

## Misclassification Risk (And How to Avoid it)



Misclassification risk is an important topic for all employers in the United States, but especially for staffing firms. As a staffing firm owner or manager, it's important to understand misclassification to protect your business. Misclassification, even when unintentional, has serious financial and legal consequences.

### What is Misclassification?

Misclassification risk occurs when an employer classifies a worker as an independent contractor when the government thinks that person should be classified as an employee. The government has a somewhat confusing and vague definition around the difference between the two types of workers, which is why this area can be tricky. For staffing firms, the problem comes up frequently because many contract workers may want to be classified as an independent contractor, but accidentally hiring a worker as an independent contractor when they should be classified as an employee can have devastating consequences. Generally, the definition has to do with how much control the employer has over the worker, including when and how they work.

### W-2 Employees vs. 1099 Independent Contractors

There are several factors that can distinguish between employees and independent contractors.

- The employer's control over when, where, and how the employee works.
- If the worker has a business entity (an LLC or other corporation).

- The nature of the worker's contract, and how their work is defined.
- How the work is paid, and if expenses are reimbursed.
- Whether the worker is temporary or permanent, and if the worker is key to the company's business.

## Misclassification of Risks

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Misclassification and its enforcement have been receiving increased attention at both the federal and state level, in part due to the Affordable Care Act and its insurance coverage requirements for employers. The goal of the laws is to make sure that employers don't misclassify employees as independent contractors in order to avoid providing insurance coverage and other benefits, as well as paying other costs and taxes.

Penalties for misclassification are substantial. For example, Microsoft agreed to settle a misclassification lawsuit by paying \$97 million dollars. The financial damage that results from misclassification arises from fees imposed by the government, paying back taxes (what you would have paid if you had classified the worker as an employee to begin with), and legal costs. This can occur even if the misclassification is unintentional due to misunderstanding of the laws.

## How to Avoid Misclassification Risks?

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In order to avoid the risk of misclassification, a strict process for defining employees must be in place, in writing, and everyone in the organization should be aware of it and held accountable. As a staffing firm, you need to have the same kind of process in place to avoid your risk, and you need to be sure that your clients understand it.



## Conclusion:

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Misclassification is a serious issue that staffing companies must be aware of and address, but it is not easy due to the gray nature of the laws. The best practice for staffing firms is to either seek legal counsel to ensure proper compliance, or to consider leveraging an Employer of Record and Agent or Record provider who can take on this liability and properly classify workers for you.

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