

Independent Contractors:

Avoiding Costly Misclassification

Kara G., JD, SPHR | Principal Legal Analyst | November 2023





Welcome to the Webinar!

- We will email you a link to the recording + PDF of slides within 24 hours
- Please participate in our polls
- Please use the Q&A box for questions

Agenda

- Benefits and Drawbacks
- DOL Test
- IRS Test
- ABC Test
- Tips and Traps

Benefits of the Independent Contractor Classification

- No overtime or payroll hassles
- No Social Security and Medicare taxes
- No workers' comp* or unemployment insurance*
- No benefits
- Keeps employee count down
- Reduces management burdens
- Saves office space





Drawbacks of the Independent Contractor Classification

- Can't manage the work as closely
- Can't impose as many expectations on worker
- If done incorrectly, it will be very expensive

Employee or Independent Contractor: Key Tests



Two Federal Tests for Worker Status

**The old and soon-to-be-new-again
DOL test:** the Economic Realities Test

The IRS Test: the Right to Control Test

The DOL's Economic Realities Test

(also used by a majority of states and courts)

The Factors

1. Extent to which the work is integral to employer's business



2. Opportunity for profit or loss



3. Investment of worker versus employer



4. Skill and initiative used elsewhere



5. Permanency of relationship



6. Nature and degree of control



Work Integral to Employer's Business



Example: At a business consulting company, the work of the consultants is integral to the business, while the work of the IT support team and the handyman is not.



Example: In a restaurant, the work of cooks and waitstaff is integral to the business, while the work of the interior designer and menu designer is not.



Opportunity for Profit or Loss Based on Managerial Skills

An IC will make decisions about:

- Which jobs to take
- How to staff them
- Contract negotiation
- Purchasing and marketing

Relative Investment of Worker

Relative is the key word.

Occasional or limited investments by the worker (e.g., using their own laptop) will not make them an independent contractor.



Business Skill and Initiative Used Elsewhere

- Is the worker out there on the open market selling their skills to others?
- Do they have other clients?
- Do they have a registered business?





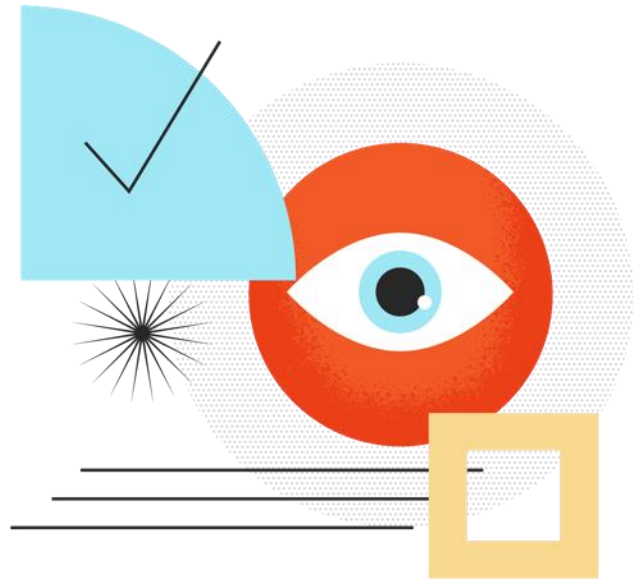
Permanency of Relationship

- It's rare for a properly classified IC to have an open-ended, *continuous* relationship with an employer
- An employer can reuse an IC, but if the IC never stops working the classification will be suspect
- *Spell out the nature of the relationship early on*



Nature and Degree of Control Over the Work

- The employer can dictate the *what*
- But as much as possible they should avoid the *when, where, and how*



Poll

Does your organization use independent contractors?

The IRS Control Test

-
1. Behavioral
 2. Financial
 3. Type of Relationship



Behavioral Control



Does the company control or *have the right to control* what the worker does and how the worker does their job?

- Type of instructions given
- Degree of instruction
- Evaluation systems
- Training

Financial Control



Are the business aspects of the worker's job controlled by the company?

- Significant investment
- Unreimbursed expenses
- Opportunity for profit or loss
- Services available to the market
- Method of payment

Type of Relationship

What expectations have been communicated about the relationship?

- Written contracts
- Employee benefits
- Permanency of the relationship
- Services provided are key activity of the business

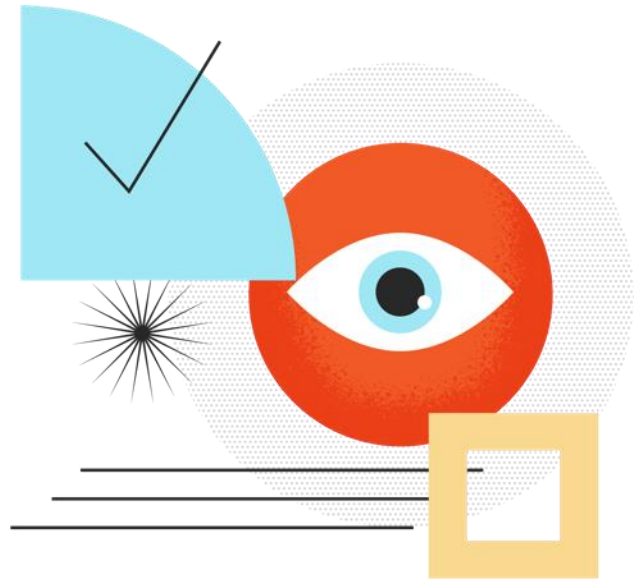


The ABC Test

A close-up photograph of a person's hands working on a laptop. The right hand is on a white mouse, and the left hand is on the keyboard. The background is blurred, showing another person's arm and a white shirt. The overall scene is brightly lit, suggesting an office or workspace.

To pass the ABC test, *all three* must be true:

1. There is no control from the employer, in contract *or in fact* (just saying “we won’t tell you how to do the work” in the agreement won’t cut it)
2. The work is outside the usual course of business
3. The worker is independently established in the trade, occupation, or business of the same nature as the work performed for the hiring entity



Poll

After reviewing these tests, how do you feel about your IC classifications?

If You Think You Have Misclassified Workers...

Call an attorney. They can help you assess your current risk and potential liability and communicate changes in a way that will (hopefully) reduce both.



Tips and Traps

Do NOT...

- Give them an employee handbook
- Micromanage hours
- Forbid working for competitors
- Use IC schemes to avoid overtime





Do...

- Put the relationship in writing
- Provide project deadlines
- Check in as necessary
- Give them as much control as possible

Q & A

Thank You