

## MISCLASSIFYING EMPLOYEES AS INDEPENDENT CONTRACTORS: IS IT WORTH THE RISK?

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Determining whether an individual is an employee or an independent contractor under federal and state law requires more than a written agreement designating the individual as an independent contractor. The tests for determining who can qualify as an independent contractor vary under federal and state law. While this article focuses primarily on federal law, the analysis that is used under federal law generally applies as well under state law.

First, understand that the law favors the employer-employee relationship, not an independent contractor relationship. Why? Because employers are efficient tax collectors and the relationship ensures that an individual is protected under state workers' compensation laws, has access to employee benefits and has protected employee rights under applicable law.

***Why do businesses prefer to classify individuals as independent contractors even though in most cases the business pays a higher hourly rate than it would pay if the individual was treated as an employee?***

Because the business avoids paying the employer's portion of employment taxes, workers' compensation premiums, or employee benefits, which is allowed if the individual is properly classified as an independent contractor. If the business misclassifies the individual as an independent contractor and it turns out the business was wrong in its determination, the penalties can be financially punitive.

### ***Determining Independent Contractor vs. Employee Status***

The agencies<sup>1</sup> that enforce statutes governing laws that affect employee classification issues, including antidiscrimination laws, the Fair Labor Standards Act and the Internal Revenue Code focus on the economic realities of the relationship. Primary factors used in determining proper classification include:

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<sup>1</sup> To name a few, the U.S. Department of Labor, the Internal Revenue Service, Florida Department of Financial Services (unemployment tax and workers' compensation).

- What party is at risk for profit and loss.
- What party pays the expenses associated with delivery of the services under the parties' agreement.
- What party is responsible for compliance with laws governing the collection, remittance and reporting of employment taxes.
- Whether the work must only be performed by an employee or usually is done under the direction of a supervisor or is done by a specialist without supervision.
- The skill required in the particular occupation.
- The absence of a legal requirement that the individual must be supervised by a licensed professional.<sup>2</sup>
- What party provides the equipment necessary to perform the work.
- What party controls service or work hours.
- The method of payment, whether by time or by the job. All independent contractors receive a 1099, not a W-2.
- The manner in which the work relationship is terminated, i.e., by one or both parties, with or without notice and explanation.
- Whether the individual receives any benefits.
- Whether the work is an integral part of the business of the "employer."
- Whether the "employer" pays social security taxes.
- Whether the IRS has issued a determination of status in response to the submission of an IRS SS-8 form.

### ***Penalties***

Under federal tax law the following penalties apply and can be imposed on the business entity that misclassified an individual as an independent contractor.

- Unintentional misclassification of an individual as independent contractor, but issued 1099:
  - 1.5% of the employee's wages in federal income tax;
  - The entire amount of the employer's share of FICA;
  - 20% of the employee's portion of FICA;
  - No right to seek payment from the employee;
  - Employer remains liable for employment taxes.
- Failure to file a 1099 form, the above penalties double:
  - 3% of the employee's wages in federal income tax;
  - The entire amount of the employer's share of FICA;
  - 40% of the employee's portion of FICA;
  - No right to seek payment from the employee;
  - Employer remains liable for employment taxes.
- Intentional misclassification:
  - Full amount of the income tax that should have been withheld;
  - Both the employer's and the employee's portions of FICA;
  - Significant additional penalties and interest;
  - Additional civil penalties;

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<sup>2</sup> For example, in Florida a Registered Behavior Technician (RBT) must be supervised by a Board Certified Behavior Analyst (BCBA), a Board Certified Assistant Behavior Analyst, or a Florida Certified Behavior Analyst.

- Possible criminal charges.

In addition there are potential state law penalties for failure to remit unemployment tax and penalties in the State of Florida for not providing workers' compensation coverage for the individual that may include \$5,000 per misclassified individual and a 1.5% penalty on top of the workers' compensation premium that should have been paid.

### ***Unfair Trade Practices***

Under Florida law a business can be held liable for unfair trade practices if the unfair trade practice caused harm to a person. Florida's law is known as Florida's Deceptive and Unfair Trade Practices Act ("FDUTPA"), § 501.201, et seq., *Florida Statutes*. FDUTPA should not be taken lightly. Improperly misclassifying a person as an independent contractor who should be classified as an employee could constitute an unfair trade practice. For example, if a statute requires that certain individuals in licensed professions be classified as employees (see footnote 2) because supervision is required, a decision to misclassify the person to gain a competitive advantage could be an unfair trade practice, and most likely would be if a person suffered harm as a result of such misclassification. Intentionally misclassifying individuals as independent contractors for the sake of saving money is risky business. Before deciding whether an individual is an employee or an independent contractor, a thorough review should be conducted to ensure the right choice is being made. Just because an individual signs an agreement that provides that the individual is an independent contractor does not make it so. It is the substance of the relationship that matters.

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*A note to the reader: This article is intended to provide general information and is not intended to be a substitute for competent legal advice. Competent legal counsel should be consulted if you have questions regarding compliance with the law.*

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