



# INDEPENDENT CONTRACTOR OR EMPLOYEE?

**THE DEPARTMENT OF LABOR MAY CONSIDER AN INDEPENDENT CONTRACTOR TO BE AN EMPLOYEE MORE OFTEN THAN YOU REALIZE.**

**T**he Department of Labor (DOL) says that most independent contractors are actually employees and that reviewing an employer's use of independent contractors is their number one enforcement priority. The vacation rental and hospitality industries regularly use contract workers to supplement and even outsource entire departments. In light of the DOL's renewed emphasis on misclassification of independent contractors, it is more important than ever that you be proactive and take another look at your contractors. Particular positions such as housekeeping, maintenance, landscaping, grounds keeping, security and IT services are at high risk.

Consider the following scenarios:

- Jessica stopped by the laundry facility to refill her housekeeping supplies on her way to clean the next property.
- James finished up a work order and called in for his next scheduled maintenance job.
- Cindy invoiced the company for the cost to launder her uniform.

Are these individuals classified as independent contractors or employees? How confident are you that your independent contractors are "truly" independent contractors?

While the vacation rental industry is well-suited for temporary or contract workers, there is a dangerously thin line between what differentiates an independent contractor from an employee. The Department of Labor says that most independent contractors are actually employees, and they are on a mission to ensure that workers get the wages, benefits and protections to which they are entitled.

## WHY DO EMPLOYERS MISCLASSIFY WORKERS?

Independent contractors are a great resource to employers in the vacation rental and hospitality industries especially for short-term periods of time or specialized project work. There are considerable economic and business reasons to classify workers as independent contractors making them appealing for employers to use. Some of the advantages of using independent contractors include:

- Reduced costs (e.g. benefits, overtime, payroll and other taxes)
- Greater flexibility
- Greater job focus from workers
- Supplementing workforce "as needed" during busy periods
- Contractors are easier to dismiss from work duties

While there is a strong upside to using independent contractors, there is also significant risk when it comes to misclassification. Be aware that if you are audited and have misclassified independent contractors then there are a number of potential pitfalls and expensive consequences coming your way – even outside of the DOL's arena. Some of the areas you may be held liable for include:

- Income tax liability for employment taxes that should have been withheld from "wages"
- Potential overtime pay and other wage claim liability
- State unemployment insurance payments
- Worker's compensation insurance premiums (and potential liability for workplace injuries)
- Benefits and coverage under existing employee benefit plans
- Fines for failure to complete I-9 forms
- Attorneys' fees and costs

- Other civil and criminal liability

### THE DEPARTMENT OF LABOR'S INCREASED ENFORCEMENT PRIORITY

Independent contractor misclassification is the number one priority of the DOL Wage and Hour Division (WHD). In fact, they have set up a misclassification initiative and have agreements with 29 states to combat the ongoing issue of misclassification of employees as independent contractors. In Fiscal Year 2015, the DOL found over \$246 million in back wages for more than 240,000 workers in janitorial, temporary help, food service, daycare, hospitality and similar industries. To make this a bit more real for you, here are some recent examples of companies fined for misclassification:

- **June 2, 2016:** Allstars Staffing LLC, an agency providing workers to local resorts and hotels in Tempe, Arizona, will pay more than \$151k in overtime back wages and damages after misclassifying 275 hotel employees as independent contractors.
- **May 23, 2016:** Perfect Service Excellent Benefits Services, a staffing agency in Kissimmee, Florida, misclassified employees working as housekeepers, launderers, maintenance and front desk personnel as independent contractors instead of employees which resulted in the Staffing Agency paying nearly 25k in back wages to 15 employees.
- **April 6, 2016:** Investigators with the WHD found that Elite Energy Efficiency, an Idaho home energy contractor, misclassified employees as independent contractors and will pay \$41k in back wages to 44 employees.
- **March 16, 2016:** Tampa District Office found that Toria's Support Care Services misclassified one maintenance worker and one care provider as independent contractors instead of employees and failed to meet minimum wage requirements with several other employees resulting in more than \$56k in back wages to nine employees.

It is important to understand that an investigation isn't completely random and can occur based on any of the following:

- An independent contractor files a claim to receive unemployment or workers compensation benefits from your company
- Your company issues a W-2 and 1099 to the same worker in the same year
- The IRS has an unmatched 1099 to an individual's income tax report
- A government tax audit
- An I-9 audit
- A formal review request initiated by the independent contractor for misclassification – the IRS has a form for this

### WHAT SHOULD BUSINESS OWNERS DO NOW?

Be proactive. Take time to compile a list of all the individuals you pay as individual contractors and for those whom you issue 1099's to. For each individual on the list, you should review their working relationship and then evaluate the risk. In addition to your independent contractors, also review your outsourced vendors and examine each of these third-party relationships.

The best way to evaluate the risk for both independent contractors and third-party relationships is to review the working relationship based on the IRS Common Factor Test, the DOL's Economic Reality Test and your state laws. Here are some key factors and information to get you started:

Internal Revenue Service Common Factor Test – The IRS uses a 20-factor test to determine independent contractor status based on:

- **Behavioral Control** – These factors relate to how the employer directs or controls how the independent contractor does the work. For example, who sets the work schedule? The employer or the contractor?
- **Financial Control** – These factors refer to facts that show whether or not the business has the right to control the economic aspects of the job. For example, does the worker have unreimbursed expenses that the employer pays?
- **Type of Relationship** – These factors refer to facts that show how the worker and business perceive their relationship to each other. For example, what benefits (if any) are provided to the worker such as uniforms, supplies, keys, business cards, phones, computers, etc.?

It is important to note that no single factor automatically makes the worker an employee or an independent contractor. The IRS 20-factor test is only a set of guidelines.

**Department of Labor – Economic Reality Test (FLSA)** uses seven factors to determine whether workers are employees. The focus here is whether or not the worker is economically dependent on the business he is working for or if he is in business for himself. For example, can the worker make more profit or lose money depending on how he does the job? Is he in business for himself? Can he document other employers?

**State Laws** – Beware. Some state laws may trump federal law in determining employee status. Many states (such as California) have laws that more specifically define an independent contractor status.

Once you have reviewed and considered the risks associated with the classification of independent contractors, you should review and modify your contracts and agreements as appropriate. If you decide to continue the relationship with your contractors, consider including indemnification language and other provisions to protect your company from liability. Don't forget to review contracts with your third-party vendors in the event that a government audit determines the contractor's workers are actually your employees.

### THE BOTTOM LINE

The DOL's misclassification initiative is real. Don't wait for an audit or an investigator to show up on your doorstep before you take action. Takes steps now to properly classify your workers.

#### Resources:

IRS Independent Contractor (Self-Employed) or Employee? <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>

Employment Relationship Under the Fair Labor Standards Act (FLSA) <https://www.dol.gov/whd/regs/compliance/whdfs13.htm>

Department of Labor Wage and Hour Misclassification Initiative <https://www.dol.gov/whd/workers/misclassification/#stateDetails>

The Wage and Hour Division Resources for Workers <https://www.dol.gov/whd/workers.htm>



Sue Jones, Founder and Managing Director of KLS Group, is passionate about creating strategic human resource programs and services to effect positive change in organizations. She is an innovative HR leader experienced with both large and smaller businesses. Sue has worked in many different industries and is adept with transferring her knowledge, skills and abilities across business channels. An experienced HR professional, Sue brings a fresh approach to her clients, addressing their needs in a personalized manner. Sue is a Veteran of the US Navy, holds a Master's Degree in Business Administration from Northeastern University and is both SHRM-SCP and SPHR certified.