

Independent Contractors and Gig Workers

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Today's Topics

- Employee misclassification and potential liability
 - Federal and state taxes
 - Minimum wage and overtime wages
 - Workers' compensation coverage and premium audits
 - Employee benefits
- Employee or Independent Contractor (IC) – How do I make the decision?
 - IRS 20 Factor Test
 - Economic Reality Test
 - Common Law (Right to Control) Test
- Practical tips on establishing the IC relationship
- Fact pattern – IC or employee?
- Questions

Independent Contractors and Gig Workers

- What is a Gig Worker?
 - Short term contractors or free lancers that typically do short-term work, sometimes for multiple different companies at the same time
 - People that work short term “gigs” for companies
- ICs and Gig Workers
 - Not on your employee payroll
 - No W-2 wages – 1099-MISC
 - No employment taxes (FICA, FUTA, State Unemployment)
 - No income taxes withheld or remitted
 - Tax savings
 - Less administrative hassle

Employee Misclassification and Potential Liability

Employee Misclassification

- When individual workers or groups of workers are incorrectly classified as ICs (1099-MISC) – when they should have been classified as employees (W-2)
- Misclassification can lead to *substantial liability* for employers
 - Uber - \$100 million to the NJ Unemployment Trust Fund for misclassified drivers (9/13/22)
 - PL Construction - \$246,000 to the USDOL for misclassified painters (8/4/22)

Misclassification - Employment Tax Problems

- FICA (SS and Medicare) – Employer and employee each pay 6.2% (SS) + 1.45% (Medicare)
- FUTA – 6% of the first \$7,000
- State Unemployment Insurance – SUI tax rate on the first \$9,500
- Example: IC - \$70,000/year
 - FICA = \$4,340 + \$1,015 = \$5,355
 - FUTA = \$420
 - SUI = 6.0% x \$9,500 = \$570
 - Total = \$6,345/tax year + penalties + interest
 - What if – (a) Multiple tax years; and (b) You have 50 ICs just like this one

Misclassification – Minimum Wage and Overtime Problems

- State and federal law require employees to be paid at least minimum wage for all hours worked and overtime for all hours worked over 40 in a week
- Employers must track hours worked, pay a proper wage, and accurately calculate overtime
- Workers classified as independent contractors often get paid on a project basis, don't track their hours worked, and don't pay attention to minimum wage and overtime

Possible Costs and Damages

- Back wages
- Unpaid overtime (at overtime premium)
- Liquidated damages
- Civil penalties
- Attorney's fees and costs
- Individual liability

Minimum Wage and Overtime

- About 100 direct care workers who were classified as ICs filed a complaint with the DOL and alleged that the company misclassified them as independent contractors, which meant that it (1) failed to maintain accurate records of hours worked and (2) failed to pay overtime.
- Judgment:
 - \$182,624 in back wages
 - \$182,642 in liquidated damages
 - \$34,752 in civil penalties
 - **\$400,000 total (\$4,000 per worker)**

Minimum Wage and Overtime

- A cement-cutting contractor classified 21 workers as independent contractors, did not maintain proper pay records, and failed to pay overtime. The DOL sued.
- Judgment:
 - \$69,534 in back wages
 - \$69,534 in liquidated damages
 - **\$139,068 total (\$6,622.29 per worker)**

Minimum Wage and Overtime

- A Michigan transport company classified drivers who move new vehicles between different yards in Detroit as independent contractors. Some workers complained to the DOL. The DOL sued.
- Judgment:
 - \$808,831.38 in back wages
 - \$808,831.38 in liquidated damages
 - **\$1,617,662.76 total (\$2,310.95 per worker)**
- All of the individual defendants had to file bankruptcy

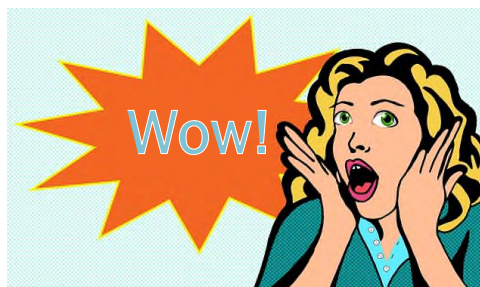


Workers' Compensation (WC) Problems

- Company does not have WC insurance (all workers are ICs)
 - Company is liable for WC or tort damages
 - Directors and officers of the Company are personally liable for all damages
- You do have WC insurance for Company's W-2 employees
 - Carrier will deny coverage for injured ICs – can result in tort lawsuits
 - Yearly WC premium audits – WC insurance carrier's audit your payroll records on a yearly basis, and they can charge you additional premiums on ICs

Misclassification – Employee Benefits

- Do we even care?
 - No, really. Do we?
 - Rarely comes up, but it could.
- Who do you want to have benefits?
 - Employees
 - Contractors?
 - Advantages
 - Pitfalls



Misclassification – Employee Benefits

Vizcaino v Microsoft Corporation

- **Facts:** “Contractors” brought a class action against MS claiming that they were actually employees and were entitled to participate in certain pension/welfare plans.
 - Workers learned the IRS had recently said they were employees, not contractors, for tax purposes.
- MS loses. Why?
 - The plan applied to any common law employee who was on the payroll.
 - MS argued contractors weren’t on payroll – unsuccessfully.
 - **Lesson learned:** make the plan terminology clear.
- MS eventually settles the case for \$96.89M, and is assessed \$27.13M in attorney fees and costs.
 - *Do you care now?*

Misclassification – Employee Benefits

Jammal v American Family Insurance Company

- **Facts:** Insurance agents, classified as contractors, brought a class action alleging they were employees and were entitled to benefits, including those under ERISA.
- Company wins. Why?
 - They are not common law employees, under court’s analysis, which is step 1 in the ERISA analysis.
 - Court focuses heavily on the fact that ERISA is about financial benefits – so, the focus should be on the *financial structure* of the company-contractor relationship.
- *Jammal* is a Sixth Circuit decision (Michigan, Ohio, Kentucky, Tennessee).

Employee or Independent Contractor (IC) – How Do I Make The Decision?

How Do I Make the Determination – Employee or IC?

- Do a thorough classification analysis up front – before the relationship begins
 - Especially when you will have multiple people performing this type of IC work
 - Liability on one misclassified IC is annoying
 - Liability on 50, 100, 500, 1,000 misclassified ICs is devastating
- In general – Three legal tests are used to make the employee/IC determination

IRS 20 Factor Test

Taxes (federal and state) & WC

1. Instructions – Do we provide instructions on when, where, how to do the work?
2. Training – Do we train the worker?
3. Services rendered personally – Cannot subcontract the work
4. Hire, supervise and pay assistants – Is the IC allowed to have his/her own workers?
5. Continuing relationship – Does IC do work for us for long periods of time?
6. Set work hours – Do we set the IC's work hours?
7. Full Time – Is the IC working full-time for us? Exclusive relationship with us?
8. Work On Premises – Does the work have to be performed on our premises?
9. Order or sequence – Do we require the work be done in a particular order/sequence?
10. Reports – Are regular oral or written reports required?

IRS 20 Factor Test (Cont.)















11. Paid by the hour, week, month or by the job?
12. Expenses – Do we pay the ICs expenses?
13. Tools and materials – Do we furnish tools and materials to the IC?
14. Does the IC have a significant investment in the facilities where the work is performed?
15. Can the IC make a profit or suffer a loss on the job?
16. Integration – Is the IC doing work that is integral to your business? *Important
17. Does the IC work for more than one company at a time?
18. Does the IC make services available to the general public?
19. Can the Company fire the IC without and liability?
20. Can the IC quit without any liability?

IRS 20 Factor Test: Main Issues

All 20 factors boil down to three main issues:

1. Behavioral Control – Does the Company have the right to direct and control how the IC performs his/her services?
2. Financial Control – Are the business aspects of the IC's services controlled by the Company? (Pay, reimbursements, tools and materials)
3. Relationship of the Parties – As evidenced by written and oral agreements, duration of the relationship, employee benefits/health insurance, IC's services are a critical part of the Company's business

DOL: Economic Reality Test

 EMPLOYEE	OR	INDEPENDENT CONTRACTOR
 Working for someone else's business		Running their own business
 Paid hourly, salary, or by piece rate		Paid upon completion of project
 Uses employer's materials, tools and equipment		Provides own materials, tools and equipment
 Typically works for one employer		Works with multiple clients
 Continuing relationship with the employer		Temporary relationship until project completed
 Employer decides when and how the work will be performed		Decides when and how they will perform the work
Employer assigns the work to be performed		Decides what work they will do

California: ABC Test

All workers are employees unless they satisfy all three of these conditions:

1. The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract and in fact.
2. The worker performs work that is outside the usual course of the hiring entity's business.
3. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature of the work performed.

Benefits – Test for Employee vs Contractor

Step 1: Common law test (20 factors)

- Control manner/means by which product is done/made
- Skill required
- Source of tools
- Work location
- Relationship duration
- Right to assign additional projects to worker
- Worker's discretion over time/length of work
- Method of payment
- Worker's role in hiring/paying assistants
- Whether work is part of company's regular business
- Provision of employee benefits
- Tax treatment of worker
- And more!

In the end, it comes down to control – but be mindful of the *financial structure* for ERISA benefits, as mentioned in *Jammal*.

Step 2: Review the plan documents

- Even if a worker is considered a “common law employee” under Step 1, the specific language of plan documents will still control.
- Important language in plan documents:
 - Benefit plan should give administrator or fiduciary discretionary authority to determine eligibility for benefits or construe terms of the plan.
 - Go above and beyond merely needing to be an “employee” to qualify. There should be qualifications that would only apply to workers the employer would consider/want to be an employee.

Practical Tips – Establishing the IC Relationship

- Clearly establish the relationship up front – before any work is performed – how they will be paid, how taxes will be handled, etc.
 - Best practice: Written IC Agreement – more later
- Encourage LLC or Corporation formation, but do not require it
- Avoid having ICs performing the primary/integral functions of your company
 - Best practice: Hire these individuals as employees of your company

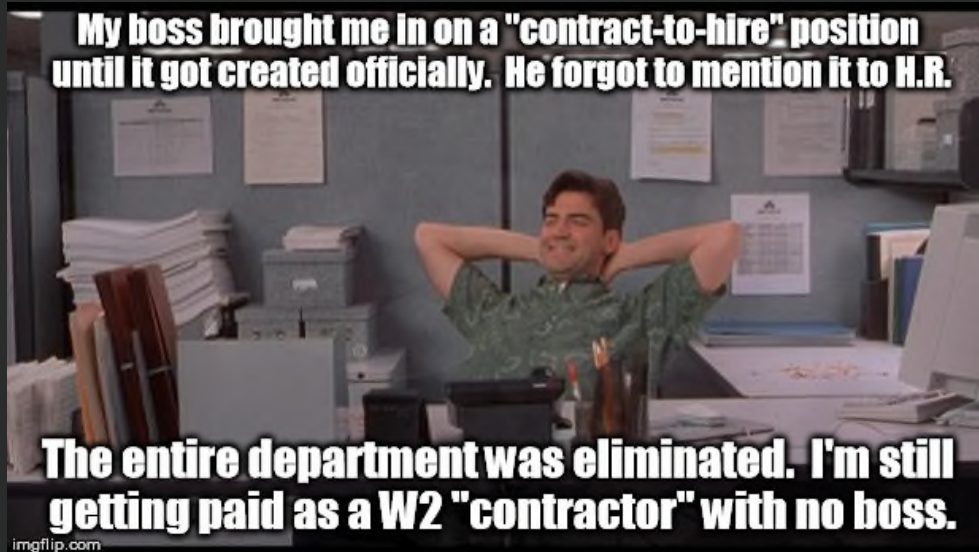
Independent Contractor Agreement

Parties & Description of the Services

- Parties
 - Your entity contracts with the contractor's entity
 - Preferably the contractor has its own LLC or corporation (which you did not help create)
- Description of the Services

Performance of Services

- Performance of the Services
 - Contractor has sole control over:
 - Manner and means
 - Schedule
 - Starting / ending time
 - Contractor is responsible for:
 - Place of work
 - Equipment, tools, and materials (phones, laptops, computers, internet access, printers, office supplies, staff, travel, insurance, etc.)



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Payment for Services

- Require contractor to submit a W-9 (preferably with a FEIN, not SSN)
- Specify the amount and how it is paid (*i.e.*, monthly, quarterly, at completion of project, etc.)
- Contractor submits regular invoices
- Your entity pays invoices (through AP, not payroll) within a certain time or the amount is subject to interest
- No withholding of taxes, FICA, unemployment, or any other deductions
- Reported on a Form 1099
- Contractor indemnifies your entity for any tax issues
- No benefits

Independent Contractor Agreement

- State that contractor is working as an independent contractor, that neither the agreement nor the work create an employer-employee relationship, and that the parties deny the existence of anything but an independent contractor relationship
- Non-exclusivity

Things To Avoid

- The services are part of your organization's primary function
- Control over the contractor's work or methods
- 40 hour work weeks / exclusivity
- Non-competes, non-solicits, exclusivity clauses
 - Non-disclosure of confidential information is usually ok
- Paying through payroll (even if on a 1099 basis)
- Benefits
- Reimbursement of expenses (sometimes)

Fact Pattern

Fact Pattern: Architecture Firm

- Has employees that are licensed architects
- Retains an IC architect to handle overflow drawing, plans, design, and construction analysis
- About 15-20 hours/week – sometimes 30-40 during busy periods
- Firm and IC agree on an hourly rate of pay – no benefits
- IC submits time sheets every two weeks, and the firm pays IC
- IC and Firm have a written agreement indicating an IC relationship exists
- IC submitted a W-9 with her SSN on it
- IC has no corporation or LLC
- IC only provides services to Firm
- Firm covers IC on its professional malpractice insurance
- Firm requires IC to do the work, as it must be completed by a licensed architect, but it does not tell IC how to do her job
 - **Employee or IC?**

Fact Pattern

- Architecture firm
 - Employee (part-time)
- What if:
 - IC had her own LLC and FEIN
 - **Leaning toward IC status**
- What if:
 - IC had her own LLC and FEIN; and
 - IC was providing services to 4 other firms at the same time
 - **Pretty clear IC**
- What if:
 - IC was not an architect, but instead provided marketing services and spent 10-15 hours per week marketing the firm's services through social media and other platforms
 - **Probably an IC**



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