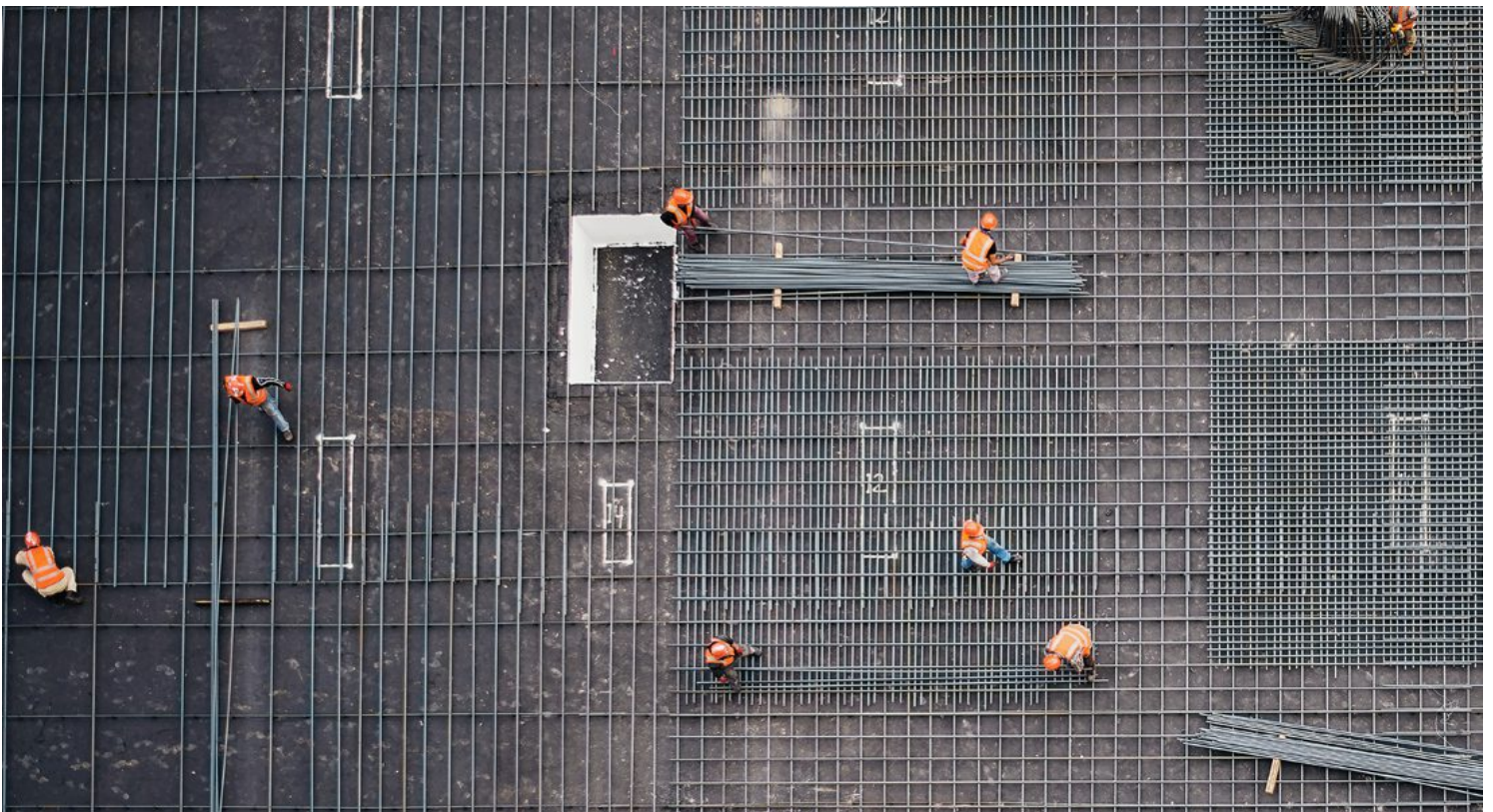


NEWS & INSIGHTS

# What businesses need to know about independent contractor misclassification audits

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Misclassification of employees as independent contractors has been a hot button topic over the last several years for the trucking and construction industries. State and local governments have ramped-up investigative measures targeting potential civil and even criminal sanctions for misclassification. In this climate of increasing scrutiny and enforcement, businesses must understand the risk and take proactive measures to ensure their compliance and avoid the risks associated with a misclassification audit.

Misclassification of a worker occurs when a company treats certain employees as independent contractors when in reality, the arrangement is more appropriately classified as an employer-employee relationship. Although the trucking and construction industries have historically made proper use of independent contractors, a myriad of state and federal laws that attempt to apply a “one size fits all” interpretation to the classification of independent contractors has done nothing but muddy the waters. To fill budget deficits, federal and state government agencies are conducting audits to determine whether workers are being improperly classified as independent contractors so that back employment taxes, interest, and penalties can be imposed against a company. In Pennsylvania, chief among targeted businesses are those that pay no unemployment compensation taxes.

Oftentimes, misclassification audits involve a review of financial records and business practices dating back several years. Any business owner who understands how the use of independent contractors can reduce employment taxes, payroll and other costs, will also understand how devastating the imposition of back taxes, interest, and penalties could be to a company. Not only could the results of an audit put a company out of business, but some states also allow for collection against the personal assets of a company’s individual owners.

And the threat is not purely economic. In Pennsylvania, the Construction Workplace Misclassification Act, “Act 72,” authorizes criminal charges for the misclassification of employees as independent contractors on construction sites. Prosecutors have [recently brought criminal charges under Act 72](#), and [given the increasingly aggressive use of prosecutorial](#) power against construction contractors in Pennsylvania and beyond the risks to employers are at an all-time high.

Unfortunately, when facing a government audit, many business owners wait to contact an attorney until after they have already produced documents and participated in interviews with an auditor. However confident the employer may be, this approach is fraught with peril. For instance, engaging with an auditor without a thorough understanding of which interpretation of independent contractor status is going to be applied can lead to a negative determination and severe consequences. In addition, although a business has a duty to provide records in response to an audit, owners do not have a duty to submit to an interview. As the saying goes, “what you say can and will be used against you,” and the chances of this happening increase exponentially when you speak without the support and oversight of an experienced attorney.

If you answer “no” to any of the following questions, your company is at risk for having penalties imposed for improper classification of employees as independent contractors.

- Does your independent contractor supply its own tools and equipment?
- Does your independent contractor operate as a separate and distinct business entity?
- Does your company have a written agreement in place with its independent contractor?
- Does your independent contractor have a place of business that is separate and distinct from your company’s place of business?
- Does your independent contractor provide services that differ from the services provided by your company?
- Does your independent contractor provide services for companies other than yours?
- Is your independent contractor free from control or direction by your company?

If you receive an audit notice, do not wait to contact your attorney. Failure to involve counsel in these matters exposes your company, and yourself, to possibly avoidable devastating financial and criminal penalties. If you

suspect your company may not be properly classifying workers, contact your attorney to help the company resolve the issue before it becomes too late. The more proactive the better. Given the cost and disruption of an audit – even one that leads to no sanctions – the wisest course is to have a qualified lawyer review your company’s approach to classifying workers as independent contractors to insulate your company most effectively from the risks in our current climate.

On the federal tax level, the Internal Revenue Service (IRS) offers the Voluntary Classification Settlement Program (VCSP) that offers employers an opportunity to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes. A taxpayer participating in the VCSP will agree to prospectively treat the class of workers as employees for future tax periods and, in exchange, the taxpayer will:

- Pay 10 percent of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year;
- Not be liable for any interest and penalties on the amount; and
- Not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified under the VCSP for prior years.

If an employer has any reason to suspect that it may be misclassifying employees, it is worth considering the VCSP because the reduced tax liability and penalty/interest relief granted under this program is significant.

If you need representation or legal advice, especially regarding these issues, our [Trucking and Commercial Transportation](#) team, led by [Michael T. Traxler](#), is able to assist you with assessing or navigating worker classification or other legal questions. Additionally, Saxton & Stump clients have access to a robust [White Collar Defense](#) team, led by former Pennsylvania Deputy Attorney General [Carson B. Morris](#).

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