

# *Legal Update*

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## **EMPLOYEE MISCLASSIFICATIONS: DON'T CUT COSTS BY CUTTING CORNERS**

By Orley Moskovits Desser

Classifying employees as independent contractors may seem like a good way to save money. In general, if an employer classifies an individual as an independent contractor rather than as an employee, the employer does not have to pay that individual overtime compensation, make social security payments for the benefit of the individual, provide other benefits (such as vacations, holidays, health insurance, and retirement), or make payments for government-provided benefits such as worker's compensation or federal and state unemployment benefits. Employee misclassifications, however, can end up costing employers a great deal more in back taxes and penalties than they save by misclassifying employees.

Recent federal initiatives provide the government additional resources to combat employee misclassification. In 2010, the IRS began to conduct employment tax audits of thousands of employers as a means to discover employee misclassification. An allocation of \$46 million is proposed for the 2012 budget to fund another push to weed out employer misclassification of employees. These initiatives not only protect employees from abuse, but also protect a major source of government revenue. Indeed, according to the Government Accountability Office, hundreds of thousands of employees are misclassified each year, resulting in billions of dollars of lost tax revenue.

In the past, most Wage and Hour Division investigations of employee misclassifications were initiated not by the government, but by employees who lodged complaints about misclassifications. The new federal initiatives mean that the possibility that an employer may be subject to an investigation no longer depends on a disgruntled employee.

Many states have followed suit and have either already passed laws or are in the process of passing laws and/or creating taskforces aimed at protecting employees from misclassification. In 2008, for example, Illinois enacted the Employee Classification Act. This Act, aimed at protecting individuals in the construction industry from misclassification, imposes penalties of up to \$1,500 per day, plus liquidated damages, on employers who misclassify employees. [Click here for our prior newsletter addressing this law.](#)

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The writing is on the wall now more than ever – federal and state agencies will continue to increase the number and nature of investigations to combat employee misclassifications. FVLD published a previous Legal Update entitled *Employee or Independent Contractor? The Consequences of Misclassification*, which discusses some of the factors the IRS and other agencies look to when determining whether an individual is properly categorized as an independent contractor. [Click here for the Legal Update](#). Employers should carefully review their employee classification policies and scrutinize each individual classified as an independent contractor to ensure proper classification.

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