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WHO IS YOUR EMPLOYEE?:
INDEPENDENT CONTRACTORS AND OTHER CONTINGENT WORKERS

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2013

Introduction

Various governmental agencies today are questioning the employment status of workers in every type of industry, including consultants, freelancers, per-diems and other contingent workers. No one has been overlooked, from bicycle messengers to nurses and physicians. If an employer is found to have misclassified an employee as an independent contractor or other contingent worker, then the exposure to liability can be quite substantial.

The liability arises from the various federal and state labor, employment and tax laws.[1] These laws include among others, the New York State Labor Law provisions relating to the payment of wages, overtime and unemployment compensation, and their federal counterparts in the Fair Labor Standards Act ("FLSA"); the New York State Workers' Compensation and Disability Benefits Law, which provides for the payment of medical care and salary when employees are injured on the job; the New York Human Rights Law ("NYHRL") and its federal counterpart, Title VII of the Civil Rights Act of 1964, as amended ("Title VII"), which protect against employment discrimination; the Employee Retirement Income Security Act of 1974 ("ERISA"), which governs administration of employee benefit plans; the Internal Revenue Code (the "Code"), which encompasses all aspects of federal taxes; the National Labor Relations Act ("NLRA"), regulating rights of workers and unions under federal law; the Age Discrimination in Employment Act ("ADEA"), which proscribes employment discrimination on the basis of age; and the Americans with Disabilities Act ("ADA"), which protects disabled individuals from discrimination. As will be discussed, because some of these laws assess as much as 100% of the amount owed as penalties and interest, it is essential that employers properly classify all workers.

In addition to the financial exposure that arises from the misclassification of workers, significant concerns arise regarding immunity from suit. For example, under Title VII, the ADEA, the ADA and the NYHRL, independent contractors are generally not protected. Therefore, claimants first must establish their status as employees in order to file claims. Another example arises in connection with respondeat superior in tort law. This phrase denotes that the employer is automatically liable, by virtue of the employment relationship, for wrongs

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[1] While these materials focus on a number of New York State laws, many other jurisdictions have analogous statutes under which employer liability may arise.

committed against other persons or property by employees acting within the scope of their employment. Therefore, while employers are traditionally held liable automatically for the wrongs of their employees, they are not necessarily held liable for the wrongs committed by those workers deemed independent contractors. Furthermore, if an employee is injured on the job, he or she cannot sue the employer individually, due to a workers' compensation exclusivity clause. An independent contractor can, however.

The key to avoiding legal liability necessarily involves understanding whether an individual or group of workers qualify as employees or independent contractors. However, this is no simple task. The standards for assessing the status of a worker or group of workers vary, and workers classified by one agency as employees may be classified as independent contractors by another agency. As will be discussed in detail below, New York agencies and the Internal Revenue Service ("IRS") generally apply the "right-to-control test," and many federal agencies, with the exception of the IRS, apply either the "economic realities test" or a hybrid test. The right-to-control test focuses on a factual determination of whether the putative employer controls the principal aspects of the worker's employment. The economic realities test focuses on whether the worker is economically dependent on the portion of his or her livelihood earned from the putative employer. The hybrid test combines the factual control and financial dependence inquiries. Additionally, an expanded common law agency test that essentially is a modified version of the hybrid test has been used in circumstances of alleged employment discrimination. This test places emphasis on the right-to-control factors but also takes into account economic factors.

Under any of these standards, however, the regulatory agencies generally begin with the proposition that most, if not all, workers are employees. Then the regulatory authorities require the employer-entity to persuade them to the contrary.

In addition to the retention of individual independent contractors, many companies have in the past utilized the services of individual temporary employees, who are often paid hourly and do not receive the various benefits provided to a company's regular employees. Other companies have utilized "temp" staffing agencies that provide a workforce, but do not consider those workers its employees.

In the last several years a new form of staffing agency has appeared with more and more frequency in the form of the Professional Employer Organization ("PEO"). In order to attract a cadre of skilled, experienced workers that can be provided on site to their service recipient clients, the PEOs have realized that they must offer an attractive and competitive salary and benefit package to their employees. The PEOs therefore, have assembled a stable of talent, who are initially considered employees of the PEO and who often receive generous salaries and employee fringe benefits, including paid time off and participation in the various employee benefit programs offered by the PEO. (In some instances, in an attempt to eliminate any liability or employer obligations, the PEO would hire all of the employees of the service recipient entity as its own employees, and have these workers provide services to their "former" employer).

By contract, the PEO generally recognizes itself as at least the joint or co-employer of the workers and obligates itself to be responsible for, among other things, tax withholding obligations, the payment of social security and employment taxes, workers' compensation and

unemployment insurance premiums. The PEO also generally assumes responsibility for recruitment, hiring, training, evaluation and discipline and discharge of the workers placed on-site at the service recipient. However, the PEO and the service recipient recognize that the workers placed on-site may be considered employees of both the PEO and the service recipient entity. To the extent that the service recipient exercises direction and control over the services provided by the workers, as well as other indicia of a common law employer, the service recipient entity will be considered a joint or co-employer with the PEO. By contract, the PEO and the service recipient will jointly assume employer designation along with the resultant employer obligations and risks. The parties often in their agreement will then seek to limit their respective exposure and liability by the inclusion of various indemnification provisions.

I. The State and Federal Standards

A. The State Common Law Standard

New York State courts and administrative agencies, such as the New York State Department of Labor and Workers' Compensation Board, which enforce state minimum wage, unemployment compensation, workers' compensation and disability laws, have applied traditional common law rules to determine whether an individual is an employee or independent contractor.[2]

Common law principles are those which have developed throughout the course of history due to judicial determinations. They are judge-made law, not statutory enactments. The IRS has also adopted the common law standard by focusing primarily on the factual right to control by the putative employer. Although the IRS's approach is right-to-control oriented, it does look at 20 criteria to assess the employment relationship.[3]

Under this common law standard, the determination of employee or independent contractor status is a question of fact, taking into consideration all aspects of the relationship

[2] The Unemployment Insurance Division of the New York State Department of Labor, for example, has issued a policy statement enumerating the factors it will consider in determining employee/independent contractor status for purposes of administering the unemployment insurance laws. A copy of this policy is attached for your reference following the last page of these materials. (See Appendix A.)

[3] See, e.g., Yisrael v. Per Scholas, Inc. No. 01 Civ. 8299 2004 WL 744485 (S.D.N.Y. April 7, 2004) (holding that a computer technician who worked under the instruction of the company's supervisors, worked eight hours per day, five days per week, and was paid weekly was an employee based on a consideration of the factors enunciated by the IRS). A list of the IRS's 20 criteria is attached for your reference following the last page of these materials. (See Appendix B.) Note that the IRS issued its Final Training Guidelines on Worker Classification (Employee vs. Independent Contractor) (PJC Publishing, LLC, 1997), which discusses, inter alia, the relative importance that certain criteria might have in a particular set of circumstances. In addition, on its website, the IRS divides into three categories the factors that demonstrate evidence of the degree of control and independence a putative employer has over its workers: behavioral control, financial control and type of relationship. See Independent Contractor (Self-Employed) or Employee?, last reviewed or updated August 15, 2012, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-(Self-Employed)-or-Employee%3F.

between the parties.[4] While no one factor is dispositive for any given agency, the following principal inquiries have been made.

- What is the extent of control exercised by the putative employer over the manner and means of producing the service or product? At issue is whether the employer has the right to direct what will be done and when and how it will be done.[5]

- What is the method of payment? If the worker is on the employer's payroll and receives a check every two weeks, this is more indicative of employee status than if he or she received payment at the end of each day worked.

- Who furnishes the equipment, materials and supplies? If the worker brings his or her own tools, this may indicate independent contractor status. However, if the employer provides all materials, the worker may be an employee.

- Does the employer have the right to discharge the worker? If the worker can choose not to come to work at any time without fear of being terminated, for example, he or she is more likely to be an independent contractor.

- Who controls the hours of work? If it is the worker, this may indicate independent contractor status.

- What is the relative nature of the work? This means the inquiry focuses on whether the work is temporary, permanent, continuous or intermittent. It also goes to whether the character of work suggests that the worker is engaged in a separate calling or occupation from that of the putative employer, or the work itself is

[4] See In re Noel, 38 A.D.3d 1082, 832 N.Y.S.2d 320 (3d Dep't 2007) (Ruling that a company exercised sufficient overall control over direct sellers of its products to establish an employer-employee relationship where the company recruited its direct sellers through advertisements and referrals and required them to complete application forms, provided them with training and scripts for their sales calls, imposed sales quotas which had to be met to avoid termination, set their commission rate and product prices and handled and reviewed their customer complaints, provided them with sales leads, desk space, mailboxes and telephones, and encouraged them to work certain set shifts); In re Saalfield, 37 A.D.3d 928, 829 N.Y.S.2d 738 (3d Dep't 2007) (holding that person who conducted wine tastings on behalf of wine company at wine stores and trade shows was an employee of company rather than an independent contractor; company exercised a sufficient degree of control over the person's work to establish an employment relationship).

[5] See Mace v. Morrison & Fleming, 267 A.D. 29, 31-32, 44 N.Y.S.2d 672, 674 (3d Dep't 1943) ("where an employer may prescribe what shall be done, but not how it shall be done or who shall do it, the person employed is an independent contractor")(citations omitted), aff'd, 293 N.Y. 844 (1944).

an integral part of the putative employer's business. If separate, the worker may more likely be an independent contractor.[6]

As stated earlier, although no one factor is dispositive, it has been suggested that, in certain contexts, the putative employer's control over the means and method of producing work should be given more weight than other factors in determining employee or independent contractor status.[7]

B. The Federal Standards

1. Economic Realities Test

Some federal courts and agencies, other than the IRS, in interpreting and determining coverage in the context of the FLSA, have considered a variety of factually relevant criteria to determine whether an individual is an employee or an independent contractor. Perhaps finding the common law right-to-control test overly restrictive, some courts have devised what is commonly referred to as the economic realities test, which focuses on how economically dependent the individual is on the business that he or she serves.[8] To the extent that an individual is highly dependent on the business he or she serves, and derives a substantial portion of his or her income from it, the economic realities test strongly suggests employee, rather than independent contractor, status. Additional factors that may be considered under the "economic realities" test include the following:

- What is the skill required in the particular occupation?
- Is the work an integral part of the business of the putative employer?
- What is the intention of the parties?

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[6] See, e.g., In re Bedin, 257 A.D.2d 809, 684 N.Y.S.2d 653 (3d Dep't 1999) (holding that a public relations consultant was an independent contractor rather than an employee of a foreign company); Rastaetter v. Charles S. Wilson Mem. Hosp., 80 A.D.2d 608, 436 N.Y.S.2d 47 (2d Dep't 1981) (finding that requirement of pre-employment physical exam does not change employment status).

[7] See In re Kelly, 28 A.D.3d 1044, 814 N.Y.S.2d 340, 341 (3d Dep't 2006) (ruling that employment relationship existed between retail florist and delivery driver where driver was given list of deliveries within particular geographic zone and was required to deliver product within reasonable time on same day, to obtain recipient's signature upon delivery, and to report to florist the time of delivery and driver's payment was expressly conditioned upon him being "polite and well-mannered"); In re Claim of Cromer, 248 A.D.2d 773, 669 N.Y.S.2d 701 (3d Dep't 1998) (holding corporate salespersons to be independent contractors); 26 C.F.R. § 31.3401(c)-1(b) (1998) (employee is one who "is subject to the will and control of the employer not only as to what shall be done but how it shall be done").

[8] See, e.g., Bartels v. Birmingham, 332 U.S. 126 (1947) (finding that band members were employees of band leader, not of dance hall, for purposes of Social Security); Brock v. Superior Care, Inc., 840 F.2d 1054 (2d Cir. 1988) (holding that nurses who worked for health care business engaged in referring temporary health care personnel to hospitals and nursing homes were employees for purposes of FLSA).

- Does the putative employer pay social security taxes and provide fringe benefits?

If, for example, the putative employer operates a dry cleaning store and hires a worker to do some plumbing, the worker is not an employee according to these factors. However, if the same employer requires plumbers on staff to repair the equipment regularly, the same plumber may be an employee.

2. The Combination Test

Still other federal courts have adopted a hybrid test, combining the economic realities test with the right-to-control test and the common law principles of agency. For example, in an FLSA case, a federal appellate court identified and used six factors to determine whether a worker was an employee or an independent contractor. These factors are derived from the right-to-control test in addition to general agency principles, and they call for an examination of the following:

- Who exercises what degree of control over the manner in which the work is to be performed?
- What is each party's opportunity for profit or loss according to the managerial skill of the worker?
- Who has made what type of investment in materials or equipment?
- Does the service or work require special skill?
- What is the degree of permanence of the working relationship?
- Is the worker's service rendered as an integral part of the putative employer's business?[9]

[9] Schultz v. Capital Int'l Sec., Inc., 466 F.3d 298 (4th Cir. 2006) (holding that security workers hired to provide security for a prince were "employees" covered by FLSA, not "independent contractors" where prince and security firm exercised nearly complete control over how workers did their jobs, through written security policy; workers had no opportunity for profit or loss dependant on managerial skills, as they were paid set rate per shift; the firm and prince supplied all necessary equipment for workers; although some security duties required special skills, others did not; the prince employed some workers for several years and preferred to hire workers who would stay with him over the long term; and security firm's only function was to provide security for the prince, and workers were hired specifically to perform that task).

3. The Expanded Common Law Agency Test

Earlier on, federal courts examining the employment relationship in employment lawsuits filed under ERISA, Title VII, the ADEA, and the ADA adopted an expanded common law agency test to distinguish between an employee and an independent contractor. This test, similar to the hybrid test referred to supra, considers the entire relationship between the employer and the worker and takes into account both common law factors and additional factors pertaining to the worker's economic situation. In the context of an ERISA case, the United States Supreme Court summarized the operative test:

> "In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party."[10]

Courts also have readily applied the common law agency test when considering the employment relationship within the meaning of Title VII, the ADEA and the ADA. See Salamon v. Our Lady of Victory Hosp., 514 F.3d 217 (2d Cir. 2008) (applying the common law agency test to determine if worker was employee or independent contractor within the meaning of Title VII); Speen v. Crown Clothing Corp., 102 F.3d 625 (1st Cir. 1996) (using the common law agency test and finding that clothing salesman was an independent contractor within the context of the ADEA);[11] Attis v. Solow Realty Dev. Co., 522 F. Supp. 2d 623 (S.D.N.Y. 2007) (applying the common law agency test to determine if worker was an employee or independent contractor under the ADA and the New York State Human Rights Law).[12]

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[10] Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 323 (1992) (holding that the expanded common law agency test is to be applied in determining whether a worker is an employee or an independent contractor within the meaning of ERISA) (quoting Community for Creative Non-Violence v. Reid, 490 U.S. 730, 751-52 (1989)).

[11] See also EEOC v. Johnson & Higgins, Inc., 91 F.3d 1529 (2d Cir. 1996) (applying common law agency test and finding that corporate directors are employees within the meaning of the ADEA).

[12] See also Johnson v. City of Saline, 151 F.3d 564 (6th Cir. 1998) (using common law agency test in ADA claim and finding that worker who entered into contract with city to operate the city's public access cable station was independent contractor); Janette v. American Fidelity Group, Ltd., 298 Fed. Appx. 467, 472 (C.A.6 (Mich.), 2008) (using the common law agency test to determine if worker who worked at home was an employee or independent contractor under the ADA); Dykes v. Depuy, Inc., 140 F.3d 31 (1st Cir. 1998) (utilizing the common law agency test for purposes of a claim under the ADA and ERISA

In applying this multi-factored test, some courts have identified the right-to-control factor as the paramount factor when determining whether an individual is an employee or an independent contractor. For example, even though the Second Circuit Court of Appeals held in Frankel v. Bally, Inc.[13] that the question of whether an individual is an employee or an independent contractor within the meaning of the ADEA must be determined in accordance with common law agency principles, the court was careful to observe that in practice, "there is little discernible difference between the hybrid test and the common law agency test" inasmuch as "[b]oth place their greatest emphasis on the hiring party's right to control the manner and means by which the work is accomplished and consider a non-exhaustive list of factors as part of a flexible analysis of the 'totality of the circumstances.' "[14]

II. Tax Liability Exposure

A. Federal Tax

Normally, any tax and penalties must be assessed within three years from the time the employment tax returns are filed. However, if no return is filed, the assessment could arguably be made at any time. Courts have ruled that mischaracterization of an employee as an independent contractor resulting in a Form 1099 being filed instead of a Form W-2 and Form 941 does not start the statute of limitations period because the Form 1099 return was not the proper return. Consequently, all years may be open. When the IRS successfully reclassifies a worker as an employee, the employer may become liable for penalties in addition to the income tax withholding, FICA (Social Security) and FUTA (federal unemployment) taxes that were never withheld or paid.

If there is a finding that an employer unintentionally misclassified a worker, the employer may not be held liable for all past arrears. Thus, the consequences of misclassification may depend on whether there was an intentional disregard of the rules.

If an employer incorrectly treats an employee as an independent contractor due to an unintentional misclassification, the employer's penalty for failing to deduct and withhold income taxes is equal to 1.5% of wages paid to that employee. The employer is also assessed an amount equal to 20% of the employee's share of FICA taxes that should have been deducted and withheld, and is required to pay its share of FICA taxes that were not remitted. Furthermore, if, during the period that the employer erroneously treated the employee as an independent contractor, the employer also failed to report the compensation to the worker by filing Form 1099-MISC, then the penalty for failure to withhold income taxes becomes 3% of the worker's

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and finding that a sales representative was an independent contractor).

[13] 987 F.2d 86 (2d Cir. 1993).

[14] 987 F.2d at 90 (emphasis added)**;** see also Alexander v. Rush N. Shore Med. Ctr., 101 F.3d 487, 492-93 n.1 (7th Cir. 1996) (identifying "the employer's control over the manner of work performance as the test's primary focus"); Legeno v. Douglas Elliman, LLC, 311 Fed. Appx. 403 (C.A.2 (N.Y.), 2009) (same).

earnings (instead of 1.5%), and 40% of the FICA amount that should have been withheld (instead of 20%).

These specific "failure-to-withhold" penalties do not apply to the employer if the employer intentionally disregards the withholding requirements, or if the employer deducts income taxes but fails to deduct FICA taxes. In addition to the employer still being liable for its share of FICA taxes, and for the income taxes not withheld on the employee's earnings and FICA taxes, the Code imposes interest on those amounts at the variable federal short-term rate. The Code also imposes a penalty equal to 100% of the taxes due for a willful failure to collect or account for employment taxes.

The 100% penalty may be asserted against anyone the IRS determines may be a "responsible corporate officer." A responsible corporate officer could be any officer, shareholder, director or employee who had the responsibility to withhold and remit taxes, but failed to do so, or who had authority over the payment of wages and other corporate obligations. This means that a Human Resources Manager or Accounting Manager could possibly be deemed responsible.

An employer who had a reasonable basis for classifying a worker as an independent contractor may be able to avoid both reclassification and imposition of employment tax penalties. The reasonable-basis standard is met if any of three safe harbors exist. The safe harbors are: (1) the existence of a prior IRS audit of the employer, where there was no employment tax change with respect to a worker in a similar position to the worker whose status is being questioned; (2) a long-standing industry practice of treating as independent contractors workers similar to the worker whose status is being questioned; and (3) an IRS ruling or court decision dealing with a worker in the same circumstances as the worker at issue, where there was a determination that such worker is an independent contractor. The threshold criteria for the application of the safe harbors are: (1) the employer must not have treated the worker as an employee for any period, or treated a similarly situated worker as an employee; and (2) all the appropriate tax reporting forms must have been filed with respect to the worker.

These safe harbors apply to tax years after 1978; however, the 1996 tax act has substantially altered the way these safe harbors are to be applied. Additionally, the IRS has instituted new procedures for examination with respect to the safe harbors.

It should be noted that reclassification of any worker from independent contractor to employee not only may result in employment tax liability, but also may create problems for employers with respect to pension and benefit plans.[15] Even if there is no reclassification due to the employer's ability to benefit from one of the safe harbors, the safe harbors apply only to employment taxes. Thus, there still may be issues with respect to pension and benefit plans.

B. New York Taxes

In addition to federal tax consequences, both New York State and New York City also impose penalties for failure to properly withhold and remit taxes. In both cases, the employer is

[15] See Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997).

liable for any amounts that should have been withheld and remitted. The employer will, however, be credited with any taxes paid by the employee.

Even if the employee pays the full tax liability, for New York State tax purposes, the employer who failed to withhold and remit will still be subject to penalties and interest. The penalty will depend on whether the failure was willful or not. The penalty for a nonwillful failure is equal to 5% of the tax per month up to a maximum of 25%, plus interest. If there is a finding that there was fraudulent intent, there is an additional penalty of up to $1,000. Criminal penalties are also provided.

III. State Statutory Exposure

A. Unemployment Insurance Tax

Employers are required to pay state unemployment insurance tax premiums on behalf of their employees in their quarterly remittance of tax contributions. Since unemployment tax payments are made to the State for employees based upon the formula established by the State (i.e., the employer's experience rating multiplied by each employee's salary up to the first $8,500 per annum), employers are liable for failure to remit unemployment insurance tax premiums on behalf of workers previously classified as independent contractors, and who have been reclassified as employees. Where the back premiums are promptly paid following an audit by the Department of Labor, the Commissioner of Labor generally does not assess any fines or penalties, but assesses the employer for interest on the unpaid premiums at the rate of 12% per annum. However, the New York State Labor Law provides for civil and criminal penalties for nonpayment against the entity, and provides criminal sanctions against corporate officers individually, in the event that the back premiums are not paid.

B. Workers' Compensation and Disability Payments

In New York, employers are required to remit premiums on a regular basis to the State Insurance Fund (or other appropriate carrier) to ensure workers' compensation and disability insurance coverage for its employee workforce. Proper classification is essential for the purposes of workers' compensation and disability, because if a worker not classified as an employee were to be injured and elect to sue, he or she would not be prevented from doing so by the workers' compensation exclusivity clause. If the State were to conduct an audit of an employer's books and records and find that there was a misclassification of independent contractors, the State could make an assessment against the company for retroactive and unpaid workers' compensation and disability insurance premiums. In addition, when an independent contractor is reclassified as an employee and makes a claim, the employer may be required to pay direct benefits to the employee.

When an employer fails to provide the payment of disability premiums, it will be subject to a "penalty not in excess of a sum equal to one-half of one per centum of his weekly payroll for the period of such failure and a further sum not in excess of $500.00." That statute's implementing regulations provide that, whenever an employer fails to comply with any requirement of the Disability Benefits Law or violates any of its provisions, then those fines,

assessments, or other penalties prescribed by the law shall be imposed.[16] Furthermore, if the employer willfully makes a false statement or representation, or fails to disclose a material fact for the purposes of obtaining any benefit or payment or influencing a determination regarding benefits, then the employer is guilty of a misdemeanor.

The Workers' Compensation Law penalties are invoked when there is a "failure to secure compensation." Failure to secure the payment of compensation for five or less employees within a twelve month period constitutes a misdemeanor, punishable by a fine of at least $1,000, but not more than $5,000. Failure to secure the payment of compensation for more than five employees within a twelve month period constitutes a class E felony, punishable by a fine of at least $5,000, but not more than $50,000.[17] Such law further provides that, where the employer is a corporation, the president, secretary, and treasurer shall be liable for failure to secure the payment of compensation. Thus, the corporate officer would be liable for the fine and charged with the misdemeanor or felony.

Furthermore, once it has been found that an employer failed to provide for payment of compensation, it may impose an additional penalty of $2,000 for each 10-day period of noncompliance, or a sum not in excess of two times the cost of compensation for its payroll for the period of such failure.[18] Where the employer is a corporation, the president, secretary and treasurer shall be liable for the penalty. If any person willfully makes a false statement or representation for the purpose of obtaining any benefit or payment under the Workers Compensation Law, then the person who makes that willfully false statement will be guilty of a misdemeanor.

C. Recapitulation

In sum, employers face an almost certain exposure to state civil and criminal sanctions in connection with nonpayment of unemployment, workers' compensation and disability premiums. As the State Department of Labor is most interested in receiving what it considers the employer's monetary obligations under the Labor Law, absent fraud or bad faith, it is unlikely in most instances to pursue criminal sanctions.

IV. Minimum-Wage Exposure

The FLSA regulates minimum standards for wages and working hours for employees whose employers either engage in interstate commerce or produce goods for interstate commerce. As such, the FLSA protects almost all employees in the United States. However, the FLSA does not preempt state legislation. This means that states are free to go farther than the protections afforded by the FLSA. On May 25, 2007, President Bush signed a spending bill that, among other things, amended the FLSA to increase the federal minimum wage in three steps: to

[16] N.Y. Comp. Codes R. & Regs. tit. 12, § 363.14.

[17] N.Y. Worker's Comp. Law § 52 (McKinney 2006 and Supp. 2008).

[18] Id.

$5.85 per hour effective July 24, 2007; to $6.55 per hour effective July 24, 2008; and to $7.25 per hour effective July 24, 2009.

New York's minimum wage is $7.25 per hour. Violations are characterized as Class B misdemeanors.

In New York, the statutory guidelines for the payment of overtime compensation provide that generally employees must be paid one and one-half times the basic hourly rate for work in excess of 40 hours per week. However, if the employee works a split shift and/or a spread of hours exceeding 10 hours per day, then the employee also may, depending on the circumstances, be eligible to receive one hour's pay at the minimum hourly rate in addition to the minimum wage. Therefore, if a worker were improperly classified, the employer would be liable at these rates for all the overtime previously worked by the reclassified employee.

An employee must be paid overtime unless the employee's position and duties fall within any of the exemptions (e.g., executive, administrative and professional) to overtime provided in the FLSA or state statute. The rate of base pay may be set at any amount deemed appropriate above the statutory minimum. Finally, under the New York Labor Law, employers must notify workers, at the time of their hire or reclassification, of the rate of pay and of the regular designated payday.

V. Agency and Legislative Action

Misclassification of employees as independent contractors has become a hot button issue under the Obama administration. Federal and state agencies and legislatures have become increasingly active in trying to combat employee misclassification.

Former U.S. Department of Labor Secretary, Hilda L. Solis, and IRS Commissioner, Douglas M. Shulman, signed a Memorandum of Understanding ("MOU") in 2011, creating an agreement between the agencies and establishing a joint initiative to reduce the frequency of employee misclassification and improve compliance with federal labor laws.[19]

A number of states have signed MOUs with the Department of Labor's Wage and Hour Division. With respect to a few of these states, the Employee Benefits Security Administration, Occupational Safety and Health Administration, Office of Federal Contract Compliance Programs, and the Office of the Solicitor are also signatories to the MOU. Each MOU explicitly sets forth that the partnership was created "with the specific and mutual goals of providing clear, accurate, and easy-to-access compliance information to employers, employees, and other stakeholders, and sharing resources and enhancing enforcement by … conducting coordinated enforcement actions and sharing information consistent with applicable law."[20]

[19] See Memorandum of Understanding between the Internal Revenue Service and the U.S. Department of Labor, dated September 19, 2011.

[20] See. e.g., Partnership Agreement between the U.S. Department of Labor, Wage and Hour Division and California Labor and Workforce Development Agency, dated December 21, 2011.

Many states also have created task forces charged with combating worker misclassification. For example, in 2007 the New York State Joint Enforcement Task Force on Employee Misclassification ("JETF") was created to coordinate the investigation and enforcement of employee misclassification requirements across all state agencies, including the State Department of Labor, Workers' Compensation Board, Attorney General, and Department of Taxation and Finance. Previously, enforcement efforts were divided among various agencies, and violations were not shared with other relevant agencies. In 2011, JETF identified over 19,600 instances of employee misclassification, discovered over $412 million in unreported wages and assessed over $14.5 million in unemployment insurance taxes.[21]

In addition to the activity by state and federal agencies, state and federal legislatures have taken action to prevent employee misclassification. States have responded to employee misclassification issues by enacting legislation aimed at defining the term "independent contractor," increasing penalties for willful misclassification and implementing more stringent reporting requirements. For example, in 2011 California enacted a law which prohibits the "willful misclassification" of an individual as an independent contractor, and also prohibits an employer from charging fees to a misclassified individual for items that an employee is not normally required to purchase, such as equipment, space rental, services, or licenses.[22]

The New York State legislature enacted the New York State Construction Industry Fair Play Act in 2010 creating a rebuttable presumption that all construction workers are employees. Under the Act, an individual may be classified as an independent contractor if the individual is (i) free from control and direction in performing the job, both under contract and in fact; (ii) performing services outside of the usual course of business of the company; (iii) and engaged in an independently established trade, occupation, or business that is similar to the service they perform.[23]

In the last five years, there have been numerous misclassification bills introduced in both the U.S. Senate and the U.S. House of Representatives. Although none of these bills has been passed, they are proof that employee misclassification is a prominent issue affecting employers and workers. In 2007, the Independent Contractor Proper Classification Act ("ICPC") was introduced by then-Senator Obama and was one of the first of its kind. This law would have, among other things, allowed the IRS to develop a process for workers to ask for an evaluation of their proper classification. In 2008, the Employee Misclassification Prevention Act ("EMPA") was introduced by both the Senate and House of Representatives. EMPA sought to specifically amend the Fair Labor Standards Act by requiring employers to keep records of non-employees who perform labor or services for remuneration, and by providing a special penalty of double liquidated damages and a fine of up to $10,000.00 for each violation for employers who repeatedly and willfully misclassify employees as non-employees.[24] EMPA was introduced again by both the Senate and House of Representatives in 2010 and by the House of

[21] See Annual Report of the Joint Enforcement Task Force on Employee Misclassification, dated February 1, 2011.

[22] Cal. Labor Code §§ 226.8 and 2753.

[23] New York Construction Fair Play Act, N.Y. Labor Law § 861

[24] See S. 3648 (2008); H.R. 6111 (2008).

Representatives in 2011.[25]

VI. Conclusion

The failure to delineate correctly the status of a worker or group of workers exposes an employer to the possibility of tremendous legal liability. Any subsequent failure to adjust the status of independent contractors, once it is known that they should be employees, promptly and markedly increases that potential liability, both criminal and civil, for violations under the tax, employee benefit, wage and hour, workers' compensation, disability and unemployment insurance laws. Additionally, the longer the change of status is postponed, the more likely "willfulness" may be found.

While changing the status may expose an employer to potential suit under Title VII, the ADEA, the ADA and the NYHRL, any individual improperly classified also would be able to seek protection either individually or through the government under these statutes, once establishing his or her true status. In such cases, therefore, it simply is not prudent to keep the individuals improperly classified.

[25] See S. 3254 (2010); H.R. 5107 (2010); H.R. 3178 (2011).

Appendix A

17-FACTOR ANALYSIS

NEW YORK STATE DEPARTMENT OF LABOR
UNEMPLOYMENT INSURANCE DIVISION

INDEPENDENT CONTRACTORS

Independent contractors are excluded from coverage under the Unemployment Insurance Law. These are persons who are actually in business for themselves and hold themselves available to the general public to perform services. A person is an independent contractor only when free from control and direction in the performance of services.

While the law does not define an independent contractor, court decisions have held that the common law tests of master and servant must be applied in making a determination of whether services rendered by an individual are in the capacity of an employee or an independent contractor. Under the common law tests, all factors concerning the relationship between the two parties must be taken into consideration to determine if the party contracting for the services exercises, or has the right to exercise, supervision, direction or control over the person performing the services.

The mere designation by the employer of an independent contractor status, even if accepted by the individual, is not conclusive. A written agreement does not preclude an examination of the facts to determine whether the performance of the services is subject to supervision, direction or control. However, contract provisions reserving the right of control may establish the existence of an employment relationship, even though the employer allows the individual significant freedom of action. If the circumstances demonstrate either the exercise of, or the right to exercise, such supervision, direction or control, an employer-employee relationship exists. It is immaterial if the services are performed on a full-time, part-time, or casual basis.

Generally, an officer of a corporation is an employee, and cannot be considered an independent contractor while performing either the usual management activities, or services for which the corporation was formed.

While there is no single factor, or group of factors, that is 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 by such means as requiring full-time services, stipulating the hours of work, requiring attendance at meetings, and requiring permission for absence from work.

2. Requiring the individual to comply with instruction as to when, where and how to do the job.

3. Direct supervision over 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 compensation in the form of a salary, an hourly rate of pay, or a drawing account against future commissions with no requirement for repayment of unearned commissions.

7. Providing reimbursement or allowance for business or travel expenses.

8. Providing fringe benefits.

9. Providing training, particularly if attendance at training sessions is required.

10. Establishment of limits within which the individual must operate: territorial, monetary, or time limits.

11. Requiring services to be rendered personally.

12. Requiring oral or written reports.

13. Services performed are an integral part of the business, particularly when performed on a continuing basis.

14. Furnishing business cards, or other means of identification of the individual as a representative of the employer.

15. Restricting the individual from performing services for competitive businesses.

16. Reservation of the right to terminate the services on short notice.

17. Nature of services: unskilled labor is usually supervised, or considered to be subject to supervision.

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 and billheads, carrying business insurance, maintaining own establishment.

2. The individual has a significant investment in facilities. Such items as hand tools and personal transportation are not considered significant.

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. No required attendance at meetings or training sessions. No oral or written reports.

6. Freedom to provide services concurrently for other businesses, competitive or noncompetitive.

The following persons are employees by law, even though the circumstances under which they work may not meet the common law tests of an employer-employee relationship:

1. An agent or commission-driver engaged in distributing meat, vegetables, fruit, or bakery products; beverages (other than milk); laundry or dry-cleaning services.

2. A traveling or city salesperson who works full-time soliciting orders for merchandise for resale or supplies for use in the purchaser's business operations.

The services of persons in both groups are covered if they work in a continuing relationship with an employer, substantially all of such work is personally performed, and the person performing it has no substantial investment in the facilities used in the performance of the services except the facilities for transportation.

Employers with any question concerning the status of individuals performing services for them should write to the Liability and Determination Section, furnishing complete details of the relationship, and request a determination. Failure to report the earnings and pay the tax due on the earnings of persons, on the assumption that they are independent contractors, may result in additional assessments and interest when they are later determined to be employees.

Appendix B

20-FACTOR ANALYSIS

A Serious Game Of Twenty Questions

The IRS has compiled a list of 20 factors that it reviews in making determinations regarding common law employees' status. Similar to the other tests discussed, no one factor is controlling; the determination is based on the totality of the circumstances. The IRS 20 factors are as follows:

1. **Instructions**. An employee is required to comply with instructions as to when, where and how to work. Even if no instructions are given, the control factor is present if the employer has the right to give instructions;

2. **Training**. An employee is trained to perform services in a particular manner. Independent contractors usually use their own methods and receive no training from the purchasers of their services;

3. **Integration**. An employee's services are integrated into the business operations because the services are important to the success or continuation of the business. This shows that the employee is subject to direction and control;

4. **Services Rendered Personally**. An employee renders services personally, which shows that the employer is interested in the methods as well as the result. Furthermore, if a business insists that services be performed personally, this factor indicates control over the worker;

5. **Hiring Assistants**. An employee works for an employer who hires, supervises and pays assistants. An independent contractor hires, supervises and pays assistants under a contract that requires him or her to provide materials and labor and be responsible only for the result;

6. **Continuing Relationship**. An employee has a continuing relationship with an employer. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals;

7. **Set Hours of Work**. An employee has set hours of work established by an employer. An independent contractor is the master of his or her own time;

8. **Full-Time Work Required**. An employee is normally required to work full-time for an employer. An independent contractor can work when and for whom he or she chooses;

9. **Work Done on Premises**. An employee works on the premises of an employer or works on a route or at a location designated by an employer;

10. **Order or Sequence**. An employee must perform services in the order or sequence established by an employer. This shows that the employee is subject to direction and control;

11. **Reports**. An employee submits reports to an employer. This shows that the employee must account to the employer for his or her actions;

12. **Payments**. An employee is paid by the hour, week or month. An independent contractor is paid by the job or on a straight commission;

13. **Expenses**. An employee's business and travel expenses are paid by an employer. This shows that the employee is subject to regulation and control;

14. **Tools and Materials**. An employee is furnished significant tools, materials and other equipment by an employer;

15. **Investment**. An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else;

16. **Profit or Loss**. An independent contractor can make a profit or suffer a loss;

17. **Nonexclusivity**. An independent contractor gives his or her services to two or more unrelated persons or firms at the same time;

18. **Services Offered to General Public**. An independent contractor makes his or her services available to the general public;

19. **Right to Terminate**. An employee can be fired by an employer. An independent contractor normally cannot be fired, so long as he or she produces a result that meets the specifications of the contract; and

20. **Right to Quit**. An employee can quit his or her job at any time without incurring any liability. An independent contractor usually agrees to complete a specific job, and is responsible for its satisfactory completion or is legally obligated to make good for his or her failure to complete the assignment.

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WHO IS YOUR EMPLOYEE?: INDEPENDENT CONTRACTORS AND OTHER CONTINGENT WORKERS

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