Congress Reintroduces the Employee Misclassification Prevention Act that Would Make Misclassification of Employees as Independent Contractors a Federal Offense

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Following on the heels of aggressive new measures announced by the U.S. Department of Labor and IRS in the past month and the recent enactment of a new California law to crack down on willful misclassification of employees as independent contractors, Rep. Lynn Woolsey (D-Calif.) reintroduced as H.R. 3178 the Employee Misclassification Prevention Act (EMPA) on October 13, 2011.

Woolsey was a co-sponsor of the Employee Misclassification Prevention Act of 2010 (H.R. 5107), which was also introduced in the Senate in identical form (S. 3254). Hearings were held on EMPA 2010 by the Senate on June 17, 2010. The bill, however, languished in Congress in the face of more urgent legislative measures. EMPA 2011 is the second independent contractor misclassification measure introduced in Congress this year. In April 2011, Sens. Sherrod Brown (D-Ohio), Tom Harkin (D-Iowa), and Richard Blumenthal (D-Conn.) introduced the Payroll Fraud Prevention Act (S. 770), a trimmed-down version of EMPA 2010. In contrast to this Senate initiative earlier this year, Woolsey’s EMPA 2011 bill includes all of the original provisions of EMPA 2010.

Summary of EMPA 2011

EMPA 2011 would amend the federal Fair Labor Standards Act to impose strict recordkeeping and notice requirements on businesses with respect to workers treated as independent contractors, and expose such businesses to fines from $1,100 up to $5,000 per employee for each violation of the law.

Importantly, EMPA does not prohibit businesses from continuing to use properly classified independent contractors; it only prohibits companies from misclassifying workers as independent contractors when such workers are really employees.

Nonetheless, all businesses would be affected by EMPA because it would impose upon every company that uses either employees or independent contractors a recordkeeping and a notice requirement. Any business that fails to provide the required notice would be subject to fines, even if its independent contractors are properly classified.

Briefly, if enacted into law as drafted, EMPA would:

- require every company covered by the law to provide a written notice to all workers who perform labor or services informing them that they have been classified as either an employee or “non-employee,” directing them to a Department of Labor Web site for further information about the rights of employees under the law, and informing them to contact the Department of Labor if they have any questions about whether they have been misclassified
- require companies that are now required to keep records of the hours of work and wages of employees to keep comparable records for “non-employees” providing labor or services to the business
- add a new provision making it a “prohibited act” under federal law to fail to accurately classify a worker as an employee (i.e., to misclassify a worker as a non-employee)
- impose upon businesses a penalty from $1,100 to $5,000 per worker for a violation of the notice or recordkeeping requirements or for misclassifying an employee as a non-employee, and
impose triple damages for willful violations of the minimum wage or overtime laws in cases in which the employer has misclassified the affected employee.

In addition, EMPA would direct the Secretary of Labor to:

• establish a misclassification Web site that would enable workers to file complaints online and notify them that employees may have greater rights under state or local laws than under federal law
• amend the Social Security Act to establish penalties for misclassifying employees or for paying unreported wages to employees for unemployment compensation purposes
• authorize the Department of Labor to report misclassification information to the IRS, and
• direct the Department of Labor to conduct “targeted audits” of certain industries “with frequent incidence of misclassifying employees as non-employees.”

The proposed legislation also seeks to pierce the corporate veil of corporations, partnerships, and LLCs owned in whole or part by the worker and used to avoid the issuance of Form 1099s.

ANALYSIS OF EMPA 2011

1. Unlike the recently enacted California Independent Contractor Law7, which prohibited “willful misclassification,” this proposed federal legislation would prohibit both willful and unintentional misclassification. Even if a business had a reasonable belief that it was properly paying certain workers on a 1099 basis as independent contractors, EMPA 2011 would make any misclassification a federal offense— even if the misclassification was genuinely caused by the confusing nature of the varying tests under federal and state laws for determining a worker’s status.

2. Some companies, however, may find relief from potential liability under the federal employment tax laws for misclassification by virtue of the safe haven available under Section 530 of the Revenue Act of 1978. To be eligible for Section 530 relief, a business (other than one using certain technical service workers) must have had a reasonable basis for treating workers as independent contractors, must have consistently treated the workers as independent contractors, and must not have treated any substantially similar workers as employees.

A bill introduced in Congress last year, the Fair Playing Field Act of 20108, would have eliminated Section 530 relief would not, however, protect a company from liability for independent contractor misclassification under the federal Fair Labor Standards Act or other federal or state laws providing workplace protections for employees.

At a conference of employee benefits lawyers sponsored by the American Law Institute – American Bar Association in Washington, D.C. on October 13, 2011, George Bostick, Benefits Tax Counsel at the U.S. Treasury Department, stated that he expects a version of the Fair Playing Field Act to be reintroduced in 2011 as part of the President’s proposed jobs legislation.

3. Employers that may wish to participate in the recently announced IRS Voluntary Classification Settlement Program (VCSP)9 may reduce their potential exposure under the federal tax laws but would be not be exempt from exposure to misclassification liability under EMPA 2011 (or from any existing federal or state law providing for employee rights). The pros and cons of this new IRS program were discussed in a prior Client Alert.10 In connection with the VCSP, Bostick commented at the October 13 conference that the IRS will not share individualized employer information gathered under the VCSP with other federal, state, or local government agencies.

4. As briefly noted above, the Labor Department and IRS recently announced a joint law enforcement program11 aimed at businesses that misclassify employees as independent contractors. The Memorandum of Understanding signed by both agencies will enable the Labor Department and IRS (outside of the VCSP) to share information with each other and coordinate law enforcement efforts. The Secretary of Labor also announced that seven states have signed memoranda of understanding with the Wage and Hour Division of the U.S. Department of Labor to address and combat employee misclassification: Connecticut, Maryland, Massachusetts, Minnesota, Missouri, Utah, and Washington. Four other states have agreed to enter into similar memoranda of understanding with the Wage and Hour Division: Hawaii, Illinois, Montana, and New York.

TAKEAWAYS

1. Use of independent contractors remains a legitimate business model. Nothing in EMPA 2011 (or for that matter any of the other recent state or federal laws, whether proposed or enacted) prohibits or limits most businesses from lawfully paying workers who are properly classified as independent contractors on a 1099 basis. Businesses should not hesitate to continue with such business
models – except in those few states where the test for independent contractor status under an applicable state wage, unemployment, or workers compensation statute is overly restrictive.

Presently, about half of the states have narrower tests for independent contractor status than the tests under federal law. Nonetheless, companies can often take bona fide actions to enhance their independent contractor compliance in almost all of those states.

2. It is not too late to enhance independent contractor compliance. The introduction of EMPA 2011, along with other recent legislative and law enforcement measures at the state and federal levels, makes it abundantly clear that businesses are facing a more aggressive effort to combat independent contractor misclassification. This changing landscape makes it even more imperative for companies that use a number of independent contractors to evaluate and enhance their independent contractor compliance.

Challenges to an individual’s classification can arise in an array of contexts. Although government law-enforcement efforts including IRS and federal and state Labor Department audits are increasing, most independent contractor disputes still derive from challenges by the workers themselves. While class action lawsuits usually receive the most headlines, a more common type of legal challenge to an employee’s classification status involves unemployment benefits. More and more workers being paid on a 1099 basis are applying for unemployment benefits. In the course of determining whether the worker is entitled to unemployment benefits, state Labor Departments typically make an inquiry of the company about the worker’s status as an employee or independent contractor. If the state Labor Department concludes the worker has been misclassified, it usually issues a determination that the company should have been paying unemployment taxes not only for the claimant but for all other similarly situated workers as well. An assessment of unpaid unemployment taxes, plus interest and penalties, typically follows.

Pepper Hamilton’s Independent Contractor Compliance Practice Group uses its proprietary IC Diagnostics™ 12 tools including its 48 Factors-Plus Analytics™ and IC Compliance Scale™ to advise companies how they can enhance their independent contractor compliance using a number of alternative compliance methods: bona fide restructuring, use of a knowledgeable and experienced staffing company to manage the workers, or reclassification. In a legal environment that is increasingly skeptical of businesses that issue 1099s, companies that properly re-structure, re-document, and follow updated practices can put into place an enhanced independent contractor model that will minimize or eliminate exposure to misclassification liability under federal and most state laws.

ENDNOTES


6 http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=112_cong_bills&docid=f:s770is.txt.pdf.


