

REUTERS/Stringer

The Dos and Don'ts of Using Independent Contractors

March 26, 2015

Presenters:

Paul Bittner, *Ice Miller LLP (Moderator)*

Paul R. Barsness, *Parker Hudson Rainer & Dobbs LLC*

Paul Peralta, *Moore & Van Allen PLLC*

Jennifer Williams, *Akerman LLP*

Wage & Hour Defense Institute

Suzanne Brown, *Practical Law Labor & Employment*

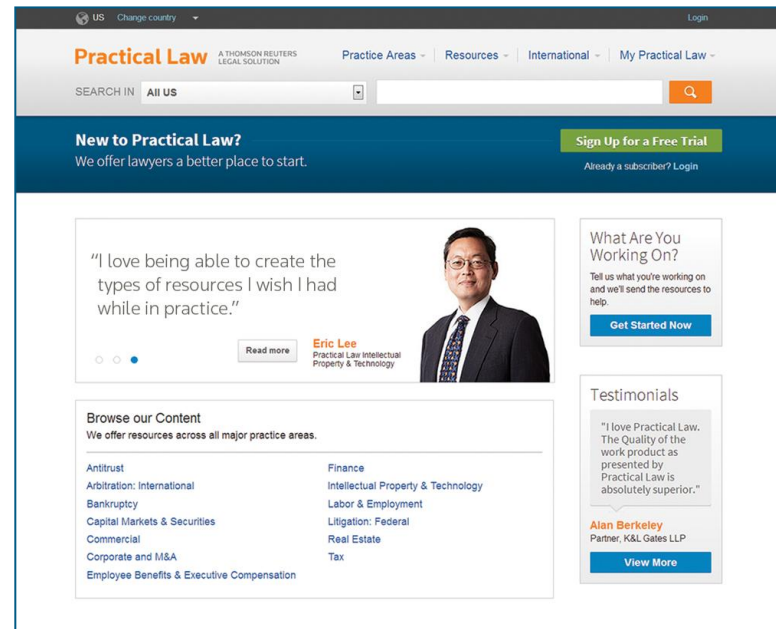


NATIONAL NETWORK. LOCAL KNOWLEDGE.

Practical Law™ A THOMSON REUTERS
LEGAL SOLUTION

About Practical Law

- Practical resources covering all major practice areas.
- Overviews, model documents, trend articles and more created by our expert attorneys.
- Dedicated areas for law firms, law departments and law schools.
- Practice centers for specialists
- What's Market for executive employment agreements and more.
- Updates on the latest legal and market developments.
- *Practical Law The Journal* magazine covering today's transactional and compliance topics as well as key issues and developments in litigation practice and procedure.



Why You Care About Classification

Spotlight on Worker Classification

- Who cares about worker classification?



Spotlight on Worker Classification

- Answer – Everyone
 - White House
 - Office of Federal Contract Compliance Programs (OFCCP)
 - Department of Labor (DOL)
 - Internal Revenue Service (IRS)
 - State and local executive, legislative and regulatory bodies
 - Plaintiffs' attorneys

Spotlight on Worker Classification

- Expect more changes
 - DOL regulatory changes
 - Right to Know requirements
 - State laws – CA example (\$5,000 to \$25,000 penalty for each violation)



Importance of Proper Classification

- Independent contractor status is defined by law, not by the parties' agreement.
- It is critical that business owners correctly determine whether the individuals providing services are employees or independent contractors by carefully evaluating the relevant factors.
- Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. Instead, they are issued IRS Form 1099s.
- In determining whether the person providing service is an employee or an independent contractor, all information that evidences the degree of control and independence must be considered.

Other Misclassification Issues

- Government Investigations
 - Many state Attorneys General have publicly committed to investigating and curbing misclassification.
 - Investigations may generate negative publicity and can result in civil citations and hefty fines.
 - In some states, the Attorney General may have the option of bringing a court action against non-complying employers.
 - Criminal penalties are available in some states.

Other Misclassification Issues

- Tax Consequences
 - The IRS has also publicly stated it intends to step up enforcement of worker misclassification rules, in particular, committing to performing additional, targeted audits in the coming year.
 - If a tax violation is found, employers may be assessed fines and penalty fees and be held liable for years of back payroll taxes on misclassified workers.
 - For employers who offer tax-qualified benefit plans, misclassification of workers who would otherwise be eligible for plan enrollment may jeopardize the tax-qualified status of those plans.
- Benefit Claims

Multiple Tests – Know the Test in Your Jurisdiction

Determination of Contractor Status

- Remember: Independent contractor status is defined by law, not by the parties' agreement.
- Different Agencies and Different Jurisdictions Use Different Tests:
 - Fair Labor Standards Act: Economic Realities Test
 - Internal Revenue Service: Right to Control Test
 - National Labor Relations Act: Common Law Agency Test
 - Title VII of the Civil Rights Act of 1964: Combined Test
 - Employment Retirement Income Security Act: Common Law Agency Test
 - Many varying state laws

Multiple Tests – Know the Test in Your Jurisdiction

- Right to control – (IRS) narrowest test
- Hybrid test – slightly broader
- Economic reality test – (FLSA) even broader
- Different state tests – broadest (NJ – presumption of employee status; Illinois Employee Classification Act (for construction workers, presumption) (may have different tests within the same jurisdiction))

Independent Contractor or Employee?

- Confirm the test in your jurisdiction
- Typical Factors:
 - degree of control;
 - investment in facilities;
 - opportunity for profit and loss;
 - permanency; and
 - required skill.

FLSA Test: Economic Realities Test

Employment Tests Vary By Statute - FLSA

- Some courts consider only five factors (leaving out #6 below), while others consider all six.
 - (1) The degree of control exercised by the company over the work performed.
 - (2) The relative investments by the company and the worker in materials and equipment.
 - (3) The degree to which the worker's opportunity for profit and loss is determined by the company.
 - (4) The skill and initiative required in performing the job.
 - (5) The permanency of the relationship.
 - (6) Whether the worker's service is an integral part of the company's business.

IRS Test: Right to Control

IRS Test: Right to Control

- For federal tax purposes, the usual common law rules are applicable to determine whether a worker is an independent contractor or an employee.
- Under the common law, you must examine the relationship between the worker and the business. All evidence of the degree of control and independence in this relationship should be considered.
- The facts that provide this evidence fall into three categories:
 - behavioral control;
 - financial control; and
 - the relationship of the parties.

IRS Test: Behavioral Control

- *Behavioral Control* covers facts that show whether the business has a right to direct and control what work is accomplished and how the work is done, through instructions, training or other means.

IRS Test: Financial Control

- *Financial Control* covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker's job. This includes:
 - the extent to which the worker has unreimbursed business expenses;
 - 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.

IRS Test: Relationship of the Parties

- *Relationship of the Parties* covers facts that show the type of relationship the parties had. This includes:
 - 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 pay or sick pay;
 - the permanency of the relationship; and
 - the extent to which services performed by the worker are a key aspect of the regular business of the company.

Other Tests

Tests Under Other Laws Vary

- Other Federal Statutes
- State Wage Laws
- State Unemployment Compensation Laws

Dos and Don'ts – Drafting Agreements, Common Pitfalls and Key Issues

Drafting Independent Contractor Agreements

- Control – compliant agreements focus on this common theme, including:
 - the manner and means of performing the services;
 - where the services will be performed;
 - when the services will be performed; and
 - who will or can perform the services.
- Who has the “right” to decide these important questions?
- Are any restrictions imposed?

Drafting Independent Contractor Agreements

- The Provisions – many sections of an independent contractor agreement may be interpreted as demonstrating the right to control, including:
 - The manner and means of performing the services:
 - Instructions / scope of work
 - Focus on the result – what is it you want the contractor to do?
 - Where?
 - At the principal's place of business?
 - At the customer's location?
 - Does it matter?

Drafting Independent Contractor Agreements

- The Provisions – continued:
 - When?
 - Is there a project completion date or are there daily/weekly tasks assigned?
 - Who?
 - Use of substitutes or ability to subcontract?
 - Is the contractor required to obtain approval for a replacement or helper?

Drafting Independent Contractor Agreements

- The Secondary Indicia – aside from control, what does the agreement say regarding each of the other factors used in the various tests?
 - Method of payment?
 - Hourly or project-based?
 - Ability to terminate
 - At-will or only with notice / for cause?
 - Effect of termination: rights and obligations of each party
 - Statement of parties' understanding of relationship status
 - Payment of expenses / costs
 - Provision of equipment / tools (including selection)

Best Practices for IC Agreements

- Centralize control over who can retain independent contractors and under what circumstances.
- Train employees who manage independent contractor relationships.
- Routinely review individuals classified as independent contractors to ensure their status is appropriate.

Managing an Independent Contractor



DO:

- Allow the independent contractor to work a flexible schedule that focuses on completion of the final result by the delivery deadline.
 - An independent contractor should work at his own discretion utilizing the resources and skills the contractor decides are necessary.
- Allow the independent contractor to subcontract part of the services if he sees fit.
- Pay independent contractors out of accounts payable and provide them with a Form 1099, if appropriate.
 - Do not pay them out of payroll or provide them with a W-2.

Managing an Independent Contractor



DO NOT:

- Provide the independent contractor with:
 - employee benefits;
 - payment at an hourly, weekly or monthly rate;
 - use a fixed or project rate
 - training or instructions;
 - tools, equipment, supplies or materials for free or at a subsidized price; or
 - a uniform.
- Allow the independent contractor to represent himself under the company's name or use copyrighted or trademarked company materials.
- Require the independent contractor to provide services exclusively for your company or perform services exclusively on your property.

Best Provisions and Practices: Titles and Names

- The contract should affirmatively state that the contractor is engaged as an “independent contractor.” Nowhere in the contract should the individual contractor be referred to as an “employee.”

Independent Contractor. Contractor is an independent contractor to the Company. Nothing in this agreement shall be construed or applied so as to create or constitute any employment arrangement, partnership, joint venture, membership or other relationship besides that of an independent contractor between Contractor and Company. Under no circumstances shall Contractor look to Company as his employer, or as a partner, agent or principal.

Best Provisions and Practices: Nature of Services

- The contract should specify the particular purpose for the engagement – the services the contractor will render – but should not dictate how the services will be performed on a day-to-day basis. There should be no directions or control, other than the end result of the engagement.
- The agreement should expressly grant the independent contractor the right and freedom to work the hours that he deems necessary to perform under the contract.

Independent Contractor To Control Performance. Company shall have no right or authority to direct or control the Contractor or his employees with respect to the performance of the Contractor's duties under this Agreement, or with respect to any other matter, except as otherwise provided by this Agreement. It is understood and agreed that Company is interested only in the results to be achieved by the Contractor under this Agreement; the manner and method of performing all duties and services of the Contractor under this Agreement and achieving the desired results shall be under the exclusive control of the Contractor. It is further understood that the Contractor is free to contract with other companies to provide consulting services, as long as such companies do not sell products or services which are directly competitive with the products or services sold by Company.

Best Provisions and Practices: Duration of Engagement

- The engagement should have a definite duration or be for a specific project and state that the relationship will terminate at the close of the specified time or project.

Term and Termination. The term of this Agreement shall be for a period of ___ months, commencing on _____. This Agreement may be terminated by either party hereto for any reason whatsoever by providing written notice to the other party at least seven calendar days prior to the effective date of such termination. Company shall not owe the Contractor compensation for any services provided by the Contractor following the effective date of such a termination.

Best Provisions and Practices: Benefits

- The parties should agree in writing that the contractor will not receive any employee benefits.

Benefits. Neither the Contractor nor his employees shall be eligible to participate in any benefits or programs sponsored or financed by Company for its employees, including, but not limited to, any insurance, profit sharing, workers' compensation, retirement, vacation, sick or holiday programs and benefits.

Best Provisions and Practices: Insurance

- The parties should agree that the contractor is responsible for obtaining all general business and liability insurance, as well as appropriate licenses.

Insurance. The Contractor is responsible for obtaining liability insurance, as well as all other forms of insurance required by law.

Best Provisions and Practices: Non-Exclusivity

- The agreement should not restrict the independent contractor's ability to work for other companies.

Non-Exclusive, No Guarantee. The relationship between Company and Contractor is discretionary and non-exclusive. It is anticipated that Contractor will provide services to third parties, and this Agreement does not restrict Contractor from any pursuits unrelated to the Services. Company may employ or engage other contractors to perform services similar to the Services provided by Contractor.

Best Provisions and Practices: Compensation

- Payment should be in the form of a lump sum or in installments as work is performed. It should not be given on an hourly, weekly or monthly basis, because this too clearly mirrors employee wages.

Compensation. The Contractor shall be paid a project fee equal to _____. The Project Fee will be paid to the Contractor at/on _____.

Best Provisions and Practices: Performance of Services

- The agreement should allow the contractor to have the discretion to decide where to perform the work, rather than forcing the independent contractor to always be on company premises.

Services. Contractor shall provide the services and any associated tangible items described in this contract. Contractor, and not the Company, shall determine and control the means, details and methods used in performance of the Services.

Best Provisions and Practices: Expenses

- The contract should expressly state that the contractor is responsible for paying business expenses related to furnishing services under the contract, such as the cost of equipment, tools, office space and support services.

Equipment, Supplies and Expenses. Except as specified below, Contractor shall provide, at Contractor's expense and without reimbursement by the Company, all equipment, supplies, and other resources used by Contractor, and pay all other expenses incurred by Contractor, in the provision of the Services and other performance under this Agreement.

Best Provisions and Practices: Non-Disclosure/ Confidentiality

- The agreement should protect the confidentiality of information and the ownership rights of the company with respect to material created by the contractor.

Confidentiality / Intellectual Property / Non-Disparagement. In performance of the Services, Contractor may have access to Company Confidential Information. At all times during and after the term of this Agreement, Contractor shall keep all Company Confidential Information confidential, shall not disclose Company Confidential Information to any third party, and shall not use any Company Confidential Information in any manner or for any purpose other than the performance of the Services. Upon termination of this Agreement or earlier upon request by Company, Contractor shall return to Company all Company Confidential Information and all property of Company or its members.

Provisions and Practices To Avoid

- Do not utilize independent contractors to perform the same duties as company employees.
- Do not convert contractors to employees doing the same job.
- Do not hire former employees as independent contractors and, if you do, establish restrictions on their engagement that prohibit them from performing the same work they did when they were employees.

Provisions and Practices To Avoid

- Do not provide independent contractors with employee benefits.
 - Not only access to benefit plans but things like vacation, access to employee discounts and invitations to employee events.
- Do not pay independent contractors in the same manner as employees – no Christmas Bonus.
- Limit training provided to the independent contractor to “need to know” items that are related to a specific project. Do not provide a new independent contractor with the full panoply of training or orientation you would provide to a new employee.

Provisions and Practices To Avoid

- Do not require independent contractors to work a particular schedule or hours of work. It is also important to avoid tracking independent contractor hours or whereabouts. Independent contractors should have far greater flexibility to come and go as needed to complete the assigned project.

Provisions and Practices To Avoid

- Place limits on direction given to independent contractors. Although some degree of communication regarding the execution of a project is acceptable, you should avoid controlling the way in which the goals of the independent contractor are accomplished. Consider financial penalties in the independent contractor agreement for failure to achieve goals.

Provisions and Practices To Avoid

- Limit the length and scope of independent contractor projects. Do not retain independent contractors on an open-ended basis.
- Do not use one independent contractor agreement to cover a lengthy or open-ended retention. Enter into new independent contractor agreements for each significant project. Defining the scope of the work to be performed and the length of the engagement in the agreement are important.
- Do not prohibit the independent contractor from working for more than one client at a time.

Importance of Audits

Why Perform Wage and Hour Audits?



- Limit liability
- Correct mistakes
- Take advantage of safe harbor provisions
- Affirmative defense
- Insurance requirements

Wage and Hour Audits – Affirmative Defense

Section 11 Good Faith Defense:

- Provides court discretion to award no liquidated damages if act/omission was in good faith and employer has reasonable grounds for believing there was no FLSA violation. *29 U.S.C. § 260.*
- Good faith requires employer to take affirmative steps to know, and comply with, FLSA requirements.

Wage and Hour Audits – Privilege Issues

- Internal audits generally discoverable (not necessarily done in anticipation of litigation).
- To enhance protection, attorneys should take a lead role, and (in writing):
 - initiate the review;
 - request the gathering of info;
 - receive the gathered info;
 - conduct/participate in the analysis;
 - limit communications and instruct others to limit communications; and
 - mark all documents.

Communications with Potential Class Members

- Is litigation pending?
- What is the status of the employees at issue?
- Some states may limit communications even prior to certification (PA).
- Provide full disclosure in writing and have sign.



Admissions

- Be careful with the language in the audits and communications to avoid making improper legal conclusions or admissions of liability.



Implementing Changes – Worker Classification

- Reclassification
- Job modification
- Exempt or non-exempt
- Do nothing



Reclassification

- Convert contractor's project rates into hourly rates.
- Establish timekeeping procedures.
- Training (so former contractors learn to record time, meal and rest breaks, and managers can understand their responsibilities).
- Advance planning and coordination can minimize chaos.
- Be careful to limit communication on the reclassification. The language should be neutral/benign to avoid admissions of liability. "We are doing this out of an abundance of caution...despite the fact that these positions are not controlled by the company...to mitigate litigation risks...etc."
- Reclassification can serve as a basis for certification.

Reclassification

- Deciding whether to pay back pay?
- Intertwined with good faith.
- Back pay awards are wages, subject to garnishment.
- Former contractors?
 - If a company decides to provide back pay to current employees following a reclassification, it may be appropriate to pay former contractors as well.
 - It might be difficult to track down former contractors, and notice efforts could trigger litigation.

Do Nothing



- Prolong risk v. avoiding a litigation trigger
- Limit future exposure
 - Track and limit overtime
 - Refocus job descriptions or job tasks

Questions

Relevant Practical Law Resources

- *Using Independent Contractors and Outside Firms: Avoiding Employee Misclassification Checklist*
- *Standard Document, Independent Contractor/Consultant Agreement (Pro-client)*

These relevant resource are available with a free, no-obligation trial to Practical Law.

Visit [Practicallaw.com](https://www.practicallaw.com) and request your free trial today.

About the Speakers

Wage & Hour Defense Institute



To learn more about the Wage & Hour Defense Institute,
please visit <http://whdi.litcounsel.org/>.

About the Speakers

Paul Bittner, *Ice Miller LLP*

Paul Bittner is a partner and co-chair of Ice Miller's Labor, Employment & Immigration Group. He has been practicing law since 1993, representing employers in all aspects of labor and employment law. He has extensive experience representing employers in wage and hour matters, including both jury and bench trials under the Fair Labor Standards Act and providing compliance counsel before the Department of Labor and various state agencies.

Paul R. Barsness, *Parker Hudson Rainer & Dobbs LLC*

Paul Barsness represents large retailers and other employers in a host of employment areas, in particular the defense of collective and class actions. He also represents local governments, employers, and workforce management companies in the use of employment tests, screening devices, and personnel selection procedures.

Paul J. Peralta, *Moore & Van Allen PLLC*

Paul Peralta is a partner representing employers in a range of state and federal areas of labor and employment law. His practice includes counsel and defense in wage and hour, Fair Labor Standards Act, FCRA, ADA, Title VII and unfair competition claims ranging from trade secret prosecution and defense to restrictive covenant litigation. He has tried cases in multiple jurisdictions, in both federal and state courts.

About the Speakers

Jennifer Williams, Akerman LLP

Jennifer Williams is a partner in the Miami office of Akerman LLP. Jennifer represents management in all facets of labor and employment law. Jennifer routinely represents companies in a variety of wage/hour issues under the Fair Labor Standards Act as well as representing clients in employment litigation brought under federal and state laws. Jennifer is Board Certified by The Florida Bar in Labor and Employment Law and has been recognized by *Chambers USA* since 2006.

Suzanne Brown, Practical Law Labor & Employment

Suzanne Brown joined Practical Law from Epstein Becker & Green, P.C., where she was a litigation associate in the labor and employment group, concentrating on wage and hour litigation and compliance. Previously Suzanne was a labor and employment associate with Gibbons, P.C., McElroy Deutsch Mulvaney & Carpenter, LLP, and the Law Department of the Port Authority of New York and New Jersey.