

## Alert

### Government Cracks Down on Employee Misclassification

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Since the economic downturn, the proper classification of workers has become a hot-button issue. As enforcement agencies step up efforts to curb misclassifications, it is more important than ever for employers to understand how to properly categorize workers.

#### Unpaid Interns

Now that the summer has begun, many employers are considering making unpaid internships part of their staffing strategy. Unpaid internships are a win-win for employer and intern alike. Employers like unpaid internships because they can get work done at a low cost, and interns like them because they receive “real world experience” and another item to add to their resume.

The Fair Labor Standards Act (the “FLSA”), however, provides that if the intern is, in fact, an “employee,” the employer will be subject to its minimum wage and overtime provisions and must provide compensation. With the number of unpaid internships increasing, the U.S. Department of Labor (“DOL”) has noted that it will be more aggressive in enforcing the law and in educating companies, colleges and students on the FLSA.

The definition of “employee” under the FLSA is extremely broad. It includes “any individual employed by the employer.” Because this definition is so broad, it covers most workers, and will generally cover interns at for-profit institutions.\* An exception exists, however, if the intern’s work serves only his or her own interest. In this instance, the intern could be considered a “trainee,” a category of worker not covered by the provisions of the FLSA. This is a fact-specific inquiry, and the DOL has issued a fact sheet, available [here](#), to help for-profit private sector employers determine whether interns are covered under the FLSA.

The DOL uses the following six factors to make this determination:

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in an educational environment;
2. The internship experience is for the benefit of the intern;
3. The intern does not displace regular employees, but works under close supervision of existing staff;
4. The employer that provides the training derives no immediate advantage from the activities of the intern; and on occasion its operations may actually be impeded;
5. The intern is not necessarily entitled to a job at the conclusion of the internship; and
6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

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\* The DOL has special rules for volunteers at non-profits.

If all of the above factors are met, the individual will be considered a “trainee.” It is important to note, however, that this is a very narrow exception to the FLSA. Employers should tread carefully in making this determination, and make sure to comply with all of the above factors if offering unpaid internships and classifying individuals as “trainees.”

### **Independent Contractors**

Another area of employee classification that has become a hot-button issue since the economic downturn is the misclassification of “employees” as “independent contractors.” This has also become a major focus of the Internal Revenue Service, as well as of state taxation and labor agencies, because it deprives workers of benefits such as overtime pay, unemployment compensation and Social Security benefits, and deprives federal, state and local governments of tax and insurance revenues. There has been a new focus in Congress on pending legislation that would, among other things, penalize employers that misclassify employees as independent contractors.

Assessing an individual’s status as employee or independent contractor is difficult, as there is no universal standard, with state and federal agencies often using somewhat different criteria in making a determination.

The IRS advises that an employer look at various aspects of its relationship with the worker and, with respect to each, evaluate the degree of control and independence that exists, focusing on three categories:

“(1) Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job? (2) Financial: Are the business aspects of the worker’s job controlled by the payer? (3) Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?”

The New York State Department of Labor, for its part, examines many factors for unemployment insurance purposes. See information attached [here](#).

Meanwhile, the State of Connecticut, which recently enacted a new law increasing penalties for worker misclassification, uses yet another test for unemployment insurance purposes and tax purposes. See information attached [here](#).

Faced with these varying standards, a good rule of thumb in making a classification determination is to look at the entire relationship between the employer and the worker, and if the employer is found to exhibit control over the worker, the worker typically will be considered an employee.

The DOL recently launched a new website, <http://www.dol.gov/wecanhelp/>, to educate workers on the FLSA and to publicize its efforts to more aggressively regulate the classification of employees. The agency also is considering a requirement that employers notify workers of their rights under the FLSA and provide information regarding hours worked and wage computation, as well as the reasons for an exempt or independent contractor classification. These actions highlight the DOL’s increasing efforts to provide greater transparency for workers and to regulate employers. Thus, it is more important than ever to make sure that classification decisions are thoroughly considered and carefully made.

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If you have any questions concerning this *Alert*, or would like additional information about the classification of workers, please contact one of the authors or your attorney at SRZ.

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