

IRS Steps Up Enforcement of Subcontractor Laws

Businesses that have been misclassifying employees as independent contractors might soon find themselves writing a hefty check to the IRS for past-due taxes, interest, and fines.

The IRS has announced that it will audit 2,000 randomly selected businesses this year and an additional 2,000 in each of the following two years under its newly formed Employment Tax National Research Program, part of an enforcement effort targeted at employee misclassification. Data from the audits will be used to estimate how much tax revenue is going uncollected because of misclassification and to identify red flags that will allow the IRS to pinpoint questionable returns to audit in the future.

Research done over the last several years by the federal government and state labor departments points to employee misclassification as a major contributor to the “tax gap,” the term the IRS uses to describe the difference between taxes that were paid and taxes that by law should have been paid but weren’t. That research has also shown that a high percentage of independent contractors underreport their income. Thus, the IRS calculates

that an investment in enforcement in this sector has potential for a large payback — from both employers and subcontractors.

Indeed, the proposed 2011 federal budget estimates that the IRS crackdown on employee misclassification will garner \$7 billion over the next 10 years, and it allots \$25 million for 100 additional agents and for grants to state programs that address the problem. In addition, the budget allocates \$8 billion to the Department of Labor to support “the IRS’ continued progress in reducing the tax gap through fair, robust, and equal application of the tax laws — including new revenue-generating enforcement initiatives that will increase recovery of tax debts by nearly \$2 billion a year once the initiatives are fully mature in 2013.” In other words, the IRS isn’t fooling around, and subcontractors and employers had better be prepared if the IRS comes calling.

Employers can be tempted to classify workers as subcontractors rather than as employees because they have a substantial financial incentive to do so: They don’t have to pay Social Security, Medicare, and unemployment taxes for subs, nor do they have to withhold income taxes for those work-

ers. Depending on state law, they may not need to pay for workers comp, either. The 2011 budget mentions that the federal Labor and Treasury departments are pursuing a proposal “that eliminates incentives in law for employers to misclassify their employees,” but it doesn’t go into detail.

How do you know if someone is an employee or a subcontractor for tax purposes? The IRS looks at the level of control the company has over the worker, divided into three basic categories: behavioral control, financial control, and the relationship between the parties. The more the company directs the what, when, and how of the work, the more likely the worker is an employee. On the other hand, if a worker advertises his or her services, uses his or her own equipment and tools, and performs work for numerous businesses, that worker is more likely to be a subcontractor.

For more information, see IRS Publication 15-A, *Employer’s Supplemental Tax Guide* (www.irs.gov/pub/irs-pdf/p15a.pdf), and Publication 1779, *Independent Contractor or Employee?* (www.irs.gov/pub/irs-pdf/p1779.pdf). Also be sure to check with your state’s labor department for additional state requirements. — *Laurie Elden*

Decking Company Recycles In-House

In February, Advanced Environmental Recycling Technologies, maker of MoistureShield composite decking and railing, began operating a new recycling facility in Watts, Okla., that’s designed not only to supply the company with recycled plastic for its building products and exploit previously untapped sources of used plastic,

but also to meet U.S. Green Building Council requirements for LEED (Leadership in Energy and Environmental Design) certification.

Certainly, recycling plastic instead of creating new plastic keeps it out of landfills and consumes less energy; Joe Brooks, AERT founder and CEO, estimates “in its first year of operation

the plastics recycling process at Watts will help save around 2.1 trillion Btu of energy compared to use of virgin polyethylene.” However, it’s not all about the environment. The output from the new facility will add to that from an existing facility the company owns in Lowell, Ark., offering AERT more insulation from petroleum and

natural-gas price swings, better control over feedstock quality, and even a new customer base. “With the addition of the Watts recycling facility,” says Brooks, “we expect to supply all of our plastics needs internally and sell additional recycled plastic resins to other manufacturers.”

The technology used in the Watts plant is also enabling AERT to recycle lower-quality, lower-cost materials. “These are waste plastics that are a challenge to recycle due to density and handling constraints such as films and contaminants or logistics such as post-consumer and post-industrial polyethylene plastics that contain paper, metal, or other contaminants,” Brooks explains. “The Watts facility uses a new wet recycling process that is more efficient in cleaning waste plastics and removing contaminants.”

Managing water supply and disposal from any manufacturing process can be a problem, but in this case, none of the water used is potable — all of it is recycled and reused — and water management systems are in place to recycle rainwater and prevent stormwater from being discharged from the site. The grounds are irrigated with wastewater, as well, as part of the overall plan for the facility to meet LEED standards. Another “green” aspect of the plant is that the building was insulated and laid out in such a way that it doesn’t need a heating or cooling system, which should lower operating costs in addition to saving energy. Other features include low-flush toilets and lights that turn off when sensors detect a room is empty.

AERT has submitted an application to the U.S. Green Building Council for LEED certification, but Brooks notes that confirmation “can take upwards of a year.” — *L.E.*

Web Site for Wood Geeks

I don’t say this about a lot of government agencies, but I’m a fan of the U.S. Department of Agriculture’s Forest Products Lab (FPL). If you want to find out something about wood, those guys know the answer. I was introduced to them in 1996, when the Internet was a shadow of its current self and getting information from the FPL might take a couple of phone calls or the purchase of a paper pamphlet that would arrive a week or two later through the U.S.P.S.

The FPL had a Web site early on, but for a long time it wasn’t very easy to use. That’s changed. The new site (www.fpl.fs.fed.us/) is easily searched (tip: search by “topic” under “Information products and services”), and many of the old paper pamphlets, as well as a bunch of new research, are now available for free as pdfs. Some, particularly the *Factsheets*, are in layman’s terms, while much of the rest is presented more academically.

For definitive information about how to prevent paint from peeling, or about the characteristics of ipe, the history of dimensional lumber, or a whole host of other wood-related issues, this is the best single source I’m aware of. — *Andy Engel* ❖

In a trade secrets lawsuit

against a former employee and Sensibuilt Building Solutions, Deceuninck North America (DNA) was awarded a \$1.158 million jury verdict in March. DNA, the Ohio-based maker of Kodiak decking products, alleged in its complaint that Michael Hutflless had improperly downloaded hundreds of files containing trade secrets to a portable flash drive in his final weeks of employment as a vice president at the company, just before he became CEO of Sensibuilt in September 2007. DNA uncovered the file transfers through a forensic analysis of Hutflless’ office computer — which the company undertook in October 2007 after learning of his employment at Sensibuilt — and alleged that Hutflless “had no legitimate business reason” to access the files and had misappropriated the data for Sensibuilt to use in its decking business. The company also claimed that in one of his final expense reports, Hutflless had charged DNA for the flash drive.

A class action lawsuit against Trex over surface flaking of some of the company’s decking products was settled in March in U.S. District Court. According to court documents, the company has agreed to replace defective boards or provide a refund based on retail price; if more than 50 percent of the boards on the deck are defective, then Trex will replace all the decking or provide a refund. Trex has also agreed to pay shipping costs, and \$1,250,000 in legal fees for the class. The labor portion of the settlement is minimal — \$0.18 per linear foot of decking replaced, which comes to about \$225 for an average deck — causing a small number of the 17,240 class members to object to the settlement (18) or opt out of the lawsuit (117). At the same time that the court approved this settlement, it also consolidated two class action lawsuits over mold claims into a single action against Trex. That class action has not been settled.

Lumber supply in the U.S. has shrunk by more than half since 2005. In that banner year, U.S. output was more than 40 billion board feet (bbf), and after accounting for imports and exports, a total of about 64 bbf was available for U.S. consumption, according to the forest products industry publication *Random Lengths*. As the housing market collapsed and demand for lumber plummeted, the industry scaled back both production and imports accordingly, so that by 2009, U.S. production was down to about 22 bbf, and total U.S. lumber supply amounted to just over 30 bbf.