Who Is & Who Isn’t an Independent Contractor

Presented by: Kevin M. McCarthy
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HR Solutions Come Full Circle

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• Misclassification of employees as
  – Independent contractors
  – Interns

• Misclassification of FLSA non-exempt employees as exempt employees
Reasons Government Agencies Are Concerned about Misclassifications

• IRS & State Treasury Departments
  – Early collection of income taxes

• U.S. Department of Labor & State wage & hour agencies
  – Payment of minimum wage and overtime
  – ERISA enforcement (U.S. DOL)

• EEOC & State EEO agencies
  – Anti-discrimination, harassment and retaliation laws
Government Agency Concerns

• Homeland Security
  – I-9 obligations

• NLRB
  – Employee protections under the National Labor Relations Act

• State unemployment agencies
  – Unemployment benefit contributions and protections for employees

• State workers’ compensation agencies
  – Workers’ comp benefits
What Liability Exists for Misclassification?

- Liability can be extensive
- IRS
  - $50 for each W-2 not filled out
  - Penalties of 0.5% of “wages” paid, plus 40% of the FICA taxes not withheld and 100% of the matching FICA taxes the employer should have paid
  - “Failure to pay” tax of 0.5% of the unpaid tax liability per month and 25% of the total tax liability
  - For intentional misclassification, 20% of all wages paid and 100% of the FICA taxes, with criminal penalties of up to $1,000 for each misclassified worker and 1 year in prison
Liability

• IRS
  – The individual responsible for withholding taxes could be held personally liable in intentional misclassification cases

• Recent DOL settlements and judgments
  – $1,500,000 judgment for 250 cable installers (overtime)
  – $560,000 relating to telemarketers (minimum wage and overtime)
  – $395,000 for construction workers (overtime)
  – $277,000 assessment for janitorial workers (minimum wage and overtime)
Liability

• State Actions
  – New York Labor Department in 2014 assessed over $40,000,000 liability as to 133,000 misclassified workers (unpaid unemployment compensation contributions)
  – Illinois in 2013 recovered $5,100,000 in unemployment compensation contributions from 3,500 employers
Multiple Tests for Determining Worker Status

• Economic realities test (DOL)
• Control test (many state agencies)
• Hybrid tests (IRS)
• There is not a uniform test relative to worker status
July 15, 2015 – Administrator’s Interpretation 2015-1

Economic Realities Test -- “whether the worker is economically dependent on the employer (and thus an employee) or is really in business for himself or herself (and thus an independent contractor)"

Six factors are to be considered
DOL Factor 1 – Integral Part of the Employer’s Business

• The extent to which the work performed is an integral part of the employer’s business
  – This is a “compelling factor” to many courts
• The worker’s opportunity for profit and risk of suffering a loss depending on his/her managerial skill
• The relative investments of the employer and the worker
  – A contractor’s investment should not be relatively minor compared with that of the employer
• Whether the work to be performed requires special skills and initiative of a business nature
• The permanency of the relationship
  – Contractual relationships tend to be for a fixed period of time or a specific project
The degree of control exercised or retained by the employer
– Not the most significant factor
IRS Test

• Formerly used a 20-factor test
• Now uses a 3 or 18 factor test, depending on how you count
  – Focuses on 3 categories of factors
    • Behavioral control
    • Financial control
    • Type of relationship
• Type of instructions given
  – When & where to do the work
  – What tools or equipment to use
  – What workers to hire or assist with the work
  – Where to purchase supplies or services
  – What work must be performed by a specific individual
  – What order or sequence to follow when performing the work
• The degree of instruction exercised by the employer
  – The more instruction that is given, the more likely it is that the worker is an employee
• Evaluation systems
  – If it measures the details of how the work is performed, it points toward employee status
  – If it only measures the end result, it points toward either employee or contractor status
• Training
  – Training on how to do the job is “strong evidence” the worker is an employee
  – Periodic or ongoing training about procedures and methods is “even stronger evidence” of employee status
• Significant investment
  – Contractors often have significant investments in equipment, depending on the industry
• Unreimbursed expenses
  – Contractors are more likely to have unreimbursed expenses
• Opportunity for profit or loss
  – The possibility of incurring a loss indicates contractor status
• Services available to the open market
  – Contractors often advertise, maintain a visible business location and are available to work in the relevant market

• Method of Payment
  – Pay based on an hourly, weekly or other period of time indicates employee status
  – Contractors are usually paid a flat fee for a job, although in some industries hourly rates are common
IRS Factor 3 – Type of Relationship

• Written Contracts
  – A contractual statement that the worker is a contractor carries no weight; how the parties actually work together is the relevant consideration

• Employee Benefits
  – Benefits such as insurance, retirement plans, paid vacation and sick days are indicative of employee status
  – The absence of such benefits does not necessarily mean the worker is a contractor
• Permanency of the relationship
  – A relationship for a specific project or period indicates contractor status
  – An indefinite relationship looks more like employment
• Whether the services provided are a key aspect of the business
  – If the worker provides services that are a key aspect of the business, it is more likely the business will retain the right to direct or control the worker’s activities, indicating employment status
Actions for Employers to Take

• Evaluate contractor relationships
  – Consider using your employment lawyer to conduct the review
• Modify workers’ status as necessary
• Be aware of statutes of limitations on claims
• Periodically conduct updated reviews
• FLSA releases must be approved by DOL or a court to be valid
Questions

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