Avoid These Common Mistakes in Classifying Workers

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The Department of Labor (DOL) has made it clear. Regardless of the reason, classification errors can be costly for employers, as the error often affects a number of employees having similar job titles and therefore lends itself to class treatment of the claim. Furthermore, if you are on the unlucky end of a DOL audit, you will likely be stuck paying payroll taxes, unemployment taxes, overtime, as well as a host of fines, fees and other costs.

The complex details of what you need to know for proper worker classification can be found in the 2016 Employers Supplemental Tax Guide, published by the IRS. The IRS guide, however, is not only complex, but often times, confusing. Identified below are the five most common employee classification mistakes.

**Mistake 1: Going by the written contract**

Despite what the agreement with the individual worker provides, the nature of the work relationship between the company and the worker determines how he or she is classified. Some employers believe that having a written contract that provides for the independent contractor status supersedes all other considerations. This is
untrue. If the “independent contractor” is doing the same type of work as someone else (who is classified as an employee and is issued a W2), the “independent contractor” is misclassified. If, however, the worker provides the same or similar services to other companies, they are more likely to be deemed an independent contractor.

**Mistake 2: Allowing the Worker to Classify the Relationship**

Even if the worker requests or even agrees to be treated as an independent contractor, this does not mean that it is appropriate, legal or ethical.

**Mistake 3: Trying to Control When and How the Work Gets Completed**

A key factor in considering whether a worker is an independent contractor or an employee is the amount of control over the details of the work being performed. If the relationship is intended to be long term and the company tells the worker how to complete the work, the worker is likely an employee, not an independent contractor. True independent contractors typically perform services for a brief period of time. True independent contractors are also typically given an objective and then are free to fulfill it using their own tools, methods and where and when they choose. Generally, if you tell your workers where to work, when to work or to perform the work in a specified manner, you have an employee, not an independent contractor.

**Mistake 4: Method of Payment**

Independent contractors are typically paid a flat fee for a job, however, confusion arises in situations where independent contractors are paid hourly. Employees are usually offered benefits. Just because you do not offer a worker benefits (such as sick days, retirement plans, etc.) does not mean they are properly classified. Some employers mistakenly believe they have the choice (or allow the employee the choice) of providing the worker with benefits and calling them an employee, or not offering benefits, but paying a higher rate and treating the worker as a contractor.

**Mistake 5: Improperly defining an investment in job training and equipment**

Independent contractors typically have significant investments in both job training, as well as in their equipment. However, employees may also invest to some degree in the tools and materials they use for their jobs. The difference in classification depends upon the size of the investment and factors such as whether or not the company offers reimbursement of expenses to the worker. If the company reimburses, the worker is more likely to be deemed an employee.

**Consequences for Misclassifying**

If the DOL or IRS performs an audit, you will be required to expend significant and valuable time away from your business to respond to their inquiries. While some leniency may be provided if an honest mistake was made, possible penalties still
include significant fines, paying back taxes and wages for the misclassified employees. In addition, workers that were misclassified can come back after you for unpaid overtime, missed meal and rest breaks, and other benefits.

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