

ROBIN'S REVIEW OF EMPLOYMENT NEWS

ESSENTIAL CONCEPTS TO UNDERSTAND THE DIFFERENCE BETWEEN INDEPENDENT CONTRACTOR AND EMPLOYEE STATUS

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NOVEMBER, 2018

I. INDEPENDENT CONTRACTORS

The use of independent contractors instead of employees can be an enormous benefit to businesses. In addition to tax benefits, many federal and state laws do not apply to independent contractors. For example, Title VII discrimination laws and the Fair Labor Standards Act (the "FLSA") governing wages do not apply to independent contractors. Ordinarily, unemployment and workers' compensation laws only protect employees.

Understanding the difference between the two categories, however, is no easy task. Under the newer Internal Revenue Service ("IRS") guidelines, instead of the older 20 factor test, independent contractor status is based on three categories: behavioral control, financial control and the relationship between the worker and the company. No one factor alone is determinative; instead, the result depends on the particular facts of each situation.

The bottom line is that independent contractors are those individuals who essentially run their own business, and who provide services to their customers. An individual may qualify as an independent contractor if the company retains the right to control or direct the results of the work, but not how the work will be performed, especially if the worker is less financially dependent on the company as compared to an ordinary employee at the company.

II. THE IRS THREE FACTOR TEST

The consequences for mislabeling an employee as an independent contractor may result in tax consequences, liability for overtime pay, unpaid benefits, unpaid expenses and unemployment benefits, as well as other liability under various federal and state laws. The IRS explains the three basic factors relied upon for purposes of in determining the degree of control and independence necessary for a worker to be an independent contractor as follows:

1. **Behavioral**: Does the company control or have the right to control the manner in which the worker performs the job? Does the company instruct the worker on where or how to work, or give training on how to perform the job? (which points to employee status).

An independent contractor uses his/her own skill and experience to complete the job, and sets his/her own hours, rather than taking directions from managers. If the individual has no license, skill, experience or education that would allow him or her to make decisions independently, it may be difficult to avoid employee status.

2. **Financial**: Does the business have the right to control the financial aspects of the worker's job? Consider how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc. (paying a worker's expenses and furnishing all tools,

which includes computers, cell phones, etc. indicates employee status). If the method of payment is guaranteed, it will appear more like an employee wage, even if supplemented by commissions.

An independent contractor uses his own tools and supplies, and ordinarily submits an invoice for work performed. Moreover, the opportunity for a worker's profit and loss based on work performed indicates independent contractor status. The best practice is for the contractor to submit invoices for work performed.

3. **Type of Relationship**: While a well-drafted written independent contractor agreement is important, it is not dispositive. ***An independent contractor is generally not paid a salary, not entitled to company benefits, and is not hired exclusively by the company for a very long period of time without the opportunity to accept other work concurrently.*** The Department of Labor ("DOL") also considers whether the worker is performing a job that the company specializes in, such as a painting subcontractor hiring a painter, because there is more likely to be supervision in that case, and thus, employee status. To the contrary, if a painting company hires an accountant as an independent contractor, it is more obvious that the company is not engaged in that business and cannot control the work performed.

III. The Misclassification Prevention Initiative

The misclassification of employees as independent contractors has been recognized as a serious problem facing workers because misclassified employees are denied many benefits and protections that apply to employees under various federal and state laws. To combat this problem, the Wage and Hour Division of the DOL and the IRS have joined forces to cooperate by notifying each other of workers that are misclassified so that the appropriate actions can be taken against those employers. The government has established the Voluntary Classification Settlement Program ("VCSP"), available to business that offer a reasonable basis for not treating a worker as an employee. The IRS offers eligible businesses the option to reclassify workers as employees with partial relief from federal employment taxes.

Please note that the information contained in this article is not designed to address specific situations, and does not include rules or regulations that apply to all states. If you have questions concerning this topic, you should consult with legal counsel of your choice to obtain advice on fact specific matters.



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