

# Worker Classification: Independent Contractor vs. Employee

February 18, 2016

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# Employer Obligations to Independent Contractors

- Companies are not required to withhold taxes from independent contractors and do not have to pay FICA, FUTA, or New York unemployment taxes for independent contractors
- Companies are not required to provide government-mandated or employer-provided benefits to independent contractors
- Independent contractors cannot organize and form a union with other company employees
- Companies are not required to comply with federal workforce protection laws with respect to independent contractors

# Risks of Worker Misclassification

- Liability for additional Federal or state taxes, interests and penalties.
- Individual and class action law suits by allegedly misclassified workers (wages, overtime pay, employment provided benefits and government mandated benefits).
- Government civil or criminal actions.
- Attorney's fees, expert fees and court costs.

# Worker Classification Tests

- New York State Department of Labor (NY DOL Test)
- New York Construction Industry Fair Play Act (ABC Test)
- Fair Labor Standards Act Economic Realities Test
- Common Law/IRS “Right to Control” Test
- Other similar tests are used for specific statutes

# NY DOL Focus on Worker Classification

- New York State Joint Enforcement Task Force on Employee Misclassification
  - State Attorney General's Office, Workers' Compensation Board, Departments of Labor and Taxation, and New York City's Comptroller's office.
  - Enforcement sweeps, coordinated investigations, referrals of audit results and data sharing between the New York agencies.
  - US DOL July 15, 2015 Administrator's Interpretation – WHD entered into Memo of Understanding with states, IRS.

# NY DOL Test

## Who is an independent contractor?

- Independent contractors are free from supervision, direction and control in the performance of duties
- Evidence of independent contractor status includes:
  - Having an established business
  - Working for more than one company (incl. competitor)
  - Advertising in the electronic and/or print media
  - Using business cards, business stationery, and billheads
  - Carrying insurance

# NY DOL Test

## Who is an independent contractor?

### CON'T

- Having place of business
- Making an investment in facilities and equipment
- Paying one's own expenses
- Assuming risk for profit or loss in providing services
- Determining one's own schedule
- Setting or negotiating own pay rate
- Right to refuse work offers
- Right to hire help
- Written independent contractor agreement does not necessarily carry the day.



# NY DOL Test

- An employer-employee relationship exists when an employer:
  - Requires full-time work
  - Sets work hours
  - Requires prior permission for absences
  - Tells the individual when, where, and how to do the job
  - Directly supervises the job
  - Provides facilities, equipment, tools, or supplies
  - Provides reimbursement for business expenses
  - Provides fringe benefits
  - Broadening of the definition of “employer” (joint employment issues)

# NY DOL Test

## New York State Consequences of Misclassification:

- Unpaid unemployment insurance, disability insurance and employment taxes.
- Claims for unpaid wages or overtime.
  - liquidated damages in an equal amount to the wages owed, and reasonable attorney's fees and costs.
  - if employer fails to keep records of hours worked, presumed that employee's estimate of hours worked is accurate.
  - 6 year statute of limitations under New York Labor Law for wage violations.

# IRS “Right to Control” Test

- Test used to determine whether to withhold federal income taxes, and withhold and pay FICA and FUTA taxes
- With exception of certain statutory employees, worker classification is based on common law right to control standard
- The test under this standard is whether the business entity has the right to “direct and control” the worker not only as to the results obtained but means of achieving those results
- IRS uses three categories in determining independent contractor status

# IRS “Right to Control” Test

## Behavioral Control Factors

- Evidence that substantiates right to direct or control the details and means by which the worker performs the required services
- Behavior control factors that demonstrate employee status includes:
  - Detailed instructions on how to perform work
  - Performance evaluation system that measures compliance with details of how work is to be performed
  - Periodic or ongoing training provided by a business about procedures to be followed

# IRS “Right to Control” Test

## Financial Control Factors

- These factors look at whether there is a right to direct and control the means and details of how the worker performs services
- Evidence of independent contractor status includes:
  - Significant investment by the worker
  - Unreimbursed expenses of the worker
  - Services available to the relevant market (worker is free to seek out other business opportunities)
  - Method of payment (the worker bills for services on a flat fee basis rather than hourly)
  - Opportunity for profit or loss

# IRS “Right to Control” Test

## Relationship of the Parties Factors

- Focuses on the structure of the relationship between the worker and the business
- Factors examined includes:
  - Intent of the parties/ written contract
  - Incorporation of the worker
  - Employee Benefits
  - State law characterization
  - Discharge/termination
  - Permanency of the relationship
  - Regular business activity

# Fair Labor Standards Act Economic Realities Test

- Independent contractor issues under the Fair Labor Standards Act (FLSA) are resolved using the “economic realities test”
- Broad definition of “employ” – suffer or permit to work
- Misclassified workers are entitled to the federal minimum wage of \$7.25 per hour (\$9.00 in NY) and overtime at time and one-half the worker’s regular rate for all hours over forty in a workweek
- US DOL issued Administrator’s Interpretation in July 2015 on independent contractors: “the application of the economic realities factors should be guided by the FLSA’s statutory directive that the scope of the employment relationship is very broad.”

# Fair Labor Standards Act Economic Realities Test Factors

- Focuses on whether the employee is economically dependent on the employer versus truly in business for him or herself.
- No one factor is determinative; all must be considered
- Extent to which the services rendered are an integral part of the employer's business (performing the primary work of the employer)
- The permanency of the relationship
- The amount of the worker's investment in facilities and equipment
- The nature and degree of control by the principal
- The alleged contractor's opportunities for profits and loss
- The amount of initiative, business skill, judgment, or foresight in open market competition with others is required for success
- The degree of independent business organization and operation



# NY Construction Industry Fair Play Act

- Applies to all construction including home improvement.
- Establishes presumption of employment.
- Establishes stricter employment test with clearer guidelines for determining employee vs. independent contractor by using the “ABC” test.
- Requires Employers to Post Notices of Employee Rights.
- Imposes monetary and criminal penalties for willful employee misclassification.

# NY Construction Industry Fair Play Act

## The “ABC” Test

Presumption of “employee” status unless worker meets all three criteria:

- (A) The individual is free from direction and control in the performance of their job, both under contract and in fact.
- (B) The service is performed outside the usual course of business for which the service is performed.
- (C) The individual is customarily engaged in an independently established trade, occupation, profession or business that is similar to the service at issue.

# NY Construction Industry Fair Play Act Penalties for Failure To Comply

- Assessment of Civil Penalties
  - First violation: Up to \$2,500 per misclassified employee.
  - Subsequent violation(s): Up to \$5,000 per misclassified employee within a 5 year period.
    - No more than one civil penalty may be imposed per employee per incident of misclassification.

# NY Construction Industry Fair Play Act Penalties for Failure To Comply Cont'd

- Assessment of Criminal Penalties
  - A contractor who willfully violates the Fair Play Act may be subject to a misdemeanor and upon conviction be subject to the following penalties:
    - Imprisonment of not more than 30 days or a fine not to exceed \$25,000 for the first offense.
    - Imprisonment of not more than 60 days or a fine not to exceed \$50,000 for each subsequent offense.

# NY Construction Fair Play Act Poster Requirement

- Must be posted at the construction site and be visible to all construction workers.
- Describes the rights/responsibilities of the workers.
- Describes the responsibilities of the Independent Contractor.
- Describes protections against retaliation and penalties.

# EXAMPLES

- Example 1: Adam Sorkin writes a screenplay for an episode of the Working Dead. He sold the screenplay to XYZ Company. The work he has done is independent of the production of the episode and he receives no instruction from XYZ Company. Quincy Tarantino only works for XYZ Company and has been instructed to perform modifications to the screenplay that XYZ Company acquired from Sorkin. Are Sorkin and Tarantino independent contractors or employees of XYZ Company?

# EXAMPLES

- Example 2: Junior Edison is an electrician that submitted a job estimate to a housing complex for electrical work to complete the wiring of the laundromat. He is paid every week for the next 12 weeks. Even if Edison works more hours, he will receive the estimate payment submitted. He also performs additional electrical work under contracts with other companies. Is Edison an independent contractor or an employee of the housing complex?

# EXAMPLES

- Example 3: Heidi Banks is a model that graduated from ABC modeling agency. Heidi is not permitted to do free-lance modeling, and only functions through the ABC modeling agency. All of Heidi's expenses are reimbursed by ABC modeling agency. Is Heidi an independent contractor or employee of ABC modeling agency?



# Avoiding Misclassification

- Independent Contractor Agreements and other written agreements
  - Specify independent contractor status; tax provisions
- Policy on engagement of independent contractors
- Adopt strategies to reduce risks

# EE vs. IK – Take Away

Review status of your independent contractors!

- Are they working exclusively for you?
- Are they in your office and/or using your equipment?
- Are you requiring when, where and how services will be performed?
- Are you supervising them/reviewing work?
- Are you requiring oral or written reports?
- Are you requiring attendance at meetings and/or training sessions?
- Are you evaluating their performance?
- Are you providing them with benefits?

## QUESTIONS & COMMENTS

You can obtain a copy of the presentation/handout by emailing

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