

Contractor Reclassification Risk- Are You Misclassifying Your Workers?

The process of misclassifying workers, or treating workers as independent contractors when they should be considered employees, is a serious problem. The situation is a particular problem in the IT field and other "white collar" professions. Contractor compliance is coming under increased scrutiny from the IRS as well as many states. Companies are eager to hire workers as independent contractors because doing so saves the company a great deal of money. When a company hires someone as an independent contractor, or 1099 employee, they reduce the cost of payroll and benefits. Also, in many instances, an independent contractor is much easier to terminate than a regular employee.

In most cases, the only one to benefit from misclassifying workers as independent contractors is the employer. The employee that works under the independent contractor status does not receive any benefits from the employer, and the state and federal government have difficulty collecting the necessary taxes. This is because the independent contractor is responsible for paying his or her own taxes. The problem of collecting the correct amount of taxes has been termed the tax gap. The tax gap is made up of three issues, non-filing tax payers, under reporting tax payers and underpaying tax payers. Of these, under reporting tax payers make up 80% of the tax gap. Under reporting can take many forms, such as not reporting all income, over reporting expenses, or taking deductions that should not be taken.

Considering these factors, there are changes brewing in the hiring status of independent contractors. Several recent lawsuits have caused the business world to take a second look at how they hire independent contractors. FedEx is one example. The drivers for FedEx Ground have company uniforms, are not permitted to haul anything other than FedEx packages, and are assigned routes. To many, this appears as an employer/ employee relationship. The drivers for FedEx also own their own trucks and pay for the maintenance and upkeep, and are employed as independent contractors. This arrangement suits FedEx perfectly well, there is good deal of cost savings in not offering benefits and not maintaining their own vehicles. Meanwhile, the drivers must pay their own health care, retirement and save for vacations. FedEx had other drivers under similar treatment who WERE considered employees, making the classification of some of the drivers as contractors apparently arbitrary. The case became a Class Action suit, and so far has cost FedEx millions dollars and counting.

Microsoft is another company that has been hit by classification problems. Workers in the IT field often find themselves in the position of possibly being considered employees, and possibly being considered independent contractors. Projects in the IT field, particularly in a company as large as Microsoft, often require a jump in the number of employees while the project is underway. Once the project is completed, the need for workers dwindles. By operating with a small permanent staff and adding temporary workers to fill positions, Microsoft walked a fine line. One lawsuit filed against them, which they agreed to settle, was due to the fact that many temporary employees, some that had been at Microsoft longer than many permanent employees, could not buy stock in the company at a reduced cost, like their permanent counterparts. Microsoft's misclassification mistake ended up costing them several million dollars and counting

With the IRS and many states looking more closely at independent contractor arrangements, it is important that your company be in contractor compliance. While the IRS has a list of twenty questions that it uses to determine if someone is an independent contractor, no one factor allows for a clear determination of compliance, and there are many shades of grey. In addition, situations can change rapidly, and, as an employer, it can be difficult to stay up to date on the status of everyone working within your company.

There are three ways to maintain your compliance, and a successful contract workforce management strategy may employ all or some of these: having only W-2 employees, having a rigorous standard of contractor compliance that all contractors must meet, and/or using a safe intermediary. There are complications to each one, of course. If your employee is truly an independent contractor, and meets all of the guidelines under the 20 questions provided by the IRS, then that individual is serving multiple clients and truly operating as an independent business entity; therefore, employing them as a W-2 worker does not make business sense for either party. Maintaining a rigorous standard sounds good, in theory, but in practice, it creates a great deal of additional work for the Human Resources or Procurement departments responsible for contingent workforce management. Using an intermediary is a method used by many companies to prevent the headaches of independent contractors. When a company uses an intermediary, the independent contractor is employed through the intermediary, who bills your company for services. They take care of the employment paperwork and details of contractor compliance.

When choosing an intermediary, there are several things that you should consider. The first is the fee. The fee structure varies among companies from 5% to 60%. It is also important to know exactly what is included in the services provided by the intermediary. Will your contractor be covered by the intermediaries insurance? How much contact will you have with the intermediary? Will your contractor work for other companies? Is there co employment risk involved in the proposed structure? These are all questions that should be answered before entering into an agreement with an intermediary.

Engaging talent on a contract basis may sound like a great way to reduce costs, but the consequences of improperly classifying employees as

contractors should give you pause. The IRS and a multitude of other regulatory agencies are currently cracking down on improper classification of employees as contractors, and the consequences are increasing astronomically. Make sure your workforce management practices are in compliance and that you manage your contractor risks, by making sure actual employees are engaged as W-2s, maintaining true compliance on legitimate small business contractors, and/or by using an intermediary to more safely engage workers as contractors.

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