

The Legal Lowdown On Employee Classification: An Interview With Employment Lawyer Scott Grubin Of Wigdor LLP

March 9, 2015 • Legal Updates & Insights

Employee classification is a hot button issue in the startup world these days, with high-profile companies facing lawsuits from former 1099 contractors for employee misclassification. We asked employment lawyer Scott Grubin of [Wigdor LLP](#), one of the leading employment law firms in the country, to share his insights on the importance of properly classifying W2 employees and 1099 contractors.

1. Why is classifying employees correctly an important issue for businesses?

First, it's a violation of federal and state law to misclassify workers. Second, it is good for business. If a business properly classifies its workers and it needs to make personnel changes, the business has one less issue to worry about if its decision is challenged.

2. What are the most important factors that the IRS considers when determining whether a misclassification has occurred?

Whether an individual is an employee or an independent contractor is determined based on number of different factors. While there is no magic checklist, typically, one of the most important factors evaluated in making these determinations is the degree of control exercised by the business or payer: Who determines how the worker goes about doing his or job? Who provides the tools or supplies to do the job? Is the worker eligible for any benefits that employees are receiving?

The IRS regulations are not the only law a business or payer must be concerned with when classifying a worker. The business owner must also be concerned with federal and state wage and hour laws.

3. What happens when it goes wrong? What is the most serious penalty you have seen?

It typically goes wrong when a dispute arises with a former (or current) employee. The worker may believe that he was actually an employee, but was improperly classified as an independent contractor. As such, he may argue that he should have been entitled to benefits available to other employees, such as bonuses, medical benefits, and even equity in the company granted to other employees. Obviously, disputes whether they result in litigation or are settled can often be expensive. Moreover, they undeniably distract management and other workers. Of course, these disputes could damage the business's reputation.

The penalties businesses face include civil fines ranging from thousands to millions of dollars for the most extreme violations. Criminal penalties are another remedy available to governments when pursuing violations.

4. If the penalties for misclassification can be pretty severe, why do you think employers take the risk? Is it more often ignorance to the law or its more willful?

There are probably as many reasons as there are employers. One of the most common reasons I think is that businesses associate the issue as merely an HR-type issue rather than a business issue with regulatory and reputational implications. Another reason may be an employer's fear of discovering that their employees are misclassified and then struggling with properly handling that issue.

"Businesses associate the issue as merely an HR-type issue rather than a business issue with regulatory and reputational implications."

5. What shifts, if any, have you seen over the years in state and federal tax agency focus on the issues of employee misclassification?

I don't know that there is shift per se going on, state and federal agencies have and will continue to be focused on this issue as governments risk losing significant revenue by misclassification. However, according to a 2014 report written by the Freelancers Union and Elance-oDesk an online marketplace for freelance and [mentioned in the Wall Street Journal](#), about 34% of the labor force or 53 million Americans now work in some form of contingent arrangement. With such a large portion of the population working in the app-enabled, on-demand, contingent workforce, it certainly raises the question whether the traditional employee and independent contractor dichotomy deserves a fresh look in the face of this new reality.

6. With an emerging freelance economy expected to be more than 50% of the workforce by 2020, are employees aware of how they should be classified?

I think workers' level of awareness varies. Certainly, the amount of information available on the web and social media has heightened awareness of these issues. The level of awareness may still not necessarily result in workers being properly classified and disputes will still arise as the prevalence of misclassification lawsuits indicates.

7. How does being classified as an independent contractor financially affect the worker?

Unlike an employee where an employer withholds money from the gross paycheck for federal, state, and local taxes an independent contractor is responsible for paying such taxes including those associated with self-employment.

However, the differences extend beyond merely taxes and withholding issues. Generally, independent contractors cannot avail themselves to the protections of wage and hour laws, discrimination, and retaliation, among others.

8. Any advice for start-ups and growing businesses on how to get it right?

First, start-ups by nature are faced with countless challenges. Those challenges create an inherent need to be nimble. Many start-ups associate independent contractors with flexibility. Actually, properly classifying workers provides start-ups with the greatest flexibility. As mentioned earlier, if a business

properly classifies its workers and it needs to make personnel changes, the business has one less issue to worry about if that decision is challenged.

Second, start-ups should view employee classification as another regulatory issue that needs to be done correctly beginning with the first hire, not a merely ministerial function or some back-office HR issue that can be dealt with later.

"Actually, properly classifying workers provides startups with the greatest flexibility... If a business properly classifies its workers and it needs to make personnel changes, the business has one less issue to worry about if the decision is challenged."

Finally, proper employee classification is an important legal issue. Chances are, if you're not focused on it, a worker and/or a government agency will. If in doubt as to how a worker should be classified, take legal advice from an employment lawyer experienced with these issues. Start-ups are concerned with cash-flow; however the modest legal expenses associated with ensuring workers are properly classified will pay dividends in the face of legal disputes and government audits.

Scott Grubin is an employment lawyer with a unique multidisciplinary background as a senior human resources executive. He is Of Counsel with Wigdor LLP where his practice includes executive employment, representing individuals in negotiating employment and separation agreements, counseling clients who are moving to competitors, and handling a wide variety of disputes covering breach of contract, compensation, and discrimination. Over the course of his career, he has been a trusted advisor to executives and counseled them regarding a multitude of issues. More than half of Mr. Grubin's career has been on Wall Street in roles which include human resources management positions and as an employment lawyer. In addition to financial services, Scott also has experience in digital marketing/communications and manufacturing. Scott can be reached at sgrubin@wigdorlaw.com and 212.257.6800.

Disclaimer: *This article is for informational purposes only and does not constitute legal advice.*

Scott G. Grubin

Associate

WIGDOR LLP

85 Fifth Avenue, New York, NY 10003

T: [\(212\) 257-6800](tel:2122576800) | F: [\(212\) 257-6845](tel:2122576845)

wigdorlaw.com