

# EMPLOYEE VS INDEPENDENT CONTRACTOR

— NATIONAL CONCRETE BURIAL VAULT ASSOCIATION —

In this newsletter: **How does the new gig economy affect your business?**

Written by [Poul Lemasters, NCBVA Legal Counsel](#) | April 29, 2022

## THE ONGOING BATTLE OF EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

### WHAT YOUR BUSINESS NEEDS TO KNOW

Let's set the scene. The sky was clear. All you could see was an ocean of blue as you squinted from the sun's bright warm light. There he sat. Dennis was a young go-getter who had made his name and place in the world of international banking. And people knew this. Dennis was sought after by other companies, including a start-up. International Asset Transactions (IAT) was the new talk of town and had made plans to become a big player in the asset-backed commercial paper arena. It may not have sounded flashy - but it's a billion-dollar play, and Dennis knew it.



As Dennis sat down with the CEO and President of IAT, he knew what he could offer and what he wanted in return. Dennis laid out his terms. \$1,000 a day. Plus all expenses. He would begin at this rate - on his terms - as a consultant. Once IAT got out of its fledgling status, then Dennis would agree to become a full-time employee. But for now, Dennis worked from Chicago, would visit the office in New York, and attend events for IAT. However, Dennis was young and knew there was more out there, so he was able to still have other side jobs.

They inked the deal, and Dennis was on his way. It was great. Until it wasn't. The sun soon set, and darkness set on the parties. Months had gone by and Dennis was not receiving all his pay. Invoices began to stack up, as IAT couldn't pay the high fees. Left with no choice, Dennis filed

a suit against IAT under the Wage Claim Act. Again, Dennis was smart. He knew he could get more under the Wage Act versus a straight violation of a contract claim.

There was one issue however, Dennis had a signed agreement that stated he was in fact an independent contractor. To top it off, the Court looked at its test for an independent contractor which stated that the following 3 factors must be met to be an independent contractor:

- 1) Free from control over the performance of the work
- 2) Performs work which is either (a) outside the usual course of business, or (b) is performed outside all the places of business of the employer
- 3) Is in an independently established trade, occupation, profession, or business

The Court, when looking at the Independent Contractor Agreement signed by Dennis, as well as the test of 3 factors, quickly decided that Dennis was an independent contractor and therefore had no claim under the Wage Act. It seemed darker for Dennis. But Dennis saw a small ray of light through the darkness. As he peered closer, what he in fact saw was the Court of Appeals. Dennis followed the light.

In the Appeal's process, the Court took a different look at the factors - focusing on factor number 2. It was here the Appeals Court shined the light brightest and found that neither of the options were met. In regard to "outside the usual course of business", the Court said this was not met. The Court stated that the business being sought must be different from its actual business. In this case, IAT was developing a financial product and Dennis was hired to help develop that exact product. This was not outside - it was specifically what IAT did. The second part of the factor states that work "is performed outside all the places of the employer." Here, the Court stated that this was not met because Dennis did not work entirely outside the places of business. In fact, Dennis went to the main office and traveled to roadshows which were exactly where IAT was performing business. The roadshows were where IAT was launching its business and getting investors. Dennis was there and part of that process.

Ultimately, the Court of Appeals reversed the case and held that Dennis was an employee and entitled to damages under the Wage Act. But what about the contract that all parties signed, including Dennis, that stated he was in fact an independent contractor? The Court stated that the parties' personal preferences as to what they want a classification to be is not the final word. The classification is up to the Court and not dictated by an agreement. After that decision, the sun shined bright for Dennis but cast a dark shadow on all employers in the ongoing battle of employee classification. And scene!

## **CAN THIS REALLY HAPPEN?**

Yup - that is a real and recent case. It highlights the evolving changes in employee and independent contractor classification. In an effort to help clear the air, this article outlines the current tests out there to determine if you really have an independent contractor or an employee. Plus, we look at some pros and cons of classification; and lastly some tips to help stay out of trouble.

# THE COMMON LAW TEST

You don't know this, but you are probably familiar with this test already. The Common Law test is historically what the IRS uses to determine if someone is an employee or independent contractor. This used to also be called the 20-Factor test, because it was originally a list of 20 questions that you could answer to see if someone was under your control as an employee or free to work as an independent contractor. There was no weight to any one question, nor was there any set number of questions that put you over one way or another. However, the theory behind the IRS was that everyone was a contractor unless an employer has too much control.



Fast-forward, and while the IRS still has the 20 factors, the test is now based on 3 categories of control: behavioral, financial, and relationship of the parties. This is still the common law test and uses the 20 factors, but now they are grouped together to make it clearer. Now, if an employer has control in any of these areas, the person is determined to be an employee.

The behavioral control factor focuses on whether the employer controls how tasks are done. This can be where the work is done; when the work is done; and how the entire task is completed. Financial control focuses on employer's control of financial matters such as expenses; providing equipment or place to work; and most significantly, can the individual suffer a loss as well as experience a profit. Lastly, relationship of the parties is the relationship terms in place. This can be anything from a written contract, benefits, and terms of employment. Of course, as we saw in the case above, this element can easily be overcome.



# THE ABC TEST

Of the two tests, this test is making more and more headlines, as well as confusion. To demonstrate the confusion, you should know that the Department of Labor uses the ABC Test, compared to the IRS that uses the Common Law Test. Another thing to note is that the ABC Test presumes the worker is an employee (unlike Common Law Test) unless they can show all 3 of the factors. While the factors are similar in both tests, the ABC test is different.

The factors, A, B, and C are named so because the first factor, A, is Absence of control. Absence of control means that the worker is free from control of employer. The worker can, among other things, set their own hours, determine how the work is done, and perform the job to its standards and normal practice.

The B factor is Business of the worker. This, in many cases is the most difficult prong of the ABC Test to prove. Because of the difficulty of this factor, some states do not use it. Under

the Business of the worker, the worker must show that what they do is 'unusual' and 'not common' to the hiring entity. As an example, provided by DOL, a bakery that needed additional people and hired an independent contractor to do cake decorating would not pass the B portion of the test. Since cake decorating is part of the bakery's business, it would not be 'unusual', and the bakery would have to hire them as an employee.

The last factor is C, and this is the Customarily engaged factor. This means that if the work is customarily an independent trade and available on a per job basis, then it is more likely to remain an independent contractor status.

## WHICH TEST APPLIES TO MY BUSINESS?

Not only do the IRS and DOL each use different tests, most states also have their own test they use for determining employee versus independent contractor classification. At the time of writing this article, the following states were implementing the following tests:

State / Territory	Worker Classification Test
Alabama	Common Law
Alaska	ABC Test
Arizona	Common Law
Arkansas	ABC Test
California	ABC Test
Colorado	A&C of ABC Test
Connecticut	ABC Test
Delaware	ABC Test
District of Columbia	Common Law
Florida	Common Law
Georgia	ABC Test
Hawaii	ABC Test
Idaho	A&C of ABC Test
Illinois	ABC Test
Indiana	ABC Test
Iowa	Common Law
Kansas	ABC Test
Kentucky	Common Law
Louisiana	ABC Test
Maine	ABC Test
Maryland	ABC Test
Massachusetts	ABC Test
Michigan	Common Law
Minnesota	Common Law
Mississippi	Common Law
Missouri	Common Law

State / Territory	Worker Classification Test
Montana	A&C of ABC Test
Nebraska	ABC Test
Nevada	ABC Test
New Hampshire	ABC Test
New Jersey	ABC Test
New Mexico	ABC Test
New York	Common Law
North Carolina	Common Law
North Dakota	Common Law
Ohio	ABC Test
Oklahoma	A&B or A&C of ABC Test
Oregon	ABC Test
Pennsylvania	A&C of ABC Test
Puerto Rico	ABC Test
Rhode Island	ABC Test
South Carolina	Common Law
South Dakota	Common Law
Tennessee	ABC Test
Texas	Common Law
Utah	ABC Test
Vermont	ABC Test
Virginia	A&B or A&C of ABC Test
Washington	ABC Test
West Virginia	ABC Test
Wisconsin	A&C of ABC Test
Wyoming	A&C of ABC Test

## REGISTER FOR THE Q&A CALL

Thursday, May 19, at 2:00pm ET

## THE PROS AND CONS

Why is this even an issue? If there is so much concern over getting this wrong, why not just make everyone an employee and save the potential issues? You could do that - but understand why so many employers want the independent contractor classification.

**Pros:** First, start with taxes. An employer is not responsible for any federal, state, or local payroll taxes. Keep going, because an employer also does not have to pay social security, Medicare, or unemployment benefits. There is also no need for an employer to worry about overtime, sick pay, breaks, or vacation. And an employer also can't provide any benefits to an independent contractor such as, health insurance, pension, or retirement. This is just the employer benefits too. For independent contractors, they typically enjoy more flexibility; you are your own boss; and usually get paid more. And leave it to the lawyer for one big employer

benefit - you reduce your potential liability. Think about it, a true independent contractor has none of the potential employee claims.

**Cons:** Are there disadvantages? Of course there are, nothing is all rainbows and sunshine. Obviously, the first disadvantage is the potential audit and ultimate misclassification. As a result, you can face repayment of taxes plus penalties. As a business you have less control over the independent contractor and may also have trouble ending the relationship - depending on what the contract states. And, as far as liability, you could face a lawsuit for injuries. The dreaded double-edge sword is a real thing. While an employee is covered under workers' compensation, an independent contractor is not. Workers' compensation, a benefit to employees, provides coverage to employees for workplace injuries, but in return the employee loses the right to sue for injuries. The independent contractor has no workers' compensation from you - so they retain the right to sue for workplace injuries.

## A FEW LAST TIPS

### **Do I Need to Make a Change?**

First, if you read this and now are thinking you may have an issue - don't go changing everything yet. This is an evolving area, and what was once an independent contractor can change; and yes, you can get a different result from the IRS versus the DOL. If you have questions, talk to your tax professional. Many times, your tax advisor may not be fully aware of your circumstances, but upon further information can make a more proper classification.

If you need to make a change, there is a safe-harbor provision. Under Section 530 of the Internal Revenue Code, a business can resolve a misclassification and avoid penalties and unpaid taxes. To qualify for the safe-harbor provision, the business must show there was a reasonable basis for the misclassification. This can typically be done by showing another case where a similar classification was approved, or a business may be able to show that the classification is the norm within its industry.

### **What About My Policy Manual?**

Another thing to consider for your business classification purposes is the use of an employee policy manual. As you will hear from any great attorney - I'm sure you know at least one - you should have everyone sign off on your employee policy manual. But wait - not your independent contractors. There are cases that have shown that if an independent contractor signs off and accepts the employee policy manual, then they are in fact under the business control and therefore an employee. However, for your business, you may want or need to have them understand and agree to some of your policies.

I mean what do you do if your independent contractor is sharing your office space, working with your employees, eating lunch in the breakroom? The answer - you need an Independent Contractor Policy Manual. What goes in it? Consider adding your business history, practices, and mission statement. You can also include general health and safety practices, smoking policy, and most importantly language that describes what an independent contractor is and how they exercise their own control, own tools, own time/scheduling. What don't you include? Avoid benefits, wages, and anything that talks about employment - even if it's at-will.

### One Final Tip

One last independent contractor tip. Years ago I had the pleasure of working with a business through an audit for classification. During the process, I learned so many little nuances as to what different auditors looked at and for to determine control. After all, in all of this, control is priority. No matter what test you use, the level of control is the biggest issue to show or not be able to show. So, in this audit, the auditor shared with me their best and quickest trick. They ask for the business card of person being audited. If the independent contractor has a business card that shows them listed on the hiring business, that is huge control and most likely an employee. But, if the independent contractor has their own card showing their own business, then it is the first step to showing they have their own control. Just a last thought.

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Want to ask a question related to **Employees vs Independent Contractors**? Join Poul Lemasters, NCBVA Legal Counsel, for a 30-minute NO-CHARGE Q&A session. Feel free to [submit a confidential question](#) in advance too, if you prefer.

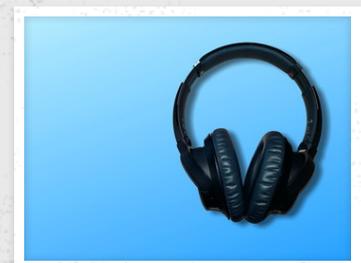


Thursday, May 19, at 2:00pm ET

Mark your calendar & [register](#). There is no charge to attend, but registration is required.

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## NATIONAL CONCRETE BURIAL VAULT ASSOCIATION

 PO BOX 8314 | GREENVILLE S...  [info@ncbva.org](mailto:info@ncbva.org)  
 888-886-2282  [ncbva.org](http://ncbva.org)

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