The Stakes for Misclassifiying an “Employee” as an “Independent Contractor” Have Increased: A Reminder of the How and Why to Properly Classify all Workers.

Certainly, as an employer, you know it is important to properly classify those working for you as either independent contractors or employees. But did you know that more is riding on that classification than just abiding by federal and state tax laws?

If a worker is your employee, you are responsible for paying Social Security, unemployment insurance, Medicare, and possibly other costs like workers’ compensation insurance for the employee. At the end of the tax year, you are responsible for compiling all necessary payroll reports, including W-2 forms.

If a worker is your independent contractor, you are not responsible for any of the above taxes or payments, and the only added paperwork is the issuing of a 1099 to the independent contractor at the end of the tax year, assuming they earned more than $600.

If you have claimed an employee as an independent contractor, there are penalties involved with such misclassification. The Internal Revenue Service may hold you responsible for employment taxes for that worker, and there are even steeper penalties for “willful neglect” under Internal Revenue Code Section 3509.

But in *The Reading and Language Learning Center v. Sturgill*, Case No. CL-2015-10699 (August 4, 2016) out of Fairfax County, Judge John M. Tran gave Virginia employers more to worry about than IRS penalties. He held that misclassifying employees as independent contractors violates Virginia public policy and is grounds for voiding any noncompete and nonsolicitation provisions contained in the employer’s agreements with its workers — even if the misclassification is unintentional.

This ruling raises the stakes of misclassifying workers because it essentially states that independent contractors will only be bound by noncompete agreements if they have been properly classified as independent contractors. The Fairfax Circuit Court had no problem finding that the consultant in *Sturgill* should have been classified as an employee and, ultimately, that the noncompete agreement the consultant had signed was unenforceable.

As an employer, the decision of whether to classify your worker as an employee or an independent contractor rests on a multi-factor test that revolves around the degree of independence and control asserted by the worker.

The IRS lists 20 factors to consider for federal tax purposes, which can be broken down into the following main categories:

- **Behavioral:** Does the company control or have the right to control what the worker does and how the worker does his or her job?
- **Financial:** Are the business aspects of the worker’s job controlled by the payer? (These aspects include things like how the worker is paid, whether expenses are reimbursed, and who provides tools or supplies.)
- **Type of Relationship:** Are there written contracts or employee-type benefits (e.g., a pension plan, insurance, or vacation pay)? Will the relationship continue? Is the work performed a key aspect of the business?

Businesses must weigh each of these factors when determining how to classify workers and there is no one-size-fits-all formula. Note also that the classification of workers for federal tax purposes may not be the same as the classification for state law purposes. We have routinely seen these issues arise not only at the front end of the relationship between an employer and its workers, but also when employers transition workers from full-time to part-time work in the hopes of cutting down on benefits.

If you are facing these issues, please know our Firm can assist in the analysis, as well as draft appropriate independent contractor and employment agreements that can survive a challenge to enforceability.