



## ***The Risky Business of Worker (Mis)Classification*** **1099 Contractors versus W4 Employees**

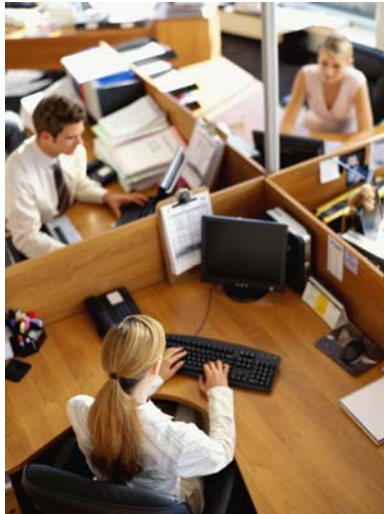
*The Challenge: What You Don't Know (or Do) Might Hurt You;  
Worker Classification from a Regulatory Perspective*

*The Solution: How Best to Determine Appropriate Worker Status;  
Worker Classification from a Compliance Perspective*

*What the IRS and the Utah Dept of Workforce Services Look For;  
Understanding Definitions of Worker Control*

*The 2007 Introduction of Form 8919;  
Misclassified Workers Can Now Report Employers to the IRS*

*Utah Legislative Snapshot;  
What to Expect in Coming Months, Years: More Scrutiny*



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*The Challenge: What You Don't Know (or Do) Might Hurt You*

## **Worker Classification from a Regulatory Perspective**

Studies conducted nationwide estimate that between 15 and 30 percent of employers may be misclassifying -- intentionally or not -- their workers, in effect cutting payroll costs by as much as one-quarter (an unfair competitive advantage) and denying their workforce important protections and benefits. Companies in construction, professional business services, health / education and transportation / utilities, often are viewed as common offenders. This misclassification of workers results in the federal government losing out on tax revenues (in uncollected Social Security, unemployment, earned personal income), upwards of \$2.72 billion dollars. States feel the pain as well. In Illinois in 2005 it is estimated \$54 million in unemployment taxes, \$149 to \$250 million in income taxes, and \$98 million in worker comp premiums went uncollected. A Massachusetts study similarly found substantial losses attributable to worker misclassification.

### **States -- and the Nation as a Whole -- Feeling the Pain Financially**

#### *Estimated Amount of Money Lost as a Result of Worker Misclassification*

Illinois (2005)



UI Taxes	\$54m
Income Taxes	\$149 - \$250m
Worker Comp Premiums	\$98m

Massachusetts (2001 - 2003)



	\$13 - \$35m
	\$152m
	\$9m



*\$2.72 Billion Lost Nationwide*

### **Multiple Legislative Actions Underway, High-Profile Investigations of Large Firms**

The federal government and state legislatures are working aggressively to stem this flow of lost revenue due to worker misclassification. In May 2007, a bill was introduced (not yet enacted) in the U.S. Senate (The Independent Contractor Proper Classification Act, ICPC Act, S. 2044) that would empower the IRS and Department of Labor (DOL) to pursue legal actions. In May 2008, a similar bill was put forth in the U.S. House: The Employee Misclassification Prevention Act (H.R. 611). Illinois, Massachusetts, New Jersey, New York, New Mexico and other states have already passed (or are in the process of formulating) laws related worker misclassification. High-profile companies are not immune from investigation. In the mid-1990s, Microsoft was ordered to pay \$97 million in benefits owed to misclassified workers. The CEO of Blackwater, the private security firm, was called before Congress in 2007 to answer to answer tax evasion charges due to misclassifying their workers. For the same reason, FedEx is being hit with \$320 million owed in back taxes tied to its workforce of 25,000 drivers.



## **Worker Classification from a Compliance Perspective**

Payday Resources (PDR) can help employers take proactive and appropriate actions to accurately classify their workforce -- be they employees or independent contractors, or some combination thereof. As hopefully has been made clear, it is important to do so; companies increasingly are coming under regulatory scrutiny at all levels. If employers continue to misclassify their workers, innocently or intentionally, they risk major consequences if caught; these consequences can be truly ruinous, severe enough to even put many companies out of business.

### **Employers Risk Liability After Liability After Liability for Misclassified Workers**



- Liability for unpaid federal, state and local income tax withholdings
- Liability for Social Security and Medicare contributions
- Liability for unpaid unemployment insurance premiums
- Liability for unpaid Workers' Compensation premiums
- Liability for unpaid overtime compensation and work-related expenses
- Liability for claims of entitlement to pension & profit-sharing benefits, medical benefits
- Liability for incentive compensation, such as bonuses and stock options

### **A Must-Do: Performing a Thorough Employer / Worker Means Test**

*What Makes an Employee an Employee? A Contractor a Contractor?*



PDR can help companies perform a thorough workforce audit (a Means-based Test) using the complex set of criteria the IRS uses to determine control (described in greater detail on the following page) -- whether a worker should be classified as an employee or as an independent contractor. We can also help companies resolve misclassification investigations initiated by the IRS or other state agencies. Our experience shows that it is much better to be upfront about any oversights or mistakes and remain cooperative. The IRS, if it wants, can stick a company with stiff penalties, up to 50 percent beyond what actually might be owed -- and it is more likely to do so when faced with a resistant or antagonistic employer under investigation.

## *What the IRS and the Utah Dept of Workforce Services Look For*

### **Understanding Definitions of Worker Control**

How much *control* an employer has over its workforce matters most to the IRS and other state authorities when determining worker status (again, whether someone should be treated as an employee or as an independent contractor). This can be characterized as who controls the “means and methods” for completing a work-related task or job. In legal terms, control has been defined by the courts as encompassing three elements: behavioral control, financial control and the nature of the work relationship. Any and / or all aspects of these three elements may be relevant when defining worker status. The state of Utah also sends out a detailed questionnaire to employers (pgs 5-6) when a worker’s status is questioned in regards to unemployment benefits eligibility.



#### **Level of Control Means Everything**

##### Behavioral Control

- *Level of Training:* If a business provides workers with training about required procedures and methods, these workers could be viewed as employees.
- *Level of Instruction:* If an employer directs how or when or where its workers must perform work, then these workers are likely employees. If an employer provides less extensive instructions about what should be done, the workers may be considered independent contractors.

##### Financial Control

- *Significant Investment:* While there is no precise dollar test, if a worker has made a substantial investment in his or her own work (in equipment, in materials, or other resources), s / he may be considered an independent contractor.
- *Expenses:* If a worker is not reimbursed for some or all business expenses, then this person could be deemed an independent contractor.
- *Opportunity for Profit or Loss:* If a person incurs a profit or a loss, this suggests that person is in business for himself / herself, and as such, could be considered an independent contractor.

##### Nature of Work Relationship

- *Benefits:* If a worker receives such things as insurance, pension or paid leave, this is an indication of formal employment; that said, if a worker does not receive such benefits, s / he still could be considered an employee or an independent contractor.
- *Written Contracts:* A contract between an employer and worker can often be significant as it may clearly indicate intentions of both parties, especially if other facts are lacking.

Utah Department of Workforce Services Worker Status Questionnaire (pg 1)

DWS-UI  
Form 1E  
REV 08/04

State of Utah  
DEPARTMENT OF WORKFORCE SERVICES  
UNEMPLOYMENT INSURANCE



DATE MAILED: 9/28/07

334225-0

SSN:

%PAYDAY RESOURCES  
376 E 60 S  
AMERICAN FORK UT 84003-3835

STATUS QUESTIONNAIRE FOR EMPLOYERS

A question has been raised regarding services performed by \_\_\_\_\_ during  
**2006,2007**. We must determine whether this individual is an employee covered by  
unemployment insurance. Please answer the following questions and return this form within 5  
days.

*PART I: Information regarding your firm*

- Describe in detail your firm's business activity. \_\_\_\_\_
- Describe in detail the type(s) of work performed by this individual for your firm. \_\_\_\_\_  
Where was this work performed? \_\_\_\_\_  
When was this work performed? Beginning Date: \_\_\_\_\_, Ending Date: \_\_\_\_\_

*PART II: Information regarding self-employment. Write "NA" if not applicable.*

- Do you consider this individual to be self-employed in a trade, occupation, or business? Yes \_\_\_ No \_\_\_  
If "Yes," why? \_\_\_\_\_
- What is the name of his business? \_\_\_\_\_
- Does this individual have a current business or contractor's license? Yes \_\_\_ No \_\_\_  
If "Yes," what type of license? \_\_\_\_\_
- How did you locate this individual (i.e. telephone book, classified ads, etc.)? \_\_\_\_\_
- Where did this individual perform this service? \_\_\_\_\_
- What kind(s) of facilities, equipment, tools, materials, and supplies were provided by your firm?  
By the individual? \_\_\_\_\_

DO NOT WRITE BELOW THIS LINE



\*334225\*

Utah Department of Workforce Services Worker Status Questionnaire (pg 2)

STATUS QUESTIONNAIRE FOR EMPLOYERS

*PART III: Information concerning the working relationship between this individual and the firm.*

- 9. Was the individual supervised or instructed in the way the work was to be done? Yes \_\_\_ No \_\_\_  
 If "Yes," by whom? \_\_\_\_\_  
 Give examples of how he was instructed or supervised. \_\_\_\_\_
- 10. Was this individual required to comply with written instructions or procedures? Yes \_\_\_ No \_\_\_  
 If Yes, please attach a copy if available.
- 11. Was the individual given training by your firm? Yes \_\_\_ No \_\_\_  
 If "Yes," what kind? \_\_\_\_\_
- 12. Did your firm require this individual to personally do the work? Yes \_\_\_ No \_\_\_
- 13. Did others help this individual do the work? Yes \_\_\_ No \_\_\_  
 If "Yes," who hired the helpers? \_\_\_\_\_  
 If hired by this individual, was your firm's approval necessary?  
 Who paid the helpers? \_\_\_\_\_
- 14. Did your firm require this individual to work scheduled hours? Yes \_\_\_ No \_\_\_  
 If "Yes," please specify. \_\_\_\_\_  
 How many hours per week did this individual work? \_\_\_\_\_
- 15. Was this individual required to submit oral or written reports? Yes \_\_\_ No \_\_\_  
 If "Yes," how often? \_\_\_\_\_  
 For what purpose? \_\_\_\_\_
- 16. How was this individual paid for his work? \_\_\_ Hourly \_\_\_ Salary \_\_\_ Commission \_\_\_ Bid \_\_\_ Piece work  
 \_\_\_ Job Other (specify) \_\_\_\_\_  
 Who determined the amount paid to this individual? \_\_\_\_\_  
 Were state or federal taxes withheld from his pay? Yes \_\_\_ No \_\_\_  
 Did your firm provide health or life insurance? Yes \_\_\_ No \_\_\_  
 Did your firm provide worker's compensation insurance? Yes \_\_\_ No \_\_\_
- 17. Did your firm pay or reimburse this individual for expenses? Yes \_\_\_ No \_\_\_  
 If "Yes," what type(s) of expenses? \_\_\_\_\_
- 18. Did other non-employees perform similar services for your firm? Yes \_\_\_ No \_\_\_  
 If "Yes," how many? \_\_\_\_\_
- 19. Is there a written agreement or contract between this individual and your firm? Yes \_\_\_ No \_\_\_  
 If "Yes," please attach a copy if available.
- 20. Additional comments. \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Signed: _____	Title: _____
Date Signed: _____	Telephone #: _____



The 2007 Introduction of Form 8919

Misclassified Workers Can Now Report Employers to the IRS

Form <b>8919</b> Department of the Treasury Internal Revenue Service	<b>Uncollected Social Security and Medicare Tax on Wages</b> ▶ See instructions on back. ▶ Attach to Form 1040, Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.	OMB No. 1545-0074 <b>2007</b> Attachment Sequence No. 72
Name of person who must file this form. If married, complete a separate Form 8919 for each spouse who must file this form.		Social security number

- Who must file.** You must file Form 8919 if all of the following apply.
- You performed services for a firm.
  - The firm did not withhold your share of social security and Medicare taxes from your pay.
  - Your pay from the firm was not for services as an independent contractor.
  - One or more of the reasons listed below under *Reason codes* apply to you.

**Reason codes:** For each firm listed below, enter the applicable reason code(s) for filing this form in column (c). If none of the reason codes apply to you, but you believe you should have been treated as an employee, enter reason code G, and file Form SS-8 on or before the date you file your tax return.

- A** I filed Form SS-8 and received a determination letter stating that I am an employee of this firm.
- B** I was designated as a "section 530 employee" by my employer or by the IRS prior to January 1, 1997.
- C** I received other correspondence from the IRS that states I am an employee.
- D** I was previously treated as an employee by this firm and am performing services in a substantially similar capacity and under substantially similar direction and control. (You must also enter reason code G.)
- E** My co-workers, performing substantially similar services under substantially similar direction and control, are treated as employees. (You must also enter reason code G.)
- F** My co-workers, performing substantially similar services under substantially similar direction and control, filed Form SS-8 for this firm and received a determination that they were employees. (You must also enter reason code G.)
- G** I filed Form SS-8 with the IRS and have not received a reply.

(a) Name of firm	(b) Firm's federal identification number <small>(see instructions)</small>	(c) Enter reason code(s) from above	(d) Date IRS determination or correspondence was received <small>(MM/DD/YYYY) (see instructions)</small>	(e) Check if Form 1099-MISC was received	(f) Total wages received with no social security or Medicare tax withholding and not reported on Form W-2
1				<input type="checkbox"/>	
2				<input type="checkbox"/>	
3				<input type="checkbox"/>	
4				<input type="checkbox"/>	
5				<input type="checkbox"/>	
<b>6 Total wages.</b> Combine lines 1 through 5 in column (f). Enter here and include on Form 1040, line 7, Form 1040NR, line 8, or Form 1040NR-EZ, line 3 . . . . .					<b>6</b>
7	Maximum amount of wages subject to social security tax . . . . .		<b>7</b>	97,500 00	
8	Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) or railroad retirement (tier 1) compensation, and unreported tips subject to social security tax from Form 4137, line 10 . . . . .		<b>8</b>		
9	Subtract line 8 from line 7. If line 8 is more than line 7, enter -0- here and on line 10 . . . . .				<b>9</b>
10	Wages subject to social security tax. Enter the smaller of line 6 or line 9 . . . . .				<b>10</b>
11	Multiply line 10 by .062 (social security tax rate) . . . . .				<b>11</b>
12	Multiply line 6 by .0145 (Medicare tax rate) . . . . .				<b>12</b>
13	Add lines 11 and 12. Enter here and on Form 1040, line 59, Form 1040NR, line 54, or Form 1040NR-EZ, line 16 . . . . . ▶				<b>13</b>

For Paperwork Reduction Act Notice, see instructions. Cat. No. 37730B Form **8919** (2007)

## What to Expect in Coming Months, Years: More Scrutiny

Closer to home, in Utah, members of the state legislature, the Department of Workforce Services and the Office of the Attorney General have discussed ways to put a stop to the misclassification of workers. Senator Ed Mayne (D-West Valley City) is spearheading the charge: "If we continue to do nothing, what we are saying is that we condone the 10, 15 or 20 percent of the industry that sets out to deliberately violate the law." Following other states, it's likely that Utah soon will increase its efforts to identify, investigate and, if need be, prosecute negligent employers.

### The Salt Lake Tribune

<http://www.sltrib.com>

#### Off-the-books crackdown

State to target employers who deliberately misclassify workers

By Steven Oberbeck  
The Salt Lake Tribune  
Salt Lake Tribune

Article Last Updated: 09/19/2007 11:57:50 PM MDT

Companies that deliberately misclassify their workers as independent contractors so they can avoid paying taxes and other benefits may soon find that Utah is no longer such a great place to do business.

The Utah Legislature's Business and Labor Interim Committee on Wednesday began delving into ways to handle what many believe is a growing problem - unethical contractors who pay their workers under the table or misclassify them as freelancers so they don't have to pay expenses such as workers compensation insurance and payroll and unemployment taxes.

"This has been going on for a long time," said state Sen. Ed Mayne, D-West Valley City. "If we keep doing nothing, what we are saying is that we condone the 10, 15 or 20 percent of the industry that sets out to deliberately violate the law."

There are laws already in place to address the problem, Mayne said, estimating that the companies violating such regulations are costing the state millions of dollars every year. The issue is those regulations aren't being enforced because of a lack of resources available to the Utah Attorney General's Office and other state agencies that would be in a position to investigate and catch the offenders.

Brandt Goble, field representative for Local 77 of the International Union of Painters and Allied Trades in West Valley City, told committee members that dealing with the problem probably will come down to enforcement.

"Right now those companies violating the law are operating with impunity. They know those regulating them don't have the resources to go after them," said Goble, who was instrumental in bringing the issue before the committee.

When workers get classified as independent contractors, the companies that hire them aren't responsible for withholding state or federal taxes. Rather, the workers become obligated to see that their taxes are paid. Often, they leave their taxes unpaid, which can give them access to additional cash but leave them without protections such as unemployment benefits for the insurance that covers them for on-the-job injuries.

Also, some companies pay under the table as a way of saving money on the jobs they bid, while at the same time exploiting undocumented immigrants, who often have no choice but to work off the books.

Although the committee focused on problems centered in the construction trades, misclassified workers can be found throughout the economy, in industries ranging from movie production to residential mortgage lending, said Bill Starks, director of unemployment insurance at the Utah Department of Workforce Services.

Starks said that last year 500,000 Utahns received 1099s - the tax form that is given to freelancers and independent contractors by the businesses that hire them. Of that number, 200,000 received 1099s from a single employer, rather than multiple businesses.

"You have to wonder when you hear a number like that whether those [200,000] who work for just one company are really independent contractors or whether they actually fit the legal definition of an employee," said William Hayden, business manager for Painters Local 77.

Mayne said he would like to see greater cooperation and information sharing among state agencies such as the Tax Commission, the Utah Labor Commission and the Division of Occupational and Professional Licensing. They have the capability of investigating companies that violate the law.

Mayne indicated he would support increasing state appropriations to help fund new investigators in the Utah Attorney General's Office. He would want them to make going after the offending companies a priority. "We've heard from the attorney general that it would pay for itself."

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What's next

\* The committee asked Brad Stevens, chairman of the state's Construction Services Commission, to meet with contractors and return with feedback at the panel's November meeting regarding steps to address the problem.

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