

Federal Auditors Targeting Contractor Use

By Holly Culhane, Contributing Columnist



Talk of double-dip recession, persistently high unemployment rates and anemic consumer confidence are just a few of the economic indicators that are making business owners cautious.

And while many owners are seeing their companies' bottom lines improve, they are cautiously controlling their spending, particularly when it comes to hiring employees.

Many complain that the nation's struggling economic recovery is basically a jobless recovery. There is reason for that.

Companies pay benefits and payroll taxes for their employees. As a result, a company that expands its production by using temporary workers, particularly independent contractors, has less payroll expenses and more flexibility when it comes to reducing its workforce if product demand declines.

But using independent contractors can be tricky business. A company's false step can be costly, with regulatory penalties overshadowing any hoped-for cost savings.

Recently I was contacted by two individuals: one, a media representative who had been laid off from his decades-long job; and the other being the mother of a recent college graduate who is struggling to establish her career as a graphic designer.

The media representative had been "hired" by a non-profit organization as an "independent contractor." He was responsible for editing and designing the organization's newsletter and writing news releases.

Although he expressed his desire to work on his own equipment at his home, his "supervisor" insisted he work in the organization's office and use the organization's computers. He also was expected to maintain an established hourly work schedule.

The mother who contacted me was concerned because her daughter had been assigned to a work station at a Los Angeles design company, where she is required to report for work five days a week, from 8 a.m. to 5 p.m., with an hour for lunch. When production deadlines loom, she often is required to work longer hours.

Both the media representative and graphic designer were designated "independent contractors." They provided their "employers" with weekly "invoices" to indicate the hours they worked and the amount they should be paid. At the end of the year, the companies will be documenting for tax purposes the total compensation earned by these "independent contractors" using IRS 1099 forms. Neither receives the benefits the companies now pay to regular employees, nor will these companies be paying taxes for these independent contractors they are required to be paying for employees.

Neither the media representative, nor the graphic designer intends to complain about their arrangements. They are grateful to have jobs, under any circumstance.

But it appears their “employers” are violating, or at least stretching, regulations that define “independent contractor.” If that’s the case, the companies may soon learn a costly lesson.

The federal Department of Labor and the Internal Revenue Service have teamed up to target businesses suspected of violating independent contractor rules. The two departments contend that misclassifying workers as independent contractors deprives employees of wage and hour protections, and deprives government agencies of owed taxes.

How will they accomplish this?? The IRS has added 200 employees to help step up the auditing of companies for independent contractor compliance, and the Department of Labor has received increased funding to help with the oversight. Upgraded computer systems that now link many federal, state and local government agencies also increase scrutiny.

It doesn’t help that the definition of independent contractor isn’t black and white. Much depends on circumstances and a company’s relationship with the independent contractor.

Generally, an independent contractor:

- Is hired to perform a specific task.
- Uses his or her own equipment, such as a computer, camera, etc.
- Can establish the method that the assigned task can be completed.
- Has a beginning and ending to the contract arrangement.
- Sets his or her own work schedule.
- Is not required to work solely in a company’s office complex or job site.
- Has other clients and is not wholly dependent upon the contracting company for income.
- Is not filling a “job” that is identical, or nearly identical to those held by current regular employees or former employees.

Companies found to be improperly utilizing independent contractors face financial penalties. They also may be required to pay back taxes and employee benefits.

Non-compliance with independent contractor rules more likely will be discovered by government auditors than by complaints from independent contractors.

Before increasing reliance on independent contractors, companies should seek the advice of a human resources consultant or an attorney who is well-versed in complying with the rules. A misstep taken to reduce a company’s payroll can most certainly be costly.

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