



Independent Contractors, Employees and Student Interns

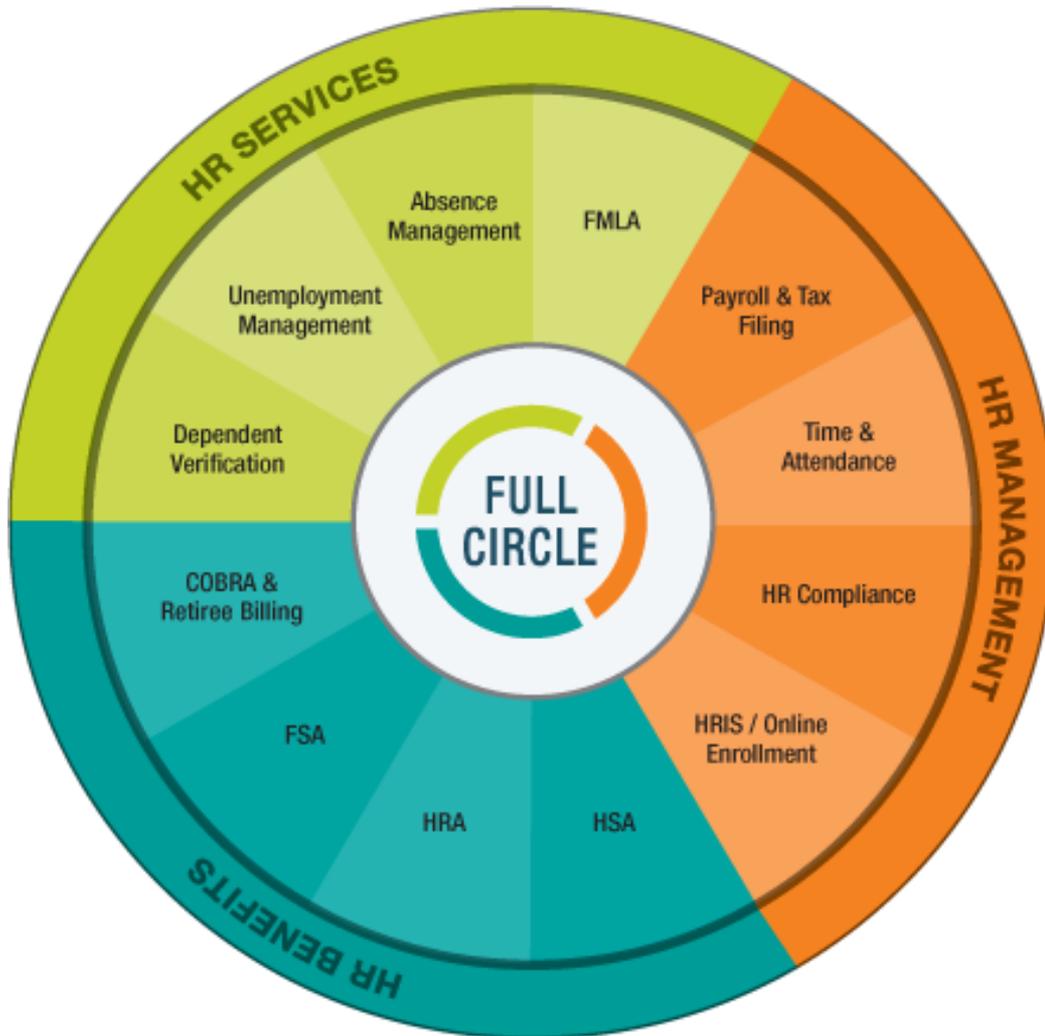
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Independent Contractors



- For a variety of reasons, including convenience or to save money, businesses engage someone to provide a good or a service as an Independent Contractor (IC) . This is likely to happen especially when both sides anticipate a short engagement. The IC relationship is advantageous:
- ICs are by definition not employees.
 - Having an IC instead of an employee relieves the business of the need to withhold or match federal and state taxes, unemployment benefits, Social Security and Medicare.

Independent Contractors



- The business can avoid including the IC in any employee benefit plans and can hire and fire the IC at will without worrying about any potential discrimination claims or employment lawsuits. State and federal anti-discrimination laws don't prohibit illegal actions against workers who are not employees.
- Businesses are not liable for overtime pay since the IC is not an employee under the Fair Labor Standards Act or related state laws.
- The IC is not covered for work-related injuries so there is no need to provide workers compensation insurance.
- A group of ICs may not organize or try to certify a bargaining representative since the National Labor Relations Act only applies to employees.

Independent Contractors



- IC's are a pretty good deal for business owners who get the benefit of the IC's knowledge and skill without having to worry about complying with employment laws.
- But having the status of an independent contractor is not a bad deal for the IC either. He or she retains the ability to take his or her services anywhere and charge as much as the market will bear. The IC also has the right to turn down business, take time off whenever circumstances permit and to control work on his or her own terms. Many people, given the option, choose to remain as independent contractors for these reasons among others.

If Business and IC Agree on the Relationship, Why Is It an Issue?



- When a business uses ICs there is a commensurate loss of revenue to a host of government bodies, state and federal or in some instances local. These agencies that depend on a steady source of withholding from employees' salaries to fund programs and enforce laws are stretched thin and are instituting compliance programs to recover lost revenue due to misclassification.
- Since 2008, the Department of Labor has recovered hundreds of millions in back pay for unpaid overtime and minimum wage violations that included improperly classified contractors. There is no indication that this trend is likely to change.

Independent Contractors



- The IRS instituted an enforcement program in 2009 to audit up to 6,000 employers over three years strictly on the issue of classification of independent contractors and whether businesses are avoiding their tax obligations by misclassification. State governments are equally aggressive in this regard.
- The IRS has the power to impose penalties, fines and bring criminal charges and also require full payment for failure to withhold taxes even if the contractor has already paid his or her share.
- Auditing of employers on the issue of IC classification is one of the highest enforcement priorities of the federal government. Be prepared.

Independent Contractors



- Since 2011, the US Department of Labor has established the “Misclassification Initiative” to address the issue of improper use of ICs and has entered into “Memoranda of Understanding” with related agencies, both state and federal, in order to share enforcement efforts. A business audited over its use of ICs by DOL may find the results of that investigation forwarded to the IRS or the state unemployment office which will then seek their own remedies against the company.
- In addition to government enforcement, employees may bring civil claims for unpaid overtime, minimum wage and employee benefits. These usually involve a number of plaintiffs and turn on the same questions of classification.
- Microsoft, FedEx, Walmart and countless smaller companies have all been sued over misclassification.

Independent Contractors



- State agencies that enforce employee rights are also using the existing laws to increase revenue based on misclassification. These enforcement actions are not just being brought by departments of revenue, but by state agencies enforcing laws relating to:
 - Workers compensation;
 - Unemployment compensation;
 - Minimum wage and overtime; and
 - Anti-discrimination in the workplace.

Independent Contractors



- Damages for misclassifying workers can run back three years. The monetary exposure is significant to any size business. It includes unpaid overtime, minimum wage, damages for employment discrimination and retroactive providing of benefits. An IC who is injured while working for your business may file a workers compensation claim that would not be covered by your company's insurance.
- Should the IRS determine that your contractors are employees, the business can be liable for unpaid taxes, penalties and interest for three years even if the IC paid his own taxes in full.
- Always keep in mind that the government agencies deciding who is an employee or IC are the same ones that stand to gain financially from making someone an employee. It is important to treat this issue seriously and make sure your classification is correct.

How Does a Business Decide Who Is An Employee Or An IC?



- There is no single answer to this question. There are no “magic words” or documents to sign that will ensure that someone you classify as an IC will be found to be one by the investigating agency or in a civil court.
- A government body investigating whether your ICs should be classified as employees will look at the “totality of circumstances” and will impose the “economic realities test” in making its decision.
- Courts take the lead from how various government agencies determine proper classification. What applies in a government investigation will help you in a civil case as well.

The Economic Realities Test



- **“Economic Realities” means what it says. How is the IC paid and managed? Does the IC have to report regularly on the progress of his work? What is the nature of the good or service the IC provides? Is it different from those of the business?**
 - **The government will ignore any written agreements between both business and IC that describe the relationship;**
 - **Titles, job descriptions and organization charts are meaningless;**
 - **A written contract in which the IC explicitly waives the right to be treated as an employee and to give up any claim for employee benefits is worthless if the economic circumstances don’t demonstrate IC status. Microsoft and FedEx both had extensive written agreements with their ICs which the IRS and Department of Labor invalidated based on the “economic realities” of these situations. The back pay and benefits award in both instances was huge.**
 - **An investigating body will generally look to how the employer “controls” the day to day activities of the IC or whether the nature of the service the IC provides is similar to that of the employer.**

What are the Indicators of Employment? It's All a Question of Fact.



- The IRS has developed its “twenty factor” test to determine whether someone is an employee or an IC. The answer will ultimately be based on whether the business “controls” the work being performed. This is not a test that receives a score which determines employment or IC status. The IRS takes all the responses to the twenty factor questions and looks at the “totality of circumstances” in making its decision. The US Department of Labor and most other federal agencies look at the twenty factors but use their own method of determining IC status based on the following guidelines.

The facts that provide evidence of control fall into three categories:

- **Behavioral** - Does the company control or have the right to control what the worker does and how the worker does his or her job? Does the employer require the worker to arrive at a certain time and sign in using the company time management system? Does the company require the worker to wear clothing identifying himself as affiliated with the company? Does the company impose any restrictions on outside work?
 - Example: For years, FedEx employed delivery personnel who wore company uniforms, drove FedEx trucks and looked to the public like employees of the company. Despite these indicia of employment, FedEx classified these workers as independent contractors. Ultimately, the Department of Labor overturned this status and FedEx was stuck with back pay and benefits going back two years.

What are the Indicators of Employment? It's All a Question of Fact.



- **Financial** - Are the business aspects of the worker's job controlled by the company? Is the worker paid by the hour or on a "per job" basis? Does the company reimburse the worker for expenses related to the job? Does the worker provide his own tools or does the company require use of its own?
- **Type of Relationship** - Is the worker (IC) separately incorporated, insured and holding himself out to the public as a business entity? (Evidence can include business cards, yellow pages listings and computer web pages.) Does the company include the worker under any of its employee benefits? If so, this is almost conclusive evidence of an employment relationship.
- **(Please note) Employers or employees may file a Form SS-8 with the IRS seeking a determination on worker status but the IRS warns that it may take up to six months to get a decision.**

Examples of IC and Employees



- **While federal agencies use the IRS factors to determine classification, state government bodies and civil lawsuits also take into account whether the service provided by the worker advances the general purpose of the business. What does it mean to “advance” the business purpose? Here are some examples:**
 - A worker who is hired to paint the exterior of a software business office will assuredly be an IC, absent other factors. The IC provides a service and is engaged in an activity which is different from the core business of the company;
 - A worker who writes software code for this same business as a temporary for a week will likely still be considered an IC if the engagement ends after a week. This is particularly true if the person was referred by a temporary staffing agency and was paid as an employee of that agency or the worker has an independent business which is separately insured and incorporated. Some states, such as Michigan, may differ with my conclusion and take a harder line but the potential exposure for back pay, etc. is minimal in any event;
 - Another code writer who has worked at this software company as a “temporary” for two years, arriving at a scheduled time to receive his assignments will be classified as an employee by any government agency. The worker’s skill, knowledge and experience are used by the company to further its business purpose. The company controls the person’s activities on a daily basis. This is what happened in *Vizcaino v. Microsoft* and cost MS close to a billion dollars in unpaid salary, withholding and benefits.

“ IF IT WERE EASY TO CLASSIFY WORKERS AS INDEPENDENT CONTRACTORS, NO BUSINESS WOULD HAVE EMPLOYEES.”

What Are the Red Flags I Should be Worried About?



- Does your company have a large group of ICs regularly on the premises?
- Are their daily activities subject to supervision by the company?
- Do they record their time using a company system?
- Does the company provide tools, transportation, uniforms or business cards?
- Do the ICs perform the same duties as regular employees?
- If you answered yes to any of these questions, you should seriously consider reclassifying these people as employees.

My Business Has Many ICs. What Can I Do to Protect It?



- **Do a thorough review of the individuals classified as contractors with an honest, critical assessment of the nature of their relationship with your business, the service they provide and all the other factors listed above to determine whether they are employees or contractors.**
- **Calculate the cost involved with reclassification. Look at the potential liability for unpaid overtime, Social Security contributions and payments to state unemployment accounts.**
- **If you conclude that some or all must be reclassified as employees, do not hesitate. Don't wait for a government agency to order your business to make the switch. You will be in a much better position if you have taken steps on your own to rectify any potential errors.**
- **Making someone an employee is easy. Just tell your contractors that effective on a certain date or immediately, they will be treated as employees. The new employees will need to complete Forms I-9 and W-4. Treat them as new hires for issues like drug screening, background checks and benefit enrollments.**
- **Have a long talk with an employment lawyer and your accountant about the potential exposure for having misclassified workers. Consider approaching the IRS or state agencies about making back payments for taxes not withheld.**

Unpaid Student Interns



- What about unpaid student interns? Can they be considered employees?
 - The US Department of Labor has targeted the use of student interns as an enforcement priority based on what they considered abuse of that relationship by “for profit” organizations, although strictly speaking the rules apply to all employers. The Fair Labor Standards Act (FLSA) defines “employee” very broadly to include anyone that an organization “suffers or permits” to perform in its behalf.
 - There have been countless lawsuits filed against many employers, including Conde Nast and Google, by former interns seeking salary and benefits that were denied them as student interns. Expect these types of cases to grow.

Unpaid Student Interns



- In 2010, the DOL issued some guidelines for employers. Under the following circumstances, an unpaid intern will not be considered an employee when the training being provided at your workplace is for the “educational benefit” of the intern:
 - The internship, even though it includes actual operation of the facilities of the employer, is similar to the training which would be given in an educational environment;
 - The internship experience is for the benefit of the intern;

Unpaid Student Interns



- The intern does not displace regular employees, but may work under the close supervision of the existing staff;
- The employer that provides the training derives no immediate advantage from the activities of the intern; and on occasion its operations may actually be impeded;
- The intern is not necessarily entitled to a job at the conclusion of the internship; and
- The employer and the intern understand that the intern is not entitled to wages for the time spent on the internship.

Unpaid Student Interns



- Many businesses now require interns to receive college credit (and sometimes pay tuition for the internship) to further their argument that the intern is not an employee.
- It is critical for your business to have a signed, written understanding with the university and the student intern that explains the purpose of the internship, the duties involved and that it is unpaid. It should also have a specific representation from the university and the intern that the internship is integral to the student's field of study.
- The easiest way for an employer to avoid liability for misclassified interns is to comply with the wage and hour laws and pay minimum wage and overtime, if applicable.



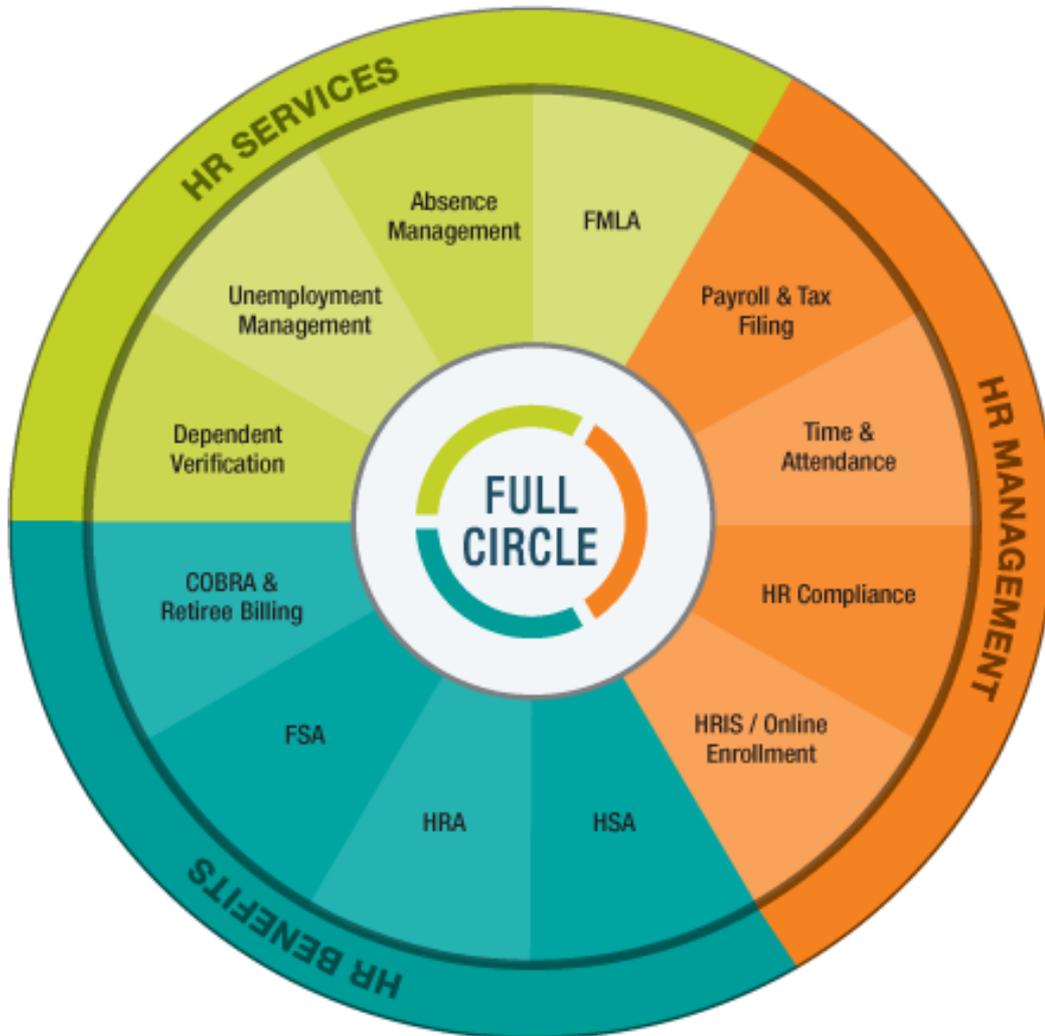
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