

# The ABCs of Independent Contracting

April 3, 2019



# NFIB Small Business Legal Center

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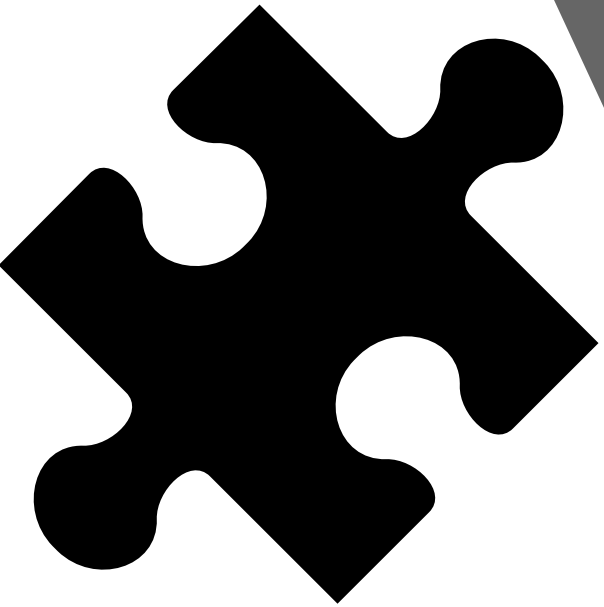


# Agenda



- Defining Employee v. Independent Contractor.
- Small business concerns and noteworthy trends.
- Strategies for avoiding misclassification lawsuits and penalties.

# The Challenge of Classifying Workers



# General Definitions:

- **Employee:** "One employed by another for wages or salary..."

**Wage:** "A fixed payment earned from work or service, typically paid on a daily or weekly basis."

**Salary:** "A fixed regular payment... made by an employer..."

–Oxford English

- **Independent Contractor:**

"A person or company providing a service or goods on a contractual basis, and not regarded as the legal responsibility of those with whom the contract is made, or formally accorded employee status."

–Oxford English

# General Definitions:

- **Employee**

Broadly defined as every person working in the service of another.

Any contract of hire, written or implied.

Undocumented workers, minors, trainees, part-time or temporary workers.

- **Independent Contractor**

"A person hired to do work who controls how the work is done."

-Merriam-Webster

## Peter the IT Guy (Easy Case)

- Initech hires Peter to perform IT services.
- Peter reports to work everyday at Initech's office from 8AM-5PM.
- Peter's manager tells him how to do his job.
- **Peter is an employee.**

## Peter the IT Guy (Difficult Case)

- Initech hires Peter to periodically update its website.
- Peter works from home, and is technically free to perform work for others.
- Peter has signed a document saying he ***is not*** an employee.
- **Is Peter an employee?**



## Bob the Consultant (Easy Case)

- Initech is considering restructuring and hires Bob as a outside consultant for advice.
- Bob runs his own LLC and has numerous clients.
- Bob makes his own decisions, on his own time, about how to complete the project.
- **Bob is a contractor.**

## Bob the Consultant (Difficult Case)

- Initech is hires Bob to provide strategic advice for its sales team for a set monthly “fee.”
- Bob has an LLC, and has had employees in the past.
- Bob has the option to work from home, except for bi-weekly mandatory sales meetings.
- Bob has a dedicated Gmail address for his consulting business, but also has an Initech email address.
- **Is Bob a contractor?**

Why does  
misclassification happen?

“Few problems in the law  
have given greater variety of  
application and conflict in  
results than the cases arising  
in the borderland between  
what is clearly an employer-  
employee relationship and  
what is clearly one of  
independent,  
entrepreneurial dealing.”

Board v. Hearst Publications, 322 U.S.  
111 (1944)

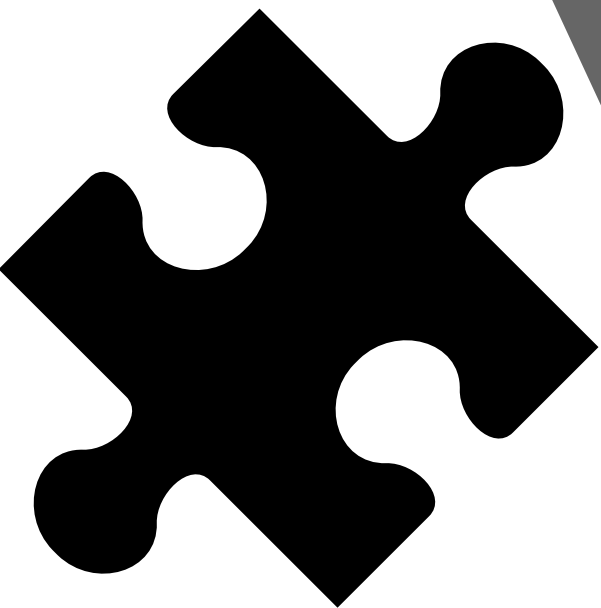


Why does  
misclassification  
happen?

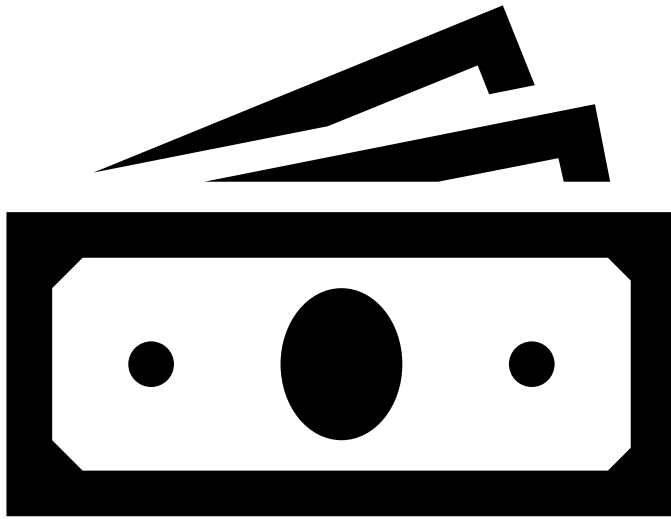
Small businesses spend inordinate time and energy on regulatory compliance issues, without benefit of HR professionals.

Employees also cost an estimated 30% more than contractors with insurance costs, added benefits, etc.

# The Risk of Misclassification



# Major Liabilities for Misclassification



- Lawsuits for backpay, including for overtime, expenses, mileage, and attorneys fees.
- Insurance premiums, possibly back-payment.
- Government fines and payment of 100% employment taxes.

# A Cautionary Tale

- Jaworski v. Master Hand Contractors (IL)
  - Plaintiffs provided electrical, mechanical and other construction services to Master Hand.
  - Defendant argued that the workers were engaged in an independently established trade.
  - Defendant failed to overcome presumption that the workers were employees under the Illinois Classification Act.
  - **Plaintiffs awarded \$340,000.**

# A Cautionary Tale

- Leevson v. Aqualife USA, Inc. (NY)
  - Plaintiffs were required to create independent corporate entities, and signed contract stating they were not employees.
  - Plaintiffs worked on a sales commission basis for Aqualife.
  - Jury found they were misclassified because of the degree of control exercised over their work.
  - Plaintiffs awarded **\$106,431** and **\$67,126**.
  - Plaintiffs awarded **\$139,800 in attorneys fees**.



# Optics Matter—Big Time!



What percentage of jurors would try to return a verdict or a worker who is unfairly treated yet no law has been broken?

- a) 10%
- b) 35%
- c) 51%
- d) 68%

# Enforcement Priority



Its not just a labor issue, it's a revenue issue.

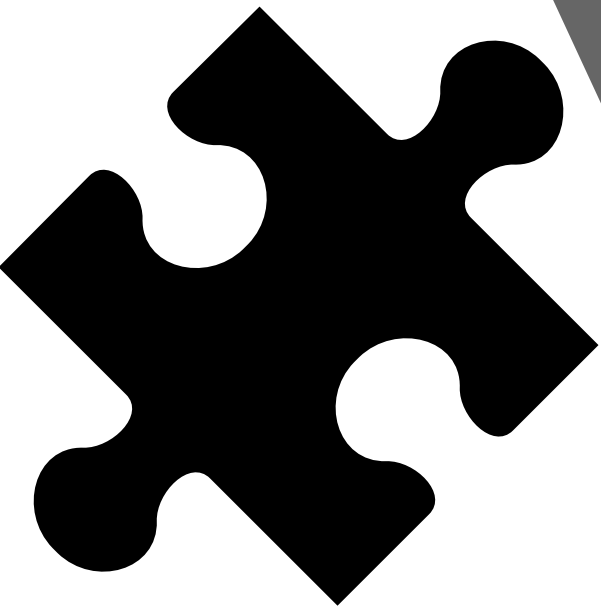


Its easier to collect income taxes from employees.



No one is paying in to state unemployment or workers compensation funds if the worker is designated as an independent contractor.

# Trends to Watch



# Evolving working relationships



- More people are working from home, and not in a traditional workplace.
- As technology better enables the “on demand” economy, more people are engaging in freelance work.

# A Shifting Legal Landscape

- Obama DOL guidance had stressed presumption that workers are employees.
- Trump DOL has rescinded this guidance, but the next Administration may reinstate.
- Meanwhile state regulators are increasingly taking an aggressive approach.

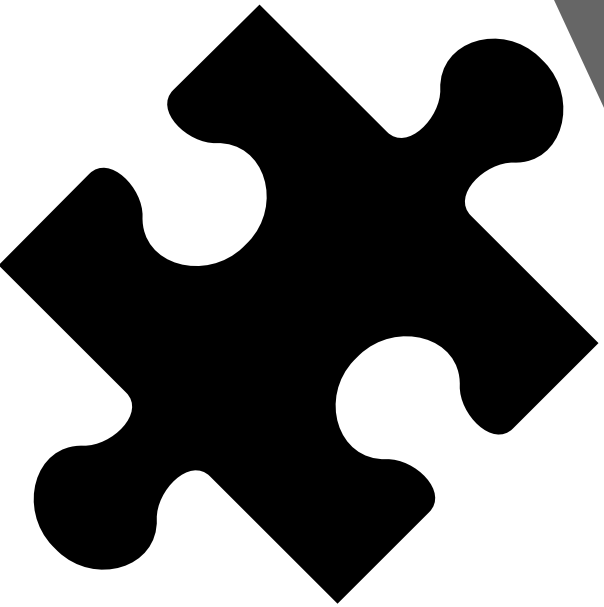
# Heightened Risk Where:

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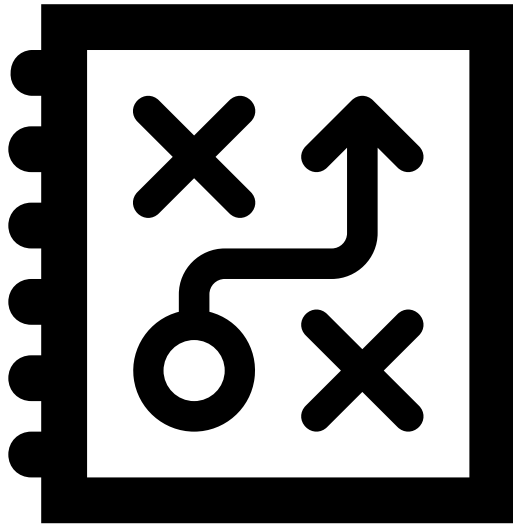
- Contract labor is essential to your business model;
- Contractor is performing same functions as employees;
- Worker is providing services on an on-going basis;
- Worker is treated as an employee.



What are the Rules?



# Various Different Tests



- Federal tests:
  - IRS – Common law.
  - DOL – Economic realities.
- State tests:
  - Many track IRS or DOL.
  - Hybrid Tests.
  - ABC test(s).



The  
Practical  
Reality

Be prepared to satisfy  
the most demanding  
applicable test!



# Common Law Test

- **Used by:** (1) IRS; (2) some state unemployment compensation insurance agencies; (3) some state workers compensation agencies.
- Courts consider and weigh numerous factors, depending on the facts of the case.
- **Is the company exerting control over the worker?**

# Common Law Test

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- Behavioral Control: Does the company control what the worker does and how the worker does their job?
- Financial Control: Are the business aspects of the worker's job controlled by the payer? (Are expenses reimbursed; who provides tools/supplies, etc?).
- Relationship of the Parties: Are there written contracts or employee type benefits?

# Behavioral Control

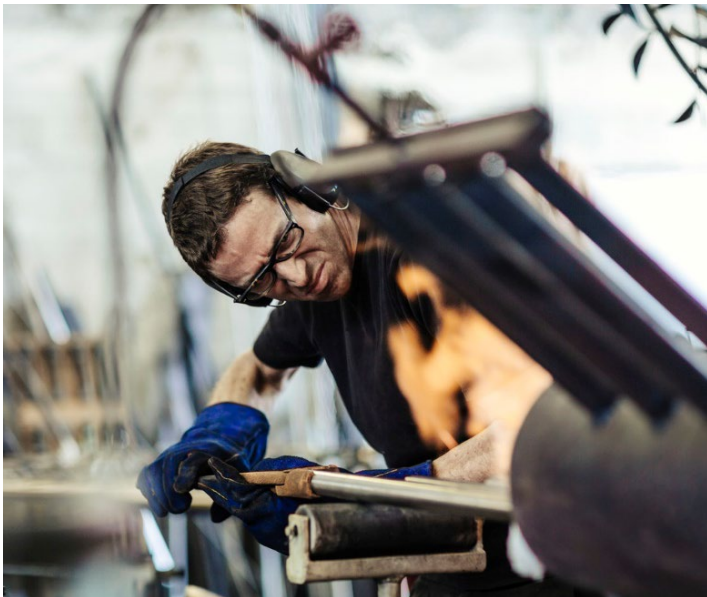
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- Control over when and where the work will be done;
- Whether or not the employer provides instruction on how the work will be done;
- Whether the worker uses the employer's or his/her own tools and equipment;
- Whether or not the employer provides training;
- How the worker is evaluated (details or end result).

# Financial Control

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- Extent of unreimbursed business expenses;
- Extent of worker's investment in equipment and facilities;
- Extent to which worker's services are made available on the open market;
- Extent to which worker can realize profit or loss; and
- Method of payment.

# Economic Realities Test



- **Used by:** (1) DOL, and various state agencies.
- Still concerned with control.
- **Asks whether the worker was economically dependent on the hiring company.**
- Courts applying the economic realities test consider and weigh five factors, with no one factor completely determinative.

# Economic Realities Test

- (1) How much control did you exert over work?
- (2) Did the worker have opportunity for profit (or loss) depending upon how well they ran their business?
- (3) Did the worker invest in facilities and equipment?
- (4) Did they perform work only sporadically?
- (5) Did the worker have Skills and initiative to generate business opportunities?

# ABC Test(s)

- **Used by:** Two-thirds of the states, primarily for unemployment insurance compensation.
- Statutory test requires consideration of three factors:
  - (A) Does the business control worker's performance?
  - (B) Does the worker operate an independent enterprise?
  - (C) Is the work outside the usual course of your business operations?



# ABC Test in Massachusetts and California



- **A** – Free from Control of the sort exercised over employees.
- **B** – Must perform work distinct from employees in the “usual course of business.”
- **C** – Worker has “take[n] the usual steps to establish and promote his independent business...”

# The *Dynamex* Surprise

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- **A – Free from Control of the sort exercised over employees.**
- Do not treat contractors like employees.
- It was highly problematic that *Dynamex* had previously treated its couriers as employees before switching them to independent contractors.

# The *Dynamex* Surprise

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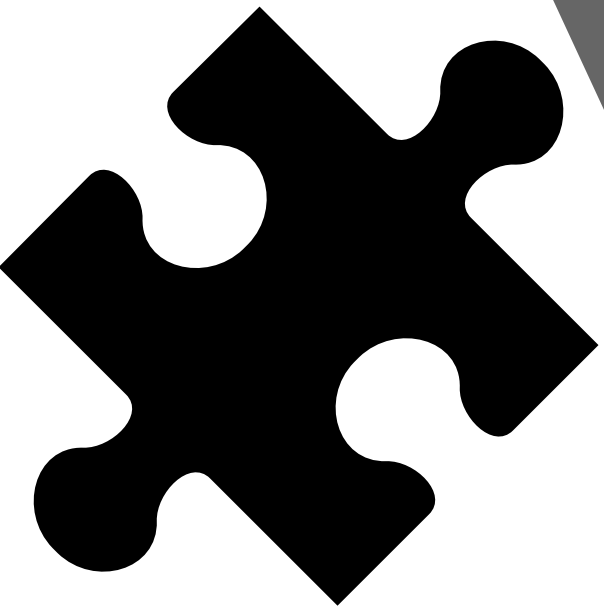
- **B – Must perform work distinct from employees in the “usual course of business.”**
- Tremendous risk if contractors are integral to your business model.
- Would he or she be viewed by others as working in your business?

# The *Dynamex* Surprise

- **C – Worker has “take[n] the usual steps to establish and promote his independent business...”**
- Great risk if they do not have other clients.
- Require documentation, such as business cards, licenses, incorporation, advertising materials, and certificate of insurance.
- Make sure they use their own tools, equipment, facilities, employees.



# Strategies for Avoiding Misclassification



# Best Practices to Minimize Risk

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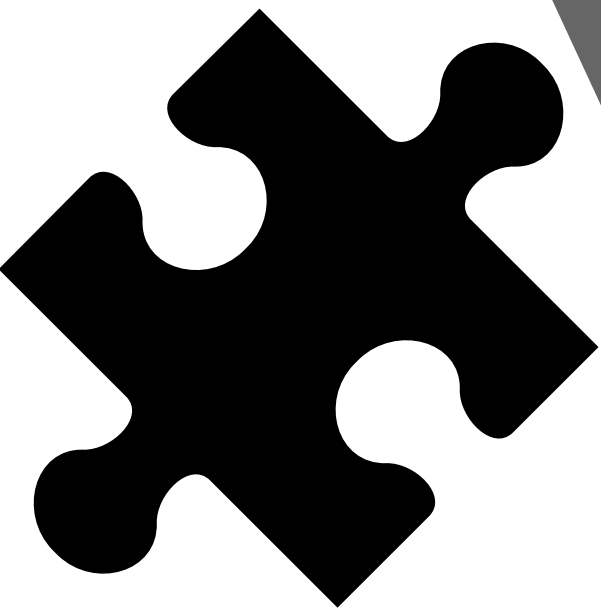


- Require documentation such as business cards, licenses, certificate of insurance.
- Put your agreement in writing.
- Do **not** treat contractors like employees.

## When in Doubt?

- Err on the side of caution – classify as an employee.
- Consult with an attorney.
- Check with insurer.

# A Few Hypotheticals





# Can Fruit-Pickers be Contractors?

- Suppose that a farm hired fruit-pickers under a contract.
- The pickers are free to come and go as they like, and they share the profit or loss of the crop.
- Not a job that requires learned skill or exercise of discretion.
- Paid piece-meal.
- No indication that they were in business for themselves.

# What About a Carpenter?

- Worker has his own tools;
- Worker has no direct supervision;
- Worker expected to get assigned jobs done, but must complete work in your shop during normal business hours;
- Worker is free to work for other companies.



# What if I'm hiring only for a single job?

- Lets say that I ask Jose to use his tractor to help me in grading soil?
- What if Jose is borrowing the tractor from a friend?
- Does it matter if I offer him an hourly rate?

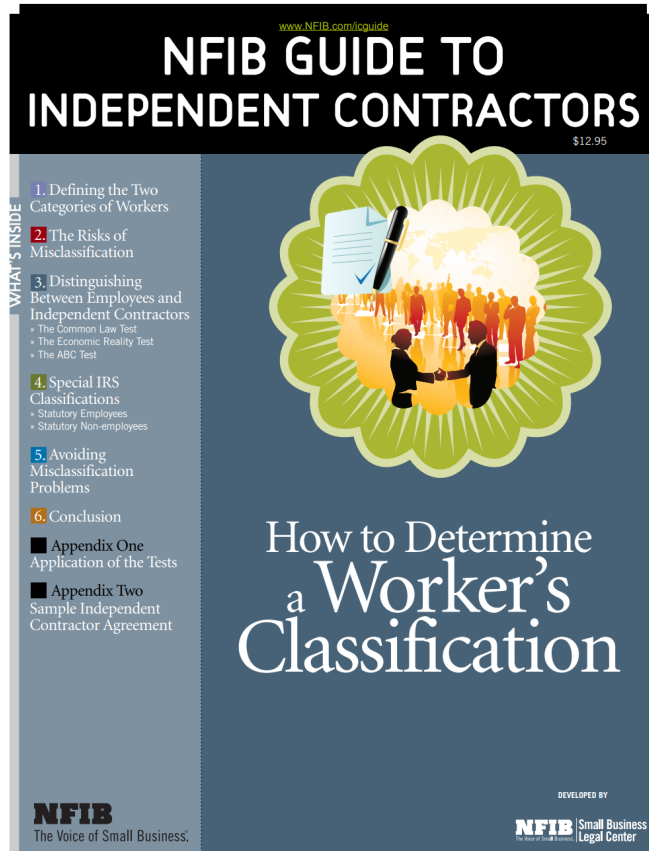


# What About These Scenarios:

- Retail store hiring a plumber to fix a leak:
- Coffee shop hiring an electrician to install an electrical line:
- Clothing manufacturer hiring a work-at-home seamstress:
- Baker hiring a cake decorator to work on custom cakes:
- Photographer who hires a beautician to prep clients for photoshoot:



# Free Help is Available



- NFIB Guide to Wage and Hour Law
- FREE [www.nfib.com/legal-center](http://www.nfib.com/legal-center)



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