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The Questionable Employment Tax Practice Initiative: The Crackdown on Misclassification of Employees As Independent Contractors Continues

By: Jill Tobia Sorger, Esq.

Introduction:

Over the past year and a half this Column has been reporting on the steps being taken by the State of New Jersey to crack down on employers who knowingly misclassify employees as independent contractors. The steps reported on have included a combined effort by the New Jersey Department of Labor and Workforce Development (“NJDOLE”) and the New Jersey Treasury to comprehensively audit employers as well as the introduction of New Jersey State legislation providing for criminal and other severe penalties for such conduct. At the beginning of this month, yet another initiative aimed at eradicating misclassification was put into place, this time through a combined effort of the IRS, the United States Labor Department and thirty (30) individual state revenue and workforce agencies, including New Jersey.

The Questionable Employment Tax Practice Initiative:

The Questionable Employment Tax Practice Initiative is essentially a memorandum of understanding between the above entities that enables them to share information, including for example, the ability of the IRS to share federal tax returns with state agencies as well as the authority

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of these entities to conduct joint or side by side examinations. Although the exact details of this Initiative remain in the planning phase, the proper classification of workers is clearly a focal point for the sharing of information, as the IRS has seen a steady increase in the number of reported independent contractors. This fact when coupled with the fact that the failure to properly pay employment taxes has been identified by the IRS as a main reason for the approximately \$290 billion annual “tax gap” (i.e. the difference between taxes owed and taxes paid) thrusts the misclassification issue onto a nationwide stage.

In light of the Questionable Employment Tax Practice Initiative, it is even more critical that employers become familiar with the legal definition of an “independent contractor.” Generally, New Jersey law establishes the following case specific factors to determine whether or not an individual may properly be classified as an independent contractor:

- Whether the individual is engaged in the pursuit of an independent trade, business, or profession in which he/she offers his/her services to the public;
- Whether the individual agrees to perform or complete a specific job or service and is responsible for the satisfactory completion of these services;
- Whether the individual has the right to direct and control the way in which the work is performed, both as to final results and as to the details of when, where, and how the work is to be done;
- Whether the individual is running a truly independent enterprise.

The clearly subjective nature of this test creates not only the potential for abuse, which is the obvious target of the Initiative and other enforcement actions, but also for mistake. However,

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employers performing an honest case by case evaluation of each employee will minimize the pitfalls inherent in the subjective nature of the test.

Advice for UTCA Contractors:

As this Column has repeatedly stated throughout its reporting on this subject, UTCA contractors will undoubtedly benefit from any effort to eradicate employers in the construction industry who gain an unfair competitive advantage by deliberately misclassifying workers in order to avoid paying social security, workers' compensation and other benefits. However, the fact still remains that legitimate independent contractors are used often and effectively in the construction industry. The arguably subjective nature of the independent contractor "test" subjects any construction industry employer utilizing independent contractors to review.

Furthermore, construction industry employers in New Jersey can expect an even higher level of scrutiny as New Jersey, along with California, Michigan and North Carolina, will serve on the Oversight Team that will manage all facets of the Questionable Employment Tax Practice Initiative. Accordingly, all UTCA contractors should immediately review any independent contractor decisions carefully and with the proper legal consultation.

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