

EMPLOYMENT SERVICES

June 2010

Independent Contractor or Employee? Employers Need to Ask Themselves Before the IRS or Department of Labor Asks

“There’s a new sheriff in town,” so said newly appointed Secretary of the Department of Labor (DOL) Hilda L. Solis to a forum organized by the AFL-CIO, and she has \$117.5 billion of the federal budget for fiscal year 2011. With this increased budget, the DOL Wage and Hour Division (WHD) expects to hire at least 90 new investigators in 2010 to focus solely on employers who misclassify employees as independent contractors and deprive them of benefits, such as overtime. Approximately \$25 million of the DOL’s budget is set aside solely for this Employee Misclassification Initiative.

In December 2009, a first-time offender was penalized \$1,500 per day for 218 days (\$328,500). The DOL’s increase in enforcement action is magnified by the IRS stating it will conduct a national audit targeting up to 6,000 employers with the goal of recovering revenue shortfalls caused by the misclassification of employees. Agencies are cooperating with each other and sharing information related to their investigations for the first time. The Occupational Safety and Health Administration (OSHA) also agreed to share information with WHD related to information it uncovers during its inspections. OSHA stated they are “committed to working closely with the Administrator of the Wage and Hour Division to enhance the exchange of information on this issue and improve protections afforded workers.” While a formal memorandum of understanding between OSHA and WHD has been in place since 1990, they have not shared information until now.

The Employee Misclassification Initiative gained momentum in August 2009 when the United States Government Accountability Office issued a report to Congress regarding Employee Misclassification. This report noted that, according to the IRS, in 2008 only 3% of employers who submitted a Determination of Worker Status Form correctly identified workers as independent contractors. The DOL commissioned a study in 2000 that determined 10-30% of employers misclassify at least some employees. In short, employers get it wrong most

of the time. With both the DOL and IRS investigating an employer’s classification of its workforce, liability for a wrong decision will prove costly. Employers may be forced to pay back wages, overtime, back benefits, statutory penalties and back taxes. The Fair Labor Standards Act (FLSA) permits the DOL to look back two years or three years for willful violations of the law, which means the DOL will determine if an employer owes an improperly classified worker overtime for a period of at least two years. Two or three years of overtime can certainly add up and that does not even factor in the back taxes. Once an agency, be it the DOL, IRS, or a state department of labor, makes a determination that an employer has misclassified its workforce, other agencies will institute enforcement actions to obtain their piece of the pie. Ohio Attorney General Richard Cordray estimates that Ohio loses at least \$160 million a year due to misclassification of workers.

It is increasingly difficult for employers to determine whether a worker may be classified as an independent contractor as there a number of factors to consider. Even more problematic is that the IRS and DOL utilize slightly different standards. The DOL utilizes an “Economic Realities Test,” while the IRS utilizes a 20-factor test broken down into three general concepts: behavioral control, financial control and the relationship between the employer and the worker.

Adding to any potential liability for employers is that if the DOL or IRS determines an employer misclassified workers as independent contractors, then the employer’s number of total employees is increased.

Continued on next page

In This Issue...

- Ohio Bureau of Workers’ Compensation Announces New Drug-Free Safety Program Rules
- Compliance Corner: Where Should You be Keeping Your Unemployment Records?
- Roetzel & Andress Attorney Selected as International Fellow

This means an employer who may have been exempt from complying with other federal laws, such as the Family Medical Leave Act, the WARN Act, and Title VII, may now fall under their purview. Further, employers are not required under the FLSA to maintain certain records for independent contractors, but the FLSA recordkeeping requirements apply to employees. If an employer improperly classifies a worker, then it may be liable for fines under the FLSA recordkeeping requirements. Employers also may now face enforcement actions for violating state workers' compensation laws that cover employees but not independent contractors. It is not difficult to imagine the scenario where an independent contractor personally incurred medical expenses because of a work-related injury only to later have the DOL or IRS determine that independent contractor is an employee who should have been covered by workers' compensation laws.

The Mission Statement of the DOL reads, in part, *"to foster, promote, and develop the welfare of the wage earners...and assure work-related benefits and rights."* Also, indicative of the DOL's current stance is the number one Outcome Goal for the DOL's recently issued Strategic Planning Overview, which is: "Increase workers' incomes and narrow wage and income inequality." The DOL adopted many of the recommendations from the GAO report, such as increasing the targeting of employee misclassification, cooperating with other agencies, and even enhancing the DOL website to provide additional information to workers regarding misclassification. This new website launched at the end of March.

Worker misclassification is an issue that is only gaining steam. Sen. Sherrod Brown (D-Ohio) recently introduced

legislation (The Employee Misclassification Prevention Act, S. 3254) that would amend the FLSA to require companies to keep records of individuals who performed work as independent contractors and that provides specific penalties for misclassifying workers. Right now, there is no specific penalty for misclassifying workers.

Employers are striving to cut costs in this economy, which may include attempting to classify employees as independent contractors. This economy, however, also causes federal agencies to seek means to increase revenue. Also, states are increasingly concerned about their revenue and the impact that misclassification may have on workers' compensation programs and unemployment tax revenue. These common concerns, coupled with the DOL's increased budget and awareness of employee misclassification creates the perfect storm for an explosion of enforcement actions related to employee misclassification. Expect the DOL to begin by targeting industries in which employee misclassification is common, such as the construction and restaurant industries, but this initiative is so large and widespread that no industry and no employer, regardless of size, is immune. There's no better time for an employer to conduct a self-audit of its workforce to determine if its independent contractors are not really employees. Even if the DOL or IRS disagree with the employer's assessment, at the very least, a self-audit can help demonstrate that any violation of the law was not willful and reduce any potential fines or penalties.

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Roetzel & Andress Attorney Selected As International Fellow

Tracy Turoff, an Employment Services associate in Roetzel & Andress' Cleveland office, was recently selected by the Alliance of Civilizations International Fellowship as one of 24 emerging leaders in its inaugural program aimed at increasing knowledge and understanding between North American, European and Muslim countries. She was the only Fellow selected from Ohio, and only one of 12 candidates from North America and Europe. Ms. Turoff traveled in March to the Middle East and North Africa where she engaged in political, economic and social dialogue regarding the importance of international cooperation and collaboration regarding international and domestic policy challenges. Ms. Turoff hopes to use this experience to help expand business opportunities in other countries, foster relationships and broaden cultural perspectives. In 2007, Ms. Turoff was selected as an American Marshall Memorial Fellow with the German Marshall Fund, which sent her on a similar mission throughout Europe.

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Ohio Bureau of Workers' Compensation Announces New Drug-Free Safety Program Rules

The Ohio Bureau of Workers' Compensation (BWC) has announced proposed rules for its new Drug-Free Safety Program (DFSP) designed to promote the health of Ohio's workforce by preventing workplace injuries attributed to the use or abuse of drugs. The new program will bring an end to the current Drug-Free Workplace Program (DFWP) with the DFSP to replace it by July 1, 2010. The changes were called for in a recent comprehensive study of Ohio's workers' compensation system.

The Drug-Free Safety Program simplifies the process for employers to join and implements a program that will provide measurable results by tracking drug or substance abuse-related accidents.

According to the Ohio BWC, the new Drug-Free Safety Program has these proposed features:

- Two levels of participation, basic and advanced, which offers premium discounts in the range of four-to-seven percent. The advanced level requires random drug testing of at least 25% of all employees.
- The new program is expected to allow some small discount stacking for group employers participating at the advanced level.
- The current five-year participation limit is eliminated.
- One enrollment period annually for private employers - May 28, 2010 for the current year and April 30 in all subsequent years. An annual progress reporting deadline will be March 31.
- Recommendations regarding employer policy elements, safety management elements and employee assistance components are further defined.

As developments arise, both before and after enactment, Roetzel & Andress will provide further information and guidance to assist you. Please contact any of our offices to discuss this matter further with any of our workers' compensation attorneys.

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EMPLOYMENT SERVICES

COMPLIANCE CORNER

Where Should You be Keeping Your Unemployment Records?

It is almost a foregone conclusion that when an employee departs from your business or organization involuntarily, an application for unemployment benefits will follow. It is another foregone conclusion that the unemployment claim will generate paperwork, sometimes quite a bit of it. A typical practice of employers is to place documents related to an unemployment claim in the former employee's personnel file. This may not be the best place for those documents, however, should future litigation ensue.

Ohio law provides that documents maintained by the Ohio Department of Job and Family Services (ODJFS) or provided to ODJFS shall not be open to the public, shall not be used in court in any action or proceeding, and shall not be admissible in evidence. R.C. 4141.21. However, courts have recently begun to chip away at this protection, holding that if these documents are obtained from a source not connected with ODJFS, then the protection of R.C. 4141.21 may not apply. The most common way that these documents come to light is through an employee's personnel file during the discovery phase of a lawsuit. If unemployment documents are produced along with the personnel file, then the former employee has an argument that they should be admissible at trial. While these documents typically reflect the reason and details related to the separation, there may be reasons why an employer would not want them to be placed in the public domain.

One way to afford your company or organization some protection is to maintain documents related to an unemployment claim separate from the personnel files. They may still be requested in discovery, but an employer's attorney will have a basis to argue that they are not personnel documents, but rather are documents protected from disclosure pursuant to R.C. 4141.21. There is no guarantee that an employer will not have to produce them, but it may provide some argument that an employer should not be required to.

If you have further questions, contact **Karen Adinolfi**, 330.849.6773 or kadinolfi@ralaw.com

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