

NOTICE TO ALL BUSINESSES WHAT IS WORKER MISCLASSIFICATION?

Misclassification of a worker occurs when a worker is treated as contract labor when the law does not allow for such classification. Arkansas law determines the proper classification of a worker for unemployment insurance (UI) tax purposes. A.C.A. § 11-10-210(e)(1)(2)(3), commonly referred to as the 1,2,3 test, is applied to determine the correct classification of a worker. The presumption is that a worker is an employee unless the business entity paying the worker can establish all three parts of the test as follows:

"Service performed by an individual for wages **shall be** deemed to be employment subject to this chapter irrespective of whether the common-law relationship of master and servant exists, unless and until it is shown to the satisfaction of the Director that:

1. Such an individual has been and will continue to be free from control and direction in connection with the performance of such service, both under his contract for the performance of service and in fact, and
2. Such service is performed either outside the usual course of the business for which the service is performed or is performed outside all the places of business of enterprise for which the service is performed: and
3. Such individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.

If the employer cannot establish that the worker meets all three parts of the test, the worker must be classified as an employee and UI taxes reported and paid.

Examples indicating that a worker should be classified as an employee and not as contract labor:

- Worker is given a work schedule.
- Worker is supervised.
- Worker is provided training.
- Worker is given instructions in the performance of the duties.
- Worker's pay is not negotiated.
- Worker performs a service at the employer's place of business or at places designated by the employer for an extended period of time.
- Worker performs the service as a representative of the employer.
- Worker uses the employer's tools, equipment and/ or supplies.
- Worker is not established in own business of the same nature as the employer.

Many employers mistakenly think as long as workers are given a W-2 or a 1099 at the

end of the year, they are within the law. This is not true.

WHY DO EMPLOYERS MISCLASSIFY?

Tax and Insurance Fraud: Employers call their workers "independent contractors" to avoid taxes, insurance costs, and payroll deductions. They pay independent contractors in lump sums and claim they will report worker's annual earnings on a 1099.

Gaming the System: Businesses say they do not have to pay taxes or insurance including UI taxes on contract labor, but nearly all such workers meet the legal definition of being employees for UI tax purposes.

Illegal Profits: The misclassification scheme helps companies avoid normal payroll taxes, so they do not pay Social Security or Medicare, workers' comp., or unemployment insurance, all of which are required by law.

IS THIS CRIME OR CONFUSION?

Unchallenged Crime: Misclassification is lawlessness, not confusion. Most businesses know what they are doing and think that they can get away with it.

Nationwide: Misclassification occurs in all 50 states.

WHY DOES IT MATTER?

Unfair to Honest Businesses: Responsible, law-abiding employers are at a competitive disadvantage; many must choose between staying afloat or breaking the law.

Billions of Lost revenue: Federal, state, and local governments are cheated out of many kinds of revenue.

Higher Insurance Costs: Hospitals are obligated to provide care for all, so workers' comp., and health insurers must raise premiums to make up for the uncovered workers who are injured on the job.

Crimes: Misclassification involves many crimes: tax evasion, mail and insurance fraud, grand theft, wage and hour violations, and money laundering.

BE AWARE!

Nationwide efforts have begun to rectify the misclassification of workers and states are taking steps to assure proper classification of workers.

The Department of Workforce Services has recognized that misclassification is occurring within its UI program. Steps are being taken to increase investigations with regard to misclassification of workers within the UI tax program and to bring offending employers into compliance with the law.

QUESTIONS?

If you are unsure of the correct classification of a worker for UI tax purposes or to report an employer that may be misclassifying its workers, please contact (501) 682-3253 (501) 682-3253 or visit the [Comparative Classification page](#).