

What's the difference?



- Employers regularly make use of independent contractors (ICs) to supplement their employee workforce.
- Historically, the legal distinction between an employee and an IC drew on common law principles of vicarious liability that distinguish circumstances in which the contracting principal is legally responsible for the actions of their workers (employees) from circumstances in which the principal is not responsible (ICs).
- Today, there is hostility throughout state and federal agencies toward use of ICs.

Pros of Independent Contractor Status



From employer's perspective:

- **The most obvious benefit of setting up a proper IC relationship is reduced labor costs.**
 - No federal or state income tax withholdings
 - No **healthcare or other benefits**
 - No unemployment insurance costs
 - No workers' **compensation** premiums

Pros of Independent Contractor Status

From employer's perspective (continued):

- Virtually no wage/hour requirements
 - No minimum wage or overtime
- Anti-discrimination laws (Title VII, ADEA, ADA, FMLA) are likely not applicable
- OSHA requirements may not apply
- Limited tort liability
- Few immigration issues (no need for I-9)

Pros of Independent Contractor Status

From the worker's perspective

- Able to spread out work amongst multiple clients
- Independence ("be your own boss")
- Potential higher income
- Work-related tax deductions
- Control over profit and loss

Cons of Independent Contractor Status



From the employer's perspective:

- Less control over how work is done
- More subject to the whims of the IC (scheduling projects, etc.)
- Work product or inventions may be something that IC can reuse absent a written agreement

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Cons of Independent Contractor Status

From the worker's perspective

- Less job security
- Must pay their own taxes
- No employer-provided benefits
- No unemployment insurance benefits (with the exception of CARES Act help from Congress)
- No employer-provided workers' compensation
- Few labor and employment law protections
- Liability

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IC Use is Growing



- The use of independent contractors by employers is growing significantly.
- A recent study by the U.S. Bureau of Labor Statistics and research by Lawrence Katz of Harvard University and the late Alan Krueger of Princeton University, show that between **6.9 percent and 9.6 percent** of all workers (10.5 million to 15 million) are independent contractors.

1099 v. W2

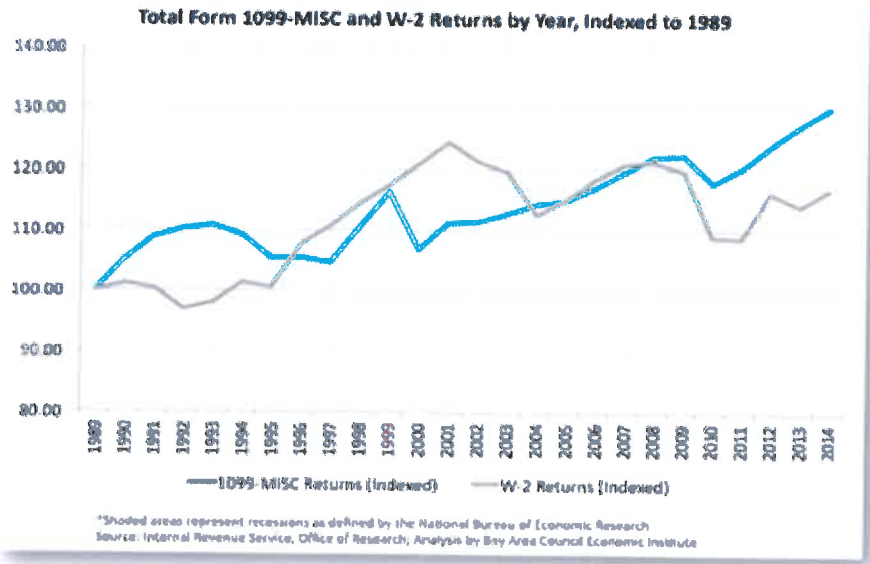
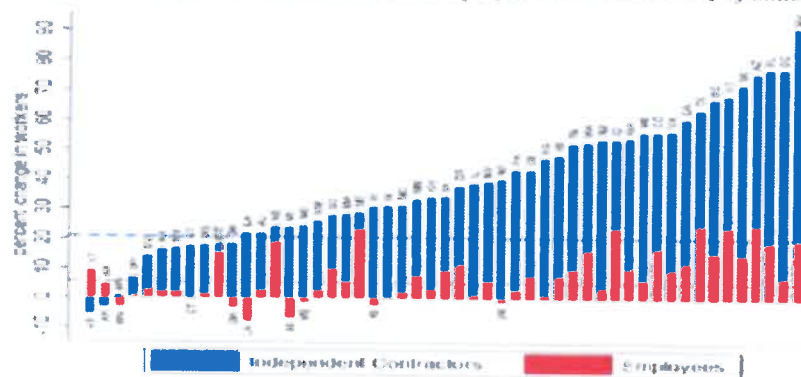


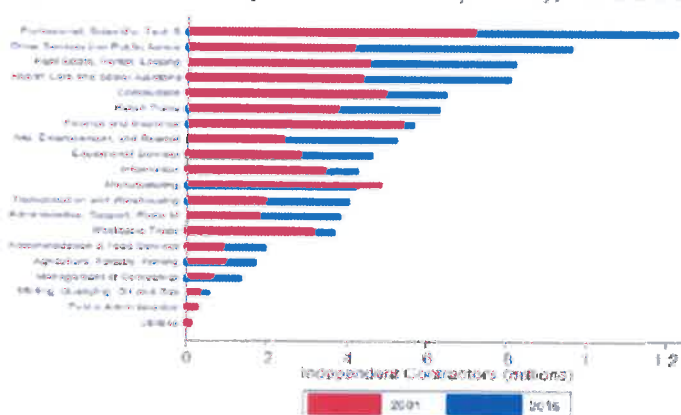
Figure 5: Independent Contractor and Employee Growth 2001-2016, by State



Notes: This figure shows the percent change in independent contractors (IC) and employees from 2001-2016 by state. The blue bars show the percent change in IC, where IC are defined as Form 1099-MISC/1099-NEC recipients that report less than \$10K in deductions on a Schedule C, excluding car and travel expenses. The red bars show the percent change in employees, defined as those who receive a Form W-2 with positive income. The horizontal blue dashed line represents the average growth rate in IC across states; the red dashed line represents the average growth rate in employees across states.



Figure 6: Number of Independent Contractors by Industry, 2001 and 2016



Notes: This figure shows the number of ICs by industry of the Form 1099-MISC/K issuing firm for the years 2001 and 2016. ICs are defined according to our preferred definition, Form 1099-MISC/K recipients that report less than \$10K in deductions on a Schedule C, excluding car and travel expenses. Industries are defined as two-digit NAICS categories are reported on the firm's income tax returns.

Increase in ICs = More Opportunities for Misclassification

According to the Economic Policy Institute, an estimated **10-15%** of employers misclassify at least one worker as an independent contractor

Increase in ICs = More Opportunities for Misclassification



- Misclassification may lead to significant liability for companies.
 - FLSA and state wage laws (see Gig Economy lawsuits)
 - Unpaid minimum wage and overtime
 - No arbitration agreement requiring individual arbitration = costly collective and class actions
 - Liquidated damages
 - Attorneys' fees

Increase in ICs = More Opportunities for Misclassification



- More problems:
 - State and federal income taxes that should have been withheld
 - State and federal unemployment taxes
 - Employer's share of Medicare and Social Security
 - Benefits

How does Misclassification Come to Light?

- Class action (state law) and/or collective action (federal law)
- Department of Labor inquiry
- IRS or local/state taxing authority inquiry

How many tests are there?

- Economic Realities Test
- “ABC” Test
- National Labor Relations Board (NLRB)
- U.S. Department of Labor (FLSA)
- IRS (20 points, 3 categories!) and state tax
- State court tests for unemployment/workers’ compensation

Government agency tests are always in a constant state of change.

Economic Realities Test



In a case decided 75 years ago, the U.S. Supreme Court found these factors important:

- 1) the degree of control exercised by the alleged employer;
- 2) the degree to which the worker's opportunity for profit and loss is determined by the employer;
- 3) the extent of the relative investments of the worker and employer;
- 4) the skill and initiative required in performing the job; and
- 5) the permanency of the relationship.

United States v. Silk, 331 U.S. 704 (1947)

ABC Test



To be considered an IC, a worker must meet the following criteria:

- 1) The worker is free from the control and direction of the employer in connection with the work's performance;
- 2) The worker performs work that is outside the usual course of the employer's business; and
- 3) The worker is customarily engaged in an independently established trade, occupation, or business.

It is the hiring entity's burden to prove all three elements.

NLRB Test



- In 2019, the Trump NLRB reaffirmed the traditional common law test, which involves the application of factors enumerated in the Second Restatement of Agency. *SuperShuttle DFW, Inc.*, 367 NLRB No. 75 (2019).
- The Board overruled a 2014 Obama NLRB decision, finding that it improperly modified the test by severely limiting the significance of a worker's entrepreneurial opportunity for economic gain.
- By placing more significance on the entrepreneurial activity, the 2019 decision gave employers more latitude in designing IC arrangements.
- Expect another pendulum shift under Biden NLRB.

U.S. Department of Labor

- On January 6, 2021, the USDOL announced the Final Rule on Independent Contractor Status Under the Fair Labor Standards Act (FLSA).
- This was set to take effect on March 8, 2021.
- However, President Biden froze the regulation on January 20, 2021 as his Administration reviews the "midnight regulations" promulgated by the Trump Administration.

What did the Final Rule Do?



- Although the rule employs the 5 commonly used factors in the “economic reality” test, two of those factors reign supreme.
- The DOL determined the first two “core factors” are most probative to the question of whether a worker is economically dependent on someone else’s business or is in business for him or herself:
 - 1) The nature and degree of control over the work.
 - 2) The worker’s opportunity for profit or loss based on initiative and/or investment.

Real World Examples

Example 1: A business installing a device on a tractor-trailer owner-operator’s vehicle limiting the owner’s speed in order to comply with federally mandated motor carrier safety regulations.





Real World Examples

Example 2: An individual accepts assignments from a company that provides an app-based service linking to people in need of the individual's services. The company has invested millions of dollars in developing, marketing, and maintaining the app and monitoring customer satisfaction.



Real World Examples

Example 3: Each winter, a housekeeper works for a ski resort. He stops working for the resort when it shuts down at the end of the season and returns at the beginning of the next winter without formally applying or interviewing.

Rule was Good for Employers

- Generally, the new DOL rule made it easier to classify an independent contractor relationship.
- Importantly, the rule provided the **actual practice** of the worker and the potential employer is more relevant than what may be contractually or theoretically possible.

Biden Administration

- We know that President Biden is hostile to the rule and will take steps to attack it.
- Unions, workers advocates, and AGs from progressive states may try to sue in court to block the rule temporarily and then permanently.
- Expect President Biden not to challenge these lawsuits.
- President Biden's DOL also may seek to reopen the rulemaking process and promulgate a new IC test.
- President Biden may seek to enact the ABC test on a national level through the Protecting the Right to Organize (PRO) Act.

Early Signals of Hostility

- On January 28, 2021, the Biden DOL withdrew three opinion letters released the week prior to Biden's inauguration.
- Publicly, the reasoning was that they were issued prematurely because they were based on rules that have not gone into effect.
- Two of those letters specifically addressed whether certain workers were employees or ICs under the new rule.
- Those letters opined the workers in question were ICs.

Due Diligence

- Because of the constant evolution of, and varying IC-employee tests, there is significant risk of liability when it comes to ICs.
- Employers must carefully proceed with setting up an IC relationship. The default position should be employee status unless convinced that a worker would be found to be an IC.



Choosing the Correct Form of Relationship



- Determine what is to be accomplished by “hiring” the worker. Is this for a definite or indefinite time? Project based?
- Is the outsourcing driven by cost reduction needs? Be very careful on classifying someone as a IC just to save a buck.
- Are you trying to change a current worker into an IC? (e.g., “consultants” doing the same work they did as an employee and receiving same pay but still being controlled by the employer).

Choosing the Correct Form of Relationship



- When you do decide to classify a worker as an IC:
 - Verify the worker’s insurance coverages
 - Verify the worker’s licenses and certifications
 - Verify (or require) the worker to have own corporate entity (LLC) with all formalities

Memorialize the Relationship in an Agreement

- Define the parties
- Describe the relationship
- Adequately describe the obligations of the parties
- Specify that worker is free to determine own hours and how the work is to be performed
- Provide a term of engagement, if practicable
- Provide for the compensation

Memorialize the Relationship in an Agreement

- State no responsibility for income taxes by employer
- Provide for procedures for termination of the agreement
- Address indemnification issues
- Confidentiality/Trade Secrets
- Restrictive Covenants if allowed under state law (non-solicit of customers/employees)
- Arbitration



What should employers do?

- Audit worker classifications
- Review independent contractor agreements
- Consult with legal counsel for help. The IC tests are constantly changing.

Questions? We are here to help.



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