



The Law of Independent Contractors: Part 1

Course #4175A

Business

2 Credit Hours

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THE LAW OF INDEPENDENT CONTRACTORS: PART 1

Businesses often hire independent contractors as a way of saving money. Both state and federal laws impose significant legal and financial obligations on employers regarding the hiring of independent contractors. This course identifies penalties associated with misclassifying employees as independent contractors and recognizes how the IRS determines worker status and the statutory classes of workers.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Chapter 1: Introduction to the Law of Independent Contractors

Chapter 2: The IRS 20-Factor Test

Chapter 3: Statutory Classes Of Workers

Study the course materials from pages 1 to 42

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Identify penalties associated with misclassifying employees as independent contractors.
- Recognize how the IRS determines worker status.
- Identify the statutory classes of workers.

NOTICE

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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CHAPTER 1: INTRODUCTION TO THE LAW OF INDEPENDENT CONTRACTORS

Chapter Objective

After completing this chapter, you should be able to:

- Identify penalties associated with misclassifying employees as independent contractors.

I. INTRODUCTION

As we saw in the last section, hiring an employee entails a huge range of legal obligations, both at the state and federal level. An employer is responsible for complying with federal employment laws, including minimum wage and overtime requirements, must withhold and remit taxes, and must contribute to the employee's social security. An employer must comply with state and federal anti-discrimination laws, must give time off to vote, must accommodate certain disabilities, and must give employees leave to have a baby or care for a dying parent. An employer must provide workers' compensation insurance coverage to employees and must accommodate certain religious practices.

This is just a short list of the myriad of obligations imposed on employers in the United States. Given the broad range of obligations facing employers, many businesses consider using independent contractors to perform certain services rather than adding more employees to their payroll. This has the dual advantage of avoiding coverage of a wide range of laws and limiting employer duties to withhold and remit state and federal taxes. An independent contractor injured "on the job" will not claim benefits from the company's workers' compensation insurance, cannot demand overtime pay, and cannot demand time off to have a baby.

TABLE 16.1 COMPARISON OF LEGAL OBLIGATIONS OF BUSINESSES FOR EMPLOYEES AND INDEPENDENT CONTRACTORS

Issue	Employees	Independent Contractors
Workers' Compensation coverage	required	not required
Unemployment Insurance coverage	required	not required
Income tax withholding	required	not required
Liability of company for worker's actions	employer vicariously liable	company may be liable in some circumstances

Issue	Employees	Independent Contractors
Wage and Hour laws, including minimum wage	covered	not covered
Employment discrimination laws	applicable	not applicable, but other general business laws may provide some protection
Family and Medical Leave laws (state and federal)	applicable	not applicable
Federal laws protecting collective bargaining and other labor organizing activities	applicable	not applicable

All of this discussion, of course, begs the question: What is an independent contractor? An independent contractor is not an employee and, conversely, an employee is not an independent contractor. Unfortunately, each state and federal regulatory body has its own definition of “independent contractor.” What the Internal Revenue Service views as an employee, a state agency charged with administering unemployment insurance benefits might deem to be an independent contractor. It is this potential for differing legal results and the lack of clarity in the law – coupled with the huge financial cost of a mischaracterization – that makes the use of independent contractors a risky proposition for many businesses.

The California Labor Code § 3353, defines an “independent contractor” as “any person who renders service for a specified recompense for a specified result, under the control of his principal as to the result of his work only and not as to the means by which such result is accomplished.”

The California Labor Code § 3351, similarly defines “employee” as “every person in the service of an employer under any appointment or contract of hire or apprenticeship, express or implied, oral or written, whether lawfully or unlawfully employed.” Title VII very loosely defines “employee” as “an individual employed by an employer” where “employer” is defined as “a person or entity who employs 15 or more employees in 20 or more calendar weeks in the current or preceding calendar year.”

These definitions are not very helpful!

Many government agencies rely not on a statutory definition of “employee” or “independent contractor,” but rather on the common law tests (that is, tests used by the courts) to determine the legal status of a worker. In adjudicating claims and controversies, courts may refer to what is known as “economic realities” of the employment relationship. In applying this economic reality test, a court will review the employment relationship of the parties and see if the worker in question is actually functioning as an employee because the worker performs most of his or her work for the employer and derives most of his or her income from the employer. Other courts may use the “common law standard” as the primary emphasis. Here they will review the degree of control and autonomy the worker has over his or her hours, the methods used to complete the work, and materials utilized.

Here are two key points for small business owners to keep in mind when it comes to classifying workers:

1. **Control.** The relationship between a worker and a business is important. If the business controls what work is accomplished and directs how it is done, it exerts behavioral control. If the business directs or controls financial and certain relevant aspects of a worker's job, it exercises financial control. This includes:
 - The extent of the worker's investment in the facilities or tools used in performing services
 - The extent to which the worker makes his or her services available to the relevant market
 - How the business pays the worker, and
 - The extent to which the worker can realize a profit or incur a loss
2. **Relationship.** How the employer and worker perceive their relationship is also important for determining worker status. Key topics to think about include:
 - Written contracts describing the relationship the parties intended to create
 - Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation, or sick pay
 - The permanency of the relationship
 - The extent to which services performed by the worker are a key aspect of the regular business of the company, and
 - The extent to which the worker has unreimbursed business expense

Case-in-Point

A milestone court decision on this matter was the case of *Viscaino v. Microsoft Corp.* (9th Circuit, 1997). At the time, Microsoft had routinely brought in outside "independent contractors" to work on various software programs. Microsoft needed their expertise, but made them sign contract agreements, in which they understood that they were not employees of Microsoft. Many of them worked several years in this capacity for Microsoft, and ultimately, a group of them filed suit under ERISA, hoping to recover lost pension and other benefits.

Microsoft defended that these individuals were "independent contractors" and had accepted the work with that knowledge and understanding. The Court disagreed. It found that the workers had assigned desks, assigned phone numbers, and were otherwise treated essentially as Microsoft employees. In fact, the only difference was that they did not receive company-paid benefits. Needless to say, Microsoft lost the case.