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Joel Rothenberg - Do independent contractor laws impact your business?

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Many businesses in the construction and service industries supplement their seasonal workforce needs with temporary workers whom they classify as independent contractors. And while it is good "business sense" to hire skilled workers on a seasonal or project basis, employers should be aware of the risks of misclassifying their workforce due to IRS and Mass. enforcement provisions.

The IRS has launched a three year employment tax audit initiative in 2010 that focuses on worker classification, fringe benefits, nonfilers and officer compensation. The service will conduct 2,000 random audits each year. Employers could be liable for their share of the unpaid payroll taxes, fringe benefits including retirement plan contributions for each individual the employer misclassifies as an independent contractor.

The IRS employs a 20 factor test to determine whether an individual is an employee versus an independent contractor. The tests center on the employer's right of control over the individual.

Mass. is also "cracking down" on employer misclassification issues in order to collect their share of the unpaid taxes, and other costs associated with employment. In addition, the Mass. law allows treble (triple) damages for all violations providing more incentive for lawsuits.

Unfortunately navigating the employee classification rules is very difficult because Mass. uses two different tests depending on the taxes involved. Mass. uses the federal 20 factor test to determine wage withholding requirements but adopts a three factor test to determine employee status for the various taxes encompassed by the labor and industries laws such as minimum wages and unemployment taxes. The three factor test is as follows:

1. The individual is free from control and direction in connection with the performance of the service both under contract and in fact. To meet this requirement, a worker's activities and duties should actually be carried out with minimal instruction. An example cited in an advisory from the office of the attorney general indicates an independent contractor completes the job using his/her own approach with little direction and dictates the hours he/she will work on the job.
2. The individual performs services outside the usual course of business of the employer. If your company is in the roofing business and hires someone to do roofing, your worker is an employee. Even if you hire someone to help during busy periods, Mass. law treats the individual as an employee.
3. The individual must be customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed. Workers who depend on a single employer for all of their business are employees.

While state and federal laws are intended to minimize abuse by employers, they do present a challenge for those employers with legitimate needs to retain independent contractors.

An advisory from Massachusetts' Attorney General's Fair Labor Division says employers who

misclassify workers may be committing insurance fraud and are depriving workers of the "protections and benefits" of employment such as health insurance, retirement funding, worker's compensation, unemployment assistance along with other employment benefits. And while the advisory is not clear about how to determine whether a business was created to avoid the regulations, the law puts the burden of proof on the employer subjecting them to all unpaid taxes and benefits plus treble damages.

Given the potential liability and the heightened level of scrutiny at the federal and state level, it is best to seek advice from your accounting professional if your company uses independent contractors or is considering using them.

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