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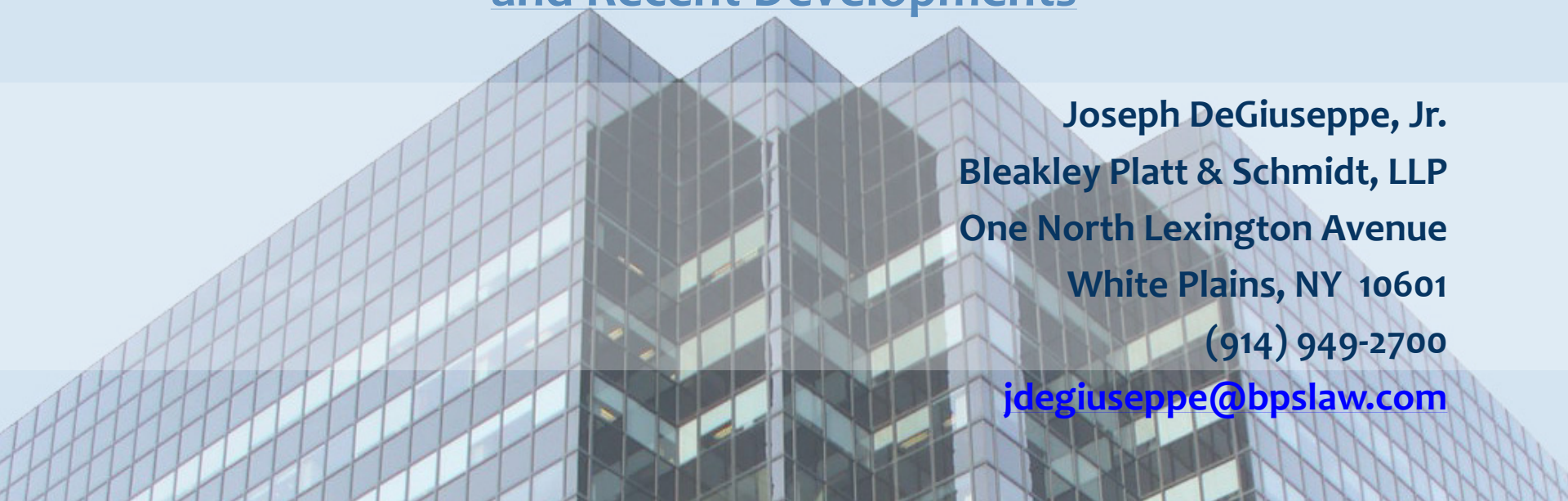
INDEPENDENT CONTRACTOR MISCLASSIFICATION

An Overview of Relevant Legal Issues and Recent Developments



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Fair Labor Standards Act

- FLSA is the federal law which sets minimum wage, overtime, recordkeeping, and youth employment standards.
- The current minimum wage under FLSA for covered “non-exempt” workers is still $7.25 per hour.
- With the exception of “exempt” employees and certain other employees, overtime ("time and one-half") must be paid for work over 40 hours a week for most employees.

New York State Labor Law

- The New York State Minimum Wage Law, N.Y. Lab. Law §§ 650-665, includes five industry minimum wage orders. These orders , with specified exceptions, apply to all workers in the State, including those subject to the FLSA.

- The N.Y.S. minimum wage is now $8.75 per hour and is scheduled to increase to $9.00 per hour effective December 31, 2015.

- On September 10, 2015, Governor Cuomo approved a Statewide $15.00 per hour minimum wage rate for fast food workers to be phased in over a 3 year period to December 31, 2018 in NYC and until July 1, 2021 elsewhere for fast food chains that operate 30 or more locations nationwide affecting about 200,000 employees.

- Governor Cuomo has also recently announced that he supports a $15.00 minimum wage rate for all other industries.

Classification Of Independent Contractors

- The misclassification of employees as "independent contractors" may result in unpaid minimum wage, overtime, employment tax liabilities for employers under both federal and N.Y.S. law.

- Traditionally, workers were generally not found to be an "independent contractor" if they performed services that could be directly controlled by an employer.

- Under the so-called "control" test (which is still used by certain government agencies), if an employer has the legal right to *control* the details of how services are performed, an employment relationship may exist.

FLSA: Economic Reality Test

- Under FLSA , the USDOL now views an employee, as distinguished from a person who is engaged in a business of his/her own, as one who, as a matter of "economic reality," follows the usual path of an employee and is dependent on the business which he/she serves.

- The employer-employee relationship under the FLSA is therefore tested by "economic reality" rather than "technical concepts." It is not determined by the common law "control" standards relating to master/servant.

- Under the "economic reality" test, "the ultimate concern is whether, as a matter of *economic reality,* the workers depend upon someone else's business for the opportunity to render service or are in business for themselves."

FLSA: Economic Reality Test

- There is no single rule or test for determining independent contractor status under the "economic reality" test--the totality of activity controls:

- 1) The extent to which the services rendered are an integral part of the principal's business;
- 2) The permanency of the relationship;
- 3) The amount of the alleged contractor's investment in facilities and equipment;
- 4) The nature and degree of control by the principal;
- 5) The alleged contractor's opportunities for profit and loss;
- 6) The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor; and
- 7) The degree of independent business organization and operation.

FLSA: Economic Reality Test

- According to the USDOL, there are certain factors which are not determinative of whether there is an "independent contractor" rather than an "employer-employee" relationship. Such factors include:

- where the work is performed,
- the absence of a formal employment agreement, or
- whether an alleged independent contractor is licensed by a federal, state or local government authority.

- Additionally, the U.S. Supreme Court has held that the time or mode of pay does not control the determination of employee status.

N.Y.S. Common Law Test

- N.Y.S. case law also does not specifically define "independent contractor" status.
- Whether an employer-employee rather than an independent contractor relationship exists under N.Y.S. common law will depend on several factors, including supervision, direction and control.
- In general, independent contractors must be in business for themselves, and make their services available to the general public.

NYSDOL Wage and Hour Test

- The NYSDOL also applies the common law tests of "master and servant" in making a determination as to whether services which an individual provides are that of an employee or an independent contractor for purposes of N.Y.S. wage and hour laws.

- Under these common law tests, the NYSDOL considers all factors about the relationship between the two parties to determine if the party who has the contract for the services provides, or has the right to provide, supervision, direction and control over the person who performs the services.

- If an employer designates a worker as an independent contractor and the worker agrees, it does not mean the worker is an independent contractor under N.Y.S. law.

N.Y.S. Wage and Hour Test

- According to the NYSDOL, an "independent contractor" must :
- (1) own an independent business operation which offers his/her services to the general public; has a commercial telephone number; advertises or markets his/her services; has business cards, stationery, etc.; carries business insurance; and maintains his/her own business premises;
- (2) have a significant investment in his/her business facilities;
- (3) bear the risk of profit or loss in providing services;
- (4) have the freedom to work his/her own hours and to schedule his/her own activities; and
- (5) have the freedom to perform his/her services for other companies.

Other Independent Contractor Tests

- The definition of an "independent contractor" differs under various federal and state statutes, including federal tax law, and N.Y.S. workers' compensation and unemployment benefits laws.

- As demonstrated by the following, the same individual may be considered by the IRS as an independent contractor for tax purposes under the "right-to-control" test but could under the same facts be considered by the USDOL as an "employee" under the FLSA's "economic reality" test.

IRS Standard of Review

- For federal employment tax purposes, the IRS applies a "20 point" checklist to determine if an employer has sufficient control over an individual to be considered an "employee" rather than an "independent contractor."

- Under this "right-to-control" test, the IRS has stated that an individual will "probably" be considered as an "independent contractor" if the answers to each of the following four questions are "yes":
- (1) Can the worker make a profit or suffer a loss as a result of the work, aside from the money earned from the project?;
- (2) Does the worker have an investment in the equipment and facilities used to do the work?;
- (3) Does the person work for more than one company at a time?; and
- (4) Does the worker offer services to the general public?

N.Y.S. WC Law Standard

- Under the N.Y.S. Workers' Compensation Law ("WCL"), the term *employee* generally includes day labor, leased employees, borrowed employees, part-time employees, unpaid volunteers (including family members) and most subcontractors .

- The factors that are considered to determine whether an individual is an "employee" within the meaning of the WCL include:
- Right to Control;
- Character of Work Is the Same as Employer;
- Method of Payment;
- Furnishing Equipment/Materials; and
- Right to Hire/Fire.

- A WCL Judge determines whether a person is considered an employee at a hearing following a work related accident or illness.

N.Y.S. WC Law Standard

- Independent contractors may be required to maintain their own workers' compensation insurance ("WCI") policy if they intend to work for other businesses.

- According to the NYSDOL, an independent business for WCI purposes usually has characteristics such as the following factors:
- media advertising, commercial telephone listing, business cards, business stationary or forms;
- its own Federal Employer Identification Number (FEIN);
- working under its own permits or operating authority;
- having its own liability insurance; and/or
- maintaining a separate business establishment.

- The independent business must also have a significant investment in facilities and means of performing work.

N.Y.S. WC Law Standard

- The WCL provides that construction industry workers are presumed to be "employees" of the contractor for whom they are performing services for work-related injuries occurring on or after October 26, 2010.

- The term "contractor" is broadly defined to include any sole proprietor, partnership, firm, corporation, limited liability company, association or other legal entity permitted to do business within N.Y.S. who engages in construction work.

- WCI carriers often assess general contractors premiums for coverage of all "subcontractors" on the job site, unless the subcontractors furnish proof that they have their own WCI policy. Accordingly, general contractors routinely require that subcontractors provide proof of their own workers' compensation coverage in order to co-work on the job.

N.Y.S. Unemployment Insurance Law Standard

- Under the N.Y.S. Unemployment Insurance Law, the NYSDOL generally applies the "master/servant" test discussed above in the N.Y.S. wage and hour section.

- The NYSDOL also cautions employers that an agreement with any individuals to waive their rights under the Unemployment Insurance Law is not valid.

- In addition, the statute either excludes or covers certain types of services, regardless of the degree of the employer's direction and control.

N.Y.S. Unemployment Insurance Law Standard

- The following is a list of occupations which are *excluded* from coverage by the Unemployment Insurance Law (with certain exceptions) regardless of the employer's direction and control: corporate officers; sole proprietors and their spouses; licensed real estate agents/brokers; business partners; and caretakers at places of religious worship.

- The following is a list of occupations which are *covered* by the Unemployment Insurance Law (with limited exceptions) regardless of the employer's direction and control: casual laborers; domestic employees (who earn at least $500 in a calendar quarter); industrial homeworkers; models; physicians; seasonal employees; temporary employees; and traveling salespersons.

Recent Developments: USDOL Interpretive Memo

- On July 15, 2015, the USDOL issued an important interpretive memorandum expressing the view that "most workers [classified as independent contractors] are employees under the FLSA's broad definitions."

- According to the DOL, this memorandum was issued in the context of its receiving "numerous complaints from workers alleging misclassification," and the DOL's "successful enforcement actions against employers who misclassify workers" as independent contractors.

- The DOL states "additional guidance regarding the application of the standards for determining who is an employee under the Fair Labor Standards Act . . . may be helpful to the regulated community in classifying workers and ultimately curtailing misclassification."

Recent Developments: USDOL Interpretive Memo

- The USDOL memo affirms the continued use of the "economic realities" test in assessing employee or independent contractor status, but makes clear that this test should be applied in the context of the FLSA's broad definition of "employ" as "suffer or permit to work."
- According to the USDOL, a worker who is "economically dependent on an employer is suffered or permitted to work by the employer," and thus should be classified as an employee.
- The "suffer or permit" standard was "specifically designed to ensure as broad of a scope of statutory protection as possible."
- An "entity 'suffers or permits' an individual to work if, as a matter of economic reality, the individual is dependent on the entity."

Recent Developments: Proposed USDOL Regulations

- On July 6, 2015, the USDOL formally proposed revisions to the so-called "white collar" exemptions for executive, administrative and professional (EAP) employees to the overtime pay requirements of FLSA.
- The minimum salary for the "white collar" exemptions would be increased to a projected $970 per week, or $50,440 in 2016. USDOL is considering whether to allow employers to include some non-discretionary bonuses for purposes of meeting the minimum salary for the "white collar" exemption.
- The proposed revisions would also increase the minimum annual salary for highly compensated employees from $100,000 to $122,148 annually, also subject to annual revisions .
- Final action on these proposals is not expected until 2016.

Recent Developments: NLRB Decisions

- On August 27, 2015, the NLRB in case involving *Browning-Ferris Industries* revised its standard for determining joint-employer status. The revised standard is designed "to better effectuate the purposes of the Act in the current economic landscape."

- While the ruling from the independent agency specifically deals with the waste management firm BFI, the decision could have broad repercussions for all companies.

- In the *BFI* decision, the NLRB reaffirmed the use of long-established principles to find that two or more entities are joint employers of a single workforce if (1) they are both employers within the meaning of the common law; and (2) they share or codetermine those matters governing the essential terms and conditions of employment.

Recent Developments: NLRB Decisions

- In evaluating whether an employer possesses "sufficient control" over employees to qualify as a joint employer, the NLRB will – among other factors – now consider whether an employer has exercised control over terms and conditions of employment *indirectly through an intermediary, or whether it has reserved the authority to do so.*

- In its decision, the Board found that BFI was a joint employer with a company that supplied employees to BFI to perform various work functions for BFI, including the cleaning and sorting of recycled products.

- In finding that BFI was a joint employer with this leased employee company, the Board relied on both the *indirect* and direct control that BFI possessed over the essential terms and conditions of employment of the employees supplied by the other company as well as BFI's reserved authority to control such terms and conditions.

Recent Developments: NLRB *McDonald's* Cases

- In December 2014, the NLRB filed 13 complaints naming the McDonald's franchisor as a *joint employer* for the alleged unfair labor practices (ULP) of various local franchisees. The ULP complaints only provide a conclusory statement that the McDonald's franchisor "possessed and/or exercised control over the labor relations policies or practices" of its franchisee's employees, and "has been a joint employer" of the employees.

- In the ongoing ULP hearings which started in March 2015, McDonald's has argued that the General Counsel is changing the legal standard for defining a "joint-employer" relationship, based only upon vague allegations about the franchisor's joint employer status — even though the case will have "far-reaching consequences."

- The anticipated ALJ ruling could alter the relationship between franchisors and franchisees, and be extended to other businesses such as contractors and subcontractors and corporate parent-subsidiary relationships.

The Downside Of Misclassification

- **A. FLSA Remedies and Penalties**

- An employee may file a private lawsuit for back pay and an equal amount as liquidated damages, plus attorney's fees and court costs.

- FLSA further provides for collective actions to be brought by groups of employees to recover unpaid minimum wage or overtime pay on behalf of themselves "and other employees similarly situated."

- These "collective actions" are a form of representative class action in which each plaintiff must affirmatively file a "Consent Form" with the court to be included in the action.

The Downside Of Misclassification

- The FLSA statute of limitations for both private and collective actions is two years.
- The statute of limitations period may be extended to three years upon a showing that the employer's violation of FLSA was "willful."
- A finding of willfulness requires a showing that the employer knew or had reckless disregard for whether its conduct was prohibited by the FLSA
- In addition to attorneys' fees, employees also may recover an award of liquidated damages in an amount equal to the unpaid wages or overtime pay.

The Downside Of Misclassification

- Failing to maintain records required by the FLSA can result in a variety of penalties.
- Although the USDOL has no authority to impose civil monetary penalties for recordkeeping violations, a person found to have willfully violated the recordkeeping requirements can face criminal sanctions. 29 U.S.C. § 216(a).
- Criminal sanctions may include up to $10,000 in fines, six months imprisonment, or both. 29 U.S.C. § 216(a). In addition, courts can issue injunctions against future recordkeeping violations. 29 U.S.C. § 216(a).

The Downside Of Misclassification

- **B. N.Y.S. Remedies and Penalties**

- The NYDOL helps collect underpayments for workers who have not received the required minimum wage overtime payments.

- Generally, the Department recovers the funds without resorting to court action through investigatory and settlement procedures and policies.

- Employees may also file a private lawsuit to recover unpaid wages and overtime compensation, 100% liquidated damages for willful violations, 9% prejudgment interest, and attorneys' fees, either individually or as part of a class action.

The Downside Of Misclassification

- **Minimum Wage Law**: An employer that violates the Minimum Wage Law is subject to criminal prosecution and penalties.

- Action may also be taken in civil court. The Commissioner of Labor may require an employer to pay interest up to 16 percent and civil penalties up to 200 percent of the unpaid overtime wages in addition to minimum wage underpayments.

- There is a six year statute of limitations in New York under the Minimum Wage Law and the related Industry Minimum Wage orders.

The Downside Of Misclassification

Wage Theft Prevention Act (WTPA)

- The WTPA requires that employers provide N.Y.S. employees hired on or after April 9, 2011 with certain written notices and statements concerning their rates of pay, wage allowances, pay dates, etc.
- The WTPA was recently amended to provide for increased penalties for employers that fail to provide new employees with the required notice within 10 days of hire from $50.00 per worker per workweek to $50.00 per worker per workday up to a maximum penalty of $5,000.
- Individual liability may now be imposed for certain LLC members and on a "successor" business for any WTPA violations caused by the predecessor company.

The Downside Of Misclassification

C. Form I-9 Employment Verification

- U.S. Immigration law prohibits individuals or businesses from contracting with an "independent contractor" knowing that the independent contractor is not authorized to work in the United States.

- Penalties for I-9 record keeping violations range from $110 to $1,100 per each paperwork occurrence per employee regardless of the number of prior offenses for which the employer has been cited. Each mistake on the I-9 Form is considered to be a separate violation.

- Penalties for committing or participating in document fraud range from $375 to $3,200 for the first offense; and from $3,200 to $6,500 for each subsequent offense.

- Penalties for knowingly employing an unauthorized alien range from $375 to $3,200 per each unauthorized worker for the first offense; from $3,200 to $6,500 for the second offense; and from $4,300 to $16,000 for each subsequent offense.

- Criminal penalties of up to $3,000 in fines per each unauthorized worker and imprisonment of up to six months for the entire violation are possible where a "pattern or practice" of knowingly employing unauthorized workers is demonstrated.

Closing Thoughts

- Concentrate on the work *results* of the independent contractor, rather than the work methods used to achieve these results.
- The contractor should set its own work schedules.
- The contractor should be responsible for deciding on the tools and instruments by which the work is done.
- The contractor should provide and maintain such equipment at its own cost.
- Contactors should neither report to your managers nor supervise any of your employees.

Closing Thoughts

- The contractor should be responsible for providing its own workers' compensation insurance.
- The contractor should agree in writing to be responsible for the payment of all required withholding taxes for its workers.
- Contractors should only be paid on an invoiced basis and not receive regularly scheduled payments.
- Contractors should be treated as a guest for such purposes as use of parking spaces, issuance of security badges, use of office facilities, etc.