take steps to educate themselves on the issue, noting that the [IRS provides online resources](#) to help employers ensure they are in compliance. "Some employers falsely believe that just because a worker signed a contract agreeing to 'independent contractor' status means they are off the hook," she said. "Not so. Such contracts are meaningless if the actual working relationship is otherwise."