

Special Edition

Independent Contractors Under Siege

I have written numerous articles regarding my concerns in reference to the reclassification of independent contractors. I've indicated that;

- IRS no longer accepts the 20 point control test.
- In fact, they're using their own set of specifications, to make a determination if companies that employ independent contractors are under compliance.
- The IRS recently announced plans to randomly audit, 6,000 companies to determine if workers are properly classified, beginning in February of 2010.

I recently attended a webinar, by a law firm that specializes in independent contractor issues and their comments were very disturbing. During the webinar, they provided;

1. An overview of Federal and State legislation developments and enforcement initiatives.
2. What the IRS, state agencies, and the courts focus on in determining whether workers are independent contractors.
3. The ramifications and potential liabilities associated with misclassification, and;
4. What preventive steps every employer must take to prepare for an audit and avoid litigation.

There is concern about the bill recently introduced by Congressman Jim McDermott;

- McDermott proposes to eliminate the Safe Harbor Provision (section 530).
- He proposes shifting the burden of proof to the company.

There is also a concern that the Tax Payer Responsibility Accountability, and Consistency Act of 2009, may gain momentum. During the webinar, the law firm discussed that;

- Prior legislation may be reintroduced – the Independent Contractor Proper Classification Act of 2007, and/or the Employee Misclassification Preventative Act of 2008.

Assuming that these federal initiatives and legislation are reintroduced, this will;

1. Substantially curtails Safe Harbor defenses.
2. It will require companies to notify workers, in writing, of how to challenge status and exception of their relationship.
3. It will offer expedited administrative procedures and attorney's fees when individuals win.
4. It will provide mandatory information sharing between agencies.
5. Misclassifications become an independent violation of FLSA – each repeat violation will be subject to a severe penalty of \$10,000.

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November 20, 2009

As the law firm stated, whether prior legislation is reintroduced or new legislation is introduced, the combined legislation or separate legislation will significantly curtail the Safe Harbor provisions. The question becomes; how likely is any company to see legislation actually enacted? The response; President Obama was one of the sponsors of both, the Independent Contractor Proper Classification Act and the Employee Misclassification Act.

In August of 2009, there was a GOE report “Employee misclassification; Improved coordination, Outreach and Targeting, Could Better Ensure Detection and Prevention”. Can you believe that title? By reading the title, you would have no clue what the initiative is targeting. However, as you start to review the initiative;

- **It specifically identifies 19 specific recommendations for reducing employee misclassification, such as;**
 1. Requiring universal withholding for payments made to independent contractors.
 2. Requiring submission of form SS-8 for all newly retained independent contractors, and;
 3. Significantly increases enforcement activity by the IRS.

Also, from July of 2008 – July of 2009, 8 states enacted misclassification legislation, while over 20 other states introduced bills into their legislature. The penalties ranged from \$5,000 – \$25,000 fines for violation to criminal penalties, prohibition from obtaining state contracts, and stop work orders.

There has also been a creation of Interagency State Task Forces, focused on misclassification and strengthening enforcement efforts. In one of my news articles, I indicated that;

- State Attorney Generals are taking very aggressive actions. I cited CA, CT, MA, NY and OH, as well as IL; taking a very aggressive stance in reference to independent contractors versus employees.
- I further stated there are numerous ongoing investigations following state misclassification legislation.

In September of 2008, the first criminal prosecution for misclassification was in the state of NY. To make matters worse, many states have implemented what amounts to injunctive penalties for companies found to have misclassified workers.

The problem with this “witch hunt” is;

- The IRS is going to “get their pound of flesh”.
- **IRS believes at least 50% of companies, currently utilizing independent contractors, have misclassified those individuals improperly.**
- **Misclassification of independent contractors also carries additional non economic components;**
 1. Adverse publicity, and;
 2. Internal cost involved in responding to audits and law suits.

The point I’m trying to make;

- This exposure is real.
- It needs to be reviewed.
- You need to find a way to distance yourself from these issues.
- You need to have your independent contractor agreement carefully re-drafted, based upon the new IRS initiatives, and;
- You need to (periodically) have your business model audited to ensure compliance, which seems to change daily.

In closing, I have copies of the recent Arkansas ruling, in which independent contractors were reclassified to employees and I would be happy to forward any of you a copy of that ruling.

QUOTE OF THE WEEK: “Anyone that has achieved excellence in any form knows that it comes as a result of ceaseless concentration”. (Louise Brooks)