



# Worker Classification 101:

Everything You Need To Know About Properly  
Classifying Your 1099 Contractors

With the boom of the on-demand economy and the rise of the contingent workforce, worker misclassification has emerged as one of the most prominent storylines over the last year.



During the last 12 months, Fortune 500 titans including

**Deloitte.**

**FedEx**®


**Google**



U B E R

...were all hit with high-profile lawsuits for misclassifying their workers as independent contractors.

From small companies to powerful mega-corps, every business engaging an independent workforce is vulnerable to labor violations.



Since 2013, **more than one-third** of mid-size U.S. businesses have been fined or penalized for non-compliance.

The classification debate has even become a topic of interest in the U.S. presidential race. In a speech this past summer, Democratic candidate Hillary Clinton acknowledged that the “so-called gig economy is creating exciting opportunities and unleashing innovation,” but vowed to “crack down on employers who misclassify employees as independent contractors,” calling it “wage theft.”

For companies using independent contractors, it's become more crucial than ever to be proactive about compliance and mitigating risk. While labor laws about misclassifying independent contractors haven't changed in decades, enforcement has become increasingly aggressive over the last few years. The Department of Labor (DOL) recently issued new guidelines for classifying contractors. They have also spent \$4 million in new auditors dedicated just to cracking down on worker misclassification. Companies that use an on-demand labor model are under the most scrutiny.

With the start of the new year, now is the perfect time to review your worker classification practices to ensure that your business is compliant.



## What is worker misclassification and why is it so important?

Worker misclassification involves classifying workers as 1099 independent contractors when they should be classified as W-2 employees.

Classifying workers as independent contractors offers business owners the significant advantage of not having to withhold or pay taxes on worker payments.

But when workers are improperly classified, they are deprived of various rights and protections

including the minimum wage, overtime compensation, unemployment insurance, healthcare, pension, and workers' compensation insurance. Misclassification also undermines federal and state revenue collections and creates an unfair playing field for employers who properly classify their workers.

## The Cost of Non-Compliance

Whether your organization employs contractors, freelancers, temps, per diems, project workers,, consultants, or specialists, you need to classify workers properly to avoid costly consequences. The cost of **non-compliance** can be staggering and include fines, penalties, back taxes, and lawsuits. Current and former employees alike can sue employers for owed income and benefits.

Depending on the severity of infractions, fines for worker misclassification levied by the IRS, DOL and state agencies can total millions. IRS penalties for misclassifying workers as 1099 contractors can range from 22%-43% of all contractors' earnings retroactive to the initial engagement.

Class action lawsuits also pose a serious threat to companies straddling the boundaries of improper classification. Last year, the cost of Lowe's class action legal dispute over the misclassification of its home contractors exceeded \$10 million (not to mention that Lowe's is reportedly involved in other misclassification lawsuits).

Moreover, an employer's brand can suffer unwieldy damage with lawsuits that become front page news in a highly magnified and never-ending news cycle.

**COST OF LOWE'S  
CLASS ACTION  
DISPUTE**

**\$10  
MILLION**



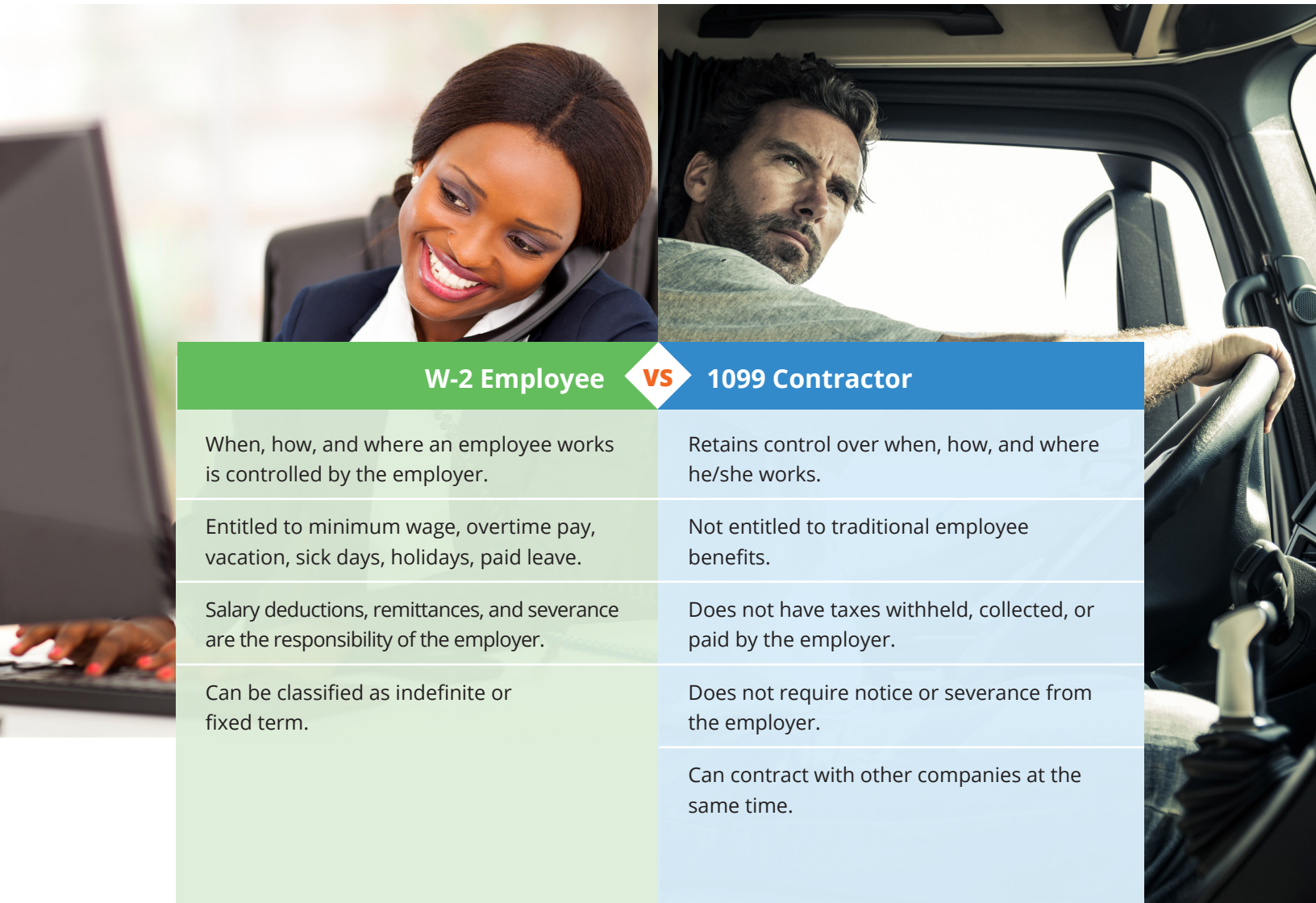
# What differentiates an employee from an independent contractor?

Distinguishing between W-2 employees and 1099 independent contractors is more complex than meets the eye. Government guidelines are fuzzy and no single factor determines misclassification. The enactment of the Affordable Care Act further complicate things.

Contrary to popular belief, retaining contractors in the form of a business entity does not necessarily eliminate your misclassification exposure. In the cases of both Lowe’s and FedEx, the courts found that they had misclassified employees as independent contractors who were operating as a business entity.

When determining how to classify a worker, businesses are supposed to consider several so-called “economic realities.” This includes the

company’s degree of control over the person, whether the work is an integral part of the employer’s business, and whether the relationship between the worker and the employer is permanent or indefinite. These factors should be considered collectively to determine the employer’s control over the worker and whether the worker is economically dependent on the employer (and therefore an employee), or truly in business for him- or herself as an independent contractor.






| W-2 Employee  | VS | 1099 Contractor   |
|---|----|---|
| When, how, and where an employee works is controlled by the employer.                 |    | Retains control over when, how, and where he/she works.           |
| Entitled to minimum wage, overtime pay, vacation, sick days, holidays, paid leave.    |    | Not entitled to traditional employee benefits.                    |
| Salary deductions, remittances, and severance are the responsibility of the employer. |    | Does not have taxes withheld, collected, or paid by the employer. |
| Can be classified as indefinite or fixed term.  |    | Does not require notice or severance from the employer.           |
|   |    | Can contract with other companies at the same time.               |



## Attributes of a 1099 Contractor

This following highlights typical attributes of an independent contractor in a 1099 work relationship. Take note that these attributes should be examined collectively and there's no silver bullet for distinguishing independent contractors from employees.

**Three “control” factors** should be considered when determining whether a worker is an independent contractor. Some factors may outweigh others and every situation is different:

|  Behavioral |  Financial |  Operational |
|--|---|---|
| Works from an SOW with defined deliverables  | Receives milestone or deliverable   | Markets services to the public  |
| Does not have training provided by the employer  | Carries business liability and other insurances   | Has multiple clients  |
| Possesses unique skills, not core to company   | Covers own expenses   | Has an established place of business  |
| Uses own equipment to perform the work   | Is responsible for profit and loss from a business risk standpoint                            | Has a history of similar services for one year or more  |
| May use subcontractors   | Has made significant business investment  | Does not have a W-2 and 1099 in same year   |
| Is not required to be on-site  |   | Uses TIN rather than SSN<br>Incorporated Contract states contractor relationship                  |
| Sets own working hours/ has no scheduling requirements   |   | Is incorporated   |
|  |   | Has a contract that states a contractor relationship  |

# New Guidelines from the DOL

Last July, the Department of Labor issued **new guidelines** to help classify workers as employees versus independent contractors. While the rules aren't new, the guidance is supposed to clarify the **six factors** that the Supreme Court deemed important in the Fair Labor Standards Act (FLSA). Under the six-factor test, the ultimate question is whether a worker is economically dependent on the employer or in business for him- or herself:

1

**Is the work an integral part of the employer's business?** For example, in a construction company, carpenters are integral to the business, but a software developer hired to create scheduling software for projects is not integral.

2

**What are the worker's opportunities for profit and loss?** Like in any business, a worker providing cleaning services for corporate clients can experience a profit or a loss, like any business, if he/she is in charge of negotiating contracts, recruiting new clients, and advertising. However, the same cleaner could be considered an employee if he/she does not independently

schedule assignments or solicit additional work. The guidelines states: "His earnings may fluctuate based on the work available and his willingness to work more."


3

**How much has a worker invested compared to a company?** The amount of money a company has invested, compared to the relative investment of the worker, can sway the scales in favor of an employer-employee relationship. This is tricky for the "gig economy" since many workers supply their own equipment. The question for companies like Uber and Lyft is if they've invested significantly more.

A worker may be considered a typical "at-will" employee if the relationship is considered indefinite.







The DOL's new guidelines don't actually mean any policy change, but it's fair warning to businesses capitalizing on a new class of independent workers that the government is paying close attention.

4

**Does the work performed require special skills?**

The special skills considered here are business skills, not technical skills. Highly skilled carpenters, for example, could be employees if they're not making "independent judgments" at the job, but are told what work to perform. On-demand companies risk falling into this trap if they're telling employees what work to perform and workers can't turn down jobs because they're afraid of the impact on their ratings.

5

**Is the relationship between the worker and employer permanent or indefinite?**

A worker may be considered a typical "at-will" employee if the relationship is considered indefinite.

6

**What is the degree of the employer's control?**

One of the most debated areas in the 1099 issue is whether companies like Uber have any control over their workers. The Department of Labor is clear that giving your workers control over their own schedules does not mean that you're not in control. "Moreover, workers' control over the hours when they work is not indicative of independent contractor status." Companies that "maintain stringent control," ranging from how employees dress to the tasks that they do and how they interact with customers, could indeed be entering into an employment contract.



# Manage Your On-demand Workforce Compliantly

With the recent onslaught of misclassification lawsuits, it's clear that the cost of addressing compliance is substantially less than the repercussions of non-compliance.

WorkMarket enables you to effectively track, manage, pay, and document all of your 1099 work engagements. Our platform offers invaluable access to a wide and diverse marketplace of talent. Professionals in our open marketplace are self-

identified as independent contractors, by posting service profiles and engaging with multiple clients. We provide businesses with the tools and audit trails they need to mitigate risk.



Advanced reporting capabilities allow you to instantly track and report your worker engagements. Perform internal audits of diverse labor practices and export up-to-date audit trails anytime, anywhere.



Effectively communicate with workers before, during and after projects. You can also use the WorkMarket mobile app to communicate with workers on-site to address specific assignment issues.



Automatically verify SSN and EINs with the IRS so you don't have to issue, retrieve or file W9 paperwork, or worry about the accuracy of your IRS Form 1096. WorkMarket also submits IRS Form 1099-MISC to workers on your behalf with Tax Services.



Define your requirements around certification, insurance and screening across groups, projects and individual assignments.



Use settings to ensure your team does not engage workers the wrong way

*"Not only does WorkMarket mitigate my compliance risk, but it helps eliminate some of the guesswork when dealing with the IRS and various state labor regulations ."*

Johanna Lopez Miyaki CEO and Founder, Tastemakers

Learn how WorkMarket can help you mitigate compliance risk and compliantly scale your workforce:

Visit [sales@workmarket.com](mailto:sales@workmarket.com) or call 877 654 WORK to learn more.