

Worker Misclassification

An Overview for Virginia Businesses

August, 2021

Overview

This presentation aims to provide Virginia businesses with basic information about classifying workers correctly.

Table of Contents

1. Defining Worker Misclassification
2. What's Changed
3. Worker Misclassification Audits
4. Classifying Your Workforce
5. Additional Resources

1: Defining Worker Misclassification

- ▶ ***Worker misclassification*** involves incorrectly identifying individuals as independent contractors when they are really employees.

2: What's Changed

Effective January 1, 2021:

- ▶ Changes adopted by Virginia's General Assembly explicitly conform to the IRS definition, and assume an individual performing services for an employer for remuneration (payment for their work or services) is an employee unless it has been shown that the individual is an independent contractor according to IRS guidelines.
 - ▶ In other words, a worker is an employee unless the employer **can prove** that the worker is an independent contractor (generally, a person who is in business for themselves)
 - ▶ Virginia Tax will use applicable IRS guidelines to make worker classification determinations.

In addition:

- ▶ Virginia's Office of the Attorney General is starting up a Worker Protection Unit, a multidisciplinary team of prosecutors and attorneys who will focus on:
 - ▶ Educating Virginia workers on their rights, and
 - ▶ Investigating, stopping, and prosecuting exploitation of Virginia workers, including wage theft and worker misclassification.
- ▶ Virginia Tax will engage with the Worker Protection Unit as requested and allowed by law.

3: Worker Misclassification Audits

Virginia Tax is conducting regular audits looking into worker misclassification that could result in civil penalties.

- ▶ What are we looking for?
 - ▶ We'll be starting with businesses and industries that have issued 1099-NECs and 1099-MISCs to determine if these individuals were appropriately classified as independent contractors.
- ▶ If you're selected for an audit, you will likely need to provide documentation for any individual you've treated as an independent contractor indicating why you classified them as a contractor and not an employee.

If you're selected for an audit, you should:

- ▶ Review the list of required documents (e.g. W-2s 1099s, cash disbursements journal, check registers, petty cash, etc.) your auditor provides at the initiation of the audit.
- ▶ Confirm with your auditor the period of time under audit – or for what period of time documentation is required.

If you're found to be in violation:

- ▶ If an audit finds an employer in violation, they will be subject to an escalating set of penalties:
 - ▶ First audit: up to \$1,000 per misclassified individual
 - ▶ Second audit: up to \$2,500 per misclassified individual
 - ▶ Third or subsequent audits: up to \$5,000 per misclassified individual

If you're found to be in violation:

- ▶ For second audits and thereafter, any employer with more than 1 misclassification violation will be barred from certain government contracts for up to a year, and up to 2 years for subsequent offenses.
- ▶ Businesses found to be in violation are also liable for withholding taxes for any individual who was improperly classified for the period they were employed, as well as penalties and interest on those taxes.
- ▶ For specific information about your rights following an audit, please see pages 7-8 of the agency's [Taxpayer Bill of Rights](#).

4: Classifying Your Workforce

Employee vs. Independent Contractor: It's All About Control

- ▶ As a general rule, anyone who performs services for you is your employee if you have the **right to control** both **what will be done** and **how it will be done**.

IRS Guidelines:

- ▶ **Behavioral Control:** Does the employer control or have the right to control what the worker does and how the worker does his/her job?
- ▶ **Financial Control:** Are the business aspects of the worker's job controlled by the payer? This includes aspects such as how the worker is paid, and who provides tools and supplies, etc.
- ▶ **Type of Relationship:** Are there written contracts or employee-type benefits such as pension plans, insurance, vacation pay, etc.? Will the relationship continue and is the work performed a key aspect of the business?

Other Considerations

Employee	Independent Contractor
Is furnished tools, materials, and equipment needed to do the work	Will have significant investment in materials, liability insurance, and other costs associated with their work
Is given the hours to work and sequence of the work to be done	Controls both what work will be done, and how it will be done
Receives direction and training about how to do the work	Will typically have an employer identification number
Paid by the hour, week, or month and has no financial risk associated with the work	Will possess a business or a contractor's license
Can be discharged by the employer	Makes their services available to the public on a regular basis and will promote through advertising or have their own website soliciting their business to the public
	Has performed services for more than just you/ your firm in the past 6-12 months

In Summary:

When looking at a worker classification determination:

1. Look at the entire relationship
2. Consider the degree or extent of the right to direct and control, and
3. Document each of the IRS guidelines used in the determination

5: Additional Resources

We will continue to add resources to our website: [tax.virginia.gov](https://www.tax.virginia.gov)

- ▶ Current Worker Misclassification info is available at:
<https://www.tax.virginia.gov/worker-misclassification>

- ▶ In the meantime, if you have questions, please contact:
misclassificationofworkers@tax.virginia.gov