GONZALEZ SAGGIO HARLAN

The GSH 60-Second Memo

Sponsored by the GSH Employment Group

October 12, 2011

Jill Pedigo Hall, Esq.

www.gshllp.com

(414) 277-8500

Want more information on this topic?

CLICK HERE!

Join Our Mailing List!

Worker Classification: Prepare for the Game or Get Leveled on the Playing Field

By Jill Pedigo Hall, Esq.

Employers are in a high stakes game. In late September, as part of its continuing effort to "level the playing field" on classification of US workers, the Department of Labor (DOL) signed additional heavy hitters to its Misclassification Initiative roster. DOL first signed the Internal Revenue Service (IRS) through a Memorandum of Understanding (MOU) designed to "improve departmental efforts to end the business practice of misclassifying employees in order to avoid providing employment protections." They also signed labor commissioners and other agency leaders in Connecticut, Maryland, Massachusetts, Minnesota, Missouri, Utah, and Washington. DOL expects to also sign Hawaii, Illinois, Montana, and New York's attorney general onto its Initiative team. The scope and implications of the Misclassification Initiative - first launched in 2010 - and the MOU are outlined in "Leveling the Playing Field for Employers: Government Initiatives Against Misclassification", which can be found here. In brief, this MOU is an initiative designed to improve agency coordination and effectiveness and which is grounded in arguably unbounded cooperation and information sharing between federal and state agencies and the plaintiff's bar.

The Misclassification Initiative battles employer classification of putative employees as independent contractors in order to avoid payment of payroll taxes and workers' compensation, unemployment, and disability insurance, as well as avoid compliance with minimum wage, overtime, and other wage and hour laws. While presenting themselves as a united line, what the Initiative agency players seem determined to ignore is that each is playing by a different set of rules. Each state and federal agency

has a different statutory or common law definition to apply in determining whether a worker is an employee or independent contractor. For example, state workers' compensation and unemployment compensation laws may use definitions of who constitutes an "employee" that are more expansive than the common law definition used by the IRS. Each player's rules for determining independent contractor status are intensively fact-driven and open to varying interpretations.

In this latest game plan, the new MOU between the IRS and DOL specifically permits DOL to provide the IRS with data that DOL believes may raise employment tax compliance issues related to misclassification. However, because DOL applies a different standard than the IRS to determine who is an employee, it is unclear what it will use to identify those issues. In turn, the IRS may share those DOL referrals with state and municipal taxing agencies with which it has agreements to share tax return information. At last count, at least 37 states had signed onto a Memorandum of Understanding with the IRS as part of the Questionable Employment Tax Practices (QETP) Initiative, which allows such sharing of tax and audit information and enforcement coordination. Through the QETP Memorandum of Understanding, the IRS and the participating state workforce agencies may exchange employment tax information for civil cases, sharing either actual employment tax reports or a template compatible with federal and state information; may participate in coordinated enforcement efforts; and may even share independently conducted examination results or work side-by-side on an examination. Again, because the states and the IRS play under drastically different rules, this communication may trigger unnecessary scrutiny of companies. Under the new MOU, the IRS may also share data with DOL relating to misclassification trends, unless the data otherwise qualifies as confidential federal tax information. The IRS may also share with DOL any information (other than return information) that could constitute a violation of any federal criminal law that DOL enforces.

On the heels of the MOU announcement, the IRS showed a possible blitz to employers with the implementation of the "Voluntary Classification Settlement Program" (VCSP). Under this program, employers may voluntarily reclassify their workers as employees for future tax periods for employment tax purposes. To participate in the program, the employer must meet certain eligibility requirements, apply to participate in VCSP, and enter into a closing agreement with the IRS. An employer is eligible if it is: (a) not currently being audited by any federal or state agency regarding worker classification; (b) has consistently treated the subject workers as non-employees; and (c) has filed all required Form 1099s for the workers for the previous three years. If the employer meets the eligibility requirements and is accepted, in order to receive the benefit of the program the employer must enter into a "closing agreement" with the IRS which, among other provisions, extends the statute of limitations for collecting back taxes (from three to six years) for the employer during the first three years following entrance into the program. A participating employer will then be able to pay just 10 percent of the employment tax liability that may have been owed on compensation paid to the workers for the most recent tax year, without interest and penalties, and will not be

audited for employment tax purposes for prior years with respect to the classification of the workers.

At first glance, the VCSP can seem desirable because of the potential employment tax relief and amnesty. However, the VCSP may be a play action pass by the Initiative team designed to fool your company's defense. First, the forgiveness offered by the IRS does not extend to the other state and federal agencies charged with classification compliance enforcement. Simply because the IRS allows a pass to employers who reclassify workers prospectively for tax purposes under the program does not mean the employers would not be flagged and penalized with a requirement by the DOL and other state agencies that the employers reclassify workers retroactively under their rules. IRS information sharing through QETP and the new MOU would seem to increase employer liability risk for: misclassification liability for state taxes, contributions, and penalties; failure to provide workers' compensation and unemployment insurance; putative violations of employment discrimination, FMLA, and immigration laws; overtime and pension plan requirements; and failure to provide certain benefits, such as paid time off, sick leave, and retirement contributions. Simply, the VCSP does not provide amnesty for violations of any law except those within the purview of IRS enforcement. Additionally, by choosing to participate in the VCSP, a company must assume the employee expenses it had previously avoided by using independent contractors. It will have to begin providing employee benefits and comply with wage and hour laws and all other legal obligations owed to employees. Moreover, and possibly most obvious, it is unclear what happens if the IRS does not accept an employer's VCSP application. If an employer is rejected, then it may have opened itself to multiple classification audits or agency enforcement actions. Finally, because the DOL has extended significant assistance to the private plaintiff's bar through a one-way liberal information-sharing program having the misnomer "Bridge to Justice," an employer's admission of misclassification may spur private wage and hour litigation.

Given how state and federal agencies are raising the stakes, to stay in the game companies must move with all due haste to carefully assess their use of independent contractors. DOL has proposed a budget increase of 107 full-time employees and $15,223,000 to support their team's misclassification enforcement efforts in 2012. Coupled with the exponential growth in collective wage and hour misclassification litigation, the team presents a formidable foe. Participation in the VCSP program or a similar amnesty program may not be the best course given the inconsistent rules of the game across the country. Game strategy should be to assess what particular state and federal classification standards apply to the company and then determine whether a self-audit may be warranted. Remaining alert and being prepared is crucial so you have the advantage to avoid being leveled along with the playing field.

In a recent 60-Second memo we advised employers subject to the NLRB that a final rule was recently published requiring them to post a new employee rights poster by November 14, 2011. On October

Office Locations:

Arizona
California
Connecticut
Florida
Georgia
Illinois
Indiana
Iowa
Massachusetts
New Jersey
New York
Ohio
Tennessee
Washington D.C.
Wisconsin

www.gshllp.com

5, 2011 the NLRB extended the implementation deadline from November 14, 2011 to January 31, 2012. Thus, the requirements discussed in the prior 60-Second memo "NLRB Requires Employers to Post New Employee Rights Notice" will not be implemented until January 31, 2012.