

ASK ALAN | BY ALAN FRIEDMAN

# Worker Status Laws, Pt 2

As discussed in last month's Part 1 of this two-part discussion on worker classification, California recently made a unanimous decision that will significantly change the California workplace. The state Supreme Court ruling now makes it much harder for employers to classify workers as independent contractors. Given California's courts are often viewed as trailblazers for needed new legislation, many other states are bound to follow with similar changes in labor law.

Classifying workers as independent contractors means a worker is paid a gross amount of compensation and the business escapes the cost of payroll taxes, employment benefits and compliance reporting associated with classifying workers as employees.

But over the years, both federal and state tax authorities have lost billions of revenue dollars from the non-collection of employer-matched Social Security and Medicare tax, unemployment tax and income tax on profits aggressively lowered by business deductions or not reported at all. This led to the stringent federal rules on worker classification, with many states implementing even tougher rules coupled with an unprecedented increase in labor audits. Accordingly, this Part 2 covers the current federal rules on worker classification with some time-tested advice on what to do in the event of a state labor audit.



## Correct worker classification is a necessity for retailers

### WHO ARE YOU?

To avoid the cost of noncompliance with worker classification rules, business owners and workers alike need to determine whether a worker is truly an independent contractor or indeed an employee.

If you are an individual who provides, markets and controls a particular service to various businesses, you may in fact be a self-employed worker and should be treated as an independent contractor by anyone you do work for. But if you are a worker who provides services controlled by others, both in the manner in which your work is performed and/or the pricing for your services, you most likely should be classified as an employee and receive all employment rights and benefits without discrimination in accordance with prevailing federal and state labor laws, including the U.S. Fair Labor Standards Act (FLSA).

Before you pay any individual for services rendered, you should first determine the character of the business relationship that ex-

ists between you and the person performing the service. In determining whether someone is an employee or an independent contractor, all information that provides evidence of the degree of control and independence needs to be considered as described in the federal "Common Law Rules" below.

### COMMON LAW RULES

Facts that provide evidence of the degree of control and independence for worker classification fall into three categories:

- 1. Behavioral:** Does the company control or have the right to control what the worker does and how the worker does their job?
- 2. Financial:** Are the business aspects of the worker's job controlled by the payer? These include things like how a worker is paid, whether expenses are reimbursed and who provides tools/supplies.
- 3. Type of Relationship:** Are there written contracts or employee-type benefits (such as a pension plan, health insurance, vacation pay)? Will the relationship continue after an engaged task is done, and is the work performed a key aspect of the business?

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate the worker is an employee, while other factors indicate the worker is an

independent contractor. There is no magic formula or set number of factors that assures a particular classification, and no factor stands alone in making this determination. Also, factors relevant in one situation may not be relevant in another. The key is to look at the entire relationship, consider the degree or extent of the right to direct and control and, finally, to document each of the factors used in coming up with the determination.

#### WHAT IF A LABOR AUDIT HAPPENS?

Simply, if you wrongly classify a worker as an independent contractor instead of as an employee with no reasonable basis for doing so, you may be held liable for all unpaid federal and state employment taxes over the

years that worker has worked for you. Ouch!

The federal and state departments of labor have the authority to audit employers at any time. The most common cause for an audit, however, is an employee complaint. The following guidelines will hopefully assist you if you receive notice of an audit, but they are not a substitute for quality legal representation:

- Immediately call the auditor to find out the purpose and scope of the audit. Find out whether the audit concerns overtime pay, minimum wage compliance or something else.
- Gather all relevant records in advance of the audit and keep a log of everything you provide the auditor. It's always best to have two copies, one for the auditor

and one for you.

- The DOL may not provide you with much notice, but you are free to ask for extra time to gather documents.
- Designate a company representative or legal counsel to work with the auditor.
- Be courteous and cooperative. It's best to provide a private room for the auditor to minimize workplace interruption.
- At the conclusion of the audit, ask for a summary report of audit findings. If violations are found, resolve them promptly by making sure you understand what the auditor wants to see to reverse or minimize the infractions. The audit report should always be provided to your legal counsel because sometimes the DOL makes violation claims that

are not actual legal violations.

#### SOME FINAL ADVICE

Frankly, the best practice is to assure no violations will be found in any audit. A proactive employer will have up-to-date job descriptions, adhere to the FLSA classification system and keep accurate payroll records. Don't fall into thinking you're too small of a company to be audited. All it takes is one employee complaint to have the DOL knocking on your door and potentially put you out of business. **MI**

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