



## **EMPLOYEE OR INDEPENDENT CONTRACTOR?**

### **Your Choice Matters**

As the economy slowly begins to improve and businesses consider increasing the size of their workforce, your business will need to make decisions as to the nature of its relationship with existing and new workers. Are your workers employees or independent contractors? Understanding the distinction between what makes a worker an independent contractor and what makes them an employee is critical for you and your business, as the consequences of misclassification can be significant.

Misclassifying workers as independent contractors can be tempting for a business owner. By classifying a worker as an independent contractor, employers can hold down costs by avoiding paying minimum wage and overtime in accordance with the federal Fair Labor Standards Act and New York State Labor Law, unemployment insurance taxes, workers' compensation premiums, and the employer share of Social Security, Medicare, and federal unemployment taxes. While you and the person you hire may genuinely believe that he or she is an independent contractor (and you may have even signed an agreement that states that), the true nature of the relationship turns on a number of different factors that must be considered before they are hired.

### **State Law**

While there is generally no single factor, or group of factors, which NYS considers as conclusive in deciding if an employer-employee relationship exists, the courts have held the following to be some of the more significant indicators of an employment relationship:

1. Control over the individual's activities.
2. Requiring the individual to comply with instruction as to when, where, and how to do the job.
3. Directly supervising the services performed.
4. Providing facilities, equipment, tools, or supplies for the performance of the services.
5. Setting the rate of pay for service performed.
6. Providing regular compensation.
7. Providing reimbursement or allowance for business or travel expenses.
8. Providing fringe benefits.

9. Establishing limits within which the individual must operate: territorial, monetary, or time limits.
10. Restricting the individual from performing services for competitive businesses.

Conversely, some of the factors the courts have found to be significant in establishing the existence of an independent contractor relationship include:

1. The individual is established in an independent business offering services to the public. An independent business is usually marked by such elements as media advertising, commercial telephone listing, business cards, business stationery carrying business insurance, maintaining own office space.

2. The individual has a significant investment in facilities.

3. Assumption of the risk for profit or loss in providing services.

4. Freedom to establish own hours of work and to schedule own activities.

5. Freedom to provide services concurrently for other businesses, competitive or non-competitive.

### **Federal Law**

The Internal Revenue Service measures the degree of control vs. independence to determine the status of a worker. Facts that provide evidence of the degree of control and independence fall into three categories: Behavioral Control, Financial Control, and Relationship of the Parties. No fact by itself is decisive, and all facts are considered in making a determination.

1. Behavioral Control - Whether there is a right to direct or control how the worker does the work. The employer does not have to actually direct or control the way the work is done – as long as the employer has the *right* to direct and control the work.

2. Financial Control - Whether there is a right to direct or control the business part of the work. For example, if the worker has a significant economic investment in his or her work, if the worker is not reimbursed for business expenses, if the worker can realize a profit or incur a loss, or if the worker has created a company through which he or she performs services, these are indications that an independent contractor relationship exists.

3. Relationship of the Parties - How the employer and the worker perceive their relationship. For example, if the worker receives benefits, such as insurance, pension, or paid leave, this may indicate that the worker is perceived as an employee. If a written contract exists, this may show what both the worker and the employer intend.

The impact of worker misclassification in New York State is significant. Since 2007, when a Joint Employment Task Force on Employee Misclassification was created, New York State has focused more of its attention on employee misclassification. As a result, through the end of March 2010, the Task Force's efforts have resulted in enforcement sweeps in a dozen cities throughout the State, which identified nearly 35,000 instances of employee misclassification, discovered over \$450 million in unreported wages, identified more than \$13 million in unemployment insurance taxes due and discovered over \$14 million in unpaid wages.

On the Federal level, in 2010 the IRS began a 3 year project in which it will audit 2,000 businesses each year, with a focus on worker classification, fringe benefits, executive compensation, expense reimbursement, and other payroll related issues. President Obama's fiscal year 2011 federal budget aggressively targets employers who misclassify their workers as independent contractors and includes a \$25 million appropriation to hire 100 new enforcement personnel to uncover misclassifications. Estimates are that by targeting and penalizing employers who misclassify employees, U.S. Treasury revenues will increase by \$7 billion over ten years.

With the increased scrutiny on worker classification, employers should conduct a compliance check of their existing arrangements with independent contractors and carefully assess how they intend to treat prospective new hires. Misclassified workers can threaten or initiate a lawsuit demanding full employee benefits for the time they were misclassified, as well as any overtime compensation and other employee protections that they were previously denied. Courts can award attorneys fees and costs to successful plaintiffs. As part of this assessment, employers should understand the worker classification rules, review current industry standards and review independent contractor agreements to confirm that they will support the classification of their workers.

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