



# Trying to Navigate the Independent-Contractor/ Employee Maze

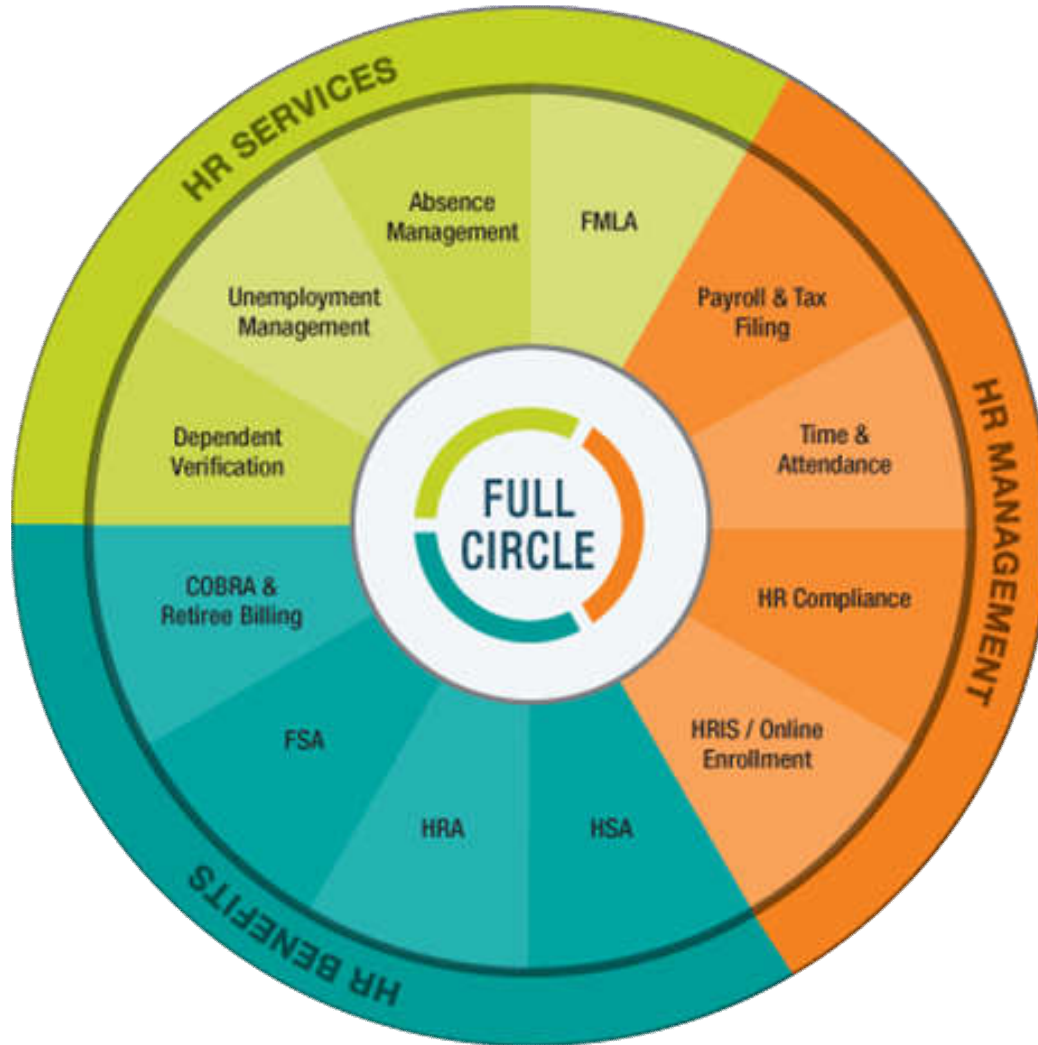
Presented by: Robert A. Dubault



- HR Benefits
- HR Management
- HR Services

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# Topics



- Independent contractor vs. employee status.
- Red flags and audit risks.
- Other risks associated with misclassifying someone as an independent contractor when they are really an employee.
- Tips for drafting independent contractor agreements.



# This is not a new topic...



- “Few problems in the law have given greater variety of application and conflict in results than the cases arising in the borderland between what is clearly an employer-employee relationship, and what is clearly one of independent entrepreneurial dealing.” NLRB v. Hearst Publications, 322 U.S. 111, 121 (1944).

# If it's not new, then why does it still matter?



- **Simply put, it matters to the government.**
  - According to the U.S. Department of Labor Wage & Hour Division:
    - “The misclassification of employees as independent contractors presents one of the most serious problems facing affected workers, employers and the entire economy.”
    - “Misclassified employees often are denied access to critical benefits and protections to which they are entitled, such as the minimum wage, overtime compensation, family and medical leave, unemployment insurance, and safe workplaces.”

# If it's not new, then why does it still matter?



- **U.S. DOL Wage & Hour Division:**
  - “Employee misclassification generates substantial losses to the federal government and state governments in the form of lower tax revenues, as well as to state unemployment insurance and workers’ compensation funds.”

# If it's not new, then why does it still matter?



- **EEOC Recently Updated/Amended its Strategic Enforcement Plan. Among the issues listed as a priority:**
  - Clarifying the employment relationship and the application of workplace civil rights protections in light of the increasing complexity of employment relationships and structures, including temporary workers, staffing agencies, independent contractor relationships, and the on-demand economy.



# If it's not new, then why does it still matter?



- **Internal Revenue Service**

- It is critical that business owners correctly determine whether the individuals providing services are employees or independent contractors.
- If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker
  - Federal Insurance Contribution Act (FICA)
  - Federal Unemployment Tax Act (FUTA)
  - Personal Income Tax withholding
  - Penalties and Interest

## Employee vs. Independent Contractor



- **No single, uniform definition of the term “employee” across all the various federal and state laws and common law causes of action.**
- **No single, unified, bright-line test for who is an employee and who is an independent contractor.**

# Employee vs. Independent Contractor



- **Tests most commonly applied:**
  - Common Law Test
  - Economic Realities Test
  - IRS 20-Factor Test
  - A-B-C Test

# Common Law Test



- Focus is on whether the putative employer exercises “control” or has the “right to control” how the work is done.
- Primarily applied as to Title VII, ADA, and ADEA, as well as NLRA
- Ten-factor test (no one of which is dispositive).

# Common Law Test



- Degree of “employer” control over the details of the work
- Whether the “employee’s” business is a distinct occupation or business
- Whether the “employee’s” occupation is usually done without supervision
- Whether a high-level of skill is required by the occupation
- Who provides the supplies, tools and the place of work

# Common Law Test - Continued



- The length of time services are provided
- Method of payment (by job, hour or day)
- Whether the work is a part of the regular business of the employer
- The parties' intent – did they believe they were creating an independent contractor relationship
- Whether the hiring entity is not in business
- NLRB – Whether the evidence tends to show the individual is, in fact, rendering services as an independent business

# IRS Test



- **In Revenue Ruling 87-41, the IRS adopted the Common Law Test and supplemented it with additional right of control factors to come up with its own 20-factor test.**
  - Factors fall into three broad categories: behavioral control, financial control, and the type of relationship of the parties.
- **Courts applying the IRS test appear to focus primarily on whether the employer not only controls the result, but the process or method the worker uses to obtain that result.**
- **Either the employer or the individual may file IRS Form SS-8 to obtain determination.**

# Economic Realities Test



- **Focus of the Economic Realities Test is whether**
  - the individual is economically dependent on the business to which services are being provided (and thus an employee), or whether the individual is in business for himself.
- **Primarily employed in FLSA and FMLA context**



# Economic Realities Test



- **Applies six roughly equal factors:**
  - The extent to which the services provided are part of the company's business
  - The nature and extent of the relative investments of the employer and the worker
  - The nature and degree of control retained by the employer
  - The individual's opportunity for profit or loss
  - Does the Work Performed Require Special Skill and Initiative
  - The permanency or indefiniteness in the worker's relationship with the employer

# Economic Realities Test



- On July 15, 2015, the DOL issued Administrator’s Interpretation No. 2015-1, titled: “The Application of the Fair Labor Standards Act’s ‘Suffer or Permit’ Standard in the Identification of Employees Who Are Misclassified as Independent Contractors”
- Emphasizing the broad definition of “employ” under the FLSA, the AI notes “applying the economic realities test in view of the expansive definition of “employ” under the Act, most workers are employees under the FLSA.”
- DOL specifically noted: “[A]n agreement between an employer and a worker designating or labeling the worker as an independent contractor is not indicative of the economic realities of the working relationship and is not relevant to the analysis of the worker’s status.”

# A-B-C Test



- **Applied in full or part by about 2/3 of the states primarily for state unemployment tax purposes**
- **Individual is presumed to be an employee unless employer can establish all three factors:**
  - (A) the worker is free from control or direction in the performance of the work;
  - (B) the work is done outside the usual course of the firm's business and is done off the premises of the business; and
  - (C) the worker is customarily engaged in an independent trade, occupation, profession, or business.

# Independent Contractors: Red Flags and Risks



- **Things that complicate the contractor vs. employee analysis:**
  - Issuing the same individual a Form W-2 and a Form 1099-MISC in the same tax year
  - Having the contractor do the same work as employees
  - Exercising or retaining too much control over when, where and how the work is performed
  - Having an open-ended or indefinite relationship or with the individual
  - Having an exclusive relationship with the individual

# Independent Contractors: Red Flags and Risks



- **Things that complicate the contractor vs. employee analysis:**
  - Paying by the hour, supplying tools and equipment, and reimbursing expenses
  - Requiring the individual to sign the same confidentiality agreement (or otherwise abide by the same handbook) as you require of your employees
  - Requiring the individual to sign a covenant not to compete
  - Not having a written independent contractor agreement

# Independent Contractors: Red Flags and Risks



- **Independent contractor status is not without some risks:**
  - Less (or no) control over getting the work done
  - Confidential Information and Intellectual property
  - Ownership of property
  - Liability to third parties for actions of contractor

# Drafting Independent Contractor Agreements



- Although a written agreement may not be determinative, that does not mean you shouldn't have one with service providers who you consider to be contractors.
- If carefully written, it will not hurt your position as to your relationship if there is a legal dispute.

# Drafting Independent Contractor Agreements



- A statement that the contractor is an “independent contractor” and not an employee and that the parties intend the relationship to be such.
- A statement reflecting that the contractor, not the employer, has the right to control how the project is to be accomplished.
- Payment by the project, where possible, and not by the hour, day or week.
- A statement that the contractor will supply all necessary tools, equipment and supplies (and if possible the workplace).



# Drafting Independent Contractor Agreements



- Provisions addressing how the agreement can be terminated and the rights and consequences of termination.
- A statement that the contractor will pay all out-of-pocket expenses associated with the project/work.
- A statement that the contractor is responsible for and will pay all taxes for itself and its own employees.

# Drafting Independent Contractor Agreements



- A commitment by the contractor to provide workers compensation coverage and other legally required benefits for its employees (or if permissible under your policy, a statement that the contractor is a special employee for purposes of workers compensation coverage only).
- A statement that the contractor is exempted from all employee benefits.
- If the work is not project based, a cut off or termination date for the agreement.

# Drafting Independent Contractor Agreements



- No matter how carefully any agreement may be drafted, it will not help if you do not follow it, and it is how the relationship actually functions that will matter most.



# Questions



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# Contact the Presenter



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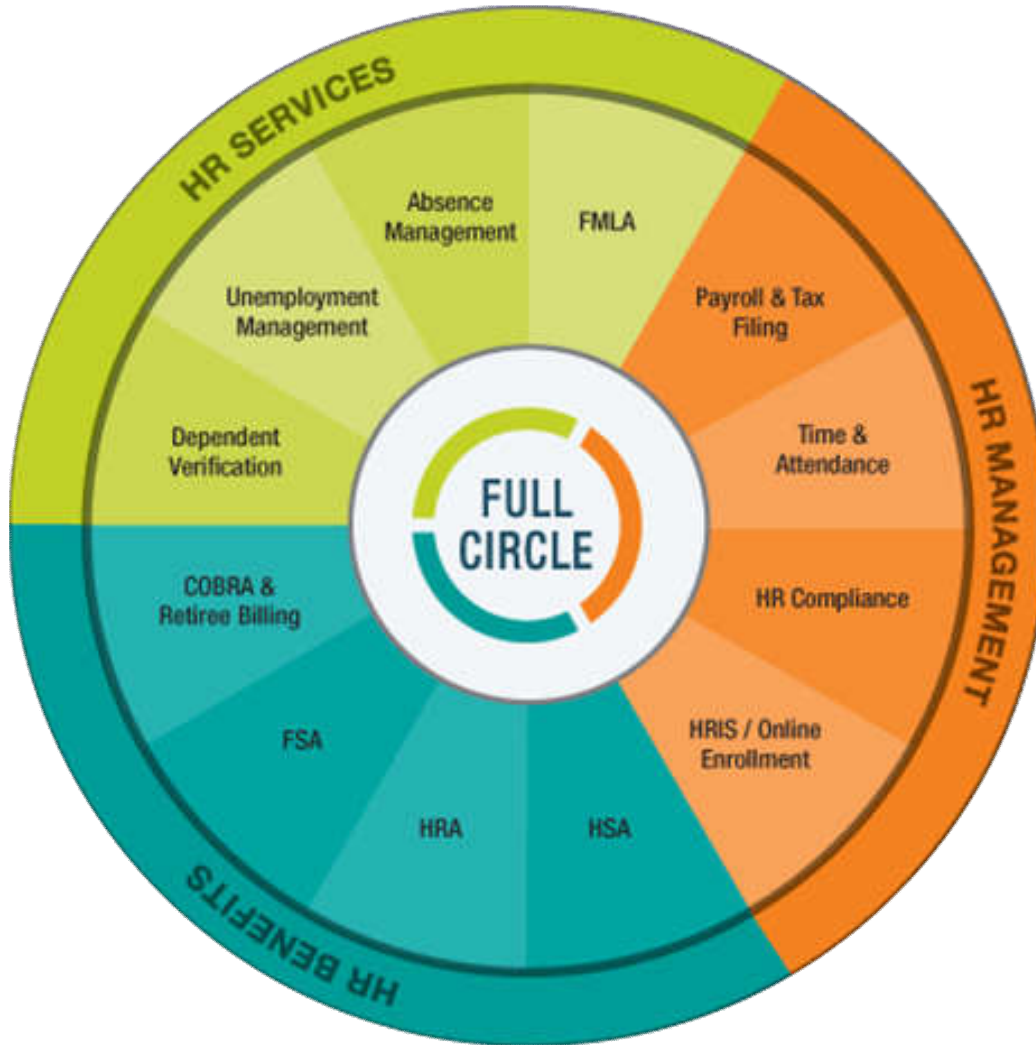
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