



# Identifying Independent Contractors

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Judith A. Moldover

[jmoldover@lawyersalliance.org](mailto:jmoldover@lawyersalliance.org)

Peter F. Martin

[pmartin@lawyersalliance.org](mailto:pmartin@lawyersalliance.org)



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# OVERVIEW

## **I. Employees vs. Independent Contractors**

- I. Who is an employee? Who is an independent contractor?**
- II. Legal obligations regarding employees and independent contractors**
- III. Factors indicating worker status**
- IV. Penalties for misclassification**
- V. Myths busted**

## **II. Independent Contractor Agreements**

## **III. Remediation & Reclassifying Workers**

- I. Voluntary disclosure of misclassification**
- II. Voluntary reclassification**
- III. Consulting legal counsel about misclassification and disclosure**

## **IV. Other Workers: Volunteers & Interns**



# Part I: Employees vs. Independent Contractors



# EMPLOYEES VS. INDEPENDENT CONTRACTORS

## Why is proper classification important?

- Misclassification as independent contractors creates financial liabilities for employers.
- Increased worker misclassification enforcement action.
  - Misclassification results in *billions* of dollars in lost revenue to federal, state, and local tax departments, Social Security, Medicare, the unemployment insurance trust funds, and workers compensation funds.
  - Economic downturns usually spur new enforcement.
  - A new presidential administration often means new regulations.
- Improper classification of workers leads to ineligibility for benefits and protections under state and federal laws.



# WHO IS AN EMPLOYEE?

**An individual over whom an employer has direct control and direction. In an employer-employee relationship, the employer, not the employee, establishes the work to be done and how.**

- Employer must:
  - Pay minimum wage and overtime
  - Withhold and pay applicable taxes (income, Social Security, unemployment, Medicare)
  - Provide NYS Workers Comp, Disability, and Unemployment Insurance
  - Comply with protective laws
  - Issue a W-2
- Employee may be eligible for private benefit plans



# LEGAL OBLIGATIONS REGARDING EMPLOYEES (PARTIAL LIST)

- Federal: Federal employment tax laws, anti-discrimination laws such as the Americans with Disabilities Act and Title VII of the Civil Rights Act, Family Medical Leave Act, Genetic Information Nondiscrimination Act, Affordable Care Act, and Fair Labor Standards Act
- NYS: Unemployment Insurance Law, Workers Compensation Law, Disability Benefits Law, wage and hour laws, including the Minimum Wage Law and the Wage Theft Prevention Act, and Human Rights Law
- NYC: Human Rights Law, Earned Safe and Sick Time Act



# WHO IS AN INDEPENDENT CONTRACTOR?

**Generally, workers who are in business for themselves and control the “when, where and how” of their work.**

- Employers do not withhold or pay any taxes on payments to the contractor.
- Organization must issue a 1099 to an independent contractor who receives \$600 or more in payments annually.



# WHO IS AN INDEPENDENT CONTRACTOR?

**Legal theories overlap and blur. The real test:**

- 1) The extent to which the hiring party has the right to control the “manner and means” by which the worker completes his/her assigned task, and
- 2) Whether, as a matter of “economic reality” the individual is truly in business for him/herself and can control the opportunity for profit and loss.

The determination of the proper classification is made based on analysis of numerous factors *regardless of written documents*. Each factor must be seen in the total context; a factor may be dispositive in one context and irrelevant in another.

Federal, state, and local law all attempt to define the boundaries—not always in the same place, and not always consistently over time.





# WHO IS AN INDEPENDENT CONTRACTOR?

## General considerations:

- Government at all levels can take in more tax revenue when paid workers are classified as employees instead of independent contractors, incentivizing regulations that require classification as employees.
- Political ideology also comes into play. More liberal governments usually seek to define more workers as employees, while more conservative governments usually seek to define more workers as independent contractors.
  - This contributes to different definitions by different levels of government, and different definitions over time.
- Nonprofit organizations should be aware of federal, state, and local laws on the question, and be aware that they can change over time.



# WHO IS AN INDEPENDENT CONTRACTOR?

## **Federal law, as set by the Department of Labor:**

- Under the past few presidential administrations, the U.S. Department of Labor issues new regulations to define who is an employee and who is an independent contractor under the Fair Labor Standards.
- The Department of Labor issued very different definitions under Obama and Trump
  - Under Obama, people performing paid work were assumed to be employees until employers proved otherwise. Test had a dozen factors
  - Under Trump, the presumption was largely reversed
- With a new administration beginning to make its mark on federal regulations, changes are likely to come in the months ahead.
  - A regulation promulgated in the final weeks of the last administration was delayed by the new administration and will likely be completely withdrawn.



# WHO IS AN INDEPENDENT CONTRACTOR?

**Federal law, as set by the IRS, other agencies, and the courts:**

- IRS
  - Definition (Pub. 15-A (2021)): “Under common-law rules, anyone who performs services for you is generally your employee if you have the right to control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.”
  - Uses a 20-factor test for payroll tax purposes
- Agencies and courts apply several different theories/tests:
  - “Right of control”: widely popular common-law test; favored by Obama DOL
  - “Economic reality” test: applied to federal wage-hour laws and by many state courts to state wage-hour laws; applied by now-frozen Trump regulation
  - “Behavioral control”: a blend of the others, focusing on how the parties interact with each other
  - Note: Additional factor under California law: is contracted work part of normal operations?
- Different courts apply different tests to different circumstances—but, as applied, the tests blur together.



# WHO IS AN INDEPENDENT CONTRACTOR?

## New York State law:

- Does not define who is an employee and who is an independent contractor
- But courts and the NYS Department of Labor have issued guidance, saying numerous factors must be considered, including:
  - How many hours does the worker work? Who sets the hours? Is attendance at meetings or training required? Is prior permission required for absences? Is the work directly supervised? Is the worker instructed when, where, and how to do the work? Are facilities, equipment, tools, and/or supplies provided? How is compensation provided? Are business or travel expenses reimbursed? Are fringe benefits provided? Are time, money, or territorial limits set? Can the worker contract with another to provide the service? Are reports required? Does the worker present themselves as a representative of the employer? Is the worker prohibited from working for competitors?

See: <https://www.labor.ny.gov/ui/dande/ic.shtm> and  
<https://www.labor.ny.gov/formsdocs/ui/ia318.14.pdf>.



# WHO IS AN INDEPENDENT CONTRACTOR?

## New York State law, continued:

- The central test is the degree of:
  - Supervision
  - Direction
  - Control
- Independent contractors:
  - Are in business for themselves *and*
  - Make their services available to the public
- Issue comes up frequently in connection with Unemployment Insurance benefits claims



# LEGAL OBLIGATIONS REGARDING INDEPENDENT CONTRACTORS

- Covered under NYS and NYC Human Rights Laws
- **NYC Freelance Isn't Free:**
  - Written contracts required for services
  - valued at \$800 or more, or
  - with an aggregate value of \$800 if performed over 120 day period
  - Minimum elements of written contract:
    - Name and address of “hiring partner” and “freelancer”
    - Itemization of the services to be provided, value of the services, and rate and method of payment
    - The date the freelancer will be paid, or the method to determine date of payment (if not provided, payment due within 30 days of completion)
  - Each party must have a copy of the written contract



# FACTORS INDICATING WORKER STATUS

## EMPLOYEE

- No right to determine method, manner and means to do the work
- Subject to direct supervision
- Services are integral part of business
- Does not provide facilities, equipment, tools, or supplies

## INDEPENDENT CONTRACTOR

- Discretion as to how to produce product or service
- Not subject to supervision
- Services are not integral even if important
- Significant investment in tools, equipment and supplies



# FACTORS INDICATING WORKER STATUS

## EMPLOYEE

- Does not have right to set own schedule
- Must render service personally
- Needs permission for absence
- Employer provides training
- May not compete with employer
- Attends staff meetings

## INDEPENDENT CONTRACTOR

- Self-schedules subject only to project deadline
- May hire another to perform the work
- May take time off at own discretion
- Does not need training; usually has special expertise
- May provide services to competing organizations
- Does not attend meetings





# FACTORS INDICATING WORKER STATUS

## EMPLOYEE

- Holds title
- Employer furnishes business cards
- Uses employer's email
- Economically dependent on employer
- Employer sets rate of pay
- On the payroll
- Reimbursed for expenses and routine business travel

## INDEPENDENT CONTRACTOR

- No title with engaging organization
- Has own business cards
- Is not on the organization's email
- Multiple clients
- Negotiates rates
- Submits invoice
- Absorbs routine expenses as part of ability to control profit



# PENALTIES FOR MISCLASSIFICATION

- **Penalties for tax violations**
  - Employers may owe back taxes that should have been paid or withheld—plus interest.
  - Fines from the U.S. Department of Labor, IRS, and state agencies can total millions of dollars.
  - For certain violations there may be civil and criminal penalties.
- **Penalties for wage and hour or benefits violations**
  - Significant fines and penalties may be imposed for failure to pay proper wages, particularly if overtime hours are involved, and for misclassification related to benefits plans, unemployment insurance, workers compensation, and other programs
- **Penalties for willful failure to pay or collect tax**
  - Is a felony punishable by up to a \$10,000 fine and/or, in egregious cases, up to five years in prison (26 U.S.C. § 7202)
- *Organization is liable even if individual insisted on being independent contractor!*



# MYTHS BUSTED

- **Myth 1: Contractual Designation.** A contract designating the individual as an independent contractor will prevent a finding that the individual is an employee.
  - **Reality:** The mere designation by the employer of an independent contractor status is not conclusive. Because evidence beyond the contract is examined, it is critical to treat the individual like an independent contractor in all aspects of the working relationship.
- **Myth 2: Part-Time Worker.** If the individual works part-time, he/she is an independent contractor.
  - **Busted:** Any control by the employer over the individual's work schedule or hours will serve as evidence of an employment relationship.



# MYTHS BUSTED

- **Myth 3: Industry Practice.** The individual is an independent contractor because other organizations treat people similarly situated to the individual as independent contractors.
  - **Reality:** Industry practice is rarely determinative. Courts examine working relationships on a case-by-case basis.
- **Myth 4: Devotion of Substantial Time.** It does not matter whether the services the individual provides for the organization constitute substantially all of his/her business.
  - **Reality:** If a worker must devote substantially all of his/her time to the business of the organization, the individual is more likely to be classified as an employee than as an independent contractor.



# MYTHS BUSTED

- **Myth 5: Permanency of Relationship.** An organization can use the individual's services as frequently as desired or establish an ongoing relationship without compromising his/her independent contractor status.
  - **Reality:** Frequent or continual use of an individual's services will likely serve as evidence of an employment relationship.
- **Myth 6: Training.** Helping the individual learn what is requested by the organization by watching another individual perform similar services is not considered "training."
  - **Reality:** This may qualify as training because it demonstrates the employer's desire to have the work performed in a particular fashion.



## Part II: Independent Contractor Agreements



# INDEPENDENT CONTRACTOR AGREEMENTS

**All independent contractors must have contracts.**

Recommended provisions:

- Independent contractor relationship
- Contractor's responsibilities and scope of services
- Project deadline
- Organization's reasonable satisfaction with deliverables
- Fees for services, and requirement for contractor to submit an invoice to organization for payment
- Organization is not responsible for reimbursement of expenses



# INDEPENDENT CONTRACTOR AGREEMENTS

- Contractor controls manner, means, details and methods of work
- Organization cannot and will not supervise, direct or control the manner, means, details or methods used by contractor
- Contractor controls his/her time and skills not devoted under the agreement
- No employer-employee type compensation or benefits (e.g., salary, bonus, health coverage, accident insurance, worker's compensation)
- No claim by contractor against the organization for payment of any employee compensation or benefits





# INDEPENDENT CONTRACTOR AGREEMENTS

- Organization will not contribute to Social Security, unemployment insurance or federal, state or local withholding taxes with respect to the contractor
- Contractor is solely responsible and liable for payment of any and all taxes and insurance that he/she may owe to any governmental authority
- Contractor will comply with all applicable laws with respect to its employees
- No reimbursement of expenses
- Contractor and its employees have proper skill, training, experience and licenses to perform services
- Indemnification provisions
- Contractor's works belong to the organization in perpetuity
- Confidentiality



## Part III: Remediation & Reclassifying Workers



# DISCLOSURE OF MISCLASSIFICATION & RECLASSIFYING WORKERS

If you come to believe your organization is misclassifying workers, what should you do?

- Consult legal counsel (see following slides)
- Remediation:
  - Ensure all relevant workers are being paid legally mandated minimum wage and/or overtime
  - Add eligible workers to employee benefit plan
- Review organization's employee handbook and benefits policies in light of questions surrounding worker classification



# VOLUNTARY DISCLOSURE OF MISCLASSIFICATION

- Employers can disclose misclassification to federal and NYS taxing authorities
- Bona fide misclassifications
- Generally, avoid penalties but admit misclassification
- Do not contact authorities without legal advice



# VOLUNTARY RECLASSIFICATION

- Pros
  - Statute of limitations stops running
  - Control over risk of loss
  - Regulators tend to be lenient when employer self-audits
- Cons
  - Cost of reclassification (prospective/retroactive)
  - May trigger audit
- *Never reclassify workers without the advice of counsel*
  - Cost including benefits eligibility
    - Retroactivity
  - Employee communications



# CONSULTING LEGAL COUNSEL ABOUT MISCLASSIFICATION AND DISCLOSURE

- If you believe your organization may be incorrectly classifying employees as independent contractors, contact an attorney to discuss:
  - Voluntary reclassification and/or
  - Application for voluntary disclosure programs
- Get legal assistance to:
  - Understand the status of your paid workers
  - Conduct an audit to ensure proper classification
  - Review/draft independent contractor agreements
  - Take appropriate corrective measures.
- Your organization will need to consider the consequences of reclassification vs. the risks of the failure to reclassify.



## **Part IV: The Unpaid Workforce: Volunteers & Interns**



# UNPAID WORKFORCE: VOLUNTEERS & INTERNS

- Volunteers
  - Provide services to a nonprofit organization completely willingly and for personal satisfaction, with no expectation of compensation
  - Workers should not “try out” for paid positions as volunteers
  - Employers should create formal processes governing volunteer work
  - Employees may volunteer services *but not to do their regular work*
  - Employers should not give expensive gifts that resemble compensation
- Interns
  - Nonprofit internships are “generally permissible”
  - May be paid or unpaid. Unpaid internships must benefit interns, e.g. through academic credit and meaningful learning opportunities. Unpaid interns should be part of structured internship programs or treated as volunteers. Paid interns should be treated like temporary employees (including paid at least minimum wage)





# TAKEAWAYS

- Workers are either employees, independent contractors, or volunteers.
  - Interns should be paid employees or volunteers if not true interns.
- Independent contractors are in business for themselves and are not subject to your organization's control
- Status as independent contractor is determined by cumulative factors
- Must have a well-drafted agreement
- Get legal assistance to correctly classify or reclassify!



# LAWYERS ALLIANCE FOR NEW YORK

Questions?

[jmoldover@lawyersalliance.org](mailto:jmoldover@lawyersalliance.org)

Resource Call Hotline: (212) 219-1800 ext. 224