



2023 Employment Law Certificate Series

Session 4: Independent Contractors

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Webinar Overview

- **Defining Independent Contractors vs. Employees**

- What is an independent contractor?
- The tests used to determine independent contractor status
- US DOL Proposed Rule

- **Understanding and Avoiding Misclassification**

- Benefits of using independent contractors vs. employees
- Consequences of misclassification
- Employer best practices

PART 1 ///

Defining Independent Contractors vs. Employees

What is an Independent Contractor?

- Generally, an independent contractor is a worker who:
 - Offers their services to the public for a fee.
 - Is not economically dependent on any single company.
 - Is **not** an employee.



What is an Independent Contractor?

- An independent contractor typically:
 - Charges a fee for their services.
 - Is engaged only for the term required to perform a specified service or task.
 - Retains control over the method and manner of work.
 - Retains economic independence and is free to offer their services to more than one company.
 - Is responsible for paying their own income, social security, and Medicare taxes.
 - Is not covered by most federal, state, or local laws designed to protect employees.

What is an Independent Contractor?

- An independent contractor typically does not:
 - Receive company-sponsored benefits, such as paid vacation, health insurance, or retirement benefits.
 - Perform the same work as the company's employees.
 - Have the “indicia” of an employee, such as company uniforms, name badges, or business cards.

What is an Employee?

- An employee is usually subject to significant oversight and control by the company and:
 - Is paid wages and receives company-sponsored benefits.
 - Is employed for a continuous period and performs whatever tasks the company requires.
 - Generally pays taxes through the amounts their employer is obligated to withhold from their wages.
 - Is economically dependent on the employer.
 - Is protected by applicable federal, state, and local employment laws.

QUESTION

Does your company or organization currently treat any of its workers as independent contractors?

Tests to Determine Independent Contractor Status

- Workers and companies cannot elect independent contractor status without meeting the legal requirements.
- Simply referring to or designating a worker as an independent contractor, even if they agree to that designation, is not enough.
- Classification depends on:
 - The facts of each case.
 - Application of the appropriate independent contractor tests.
 - Differences in how courts and government agencies interpret those tests.

Tests to Determine Independent Contractor Status

Economic Realities Test

Control Test

Common law and other state and federal law tests

Economic Realities Test

- Used to assess independent contractor status under the Fair Labor Standards Act (FLSA).
- Courts look at the totality of the parties' relationship and use a balancing test to evaluate various factors, including:
 - The degree of control the company has over the worker.
 - The relative investment in facilities.
 - The worker's opportunity for profit and loss.
 - The permanency of the parties' relationship.
 - The skill required.
 - Whether the worker's services are integral to the company's business.

U.S. Department of Labor Proposed Rule

- 2021 Proposed Rule
 - Core Factors
 - Nature and degree of control
 - Worker's opportunity for profit and loss
 - Non-core Factors
 - Amount of skill required
 - Degree of permanence
 - Whether the work is a part of an integrated unit
- 2022 Proposed Rule
 - Rescinded the 2021 Proposed Rule
 - Proposed a return of the totality of the circumstances / economic realities test
 - Final rule anticipated to be released in October 2023

Tests to Determine Independent Contractor Status

Economic Realities Test

Control Test

Common law and other state and federal law tests

Control Test: Remains the Current IRS Standard

- Used to determine whether a worker is an employee for federal tax purposes.
- Analyzes three aspects of the worker's control or independence:
 - Behavioral control.
 - Financial control.
 - The type of relationship.

Tests to Determine Independent Contractor Status

Economic Realities Test

Control Test

Common law and other state and federal law tests

Common Law Tests

- *Darden Test*
 - Commonly used in the context of Title VII, ADA, ADEA, ACA & ERISA
 - Focuses on the company's right to control the manner and means by which the worker performs the work
- 20-Factor Test
 - Previously used by the IRS, and commonly used now by state agencies making independent contractor determinations
 - Factors focus on instructions, training, integration with company operations, services rendered personally, hiring/supervising helpers, continuing relationship, and set hours of work

NLRB Standard

- In 2019, the NLRB issued more employer-friendly guidance that held a worker's opportunity for profit and loss accounts for the “core” of the test
- But as of June 2023, NLRB has reverted back to its pre-2019 test
- All traditional common law factors must again be assessed with no one factor being decisive

ABC Test

- State independent contractor tests can impose a more narrow definition than the federal equivalent.
- The most common state test is the ABC Test.
- The ABC Test **presumes an employment relationship** unless the company shows that:
 - (A) The worker has been and will continue to be free from control or direction over the performance of their work.
 - (B) The work is either outside of the normal course of business for the company requesting the work or performed outside of any of that company's places of business.
 - (C) The worker is customarily engaged in an independently established trade, occupation, profession, or business.

QUESTION

Before today, did you realize that there was more than one test to determine the appropriate classification of independent contractors?



PART 2 ///

Understanding and Avoiding Misclassification

Benefits of Independent Contractor Classification

- Because independent contractors are not employees, companies properly engaging them can generally avoid certain obligations and expenses, including:
 - Tax and insurance obligations.
 - Employment law compliance.
 - Employee benefits.
 - Immigration law compliance.
 - Affordable Care Act (ACA) compliance.

Tax and Insurance Obligations

- By properly engaging independent contractors, companies can generally avoid tax payments, withholdings, and insurance obligations required on behalf of employees, including:
 - Federal, state, and local income taxes.
 - Social security and Medicare taxes.
 - Federal unemployment insurance taxes.
 - State unemployment insurance taxes.
 - Workers' compensation insurance.

Employment Law Obligations

- Federal employment laws that cover employees, but generally not independent contractors, include:
 - Fair Labor Standards Act (FLSA).
 - Title VII of the Civil Rights Act (Title VII).
 - Equal Pay Act (EPA).
 - Age Discrimination in Employment (ADEA).
 - Americans with Disabilities (ADA).
 - Genetic Information Nondiscrimination Act (GINA).
 - Uniformed Services Employment Reemployment Rights Act (USERRA).
 - Occupational Safety and Health Act (OSH Act).
 - Worker Adjustment Retraining Notification Act (WARN).
 - Family and Medical Leave Act (FMLA).
 - Employee Retirement Income Security Act (ERISA).
 - National Labor Relations Act (NLRA).

Employee Benefits

- Companies often provide benefits to their employees that are not available to properly classified independent contractors including, for example:
 - Health insurance, including cafeteria plans.
 - Retirement or pension plans.
 - Stock options.
 - Paid vacations.
 - Sick days.
 - Life insurance.
 - Disability insurance.
 - Fringe benefits, such as tuition reimbursement.

Immigration Law and Affordable Care Act Compliance

- For independent contractors, companies are not required to:
 - Verify work authorization (by completing Form I-9).
 - Provide health care coverage under the ACA.

Benefits of Employee Classification

- Avoiding misclassification risks
- Control over manner and method of work
- Performance management
- Employee discipline
- Workers' compensation exclusivity
- Duty of loyalty

Consequences of Misclassification

The penalties for misclassification can be serious. If a company misclassifies an employee as an independent contractor, it must ensure compliance going forward and may be liable for:

- Back wages and overtime pay
- Employee benefits, including retirement benefits, and health plan coverage (or the value of those benefits).
- Disability payments and workers' compensation premiums.
- Tax and insurance obligations.
- Potential criminal penalties and personal liability for corporate officers for intentional misclassification

Employment Law Compliance

- Improperly classifying an employee as an independent contractor could lead to claims for:
- Unpaid overtime compensation and reimbursement of work-related expenses.
- Reasonable accommodation and return to work benefits under the ADA and its state equivalents.
- Leaves of absence under the FMLA and its state equivalents.
- Closure and mass layoff notice and penalties under WARN and its state equivalents.
- Discrimination under Title VII, ADEA, and other federal, state, and local anti-discrimination laws.

Affordable Care Act

- Misclassification of employees as independent contractors directly impacts both:
 - A company's compliance obligations under the ACA.
 - Its exposure to related penalties

Tax and Insurance Obligations

- The tax and insurance liabilities for misclassification are significant and can include:
 - Years of unpaid federal, state, and local income tax withholdings.
 - Social security and Medicare contributions.
 - Workers' compensation and unemployment insurance premiums, including federal unemployment taxes.
 - Interest and penalties.

What to do now?

Best Practices



Use Independent Contractor Agreements



- Confirm the independent contractor relationship
- Reduce disputes by providing details about duties, compensation, ending contractor relationship
- Agreement should contain:
 - Term
 - Emphasis on results achieved, not how results accomplished
 - Not an exclusive relationship
 - Not covered by the company's insurance

Practical Tips

To ensure that independent contractor classification requirements are satisfied:

- Avoid using former employees as independent contractors and having independent contractors do the same work as employees.
- Avoid using independent contractors to perform work that is integral to the business.
- Do not have independent contractors supervise employees.
- Keep independent contractor files with vendor files, not employee files.
- Do not reimburse independent contractors for business expenses.
- Require independent contractors to supply their own equipment.

Practical Tips (cont.)

- Do not provide contractors with employee-type benefits like paid vacation, paid holidays, sick leave, and retirement benefits.
- Do not schedule hours or days of work for contractors or their employees.
- Avoid requiring uniforms, grooming standards, and similar workplace requirements typically imposed on employees.
- Issue separate guidelines for independent contractors instead of providing them with a copy of the employee handbook.
- Do not provide contractors with company business cards or job titles.
- Be careful about restrictive covenants.

Practical Tips (cont.)

- Do not invite contractors to employee-only events or meetings.
- Deal with performance problems as contract modification or breach issues, not as disciplinary issues. Do not conduct performance evaluations for independent contractors. Do not involve Human Resources in the business relationship with independent contractors.
- Do not control the details of how the independent contractor performs the work. Focus on the end result rather than the details.
- Require invoices for services.
- Regularly audit the company's independent contractor arrangements and template agreements.

Do Not Assume

- Do not assume that calling a worker an "independent contractor" instead of an "employee" will determine the worker's status.
- Do not assume that issuing a Form 1099-NEC instead of a W-2 makes the worker an independent contractor.
- Do not assume industry practice satisfies the requirements for independent contractor classification. Entire industries (construction, for example) are often the target of enforcement efforts.

QUESTION

After today's webinar, do you believe it would be worthwhile to conduct an internal audit to ensure that your workers are classified properly?

Thank You

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