



WOODS FULLER[®]
SHULTZ & SMITH P.C.

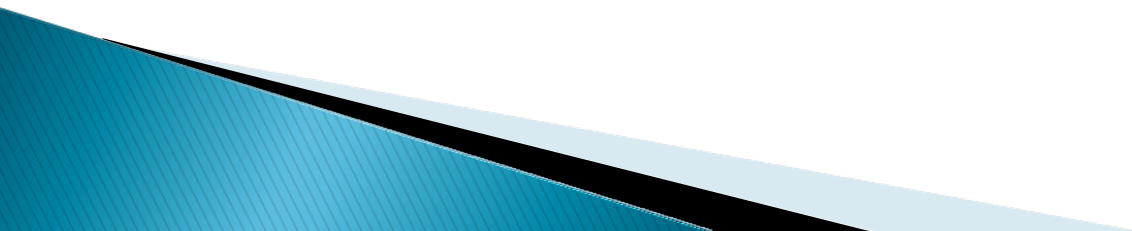
Cracking Down on Misclassification:

Is Your Worker an Employee or Independent Contractor?

November 18, 2011

Presenter: David Kroon, Attorney

The information contained in this outline is not intended to be a complete explanation employee classification. The information contained in this outline is for discussion purposes only. Users of this information should always contact an attorney when determining how to manage employee and independent contractor issues.

- I. Why Businesses Engage Independent Contractors
 - II. Increased Enforcement of Misclassification Claims
 - III. Analyzing Independent Contractor Status Under Federal Law
 - IV. Analyzing Independent Contractor Status Under State Law
 - V. What are the risks?
 - VI. Questions to Help Make Correct Classification
 - VII. Documenting Independent Contractor Status
- 

I. Why Businesses Engage Independent Contractors

- A. What is an independent contractor?
- B. Some workers prefer independent contractor status.
- C. Independent contractors impose fewer burdens.
- D. Projects of limited duration.



II. Increased Enforcement of Misclassification Claims

- A. Federal and State Governments Target Misclassification.
- B. IRS Misclassification Initiative.
- C. Questionable Employment Tax Practices (QETP) initiative.
- D. Payroll Fraud Prevention Act (S. 770)
- E. Voluntary Classification Settlement Program (VCSP)



III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

a) **Instructions** - An employee must generally comply with an employer's instructions.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

b) **Training** - An employee may be trained to perform services in a particular manner.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

c) **Integration** - An employee's services are generally integrated into the business operation.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

d) **Services Rendered Personally** - An employee renders services personally.



III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

e) **Hiring Assistants** - An independent contractor is responsible for the hiring, supervision, and payment of assistants to the worker.



III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

f) **Continuing relationship** - Continued performance of services to a single company indicate an employment relationship.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

g) **Set work hours** - Set hours of work suggest a right to control and implies an employment relationship.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

h) **Full-time work required** - If full-time work is required, the individual is more likely an employee.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

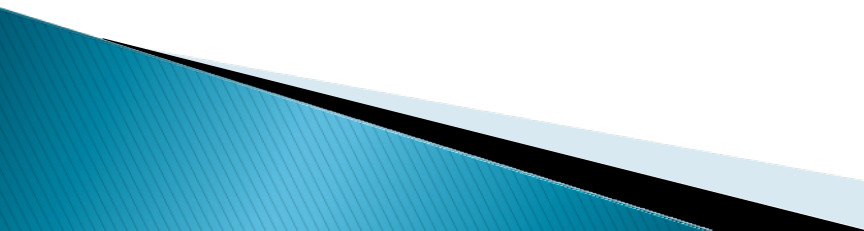
- i) **Work on the company's premises** - If the company provides workspace on the premises, an employment relationship is implied.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

j) **Order or sequence of the work** - If the company has a right to specify the order or sequence of the work to be done, the worker is more likely to be considered an employee.

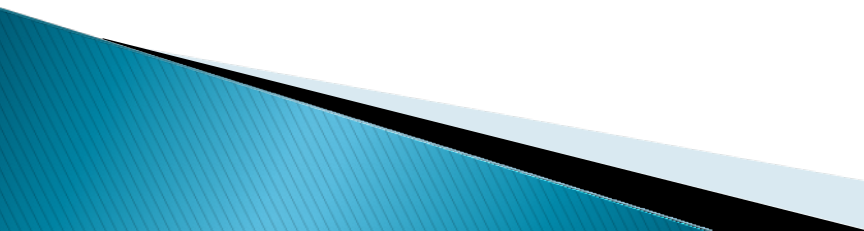


III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

1. Behavioral Control.

k) **Oral or written reports** - A requirement of oral or written reports suggests control and an employment relationship.

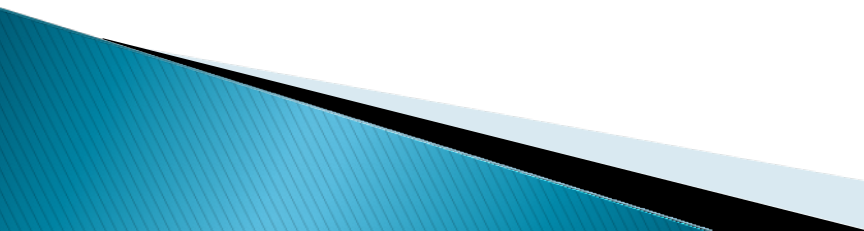


III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

2. Financial Control

a) **Payments** - Payments made by the job or commission suggests an independent contractor status. Payments by the hour, week, or month suggest an employment relationship.



III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

2. Financial Control

b) **Expenses** - If the company pays for the worker's business and travel expenses, the worker is more likely an employee.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

2. Financial Control

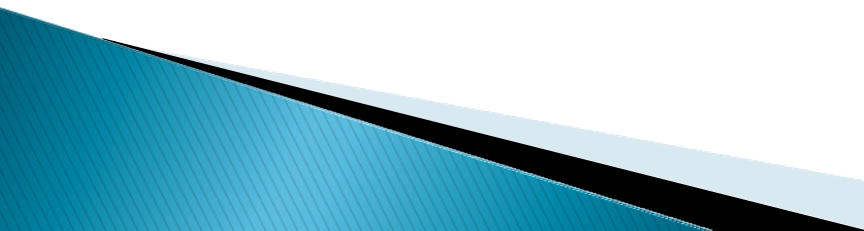
c) **Furnishing of tools and materials** - If the company provides significant tools, materials, and equipment, an employment relationship is suggested.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

2. Financial Control

d) **Significant investment** - If the worker invests in equipment and facilities unrelated to the company receiving the service, an independent contractor relationship is suggested.

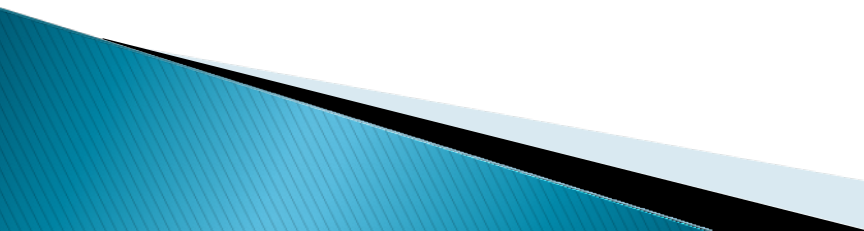


III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

2. Financial Control

e) **Realization of profit or loss** - If the worker bears the risk of realizing either a profit or loss resulting from providing the service, he or she will be considered an independent contractor. If the worker cannot suffer a loss from the work, he or she is more likely an employee.



III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

3. Relationship of the Parties

- a) **Working for more than one firm at a time** - If the worker provides services to a number of unrelated entities at the same time, he or she is likely an independent contractor.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

3. Relationship of the Parties

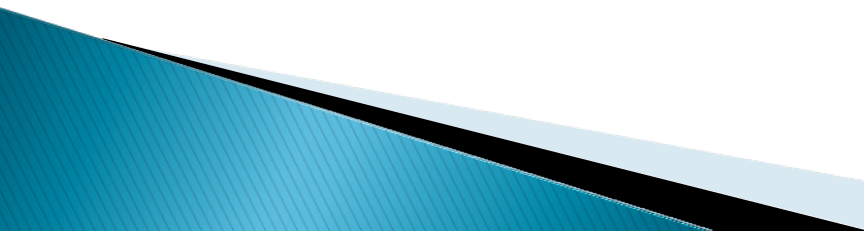
b) **Offers Services to the general public** - If the worker's services are available to the general public on a regular basis, this factor weighs in favor of independent contractor status.

III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

3. Relationship of the Parties

c) **Right to discharge** - If the company has the right to dismiss the worker at any time, an employee relationship is indicated. An independent contractor cannot be fired if the terms of the contract are met.

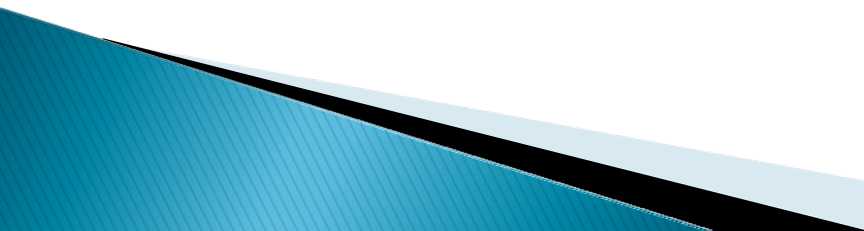


III. Analyzing Independent Contractor Status Under Federal Law

A. Common Law Control Test / IRS 20 Factors Test.

3. Relationship of the Parties

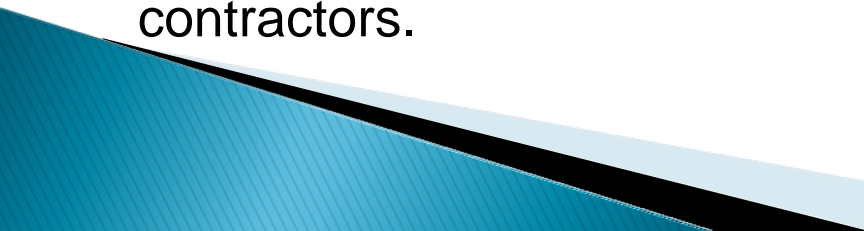
d) **Right to terminate the relationship** - If the worker has the right to terminate the relationship at any time without liability to the company, an employment relationship is indicated.



III. Analyzing Independent Contractor Status Under Federal Law

B. IRS Section 530 Safe Harbor

To qualify for Section 530 relief, an employer must have:

- (1) Consistently treated the workers (and similarly situated workers) as independent contractors;
 - (2) Complied with Form 1099 reporting requirements with respect to the tax years at issue; and
 - (3) Had a “reasonable basis” for treating the workers as independent contractors.
- 

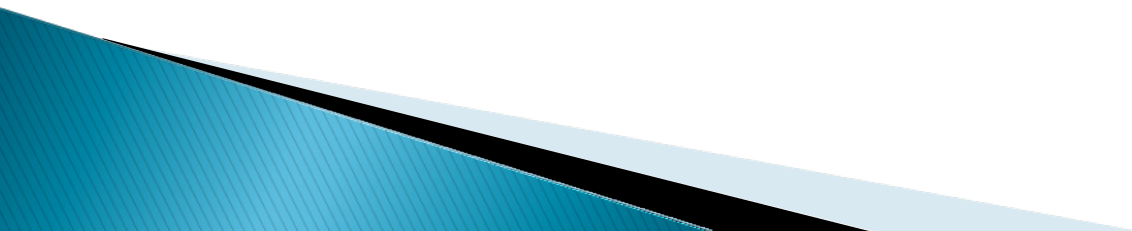
III. Analyzing Independent Contractor Status Under Federal Law

There are four categories of authority that may be relied upon as a “reasonable basis”:

- (1) Federal judicial precedent or administrative rulings including published revenue rulings, and technical advice memoranda or private letter rulings *issued to that employer*;
- (2) Prior audits of the taxpayer;
- (3) Long-standing (at least 10 years) industry custom or practice in a significant segment (25%) of the industry; and
- (4) Other reasonable bases such as reliance on advice provided by an accountant or attorney when the treatment of the workers as independent contractors began.

III. Analyzing Independent Contractor Status Under Federal Law

C. Economic Realities Test

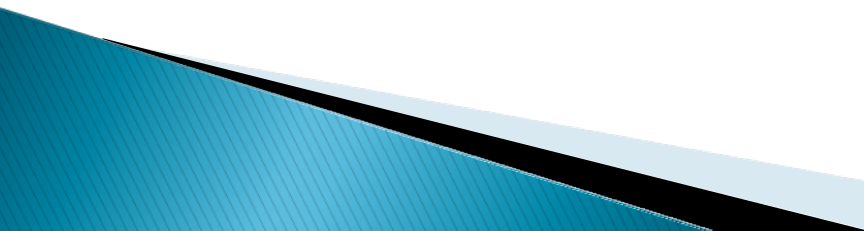


IV. Analyzing Independent Contractor Status Under State Law

A. SDCL § 61-1-11

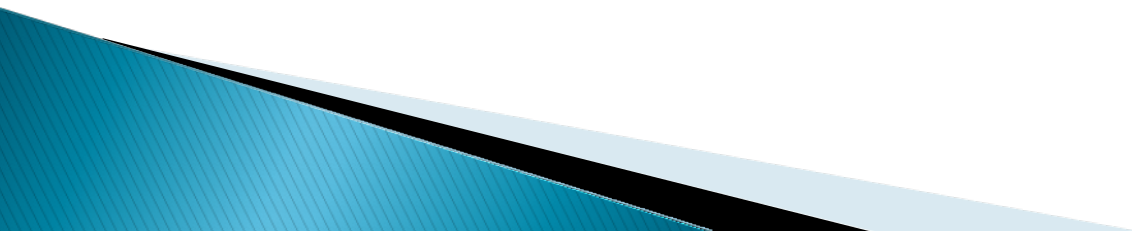
61-1-11. Employee and independent contractor distinguished

Service performed by an individual for wages is employment subject to this title unless and until it is shown to the satisfaction of the Department of Labor and Regulation that:

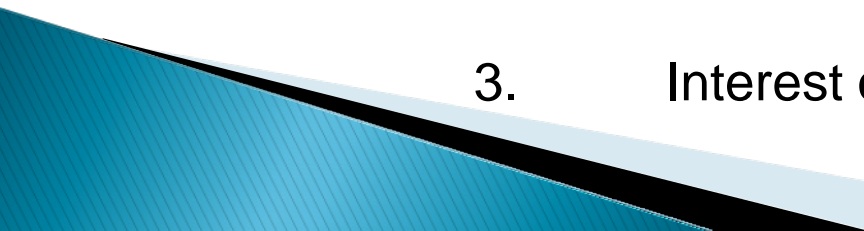


IV. Analyzing Independent Contractor Status Under State Law

B. Judicial Decisions.



V. What are the risks?

- A. Unpaid overtime compensation.
 - B. Unpaid minimum wage.
 - C. Liquidated damages.
 - D. Benefit Claims.
 - E. Taxes.
 - 1. Unpaid Social Security and Medicare tax.
 - 2. Penalties for failure to file, failure to pay, and failure to make timely deposits.
 - 3. Interest on unpaid tax and penalties.
- 

VI. Questions to help make correct classification

(1) Have all contractors signed written Independent Contractor Agreements, and do they receive Form 1099?



VI. Questions to help make correct classification

(2) Are the contractor's duties integrated with core business operations, or does worker perform non-essential business activities?



VI. Questions to help make correct classification

(3) Must the contractor's services be performed personally?



VI. Questions to help make correct classification

(4) Must the contractor's services be performed on-site, or during specific hours?.



VI. Questions to help make correct classification

(5) Does the contractor perform full-time services to only one company, or work for other companies also?



VI. Questions to help make correct classification

(6) Does the contractor receive employee benefits such as insurance coverage or paid time off?



VI. Questions to help make correct classification

(7) Does the contractor do the same job as or work side by side with company employees?



VI. Questions to help make correct classification

(8) Does the contractor have a supervisor who directs his or her work, or does the contractor supervise company employees?



VI. Questions to help make correct classification

(9) Is there a non-compete agreement that attempts to prevent the contractor from providing services to other employers?

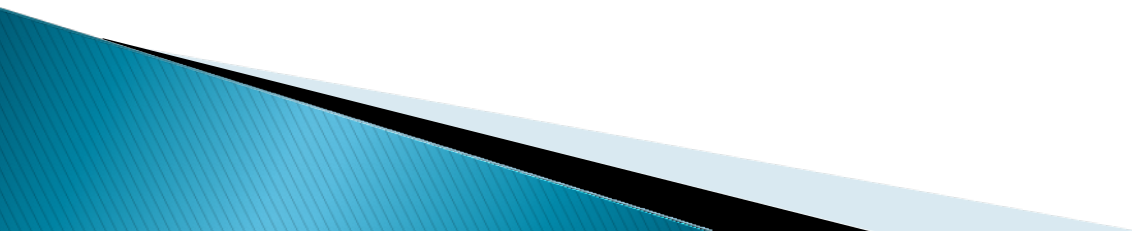


VI. Questions to help make correct classification

(10) Is the contractor expected to attend company meetings or periodic or ongoing training as to procedures and methods to be used?



VII. Documenting Independent Contractor Status

- A. Written agreement.
 - B. Workers' business card, advertisements, trade ads, etc.
 - C. Evidence of liability insurance.
 - D. Business or sales tax license.
- 



WOODS FULLER[®]
SHULTZ & SMITH P.C.

Questions?

Presenter: David Kroon

www.woodsfuller.com

The information contained in this outline is not intended to be a complete explanation employee classification. The information contained in this outline is for discussion purposes only. Users of this information should always contact an attorney when determining how to manage employee and independent contractor issues.