



Wyrick Robbins Yates & Ponton LLP
ATTORNEYS AT LAW

4101 Lake Boone Trail, Suite 300, Raleigh, NC 27607

PO Drawer 17803, Raleigh, NC 27619

P: 919.781.4000 F: 919.781.4865 www.wyrick.com

CLIENT ALERT

Employee Benefits Update

June 2013

Independent Contractor/Employee Classification Issues (*Revised July 9, 2013*)

Some companies may consider characterizing workers who might be considered employees as independent contractors to save costs and regulatory hassle. Costs associated with employees include compliance with wage and hour requirements (overtime and minimum wage), federal and state income tax withholding, FICA withholding, and employment taxes (FUTA and state unemployment). Most recently, significant costs may be associated with providing (or not providing) health care coverage for employees under the Affordable Care Act ("ACA"). There are no such costs for independent contractors.

Misclassification could be costly for companies:

- **IRS Audits.** The IRS considers misclassification a significant issue and in the last few years has instituted an audit program to look for it. By all reports the IRS has been very active with the audit program, and it has collected significant amounts in under withholding of taxes, additional FICA, and penalties. The audit program has been identified by the IRS as a "money-maker" for the US Treasury. The misclassification issue will be an even more significant target for the IRS when ACA's health coverage obligations kick in (see "Play or Pay" below).
- **Challenges by Workers.** Some workers classified as independent contractors may question this status because of the benefits which are lost with non-employee status. Independent contractors pay the entirety of their self-employment taxes; whereas, the equivalent FICA taxes are paid 50/50 by the company and the employee. Employees are eligible for 401(k) plans, health plans, and other benefits that are not available to independent contractors. In addition, employees are protected by a number of state and federal laws that generally do not apply to independent contractors, such as the Family and Medical Leave Act (FMLA), the Consolidated Omnibus Budget Reconciliation Act (COBRA) and workers compensation insurance laws.
- **Due Diligence Reviews.** Acquisition partners have become aware of the potential liability of mischaracterized workers. It is now typical in stock and asset deals for purchasers to request representations that workers have been properly classified.

The determination of employee vs. independent contractor is based on common law principles and is fact-based. The IRS has a determination letter process (Form SS-8) for a formal determination of employee/independent contractor status.

We are running into employee/independent contractor issues in several contexts:

- ACA Issues. The Shared Responsibility (aka “Play or Pay”) provisions of the ACA apply to employers with 50 or more “full-time equivalent employees.” **The Treasury Department announced on July 2nd that the effective date (originally 2014) is being delayed until 2015** (see our Client Alert, [here](#)). For purposes of the Play or Pay rules, part-time employees are aggregated; for example, two fifteen-hour per week employees are considered one full-time equivalent employee. Many companies are reviewing their employee rosters to see where they stand under ACA, and some are questioning whether employees may be moved to part-time or characterized as independent contractors. A determination by the IRS that workers treated as independent contractors are really employees could have significant financial consequences. For example:
 - Company A has 45 full-time equivalent employees and 45 full-time independent contractors, none of whom are provided health insurance. If the 45 independent contractors are found to be employees, the Company would have 90 full-time employees. If just one of those employees qualifies for a subsidy on a federal or state health exchange, the Play or Pay penalty for not providing health insurance would be \$120,000 per year: 60 employees (90 full time employees minus the 30 employees who don’t have to be counted in determining the Play or Pay penalty) times \$2,000 per employee.
- Review of Industry Practices. Basic classification issues often involve managers, project managers, and software developers.
- Professional Employer Organizations (“PEO”). PEO contracts are generally set up so that the PEO and the client company are designated as “co-employers” of the workers. While North Carolina does recognize a licensed PEO as an employer for purposes of compensation, unemployment compensation, wage-and-hour, and withholding purposes (*the original posting of this Client Alert incorrectly stated that PEOs were not recognized as the “employer”*), a contract with a PEO does not remove the ultimate responsibility of the contracting company for insuring compliance with all applicable duties devolving upon an employer under North Carolina General Statutes Chapters 95, 96, and 105.

Some PEO clients do not appreciate these distinctions, and in our experience it is not unusual for a PEO client to believe that it has no employees or benefit plans of its own, and therefore no obligations to the state or for benefit plan compliance. PEO contracts are complex and it is, therefore, important for these contracts to be carefully reviewed.

If you have any questions about this Alert, please feel free to call (919.781.4000) or e-mail your Wyrick Robbins contact or one of the following members of our Employee Benefits & Executive Compensation group: **Richard Rogers** (rrogers@wyrick.com) or **Gray Hutchison** (ghutchison@wyrick.com).

CIRCULAR 230 NOTICE: To comply with requirements imposed by the United States Treasury Department, any information regarding any U.S. federal tax matters contained in this communication is not intended or written to be used, and cannot be used, as advice for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.