

Report: Companies Failing at Worker Classification

by Joseph M. Donegan on August 14, 2013

A large number of small, mid-market, and large companies nationwide are failing to comply with the Internal Revenue Service rules that govern worker classification status, a new report reveals.

The Treasury Inspector General for Tax Administration, looking to ensure tax compliance, released new findings that show many companies who continue to misclassify employees as independent contractors. This malpractice then leaves them open to audits, penalties, and fines. The agency came to this conclusion after investigating an SS-8 program, which allows workers and employers to request a determination letter from the IRS saying whether a worker should be classified as an employee or independent contractor.

After examining more than 5,300 cases in which the IRS deemed a worker to be an employee, the agency found that only 17 percent of employers "appeared to comply with the ruling and issued one or more W-2 forms to their workers during tax years 2008 through 2010."

In addition, 19 percent "appeared not to have complied with the determinations and issued a form 1099-MISC instead of a form W-2 to their workers for tax year 2008, 2009, and/or 2010." Meanwhile, 65 percent did not issue a form 1099-MISC or W-2 to their workers, meaning that these workers were either no longer employed by the company or may have been paid under the table.

There are several reasons for which companies may want to classify employees as independent contractors. Under the contractor status, employers are not required to provide benefits coverage or withhold income. Further, companies are shielded from paying worker's compensation coverage as well as payroll taxes.

However, employers who misclassify workers as contractors to save money may face steep penalties for doing so. In addition to suffering reputational damage, these tax law violations may also levy penalties and interest and the payment of back taxes owed to the IRS. Finally, companies may be forced to reimburse workers for wages that should have been paid under the Fair Labor Standards Act, including overtime and minimum wages, and benefits afforded regular employees.