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The Independent Contractor Crackdown

Are your workers independent contractors or are they employees? It's a distinction that has significant legal ramifications for a company. If a company classifies its workers as employees, it is required to pay the costs associated with having employees such as federal and state taxes, worker's compensation insurance, unemployment insurance, employee benefits, and overtime. If a company uses independent contractors however, it can avoid the costs associated with the typical employee and, in turn, cut significant overhead.

Employers who try to cheat the system, however, and classify individuals who should be employees as independent contractors may be exposed to significant liability. For example, in 2008, a California court found that FedEx was liable for \$14 million in damages after it misclassified hundreds of drivers as independent contractors instead of employees. Additionally, in December of 2008, the Internal Revenue Service ("IRS") hammered FedEx with \$319 million in fines and penalties after determining that its workers were misclassified. As such, the consequences of misclassifying workers can be very costly. In this regard, things are likely to get even more difficult for employers in the coming months due to a government crackdown on independent contractor classifications.

Due to record budget deficits, federal and state governments have turned to penalizing companies who misclassify workers and thereby avoid paying the required taxes. In this regard, President Obama's 2010 budget assumes that the federal "crackdown" on misclassification will yield at least \$7 billion dollars in revenue over the next ten years. The crackdown includes hiring an additional 100 IRS employees to assist in a three year audit of 6,000 companies chosen at random to evaluate their classification methods. Additionally, numerous states have increased enforcement procedures and have enacted stricter penalties for misclassifying workers.

Accordingly, it is imperative that companies know the difference between an independent contractor and an employee. As a general matter, an independent contractor is free from control and direction in the performance of the work. In determining whether an individual is free from control or direction, courts and the IRS look to several factors. Among these factors are whether the service provider is paid on an hourly or fixed-rate basis; whether taxes are deducted from the individual's pay; whether the service recipient provides the tools/supplies/equipment necessary to carry out the job; whether the company provides training; and finally, the job requirements mandated by the service recipient. The courts and the IRS will also look to the extent to which a service provider can make his or her services available to the relevant market outside of the work performed for the company. Further, a detailed independent contractor agreement which spells out the particulars of the relationship increases a company's chances of prevailing should it be audited or challenged regarding the classification.

While the lines between an employee and an independent contractor may be unclear at times, that is not going to slow down the government audits. As such, if a company engages in the use of independent contractors, it should review the relationship carefully to ensure that its workers are being properly classified. This review should include an internal audit of a company's practices and an update, if necessary, of the company's independent contractor agreement. Given the pending government crackdown, it is better to be safe than sued.

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Our Labor & Employment Group counsels private and public sector clients on a wide range of issues, including workforce counseling; labor and employee relations; corporate and workforce compliance; review and updating employment policies and procedures; employment litigation; unfair competition and trade secrets; privacy and e-discovery issues, employment training; employee benefits and tax issues; wage and hour compliance; immigration and government contracts.

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