Employing Independent Contractors

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Scope—This article provides an overview of issues and practices associated with the use of independent contractors as a staffing management solution. It addresses practical matters, legal issues and proactive steps HR professionals can take to successfully and legally use independent contractors as a staffing management solution.

Overview

In addition to hiring traditional employees, HR professionals can meet their organization's staffing needs through a variety of alternative arrangements. Such options are referred to collectively as the "contingent workforce." *See* Contingent Workers Training for Supervisors Part I-III (/TemplatesTools/Samples/PowerPoints/pages/contingentworkerstrainingi-iii.aspx), Part IV (/TemplatesTools/Samples/PowerPoints/Pages/ContingentWorkersTrainingIV.aspx), and Parts V-VI (/TemplatesTools/Samples/PowerPoints/Pages/ContingentWorkersTrainingV-VI.aspx).

The possibilities include the following types of workers:

- Independent contractors.
- Temporary employees.
- Seasonal employees.
- Leased workers.
- Interns.
- Volunteers.

See Employing Contingent Workers (/TemplatesTools/Toolkits/pages/employingcontingentworkers.aspx) and Wage and Hour, DOL FLSA Advisor: Volunteers (http://www.dol.gov/elaws/esa/flsa/scope/er16.asp).

This article focuses on the first of these—independent contractors—although the categories may overlap, and some of the same principles may apply.

Perhaps the most basic question about the employment relationship is whether a worker is, in fact, an employee or an independent contractor. As with so many employment law issues, the answer is, "It depends." In this case, it depends in particular on who is asking: the U.S. Internal Revenue Service (IRS), the U.S. Department of Labor (DOL), a workers' compensation hearing officer and so on. Even courts have admitted that the distinction is not always clear.

Employee status triggers employer obligations under various federal and state laws that do not apply to independent contractors, and the responsibility for classifying a worker correctly falls squarely on the employer. Accordingly, HR professionals must understand the practical and legal differences between employees and independent contractors.

No bright-line test exists to determine when a worker should be classified as an employee rather than as an independent contractor. However, a wealth of information is readily available to help organizations make the necessary case-by-case determinations. Once the decision has been made to meet a staffing need through independent contractors, organizations can take a number of practical steps to manage independent contractors effectively.

The Staffing Decision: Employees or Independent Contractors?

Organizations cannot use independent contractors indiscriminately to avoid the tax, equal employment opportunity and other legal requirements applicable to employees. Organizations face significant risks when they improperly classify a worker as an independent contractor when, under all the circumstances, that worker should be treated as an employee.

In general, engaging a regular employee when an independent contract might have been a better staffing solution poses fewer risks. However, if the organization does hire a regular employee for a specific project, knowing additional work will not likely be available, the best practice is to inform the individual in writing that employment is for a limited duration. Keeping the employee in the dark on this subject could bring a claim against the organization for promissory estoppel, fraudulent nondisclosure or negligent misrepresentation.

Accordingly, an employer should consider a variety of factors—none of them in isolation—in deciding whether to meet a staffing need by means of independent contractors versus employees. Weighing the requirements of the job in combination with other factors will enable the employer to judge whether an independent contractor will both meet the employer's staffing needs and withstand legal scrutiny.

Duration

If the staffing need relates to a specific project with no likelihood of continued employment, using an independent contractor as project manager would avoid the problem of having to lay off an employee when the project is done. Such a case would weigh in favor of independent contractor status.

Exclusivity

If the organization needs the worker's full-time efforts over an extended or indefinite period, the situation would likely call for a traditional employee. Regulatory authorities will tend to view long-term independent contractors who have only one client as suspiciously similar to employees. If the organization needs the worker only part time, does not object to the individual having other clients or will be satisfied as long as the worker meets set deadlines, then the organization is on relatively solid footing in engaging an independent contractor.

Control

If the employer will rigidly prescribe the manner in which the work is performed, that weighs toward employee status. Hiring an employee would be the safer course of action. If the organization is concerned only about the final product and does not need to dictate how the worker gets from point A to point Z, an independent contractor may be the preferred approach.

Independent judgment

If the relevant job requires exercise of independent judgment, engaging an independent contractor may be a sound choice. An organization might choose to use an outside contractor to manage a specific complex project such as facilitating the transition after a merger or acquisition, for example.

Specialized knowledge, training or experience

Organizations routinely engage professionals such as lawyers and accountants as independent contractors. Information technology professionals also commonly serve on that basis.

Other situations requiring an independent contractor's specialized knowledge, training or experience might include:

- A defense contractor that needs specialized know-how to help win a particular contract.
- An organization that needs a trainer to deliver specialized programs.

Stewardship of confidential matter

It may seem inappropriate and risky for employers to entrust independent contractors with confidential information. Nevertheless, an argument can be made that some types of sensitive information are *more* safely lodged outside the organization than inside, where leaks and gossip predictably occur. Some organizations choose independent contractors to safeguard employees' medical privacy and family and medical leave records, for example.

Personal services

Individuals who provide clients with personal services will tend to be independent contractors rather than employees. A hair styling salon in a retirement community is more likely to be staffed with independent contractors than employees of the management company, for example. Similarly, an organization would be well justified in hiring an executive coach on an independent contractor basis.

Importance of marketing

Real estate agents, mortgage brokers, stock brokers and financial planners are often compensated on a commission basis that depends largely on their ability to bring in new business. A commission-based compensation arrangement makes meeting a staffing need through independent contractors particularly appropriate. This is especially true if the contractor's clients are deemed to be property of the contractor and not of the hiring organization.

Exigent circumstances

An urgent need may warrant engaging an independent contractor to perform work that a regular employee normally does. Meeting needs created when a worker goes on extended leave, for example, would weigh in favor of hiring an independent contractor even if the work required extensive controls over the worker's efforts and output. Generally, an organization can find a suitable independent contractor faster than it can find a suitable employee. (An organization may well want to pursue both avenues simultaneously, bringing in an independent contractor to deal with exigent circumstances, but taking its time to select a regular employee to assume the duties long term.)

Business essentials

Regulatory authorities will expect that truly independent contractors do not need organizations to provide them with an office, equipment or other basic necessities of doing business.

Employees doing the same job

Employees and independent contractors doing the same job is a big red flag for regulators. It is very risky for an organization to have two classes of workers—independent contractors and employees—performing the same job. If challenged, the employer will be expected to offer a clear and convincing rationale that does not involve avoiding legal obligations.

Industry standard

The legality of a worker's classification as an independent contractor often boils down to the issue of reasonableness. In determining reasonableness, regulatory agencies often consider how other organizations in the same industry handle similar situations. Using independent contractors works better in certain industries such as computer programming, sales and the courier industry.

Controlling administrative overhead

Independent contractors normally are not eligible for employer-provided benefits and are responsible for their own income and employment taxes. If the organization is able to legitimately treat an entire class of workers as independent contractors, it may save substantially on administrative overhead.

The July 15, 2015, DOL Administrator's Interpretation 2015-1 Subject: The Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who Are Misclassified as Independent Contractors (http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.pdf) provides additional clarification of the DOL's view on how employers and particularly courts should interpret the "economic realities" test used to determine whether a worker is an employee for purposes of the Fair Labor Standards Act (FLSA). The test includes the following six factors aimed at helping courts make this determination:

- Is the work an integral part of the employer's business?
- Does the worker's managerial skill affect the work opportunity for profit or loss?
- How does the worker's relative investment compare to the employer's investment?
- Does the work performed require special skill and initiative?
- Is the relationship between the worker and the employer permanent or indefinite?
- What is the nature and degree of the employer's control?

Companies that use independent contractors should re-examine their independent contractor relationships in light of the July 2015 Administrator's Interpretation to assess whether they are likely to withstand scrutiny under the DOL's new interpretation of the economic realities test.

Legal Ramifications of Misclassification

Classifying a worker as an independent contractor should always be an informed and bona fide business decision, not a subterfuge to avoid the employer's obligations to employees. Independent contractor arrangements have drawn increasing scrutiny and significance with the proliferation of workplace laws covering employees and the growth of the contingent workforce. Misclassification of an individual as an independent contractor can give rise to a variety of liabilities.

If the purported independent contractor arrangement is between two organizations, that is, between the organization receiving the services and the organization that actually engages the workers, there is a risk of being found a "joint employer"—a legal relationship in which *both* client and contractor can be liable for violations of employment laws.

Tax consequences

Employers are required to withhold income taxes on the basis of information employees provide on IRS Form W-4. If an employer fails to withhold income taxes on behalf of a worker improperly classified as an independent contractor, and the individual has failed to pay the taxes, the putative employer may be liable for federal or state taxes that were required to be withheld but were not.

In addition, independent contractors are not eligible to receive tax-free benefits from the organization. If the company chooses to offer health care benefits to an independent contractor, the contractor must pay income taxes on the value of the benefit. If the company includes an independent contractor in its defined benefit pension plan, it risks losing the tax-exempt status of the plan. *See* Regulation of Employee Benefits (http://www.dol.gov/oasam/programs/history/herman/reports/futurework/conference/staffing/9.6_benefits.htm).

Employee benefits obligations

In an illustrative case, *Vizcaino v. Microsoft Corporation*, the court found that Microsoft had mischaracterized certain workers as independent contractors and freelancers. Although the workers had been hired for specific projects, some continued to work on successive projects for a number of years. They were fully integrated into Microsoft's workforce, and worked onsite and on work teams along with Microsoft's regular employees. They also shared the same supervisors, performed identical functions and worked the same core hours as regular employees. Microsoft provided them with admittance card keys, office equipment and supplies. However, as independent contractors, these workers were not eligible for the same employee benefits that Microsoft's regular employees received. Microsoft reached a settlement for $96,885 million and was subsequently assessed approximately $27,128 million in attorneys' fees and costs.

Workers' compensation

A misclassified worker can result in the supposed employer being held liable for on-the-job injuries outside the protections of the workers' compensation system, and for penalties as well.

Unemployment compensation

A worker may file a claim for unemployment compensation and be granted benefits if the unemployment agency believes that the worker was misclassified as an independent contractor. If the organization misclassified the worker, it may be liable for penalties and interest in addition to unpaid unemployment insurance premiums.

Wage and hour liability

The widespread use of independent contractors invites the scrutiny of plaintiffs' attorneys who may be eager to bring a class or collective action suit for unpaid overtime or minimum wage violations under the FLSA or state wage and hour laws. *See* SHRM's State Employment Law Charts (/legalissues/stateandlocalresources/stateandlocalstatutesandregulations/pages/default.aspx). Then use the drop-down menu to access the overtime and minimum wage laws for each state.

Vicarious liability

An employer may incur liability for wrongful acts of a worker whom it has mistakenly classified as an independent contractor.

How to Classify Properly

No legal test applies in every situation when deciding to classify a worker as an independent contractor. For example, the IRS and DOL use different, although similar, analytical frameworks. In fact, the multiplicity of tests defining independent contractor status applied across federal and state laws makes it possible for a worker to be classified as an independent contractor under one law but as an employee under another.

To minimize legal risk, employers are well advised to ensure that classification as an independent contractor would satisfy *every* test that may be applicable where the organization does business.

SHRM assisted Congress in attempting to draft better and more comprehensive legislation concerning the meaning of "independent contractor." For U.S. DOL recommendations on the subject, *see* Contingent Workers (http://www.dol.gov/_sec/media/reports/dunlop/section5.htm).

Tests for independent contractor status

Various federal government agencies and some states have their own tests to determine independent contractor status.

U.S. DOL. *See*:

- 2015 DOL Administrator's Interpretation 2015-1 Subject: The Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who Are Misclassified as Independent Contractors (http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.pdf)
- Fact Sheet #13: Employment Relationship Under the Fair Labor Standards Act (http://www.dol.gov/whd/regs/compliance/whdfs13.pdf) (PDF)
- Independent Contractors (http://www.dol.gov/elaws/esa/flsa/docs/contractors.asp)

Additionally, some statutes enforced by the U.S. DOL, such as the federal Service Contract Act, contain their own definitions of what constitutes an employee for purposes of the statute. *See* Employee coverage does not depend on form of employment contract (http://www.gpo.gov/fdsys/pkg/CFR-2001-title29-vol1/xml/CFR-2001-title29-vol1-sec4-155.xml).

U.S. IRS. As reflected in Section 2 of its Publication 15-A: Employer's Supplemental Tax Guide (http://www.irs.gov/pub/irs-pdf/p15a.pdf) (PDF), the IRS now looks at 11 factors (rather than the previous 20 factors) within three areas—behavioral control, financial control and the relationship between the parties. Organizations can obtain an official determination of a worker's status under the IRS test by filing IRS Form SS-8 (http://www.irs.gov/pub/irs-pdf/fss8.pdf). It takes about six months for the IRS to rule.

Workers' compensation laws. The test for independent contractor status under workers' compensation laws varies from state to state. To find out more about the workers' compensation test in a given state, employers may contact the state department of industrial relations or the state labor department (/LegalIssues/StateandLocalResources/StateandLocalStatutesandRegulations/Documents/StateLaborDepartments.pdf).

Effective practices

Organizations can take a number of proactive steps to ensure that they effectively use independent contractors within the bounds of the law:

- Involve HR up front in making a decision whether to meet a staffing need through independent contractors or employees and in making sure that the arrangement qualifies as a bona fide independent contractor relationship.
- Use written independent contractor agreements containing language that helps establish the bona fides of the classification as an independent contractor. *See* Sample Independent Contractor Agreement (/TemplatesTools/Samples/HRForms/Articles/Pages/1CMS_006447.aspx).

Organizations may ask the worker to indemnify the organization for any losses resulting from misclassification or to regularly provide the organization with proof that the independent contractor is timely in paying all employment taxes due.

- Adopt a formal policy concerning the use of independent contractors. *See* Contingent Staff: Contract and Temporary Employees Policy (/TemplatesTools/Samples/Policies/Pages/CMS_000577.aspx).
- Use a checklist to make sure all details regarding management of independent contractors are being handled. *See* Independent Contractor: Hiring Checklist (/TemplatesTools/Samples/HRForms/Articles/Pages/CMS_010200.aspx).
- Do not treat independent contractors like regular employees, but do ensure that they understand and adhere to the organization's policies and procedures.

See Audit Checklist for Maintaining Independent Contractor (IC) Status (/TemplatesTools/Samples/HRForms/Articles/Pages/CMS_020334.aspx).

Templates and Tools

Samples

Sample Independent Contractor Agreement (/TemplatesTools/Samples/HRForms/Articles/Pages/1CMS_006447.aspx)
Contingent Staffing Policy: Contract and Temporary Employees (/templatestools/samples/policies/pages/cms_000577.aspx)

Information tools

Fact Sheet #13: Employment Relationship Under the Fair Labor Standards Act (http://www.dol.gov/whd/regs/compliance/whdfs13.pdf) (PDF)
Independent Contractors (http://www.dol.gov/elaws/esa/flsa/docs/contractors.asp)
Employee Misclassification as Independent Contractors (http://www.dol.gov/whd/workers/misclassification/pressrelease.htm)
Fair Labor Standards Act Advisor: Independent Contractors (http://www.dol.gov/elaws/esa/flsa/scope/ee14.asp)
Litigation Over Independent Contractor Misclassification Grows (/legalissues/stateandlocalresources/pages/litigationoverindependentcontractormisclassificationgrows.aspx)
SHRM Legal Report: Independent Contractor Classifications Hold Many Risks (/LegalIssues/EmploymentLawAreas/Documents/LRReport0712.pdf) (PDF)
Independent Contractor: Audit Checklist for Maintaining Independent Contractor (IC) Status (/TemplatesTools/Samples/HRForms/Articles/Pages/CMS_020334.aspx)
Independent Contractor: Hiring Checklist (/TemplatesTools/Samples/HRForms/Articles/Pages/CMS_010200.aspx)
A Study of Effective Workforce Management (/research/surveyfindings/documents/a%20study%20of%20effective%20workforce%20management.pdf) (PDF)

HR Q&As

Contingent Staffing: Can an independent contractor or a consultant manage company employees (/templatestools/hrqa/pages/contingent-staffing-can-an-independent-contractor-or-a-consultant-manage-company-employees.aspx#sthash.r91s4ivJ.dpuf)
Independent Contractor: Can an employer terminate and rehire an employee as an independent contractor doing the same job?
(/templatestools/hrqa/pages/cananemployerterminateandrehireanemployeeasanindependentcontractordoingthesamejob.aspx)
Independent Contractor: Is there any guidance for employers when managing the relationship with an independent contractor?
(/TemplatesTools/hrqa/Pages/Isthereanyguidanceforemployerswhenmanagingtherelationshipwithanindependentcontractor.aspx)
Independent Contractor: Can an employee also work as an independent contractor for the same employer?
(/TemplatesTools/hrqa/Pages/employeeasindependentcontractorandstaffemployee.aspx)
Independent Contractor: What is a statutory employee? (/TemplatesTools/hrqa/Pages/Whatisastatutoryemployee.aspx)
Independent Contractor: Who can be considered an independent contractor?
(/TemplatesTools/hrqa/Pages/independentcontractor.aspx)
Interns: Can interns be independent contractors? (/TemplatesTools/hrqa/Pages/Caninternsbeindependentcontractors.aspx)

Agencies and organizations

U.S. Department of Labor (http://www.dol.gov/)
U.S. Internal Revenue Service (http://www.irs.gov/)

(http://www.irs.gov/)

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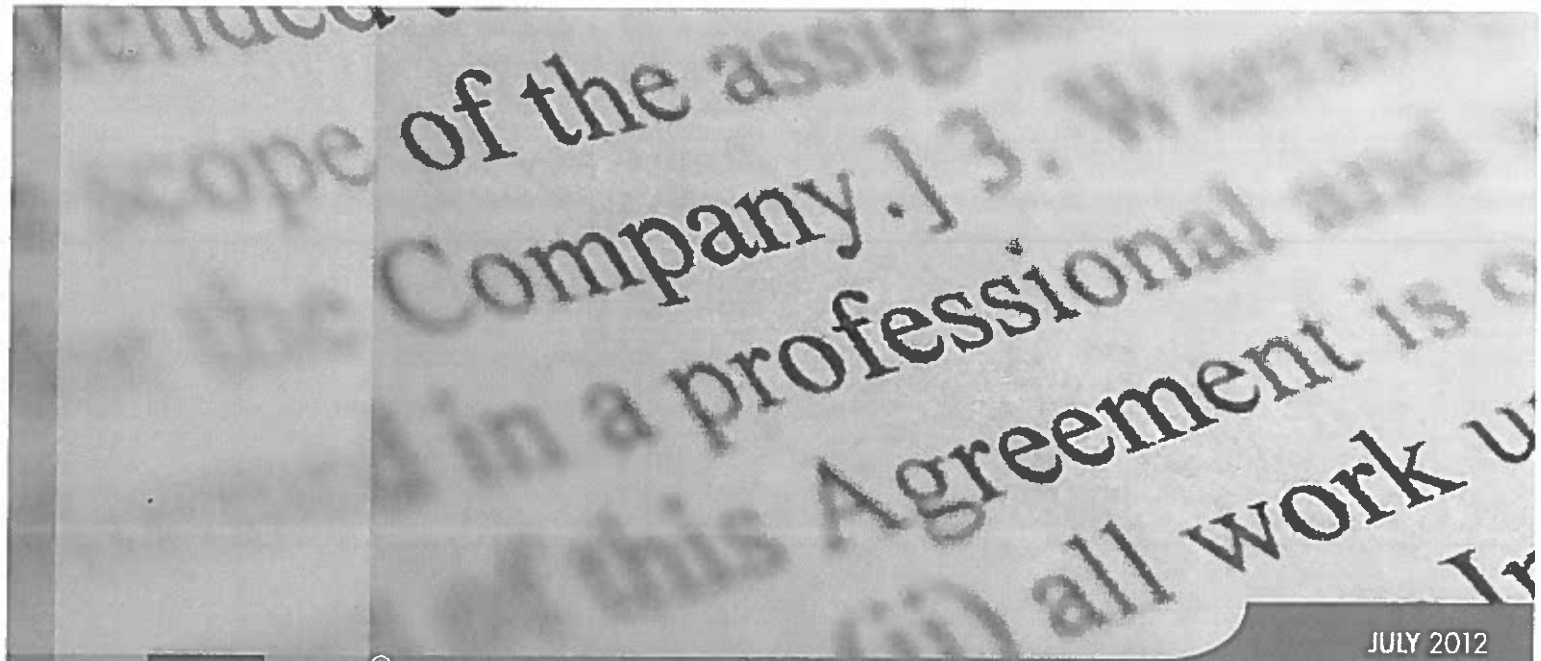

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Independent Contractor Classifications Hold Many Risks

By Randall D. Avram and Michael T. Rosenberg

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Among the handful of employment law issues currently targeted by plaintiffs' lawyers and government agencies, only independent contractor misclassifications are under attack from so many angles.

An employer's decision to classify a worker as an independent contractor can be challenged as a result of any number of triggers, such as a federal or state tax audit, a benefits dispute, a workers' compensation claim, an unemployment claim, a wage and hour lawsuit, a federal Department of Labor audit (or its state equivalent), merger/acquisition due diligence, or a discrimination lawsuit. Although each of these liability sources carries its own threat of significant penalties and costs, a misclassification challenge on any one of these fronts threatens to trigger attacks from all sides.

Potential penalties and civil damage or settlement awards represent powerful incentives for government agencies, as well as plaintiffs' lawyers, to identify misclassified workers and make employers pay. Federal and state agencies have begun treating misclassification enforcement not just as a way to protect workers but also as an important revenue source in a time of dire budget gaps. As made clear by recent legislative and administrative initiatives across all levels of government, the assault on independent contractor classifications continues to escalate.

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Allure of Independent Contractors

Employers have many good reasons for treating workers as contractors. For example, independent contractors are responsible for their own taxes. They can be paid on a Form 1099 basis without FICA or employee tax withholdings.

Also, most employment laws simply do not apply to independent contractors. Companies need not pay into the unemployment system or for workers' compensation insurance for contractors. Independent contractors also are ineligible for workers' compensation benefits (though this means they can bring civil lawsuits for workplace injuries without regard to the workers' compensation bar); are not covered by company health insurance, retirement plans or other employee benefits; are not subject to wage and hour laws, including overtime requirements; and generally cannot sue for employment discrimination under Title VII.

In addition, many businesses operate under the mistaken belief that they can safely treat a worker as an independent contractor as long as the worker agrees to be so classified. For all these reasons, many companies overuse independent contractor classifications. This trend has not gone unnoticed by government agencies.

A 2009 federal audit report estimated that independent contractor misclassification results in a $54 million underreporting of employment taxes. The prevalence of contractor misclassification makes it a prime revenue source for both plaintiffs' lawyers and governmental bodies alike, all at the expense of the employer.

Many Costs of Misclassification

The advantages mentioned above of treating a worker as an independent contractor arise because the single decision to classify a worker as an independent contractor implicates so many aspects of the company-worker relationship. However, each of these benefits of classifying a worker as an independent contractor brings a corresponding source of potential liability for misclassifying that worker.

On the tax front, the Internal Revenue Service (IRS) has implemented a three-year initiative targeting 6,000 randomly selected employers to focus on independent contractor misclassifications. Federal legislation has also been introduced to close the so-called loophole created by the safe harbor provision of Section 530 of the Revenue Act of 1978.

Section 530 protects the treatment of a worker as an independent contractor for tax purposes if, among other factors, the taxpayer has a reasonable basis for treating the worker as an independent contractor, such as reliance on judicial precedent, industry practice or the results of a prior tax audit of the company. The proposed Fair Playing Field Act of 2012 (S. 2145, H.R. 4123) would seek to limit the protection of Section 530 by requiring the IRS to issue prospective guidance on independent contractor classifications and to require that employers comply with that guidance. Significantly, the bill would also require workers classified as independent contractors to be provided a written notice of the significance of that classification and their right to seek a status determination from the IRS.

Misclassifying employees as independent contractors can also lead to significant overtime liability under the Fair Labor Standards Act (FLSA), whether triggered by a lawsuit or by a Department of Labor audit. FLSA liability can be compounded by the fact that companies often fail to keep FLSA-compliant time records for workers mistakenly believed to be independent contractors.

Inadequate time records subject employers to recordkeeping penalties and diminish their abilities to defend civil lawsuits–as courts generally accept employees' own calculations of their hours worked absent specific evidence to the contrary.

In the event of a misclassification, companies are also unlikely to have adequately focused on preserving exemptions under the seemingly inapplicable FLSA. An otherwise-exempt employee, such as a highly compensated professional, will be entitled to overtime for all hours worked over 40 each workweek if, due to a classification error, the employee was paid by the job or the hour rather than on a salary basis.

Employers are often surprised and troubled both by the magnitude of FLSA liability as well as by the realization that it could have been avoided. Had a company known a worker was not properly considered an independent contractor, it might well have structured the employee's wages so as to net the worker the same amount–such as by maintaining an FLSA exemption, by setting an hourly wage with the overtime multiplier in mind or by scheduling workweeks to avoid overtime altogether.

Even when a technical violation seems like a no-harm, no-foul situation, the FLSA holds the employer accountable for overtime payments it would never have agreed to pay in the first instance and then magnifies liability to up to six times the yearly overtime amount, plus interest and attorneys' fees. If an employer is found to have violated the FLSA, it will be required to pay back wages for the preceding two years–three years for a willful violation–to each employee. The amount will be

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doubled by a liquidated damages award unless the employer makes the difficult showing that it acted in good faith. This formula can produce staggering liability figures, especially when an entire class of employees is potentially misclassified.

Each of these various sources of liability stemming from a single classification decision has the potential to spark a chain reaction of liability. A government tax audit, or even a workers' compensation or unemployment claim by a single employee, can trigger a Department of Labor audit or a companywide class or collective action lawsuit seeking overtime pay and employee benefits.

For example, after a client recently lost an unemployment claim filed by a single worker classified as an independent contractor, it faced a companywide investigation by the state unemployment agency into whether other workers were similarly misclassified. Had we not persuaded the state that no other contractors were similarly situated to the misclassified worker, the company would have faced significant unemployment penalties, which would have threatened to spark civil liability as well.

The plaintiffs' bar monitors government enforcement efforts intently, waiting to swoop in and file wage and hour or employee benefits lawsuits on behalf of any employees who may have been misclassified. Over the last decade, while the number of cases filed each year in federal court has remained relatively constant, the number of FLSA lawsuits has nearly quadrupled and now accounts for more than 2 percent of all federal litigation.

A number of recent legislative steps seek to further connect the web of potential categories of liability stemming from a classification decision. The recently proposed Payroll Fraud Prevention Act would amend the FLSA to prohibit wrongful misclassification of employees as independent contractors. It would also require businesses to notify workers of whether they are classified as employees or "nonemployees" and subject them to fines of $5,000 per violation.

A number of state laws already prohibit the very act of misclassifying employees. New Jersey, for example, makes the knowing misclassification of an employee as an independent contractor a criminal offense punishable by 18 months in prison, thousands of dollars in fines, and a stop-work order requiring the cessation of all operations at the site of the misclassification until the employer has paid all fines and come into compliance.

In weighing the hefty costs of misclassifying employees as independent contractors against the considerable benefits achieved by classifying workers as contractors where appropriate, the obvious goal for employers should be to get classification decisions right the first time–a goal easier stated than achieved.

Paradigmatic Independent Contractor

Neither paying a worker on a 1099 basis nor having a written agreement about the worker's contractor status will justify treating an employee as an independent contractor. In the event of a lawsuit or audit, courts and government agencies will analyze whether the worker's relationship with the company more closely resembles that of the paradigmatic employee or the paradigmatic contractor.

Meet Ed. Ed is a maintenance worker in a large textile mill. He works as part of a 10-person maintenance department and reports directly to a maintenance supervisor. Ed is paid by the hour and regularly works 9-to-5 shifts Monday through Friday.

Each workday, Ed is expected to progress through a series of maintenance-related tasks such as cleaning and inspecting machine parts, checking fluid levels, and making basic repairs. Ed has been trained on how to do each task and is counseled by his direct supervisor when he deviates from his training.

Carl is a licensed plumber. He owns Carl's Plumbing LLC and markets his services primarily to industrial facilities. When he gets a call from a new customer, Carl inspects the job and gives the company a quote. Regardless of how long it

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takes Carl to complete the job, he gets paid the quoted amount. In some months, Carl's income is extremely high, but he makes almost no money in other months.

Even if Ed and Carl were to perform the same service for the textile mill, such as fixing a leaky faucet, the law appropriately recognizes the fundamentally different relationships these workers have with the mill. Since the mill does not tell Carl when to work, it is not responsible for paying him overtime. Since the mill does not tell Carl how to fix the faucet, it would not be automatically liable for workplace injuries. Since Carl is in business for himself, he bears his own risk of being out of a job. While the list goes on, the point is that at the extremes, it makes perfect sense that the very real differences between an employee and an independent contractor would have material consequences on a host of employment law issues.

Gray Area

Many workers, however, fall somewhere in the middle of the employee-contractor spectrum.

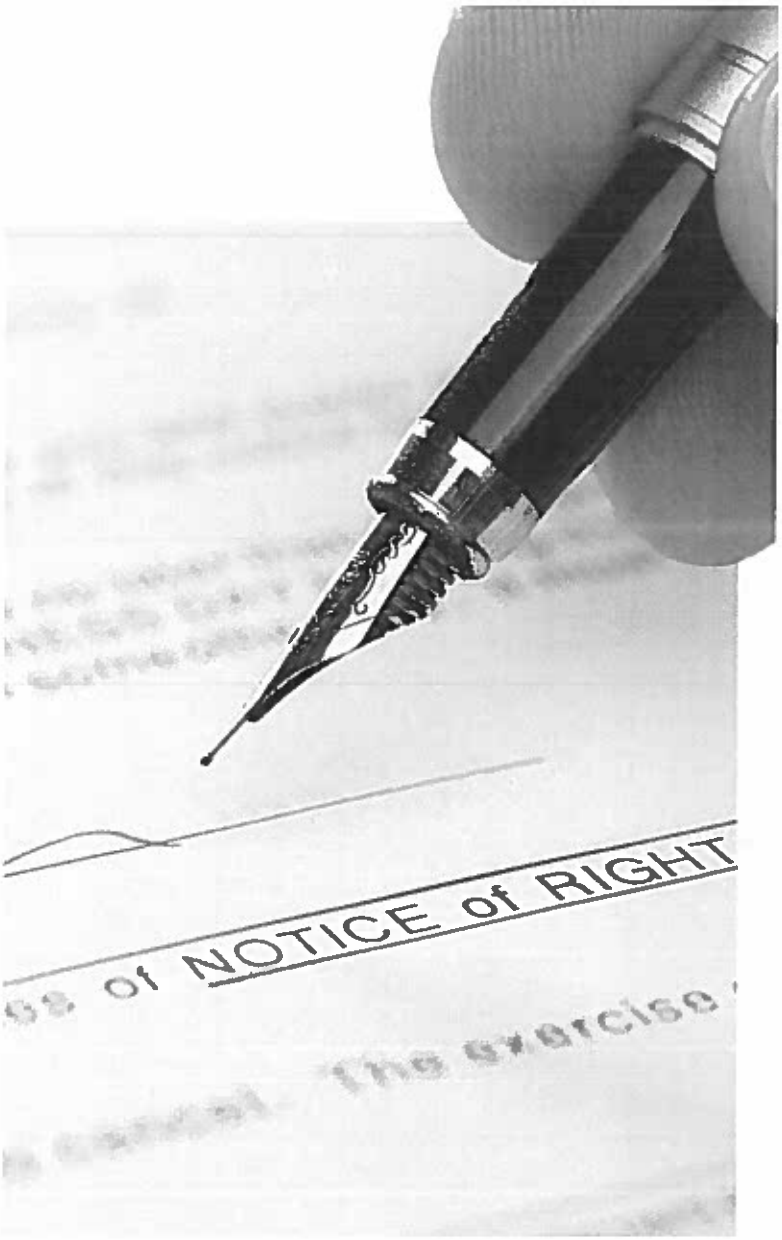
If Carl's Plumbing LLC worked exclusively for a single textile mill, Carl would look a little more like a mill employee. If the mill started telling Carl when to do his work, started paying him by the hour or started requesting that he do his plumbing work in a particular way, Carl would look more like an employee.

Quite often, certain aspects of the worker's relationship with the company resemble the employment paradigm while other aspects resemble an independent contractor arrangement. The difficulty arises because the law tries to jam each worker into one mold or the other, even if neither really fits.

Accordingly, a number of balancing tests have evolved to determine which classification is most appropriate.

The IRS test, for example, focuses on the company's right to control or direct the worker's work (such as the degree of training and performance evaluation), the company's right to control the economic aspects of the job (such as the worker's opportunity for profit or loss and whether the worker has incurred significant investment expenses), and other factors tending to show the relationship to be more like one paradigm or the other (such as whether the parties' relationship has an indefinite duration and whether the worker's duties are central to the company's business).

The difficulty in classifying a workforce is exacerbated by the recent proliferation of legislation in this area, which is only increasing the number of different tests with which a company must potentially comply.



Don't Wait

While predicting the side of the employee-contractor spectrum that a court or government agency will come down on is both highly fact-specific and extremely difficult, the costs of getting it wrong are simply too high not to fully analyze classification decisions on the front end. Companies that already use independent contractors should have their past classification decisions audited by a lawyer to identify potential liability under the protection of the attorney-client privilege and attempt to remedy any liability before a classification challenge arises. Otherwise, a single workplace injury, unemployment claim or government audit, or one worker's chat with a plaintiffs' lawyer, can trigger a host of liability for misclassifying employees as independent contractors.

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New York City Human Rights Law Has Changed Disability Law Landscape

By Neal I. Korval and Mark S. Goldstein

In a recent lawsuit that we defended, the plaintiff's attorney asserted a novel legal theory under the New York City Human Rights Law (NYCHRL).

In this case, the plaintiff suffered from a short-term pregnancy-related illness, which ceased upon delivery of her child. Her employer provided her with the requisite 12 weeks of Family and Medical Leave Act (FMLA) leave, but, upon return from leave, the plaintiff requested a part-time or work-from-home schedule. Despite the company's best efforts to reach a mutually acceptable accommodation, the requested work schedule did not coincide with the company's legitimate business needs, and the plaintiff's employment ended.

In the ensuing lawsuit, the plaintiff's attorney claimed that the plaintiff's pregnancy-related illness, although ceased by the time she sought the accommodation, constituted a record of impairment–and thus a "disability" within the meaning of the NYCHRL–that required her employer both to engage in the interactive process with the plaintiff and to provide her with the requested accommodation under the NYCHRL.

Although the notion that an employee's now-concluded temporary disability could require an accommodation is bewildering (how do you even accommodate such a record of impairment?), this would have been the first time that a court was presented with this issue. The case would have been analyzed under the explicit liberal intent of the NYCHRL, would have placed the burden of establishing "undue hardship" on the employer, could have exposed the company to uncapped punitive damages, and would have been expensive to litigate since summary judgment was unlikely due to factual issues surrounding the reasonableness of the requested accommodation. After weighing the facts and the stated liberal intent of the NYCHRL, the client chose to settle the case. But New York City employers should be on notice that the city's Human Rights Law is unique in many respects when it comes to disabilities.

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Big Apple's Own Disability Discrimination Law

As a center of global commerce, New York City is where many companies maintain headquarters, offices or some form of operations. While city employers generally are aware that their disability and leave of absence policies must comply with the federal Americans with Disabilities Act (ADA) and FMLA requirements, many are unaware that the NYCHRL imposes a greater burden on employers with respect to disability and leave practices.

The New York City Council enacted the NYCHRL to maximize protection from all discriminatory conduct for the millions of employees who work in New York City, but its impact on the field of disability law is particularly staggering. Among other things, the NYCHRL imposes responsibility on employers to accommodate and treat fairly those employees who are deemed "disabled," a principle consistent with the corresponding federal disability laws. In 2005, however, the NYCHRL was amended to ensure that courts and administrative agencies interpret the law more liberally than any of its federal and state counterparts. Thus, the groundwork was laid for an expansive disability discrimination law unlike any other.

Accordingly, HR professionals in New York City must:

- Understand the disability and leave of absence provisions of the NYCHRL.
- Appreciate the differences between the NYCHRL and other disability laws.
- Draft and implement policies in accordance with the liberal intent of the NYCHRL.
- Recognize the risks of noncompliance, including assertion of new legal theories under the NYCHRL by the plaintiffs' bar.

The NYCHRL is not the only disability discrimination law in effect, although it is the one toward which New York-area plaintiffs' attorneys appear to have gravitated in the past few years. In fact, it is rare to find a discrimination-based complaint against a New York City employer that does not contain an NYCHRL cause of action. Nevertheless, a brief review of the other relevant laws is necessary to appreciate the NYCHRL's expansive nature.

ADA

The ADA is the federal statute that prohibits discrimination based on an employee's actual or perceived disability. Although the ADA's definition of disability was recently expanded by the ADA Amendments Act, disabilities still must be permanent or long-term in nature to be covered by the ADA.

In addition to barring discrimination, the ADA requires an employer to provide a reasonable accommodation to enable the employee with a disability to perform the essential functions of his or her job. The burden is on the employee, however, to demonstrate that the employer wrongfully denied him or her a requested accommodation that would have allowed the individual to perform such functions.

FMLA

The FMLA is a related federal statute that requires employers to provide up to 12 weeks of unpaid leave within a 12-month period to those employees with a serious medical condition or other qualifying event. The leave provisions of the FMLA cover essentially all ADA disabilities as well as pregnancy-related medical conditions. With rare exception, the FMLA-protected employee is guaranteed job security and the continuation of benefits upon return from leave.

PDA

The Pregnancy Discrimination Act (PDA) requires that employers treat pregnant employees no less favorably than they treat employees with other disabilities or employees seeking nonmedical leaves of absence.

NYSHRL

Just as New York City maintains its own protective discrimination laws, New York state maintains the New York State Human Rights Law (NYSHRL). Although the NYSHRL broadens the ADA definition of "disability," it does not include short-term impairments in its definition of the term and is not nearly as expansive as the NYCHRL.

Broad Scope of the NYCHRL

While the above-referenced laws provide significant disability and leave of absence protection to employees, the NYCHRL goes much further to protect and potentially expand the rights of employees working in New York City. When the New York City Council passed the Restoration Act in 2005 to ensure and preserve the NYCHRL's broad scope and liberal interpretation, the management bar anticipated that plaintiffs' lawyers would assert significantly more claims under the NYCHRL in the following years. What has ensued, however, has shocked both

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the senses and the wallets of New York City employers. In the aftermath of the Restoration Act, state and federal courts have given a broad reading to the council's already liberal legislative intent, and have thus given rise to an extremely powerful pro-employee law.

The courts have liberally interpreted the NYCHRL with respect to employment issues. For example, the New York State Court of Appeals recently held that the *Faragher/ Ellerth* sexual harassment defense is not a permissible affirmative defense to a claim asserted under the NYCHRL (*Zakrzewska v. New Sch.*, 14 N.Y.3d 469 (2010)). Further, in recent years the New York City Council has considered (although not yet adopted) legislation that would provide employees with paid FMLA leave.

Broad Definitions

Among the principal reasons why the NYCHRL is considered so expansive are the broad definitions included in the law.

Similar to the ADA, the NYCHRL requires both non-discrimination and reasonable accommodations for employees with disabilities, but the city law defines "disability" much more broadly than its federal counterpart. In fact, by defining the term "disability" as "any physical, medical or psychological impairment, or a history or record of such impairment," it has become clear that the NYCHRL was intended to protect even those employees with short-term disabilities (arguably even those with a record of a temporary impairment). As bizarre as it may seem, until a court rules otherwise, it would be safest to conclude that the common cold or a sprained ankle are covered disabilities under the NYCHRL and that histories of such impairments are statutorily protected.

Further, the NYCHRL defines reasonable accommodation not only as those accommodations that would allow an employee to satisfy the essential requisites of the job, but also those accommodations that would allow the employee to enjoy a right that nondisabled employees enjoy as long as the disability is known or should have been known based on the specific circumstances. Relying on this broad definition, a New York state appellate court in 2009 issued a decision opining that essentially no requested accommodation should be deemed per se unreasonable according to the language of the NYCHRL (*Phillips v. City of N.Y.*, 66 A.D.3d 170, 884 N.Y.S.2d 369 (1st Dep't 2009)). According to that court, even a one-year leave of absence request (following the completion of FMLA leave) might constitute a reasonable accommodation that the employer could have a duty to provide to the employee with a disability.

Limited Defenses

In further contrast to its federal and state counterparts, the NYCHRL places the burden of refuting the reasonableness of a requested accommodation on the employer. Although two affirmative defenses are available to employers, their standards exemplify how burdensome this statute can be.

First, the employer may contend that the employee with a disability could not, even with the provision of a reasonable accommodation, satisfy the essential requisites of the job. This is in direct contrast to the ADA, under which the employee has the burden of proving that the employer wrongfully denied him or her a requested accommodation that would have allowed the employee to perform such functions.

The second affirmative defense to an employee's claim that he or she was denied a reasonable accommodation is that such accommodation would cause an "undue hardship" on the conduct of the business. The employer's burden of proving an undue hardship, however, is a difficult one to meet and will be analyzed under factors (e.g., size, financial resources, etc.)

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that will make it almost impossible for large and many mid-size employers to prevail. Thus, not only does the NYCHRL protect a wide variety of "disabilities," including those that are short-term, but it also requires that employers provide accommodations in almost all circumstances unless they can prove the unreasonableness of such accommodation by meeting a heightened legal standard.

Unlimited Damages Recoverable

The NYCHRL is unique not only in the broad protections it provides to employees but also in the damages that successful litigants may recover. In addition to compensatory damages and reinstatement, employees may recover reasonable attorneys' fees and uncapped punitive damages if they prevail under the NYCHRL. By contrast, federal discrimination laws set a statutory cap on punitive damages that varies depending on the size of the employer, and the NYSHRL does not permit successful litigants to recover either attorneys' fees or punitive damages. Thus, a jury may award considerably higher damages under the NYCHRL than under its federal and state counterparts.

The NYCHRL and You

The case that I discussed at the beginning of this article illustrates the need for companies and human resource professionals to be proactive in their approach to the NYCHRL. Understanding the law's broad protections is only the first step. Putting that knowledge to practical use, as will be demonstrated below, is the only way for companies to reduce or avoid liability under the NYCHRL.

Individualized Interactive Process

One of the easiest ways to ensure compliance with the NYCHRL is to actively address any issues as they arise and to maintain policies that assure employees that the employer will do so. When an employee who is or may be disabled (remembering the broad definition of that term) comes to you or his supervisor to request an accommodation, the company representative has an affirmative duty under the NYCHRL to "engage in the interactive process." Keep in mind that the employee does not need to explicitly request a disability-related accommodation in order for the interactive process to be initiated; the specific circumstances will dictate whether the employer knew or should have known that the employee was making a request for an accommodation.

The interactive process means working with the employee to achieve a satisfactory accommodation by considering and reviewing a variety of options. It may include a review of the employee's job functions and how the proposed accommodation(s) affects those functions, but it is important for the process to be individualized to the particular employee's situation; the goal is to "clarify the individual needs of the employee and the business." A broad, one-size-fits-all approach will not be viewed kindly by the courts. The goal is not to simply avoid a lawsuit but to make the interactive process a win-win scenario for both the employee and the company, which can often be best achieved by suggesting reasonable alternatives. In addition, it is important for the employer to document and memorialize all steps taken during the interactive process and beyond; this can be critical if an accommodation cannot be achieved and a lawsuit arises.

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Maintain Clear, Concise, Uniform Policies

Company disability and leave of absence policies should be clear and thorough. Ensure that policies cover those disabilities contemplated by the law and do not restrict rights protected by the NYCHRL. Further, such policies should provide a clear and simple mechanism by which employees may request leaves of absence (and other accommodations) and remember that the 12 weeks of FMLA leave is no longer the absolute outside boundary for disability-related leaves of absence. Clearly define how leave periods will run and the way in which the company determines the viability of accommodations. Importantly, companies must also uniformly implement their policies in order to avoid claims of discrimination.

Risks of Asserting Undue Hardship

Remember that, under the NYCHRL, it will be the employer's burden to prove that any rejected accommodation that was suggested by the employee would have imposed an "undue hardship" on the employer. Documenting your reasons for denying the accommodation and tailoring those reasons to the statutory factors for proving "undue hardship" can be invaluable.

Err on the Side of Caution

If you are unsure whether the employee is "disabled," whether an accommodation has been requested or what the appropriate accommodation is under the circumstances, it is probably safer to err on the side of caution and assume that the NYCHRL will cover the condition. Then act accordingly; it is better to be safe than sorry when it comes to the NYCHRL.

As the New York City Council and state and federal courts permit the NYCHRL to grow exponentially, it is critical to protect your company from liability. Plaintiffs' attorneys will likely continue to stretch the boundaries of the NYCHRL for the foreseeable future, so it is imperative to protect your company in advance.

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How do I know if an individual is considered an employee or independent contractor in California?

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Whether an employer is located in California or any other state, there is no bright-line test to determine when a worker should be classified as an employee rather than an independent contractor. For example, the federal Internal Revenue Service (IRS) and the U.S. Department of Labor (DOL) use different, although similar, analytical frameworks. In fact, the multiplicity of tests defining independent contractor status applied across federal and state laws makes it possible for a worker to be classified as an independent contractor under one law and as an employee under another law. To minimize legal risk, employers are advised to ensure that classification as an independent contractor would satisfy *every* test that may be applicable where the organization does business.

In California, the state agencies most involved with the determination of independent contractor status are the Employment Development Department (EDD), which is concerned with employment-related taxes, and the Division of Labor Standards Enforcement (DLSE), which is concerned with whether the wage, hour and workers' compensation insurance laws apply. There are other agencies, such as the Franchise Tax Board (FTB), the Division of Workers' Compensation (DWC) and the Contractors State Licensing Board (CSLB), that also have regulations or requirements concerning independent contractors. Since different laws may be involved in a particular situation, such as a termination of employment, it is possible that the same individual may be considered an employee for purposes of one law and an independent contractor under another law. Because the potential liabilities and penalties are significant if an individual is treated as an independent contractor and later found to be an employee, each working relationship should be thoroughly researched and analyzed before it is established.

Since there is no set definition of the term "independent contractor," an employer must look to the interpretations of the courts and enforcement agencies to decide if a worker is an employee or independent contractor in a particular situation. In handling a matter in which employment status is an issue (that is, employee or independent contractor), California's DLSE starts with the presumption that the worker is an employee (*See* Labor Code Section 3357 (http://www.leginfo.ca.gov/cgi-bin/displaycode?section=lab&group=03001-04000&file=3350-3371)). However, the actual determination of whether a worker is an employee or an independent contractor depends on a number of factors, all of which must be considered and none of which is controlling by itself. Consequently, it is necessary to closely examine the facts of each service relationship and then apply the law to those facts. In most cases, this means applying the "multi-factor" or the "economic realities" test adopted by the California Supreme Court in the case of S. G. Borello & Sons Inc. v. Dept. of Industrial Relations (1989) 48 Ca1.3d 341.

In applying the economic realities test, the most significant factor to be considered is whether the employer or principal has control or the right to control the worker both as to the work done and the manner and means in which it is performed. Additional factors that may be considered, depending on the issue involved, are the following:

- Whether the person performing services is engaged in an occupation or business distinct from that of the principal.
- Whether or not the work is a part of the regular business of the principal or alleged employer.
- Whether the principal or the worker supplies the instrumentalities, tools and place for the person doing the work.
- The alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers.
- Whether the service rendered requires a special skill.
- The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision.
- The alleged employee's opportunity for profit or loss depending on his or her managerial skill.
- The length of time for which the services are to be performed.
- The degree of permanence of the working relationship.
- The method of payment, whether by time or by the job.
- Whether or not the parties believe they are creating an employer/employee relationship may have some bearing on the question, but is not determinative since this is a question of law based on objective tests.

Even when there is an absence of control over work details, an employer/employee relationship will be found if 1) the principal/employer retains pervasive control over the operation as a whole, 2) the worker's duties are an integral part of the operation and 3) the nature of the work makes detailed control unnecessary (*See*, Yellow Cab Cooperative v. Workers Compensation Appeals Board (1991) 226 Cal.App.3d 1288).

Other points to remember in determining whether a worker is an employee or independent contractor in California are that the existence of a written agreement purporting to establish an independent contractor relationship is not determinative, and the fact that a worker is issued a 1099-MISC form rather than a W-2 form is also not determinative with respect to independent contractor status.

Source: Independent contractor versus employe (http://www.dir.ca.gov/dlse/faq_independentcontractor.htm)

Federal Resources:

- U.S. Department of Labor. *See* Fact Sheet #13: Employment Relationship Under the Fair Labor Standards Act (http://www.dol.gov/whd/regs/compliance/whdfs13.pdf) and Independent Contractors (http://www.dol.gov/elaws/esa/flsa/docs/contractors.asp).
- U.S. Internal Revenue Service. *See* Independent Contractor or Employee? (https://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Independent-Contractor-Self-Employed-or-Employee)

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Independent Contractor: Can an employer terminate and rehire an employee as an independent contractor doing the same job?

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Probably not. For an individual to work as an independent contractor, he or she must meet certain classification requirements by both the Internal Revenue Service (http://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Independent-Contractor-Defined) and the U.S. Department of Labor (http://www.dol.gov/elaws/esa/flsa/docs/contractors.asp) that demonstrate the individual is clearly working for himself or herself. If the individual continues to perform the same work in the same capacity as he or she did when employed, reclassifying the individual as a contractor will be ineffective.

One scenario where an individual may perform similar work for a former employer is if the former employee launches his or her own business (i.e., using its own resources and supplies and serving additional clients). Then, the former employer may contract that person to do some work, but the restrictions of the independent contractor relationship would apply. See SHRM's guidance on who can be considered an independent contractor (/TemplatesTools/hrqa/pages/independentcontractor.aspx) for more information on the requirements for independent contractor status.

If the change is considered to avoid employment costs, such as benefits and tax expenses, and the employer intends to maintain the same level of control and provide full-time work, equipment and supplies, the worker will not meet the definition of an independent contractor.

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Contingent Staffing: Can an independent contractor or a consultant manage company employees

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Allowing independent contractors or consultants to manage company employees is not for frugal or risk-adverse employers and is generally not a recommended practice.

Independent contractors or consultants are often hired for their specialized expertise. The intention is that the relationship will be short-term and focused on providing services that existing organizational employees are unable to provide.

Furthermore, independent contractors and consultants are usually engaged using consulting agreements or contracts, which outline the services they will provide, the manner and means for providing these services, and the expected results. Consultants and independent contractors are bound by the terms of their consulting agreement or contract, not by the organization's personnel policies, employee handbook or employment-at-will doctrine.

Managing employees, on the other hand, typically involves overseeing and enforcing the organization's personnel policies and procedures. Educating and coaching employees on how to adhere to the company's personnel policies and procedures, culture and values through orientation and other types of training is usually a management responsibility.

These are just a few examples of "behavioral control" and "relationship of the parties" criteria that are often used to distinguish an employee from an independent contractor. Both the Internal Revenue Service (http://www.irs.gov/) (IRS) and the U.S. Department of Labor (http://www.dol.gov/) (DOL) may refer to these criteria when evaluating whether a worker has been properly classified as an independent contractor. The consequences for misclassification can be extremely costly to the organization.

Managers can be long-term or newly hired employees. Although they are hired with the expectation that their employment will be long term, they may be hired under the employment-at-will doctrine or an employment contract. As employees, they are subject to federal, state and local employment laws and their employer's policies. In addition to their responsibilities for managing employees and enforcing the company's personnel policies and procedures, some managers may be responsible for managing company functions that, according to guidance from the DOL (http://www.dol.gov/elaws/esa/flsa/docs/contractors.asp), "are an integral part of the employer's business," including supervision of the company's employees.

Permitting independent contractors or consultants to manage company employees blurs the lines used to distinguish whether a worker is an employee or an independent contractor. This confusion can be costly to employers, especially if they fail to withhold and pay Social Security, Medicare and unemployment taxes, and fail to withhold income taxes. Federal and state wage and hour enforcement may also have been compromised, along with effective and meaningful employee relations.

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Independent Contractor: What is a statutory employee?

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A statutory employee is an individual who is specifically defined as an employee by statute.

Although most individuals are determined to be employees under common law, some workers—who for other purposes are viewed as independent contractors—have been defined as employees for employment tax purposes. In essence, these are independent contractors who must be treated as employees for specific tax withholdings.

In most independent contractor relationships, an employer does not withhold employment taxes that fund Social Security or Medicare (the Federal Insurance Contributions Act, or FICA). However, the **Internal Revenue Service (http://www.irs.gov/)** (IRS) stipulates certain professions for which an individual may remain an independent contractor under common law rules, but for which FICA taxes must be withheld. (States may add to this mandatory withholding of taxes by expanding the definition of a statutory employee. See, for example, California's **Information Sheet (http://www.edd.ca.gov/pdf_pub_ctr/de231se.pdf)** on statutory employees.)

Under the IRS guidelines for meeting the requirements of a statutory employee, the employer is instructed to withhold FICA taxes on income. Because statutory employees' FICA is withheld through an employer, the employees do not pay self-employment tax; however, they must still report their wages, income and allowable expenses.

The IRS provides guidelines for statutory employees, including designated categories and three required conditions. To determine if a statutory employee relationship exists, employers can find detailed information from the IRS **here** (http://www.irs.gov/businesses/small/article/0%2c%2cid=179118%2c00.html).

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Independent Contractor: Hiring Checklist

8/29/2014 Permissions

[The following are merely recommended guidelines. Each organization should look at its organizational needs and amend the following according to the organizations requirements. A legal counsel review of all independent contractor processes is recommended.]

Human resources will obtain:

□ Contractor signature on the independent contractor agreement and scope of work as well as any task-related appendices.

□ All business-related information on the independent contractors business, i.e., business name, type of business, address, phone/e-mail/fax information, and business license, if appropriate.

□ Have the organizations confidentiality or proprietary information agreement signed by the contractor.

□ Have the independent contractor provide their workers compensation certificate of coverage.

□ Have the independent contractor provide their IRS-assigned Employer Identification Number (EIN) or have this number identified in the independent contractor agreement.

Human resources will provide the independent contractor with:

□ Copies of all policies and procedures the organization expects the independent contractor to adhere to during the assignment. Have the contractor acknowledge receipt and understanding of policies, where necessary

□ Copy of invoicing requirements procedures and payment dates.

If work is to be performed on the organizations premises:

□ Have the contractor complete an emergency notification contact form; retain in the HR department.

□ Assign parking and inform about parking rules, if appropriate.

☐ Provide logins/access codes to business systems/IT systems/telephone systems and security identification/badges, as needed.

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Independent Contractor: Is there any guidance for employers when managing the relationship with an independent contractor?

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Employers want to develop a good working relationship with independent contractors (ICs), while not jeopardizing their IC status. The Internal Revenue Service (IRS) provides guidance on observing the IC boundaries, and SHRM provides guidelines for the practical application of the IRS guidance.

The IRS examines an employer's degree of control over the IC through behavioral, financial and relationship criteria. Being aware of these criteria will help employers appropriately manage the IC relationship.

Behavioral control. An IC determines when, where and how to work. The IC not only determines what apparatus is needed for an assignment, but also provides his or her own tools, including computer, workspace and administrative support. Additional staff needed to work on an assignment is hired and paid by the contractor.

The IC's manager should avoid providing work schedules to the IC and requiring the IC to adhere to company employee policies. Also, managers should refrain from training the IC on methods of work; this includes required participation in an organization's orientation program, mandatory training programs, or employee award and recognition programs.

Financial control. ICs experience different financial rewards and constraints than employees. The opportunity to make a profit or loss is an important factor in demonstrating financial control for an IC; an IC is considered a business, and businesses pay their own expenses.

The IC's manager can maintain this relationship by observing the formalities of the written agreement or contract when considering expense reimbursement to an IC and when paying him or her. Also, employers may not require the IC to work solely for their organizations; as a business, the IC should be able to work for other organizations.

Type of relationship. An IC is responsible for his or her own work benefits (such as insurance and time off), professional licenses and insurance.

The IC's manager must not blur the line between IC and employee status by treating the IC as an employee. For example, an IC should not be asked to complete an employment application; instead, a written agreement should be in place that specifies the nature and duration of the project and that outlines both the expectations of the project and the outcome on completing the assignment. Similarly, employers do not provide paid vacation, holiday pay, sick time or any other employee-related benefit to an IC.

Additional ideas on properly observing the IC relationship can be found at the IRS Tax Topic: Independent Contractor or Employee (http://www.irs.gov/taxtopics/tc762.html). Also, see the SHRM Audit Checklist for Maintaining IC Status (/templatestools/samples/hrforms/articles/pages/cms_020334.aspx).

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Independent Contractor: Audit Checklist for Maintaining Independent Contractor (IC) Status

8/29/2014 Permissions

Contract Development

- Review IRS criteria, Independent Contractor or Employee (http://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Independent-Contractor-Self-Employed-or-Employee), to ensure an independent contractor (IC) relationship.
- Use Form SS-8 for IRS determination of IC status if unclear and the determination cannot be made by the business.
- Develop a written agreement with an assigned specific scope of work for a specific duration.
- Do not have a contractor complete an employee application.
- Require the contractor to supply his or her own workers' compensation insurance.
- Require the contractor to work off company premises and/or require the contractor to supply his or her own equipment and tools.
- Require payment to be rendered upon completion of a certain task or job. Do not pay by the hour, week or month unless a flat fee is agreed to be paid at regular intervals.
- Do not pay contractor expenses. Businesses pay their own expenses, and expenses should be built into the contract for the cost of the entire job. The opportunity for profit or loss by the contractor helps to show financial independence from the employer.
- Do not provide continuing education training. The company may provide training specific to job or company procedures.
- Do not have contractors perform similar work of employees or perform routine work.
- Contractor work should not be close to core business operations and therefore considered employee-type work.
- Require documentation demonstrating an independent contractor relationship, such as copy of business or professional license, copy of insurance certificates, copies of the independent contractor's advertising, and copy of the contractor's business card and stationery.

Contract Signed; Contractor Work to Begin

- Require the contractor complete Form W-9, Request for Taxpayer Identification Number and Certification. This form can be used to request the correct name and taxpayer identification number, or TIN, of the worker. A TIN may be either a Social Security number (SSN) or an employer identification number (EIN).
- Do not complete an I-9.
- Do not pay ICs from a payroll account.
- Do not provide an employee handbook.
- Do not allow independent contractors to enroll in any company-sponsored benefit plans; do not pay contractors for any company holiday.
- Do not invite or permit contractors to attend company parties or special events.
- Do not issue company business cards, employee ID badges or facility keys to contractors.
- Restrict contractor participation in projects or department meetings.
- Do not allow or greatly limit an independent contractor's role in any hiring, disciplinary action or termination decisions.
- Do not require the contractor to work "full time" or have set hours. Contractors should control when and how they work.
- Do not conduct performance evaluations similar to employee evaluations. Companies should require deadlines and results and can require contractors to follow job and company rules.
- Review with the contractor's "company contact(s)," the contract scope and contractor limitations to maintain IC status.

Contract Work in Progress (1 month to end of contract)

- Periodically review contract and assigned scope of work to ensure IC is working within the contract scope and maintaining IC status.
- Confirm with company contact(s) that the contractor has not been provided additional duties or benefits outside the scope of the contract or anything else that would jeopardize independent contractor status.
- Retain records of all transactions with the contractor, such as contractor's invoices for billing.

Annually

- Review IRS criteria to ensure company is maintaining an IC relationship.
- Confirm W-9 is on record. It must be retained for four years.
- Send 1099-MISC each year for any contractor (e.g., attorney, accountant, consultant) paid $600 or more for services provided during the year.
    - One copy provided to IC by January 31 of the year following payment.
    - One copy to IRS by February 28, unless filing electronically through use of the Filing Information Returns Electronically (FIRE system), in which case the form must be filed by

March 31.

- Review W-9 Record Retention Schedule to purge unneeded files.

Four Years

- Retain W-9 for four years for future reference in case of any questions from the worker or the IRS.
- Destroy unneeded records that have met the four-year retention requirement unless employer is involved in a dispute that has not yet been reconciled.

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Contingent Staffing Policy: Contract and Temporary Employees

7/14/2014 Permissions

Practice Note

Employers use various types of workers to perform the services they require. Most of these workers are classified as employees. Other types of workers are nonemployees or contingent workers, such as temporary staffing agency employees and independent contractors.

Contingent staffing options make sense when an organization determines that the number or types of employees needed for operational flow varies significantly and cannot be leveled out through resource allocation strategies. When the organization's future is likely to be fluid or highly dynamic, or when an organization needs workers who have specialized knowledge or expertise to help meet new business requirements or to work on projects of definite duration, contingent staffing may be a better alternative than full-time employees who may not be needed on an ongoing basis. See **Employing Contingent Workers** (/templatestools/toolkits/pages/employingcontingentworkers.aspx).

Pursuant to federal and state laws, employers should take care in properly identifying contract workers and consultants. Misclassification of these workers can result in substantial liability under the **Fair Labor Standards Act** (/LegalIssues/FederalResources/FederalStatutesRegulationsandGuidanc/Pages/FairLaborStandardsActof1938.aspx), **Internal Revenue Service** (http://www.irs.gov/) (IRS) regulations, antidiscrimination laws, employee welfare plans, workers' compensation, unemployment insurance, and wrongful termination and other common law torts. See **Employing Independent Contractors** (/TemplatesTools/Toolkits/pages/employingindependentcontractors.aspx).

To ensure the proper and lawful use of contingent workers, human resource professionals should make certain that policies or procedures, such as the ones set forth in the sample below, are established for hiring these types of workers. See **Temporary Staffing Agencies and Human Resources: Compliance Issues** (/hrdisciplines/staffingmanagement/articles/pages/cms_000329.aspx), **Hiring Policy: Definition of Employee (Excludes Unpaid Interns)** (/TemplatesTools/Samples/Policies/Pages/DefinitionofEmployee.aspx), and **Employee Classification Policy: Employment Categories** (/TemplatesTools/Samples/Policies/Pages/CMS_003796.aspx).

[Company Name] acknowledges that a portion of its staffing requirements may be met through the employment of agency temporaries and contractors. The human resource (HR) department is responsible for identification and review of employment vendor relationships. Contractual agreements relating to fee schedules, bill rates, payment schedules, selection processes and replacement policies must be negotiated in advance of placement of temporary employees or contractors.

The director of HR is the designated company representative authorized to enter into any legally binding agreement with any type of staffing-related agency or business. Payment of services rendered by temporary and contract employees may only be paid directly to a third-party agency whose primary purpose is to provide temporary and contract employees.

Responsibility

The HR department is responsible for the overall management of the selection and hiring processes related to temporary and contract employees. The release of all contract and temporary employees must be coordinated through the HR department directly with the agency.

Authority

The director of HR has the authority to change, modify or approve exceptions to this policy at any time with or without notice.

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Litigation over Independent Contractor Misclassification Grows

By Allen Smith 1/28/2009 Permissions

The latest "lawsuit du jour" in California is taking aim at employers that misclassify workers as independent contractors, according to Betsy Johnson, an Epstein, Becker & Green attorney in Los Angeles.

At a Jan. 27 National Press Club briefing in Washington, D.C., Johnson said classification challenges are on the rise in other states as well, including Illinois, Massachusetts, Michigan, New Jersey and New York. She told attendees that they should "expect to see a lot more activity, especially if federal legislation" on independent contractor misclassification passes.

Johnson predicted that states will take a harder look at independent contractor classifications, particularly since some studies suggest there is much untapped state tax revenue where individuals have been misclassified. A 2000 Department of Labor (DOL) study found that 30 percent of firms misclassify their employees as independent contractors. And a 2007 **study (http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1009&context=reports)** by the Industrial and Labor Relations School of Cornell University estimated that in New York alone, the average unemployment insurance taxable wages underreported from 2002-2005 due to misclassification of workers as independent contractors was $4.28 billion.

Take steps now to defend your companies, Johnson recommended, noting that many employers struggle to defend themselves from challenges to their classifications because of inadequate record-keeping for their independent contractors.

Record-Keeping Challenges

Johnson has two class actions pending in California on independent contractor classification. She said that these kinds of class actions are similar to wage and hour challenges of employers' classification of workers as exempt or nonexempt. So, employers face similar difficulties defending themselves when their independent contractor classifications are challenged.

In wage and hour litigation, employers often don't have time sheet records for employees classified as exempt, because employers don't need the records if the employees truly are exempt. The record-keeping often is scantier for workers classified as independent contractors, according to Johnson. There typically won't be an I-9 for them, she noted, adding that there also often wouldn't have been any background checks either. In California, the challenges "can go back four years," Johnson said. "It can be difficult to go back and recreate the paper trail."

In the past, litigation over the misclassification of independent contractors typically has arisen when those classified as independent contractors seek to recover unemployment compensation or workers' compensation benefits. To recover the benefits, they maintain that they should have been classified as employees.

The Internal Revenue Service (IRS) has been cooperating with state agencies to fight the misclassification of independent contractors. Johnson said the IRS has entered information-sharing agreements with at least 30 states and she expects that number to increase.

Proposed Federal Legislation

Under proposed federal legislation, the Independent Contractor Proper Classification Act (**S. 2044 (http://thomas.loc.gov/cgi-bin/query/z?c110:S.2044:)**), the IRS' role in fighting misclassification would grow. Johnson said the legislation would let the IRS issue new regulations on independent contractor status and conduct more audits. The IRS would share that information with the DOL, which could lead to more DOL audits. The legislation would let workers ask the IRS for opinions of their status to see if they were properly classified, and require employers to inform those classified as independent contractors that they have to file taxes and are exempt from employment laws, wage and hour laws, and unemployment compensation and workers' compensation statutes. Employers also would have to inform employees about their right to seek a classification determination from the IRS.

In addition, the Internal Revenue Code would be amended to change the safe harbor definition of independent contractor and remove industry standards as a reasonable basis for designating someone as an independent contractor. The legislation also would prohibit retaliation against those who were misclassified.

Johnson added that, if enacted, the Employee Misclassification Prevention Act (**S. 3648** (http://thomas.loc.gov/cgi-bin/query/z?c110:S.3648:)) would increase the potential liability if the IRS reclassified the workers as employees. This bill also would require that at least 25 percent of the DOL Wage and Hour Division's audits focus on potential misclassifications of workers as independent contractors. And it would amend the Fair Labor Standards Act to require employers to keep records of independent contractors.

The bills floundered in the 110th Congress, but Johnson expects them to return, noting that President Obama sponsored both. If enacted, the legislation would dramatically change how independent contractor classification challenges arise, she predicted, observing that two federal agencies "would be tasked with going out to find and root out the problem."

Protective Action

Johnson recommended that employers take action to limit their potential legal exposure, suggesting that they conduct internal audits to ensure their classifications of independent contractors are correct. "At a minimum, have an independent contractor agreement," she said.

Make sure supervisors who work side by side with independent contractors don't treat them like employees, she added.

The definition of who is an independent contractor can vary not only between different states but by different state agencies within the same state. For example, in California, she said the Employee Development Department has a different definition of "independent contractor" than the California Division of Workers' Compensation. And the California Labor Standards Enforcement Division has a different definition from the California Franchise Tax Board.

Johnson is left resorting to the "duck test" to distinguish true independent contractors from misclassified ones. If someone "walks like an employee and quacks like an employee, the chances are that agencies will treat them like an employee," she remarked.

Allen Smith, J.D., is manager of workplace law content for SHRM.

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Independent Contractors

The Supreme Court has said that there is no definition that solves all problems relating to the employer-employee relationship under the Fair Labor Standards Act (FLSA). The Court has also said that determination of the relation cannot be based on isolated factors or upon a single characteristic, but depends upon the circumstances of the whole activity. The goal of the analysis is to determine the underlying economic reality of the situation and whether the individual is economically dependent on the supposed employer. In general, an employee, as distinguished from an independent contractor who is engaged in a business of his own, is one who "follows the usual path of an employee" and is dependent on the business that he serves. The factors that the Supreme Court has considered significant, although no single one is regarded as controlling are:

1. the extent to which the worker's services are an integral part of the employer's business (examples: Does the worker play an integral role in the business by performing the primary type of work that the employer performs for his customers or clients? Does the worker perform a discrete job that is one part of the business' overall process of production? Does the worker supervise any of the company's employees?);
2. the permanency of the relationship (example: How long has the worker worked for the same company?);
3. the amount of the worker's investment in facilities and equipment (examples: Is the worker reimbursed for any purchases or materials, supplies, etc.? Does the worker use his or her own tools or equipment?);
4. the nature and degree of control by the principal (examples: Who decides on what hours to be worked? Who is responsible for quality control? Does the worker work for any other company(s)? Who sets the pay rate?);
5. the worker's opportunities for profit and loss (examples: Did the worker make any investments such as insurance or bonding? Can the worker earn a profit by performing the job more efficiently or exercising managerial skill or suffer a loss of capital investment?); and
6. the level of skill required in performing the job and the amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent enterprise (examples: Does the worker perform routine tasks requiring little training? Does the worker advertise independently via yellow pages, business cards, etc.? Does the worker have a separate business site?).

For information about trainees (including School-to-Work programs) and volunteers or to find out whether you are covered by the FLSA, click on the underlined text.

Remember that some employees are exempt from various provisions of the law. To explore the broad categories of these exemptions or to obtain further information about the FLSA, click on the underlined text.

For more information, please contact your local Wage and Hour District Office.

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