WEBINAR OVERVIEW

Classification of Workers: Independent Contractor or Employee?

May 10, 2023

INTRO/SETTING THE STAGE

- Current Landscape
- An Oxymoron: the 1099 Employee
- Classifying correctly is vitally important and misclassification has many serious financial consequences

CURRENT LEGAL TRENDS IN CLASSIFYING INDEPENDENT CONTRACTORS AND EMPLOYEES

A. US DOL Issues Proposed Rule for Determining Independent Contractor Status (Totality of Circumstances)
B. NYC FREELANCE ISN'T FREE ACT
C. CLASSIFICATION UNDER NEW YORK LAW
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D. IRS - 20 Point Checklist
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RECENT CASES/DECISIONS OF INTEREST

- NY CASES:
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  - New York Independent Contractor Cases Affecting the Gig Economy
  - New York Court of Appeals: In re Yoga Vida NYC, Inc.
- FEDERAL AGENCY

- US Department of Labor Exacts $5.6 Million from Arizona Auto Parts Distributor in Independent Contractor Misclassification Case

HRtelligence TIPS

WEBINAR OUTLINE

I. Intro/Setting the Stage

Current Landscape

- From start-ups to freelancing, ditching the traditional workplace and going solo is a big trend in 2022.
- As the world emerges from the COVID-19 pandemic, more people than ever have quit their jobs to become independent contractors.
- But as increased numbers enter the freelance world, there are more regulations and more competitors to contend with…..So will this trend continue?

An Oxymoron: the 1099 Employee

An independent contractor, by definition, is a person or can be another company even, who is hired to perform a job for another person or business. How, where, and when the job gets done is under the sole control of the contractor, not the hiring company. ("Note: A 1099 refers to the form companies issue to independent contractors for tax purposes.)

An employee is a person hired by a company to perform a job function within a business and the hiring company controls how, when, and where the job is performed.

Someone who does work for your company is either an independent contractor or an employee and cannot fall under both categories.

Classifying correctly is vitally important and misclassification has many serious financial consequences.

Labor and employment law generally apply to employees, thus misclassifying an employee as an independent contractor can result in serious fines and penalties under almost every applicable labor and employment law (IRS, Social Security, Unemployment Insurance, Workers' Compensation, IRCA, FLSA (wage and hour), NLRA etc..) With the

government's growing tendency to challenge independent contractor classifications, it is essential for practitioners and employers to ensure compliance with the relevant rules.

- **Penalties and fines:** You may be liable for back taxes and associated penalties for paying late.
- **Back wages and benefits:** You may be required to compensate workers for lost wages or benefits that resulted from the misclassification.
- **Legal issues:** You may be vulnerable to lawsuits from groups or individuals harmed by misclassification.

II. Current Trends in Classification of Independent Contractors and Employees

A. US DOL Issues Proposed Rule for Determining Independent Contractor Status

- Date: October 11, 2022 (proposed rule)
- Law: Federal – FLSA
- What does it propose? More complex "totality-of-the-circumstances" standard instead of economic reality.

"Totality-of-the-Circumstances" Standard – Multifactor (no one factor has more weight)

- Placing less emphasis on the control a worker has in their job places more weight on other factors. As a result, workers previously classified as independent contractors might now fall into an employee designation.
- The new status can give employers more leverage to control employees' working conditions and workload.

1. the "opportunity for profit or loss depending on managerial skill;"
2. "investments by the worker and the employer;"
3. "degree of permanence of the work relationship;"
4. "nature and degree of control," including "whether the employer uses technological means of supervision (such as by means of a device or electronically), reserves the right to supervise or discipline workers, or places demands on workers' time that do not allow them to work for others or work when they choose;"
5. the "extent to which the work performed is an integral part of the employer's business"; and
6. the "skill and initiative" of workers, referring to whether a worker uses specialized skills brought to the job or is "dependent on training from the

employer to perform the work." (However, the proposed rule also states that "additional factors may be relevant" in the analysis).

In its notice of proposed rulemaking, the DOL stated that the new proposed rule would do away with prioritizing certain factors and instead focus on the multifactor economic reality "where no one factor or set of factors is presumed to carry more weight." According to the DOL, such a test will be more helpful in "evaluating modern work arrangements" and align more closely with courts' interpretations of the FLSA.

Businesses that use independent contractors can get ahead by analyzing the relationship between your company and the contractors in light of the six factors in the proposed rule and adapting if necessary. Indeed, workers who may have been independent contractors under the 2021 rule, or even the pre-2021 guidance, may no longer be properly classified. Given that the DOL has indicated this is an area of focus and the fact that a new rule may spur a wave of collective action litigation, considering taking a proactive approach is prudent.

B. NYC Freelance Isn't Free Act

The New York City Freelance Isn't Free Act (FIFA) establishes protections for freelance workers. The FIFA defines a freelance worker as a single person, or an entity composed of no more than one person (whether incorporated or using a trade name), retained as an independent contractor to perform services in exchange for compensation.

Individuals or entities practicing law, sales representatives, and licensed medical professionals are excluded. The FIFA does not define "independent contractor."

The FIFA offers certain protections for freelance workers, including requiring: (1) a written contract if the freelance work is worth at least $800, including multiple small projects over a 120-day period; (2) that payment for services be made timely and in full; and (3) that freelance workers be free from retaliation for exercising their rights under the law.

Notes: New York State recently proposed a Freelance Isn't Free Act. However, in December of 2022, Governor Kathy Hochul vetoed the Act. Under a joint effort by State Senator Andrew Gounardes and Assemblymember Harry Bonson, the Freelance Isn't Free Act has been reintroduced.

Under the new Act, freelance workers would gain a measure of financial security due to provisions like:

- *Mandatory contracts between freelancers and clients for any work worth $250 or more or aggregate work worth $800 over four months*
- *The inclusion of specific payment dates within 30 days of the completion of work in each contract, so that freelancers don't have to struggle so hard to get their invoices paid*
- *Anti-retaliation protections and legal assistance for freelancers, who would be eligible for double damages and attorney fees if the freelancer is successful in pressing a wage theft claim against a client*
- *A fine for clients who refuse to use contracts and bigger fines (up to $25,000) for clients who have a pattern of violations – plus the potential for criminal sanctions.*

C. Classification Under New York Law

1. New York Wage and Hour Law

- New York Common Law Test

This common law test requires the consideration of the following four elements:

1. Whether the principal (employer) retains the power to select and engage the servant
2. The principal's methods of payment for services rendered by the servant
3. Whether the principal has the power to dismiss the servant
4. The extent of the principal's power of direction and control over the servant's activities

Of the four elements, the essential element for purposes of establishing an employment relationship is the right of control.

Notes: New York courts have generally borrowed the common law definitions of master and servant to determine whether a traditional employment relationship exists or whether a particular worker is an independent contractor.

What is Right of Control ?

- Focuses on the principal's control over the means used to achieve the results directed.
- Particular attention given to the principal's right to exercise supervision, direction, or control over the manner and means by which the work is performed. (*No single factor or group of factors is conclusive in classifying the relationship.*
    - The proportion of worker's time that was devoted to performing the principal's work
    - Whether the principal dictates the time, place, and method of performance of the worker
    - Whether the worker held himself/herself out as an independent contractor
    - The method of payment (i.e., salary or flat fee commission)
    - Whether the principal had the power to discharge the worker
    - The nature of the work performed by the worker
    - Whether the principal set the hours of work, required attendance at meetings and/or training programs, or required prior permission for absence from duties
    - Whether the principal provided facilities, equipment, tools, or supplies used by the worker in the performance of his or her work
    - Whether the principal withheld taxes
    - Whether the principal provided fringe benefits, and if so, at whose cost
    - Whether the principal reimbursed the worker's expenses
    - Whether the principal controlled solicitation and billing of customers

- Whether the worker used business cards or other identification indicating that he or she was a representative of the principal
- Whether the principal restricted the worker's performance of services for others

2. New York Workers' Compensation Law

- Right to Control and Relative Nature Tests

When employers seek to avoid liability for a worker's compensation claim by asserting that the injured worker was an independent contractor, the state courts and the Workers' Compensation Board resolve the question of the worker's status by applying two separate tests or a hybrid of the two.

The two tests are:

1. The "right to control test" (discussed above); and

2. The "relative nature of the work test."

Under the **relative nature of the work test**, courts use the following six factors to determine if an independent contractor relationship exists:

1. The character of the claimant's work
2. How much of that work is a separate calling from the employer's or owner's occupation
3. Whether the work is continuous or intermittent
4. Whether the work is permanent
5. The work's importance in relation to the employer's or owner's business
6. Whether the claimant should be expected to carry his or her own accident insurance

Note: As with the right to control test, none of these factors is, in itself, determinative. Gregg v. Randazzo, 628 N.Y.S.2d 434, 435 (App. Div. 1995).

3. New York Unemployment Insurance Law

- When Do Issues Arise Involving Classification under the New York Unemployment Insurance Law?

The issue of a worker's employee status, for purposes of unemployment insurance, arises in two contexts:

1. When a former worker files a claim for unemployment benefits
2. Where the state enforcement agency subjects the employer/principal to an audit

Note: In both scenarios, the Unemployment Compensation Board's determination regarding the worker's status resolves the issue of whether the employer will have to make contributions to the state unemployment compensation system.

- Application of the Traditional Common Law Right to Control Test

As with workers' compensation, employers are required to contribute for unemployment insurance on behalf of employees but need not make contributions for independent contractors. New York's Unemployment Insurance Law follows the "right to control" test

Note: New York's Unemployment Insurance Law follows the "right to control" test. In re Hertz Corp., 778 N.Y.S.2d 743 (2004); In re Ted Is Back Corp., 485 N.Y.S.2d 742 (1984); In re DeRose, 989 N.Y.S.2d 193, 193 (N.Y. App. Div. 2014).

D. IRS – 20 Point Checklist

The IRS has adopted technical guidelines and revenue rulings for employment tax issues that address worker classification. The information that the IRS considers falls into three main categories:

- Facts that illustrate whether there is a right to direct or control how the worker performs the specific task for which he or she is hired (behavioral control)
- Facts that illustrate whether there is a right to direct or control how the business aspects of the worker's activities are conducted (financial control)
- Facts that illustrate how the parties perceive their relationship (relationship of the parties)

https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee

http://corporate.rfmh.org/accounts_payable/forms/IRS_ChecklistforIndependentContractors.pdf

New York tax law requires employers that maintain an office or do business in New York State to deduct and withhold New York State personal income tax from their employees' wages. Federal tax law applies/governs.

Note: The Treasury Regulations interpreting the usual common-law rules referenced in the IRC state that if an employer has the right to control the means by which the worker performs his or her services as well as the ends, the worker is an employee. It is not necessary that the employer actually direct or control the manner in which the services are performed, it being sufficient if he or she has the right to do so.

The Treasury Regulations also provide that if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he or she is an independent contractor. Thus, each case must be determined based on its particular facts and circumstances.

E. Overall Control Test

1. Medical Professionals

Overall control – "do not lend themselves to control over the results produced and means employed."

In re Concourse Ophthalmology Assocs., P.C., 469 N.Y.S.2d 78 (1983).

Court held that a group of ophthalmologists who worked for a professional corporation, but who independently provided eye care services to their patients without supervision, were employees rather than independent contractors, reasoning that medical providers "do not lend themselves to control over the results produced and means employed." In re Concourse Ophthalmology Assocs., P.C., 469 N.Y.S.2d at 79. The factors considered by the court in reaching that conclusion include:

- The patients treated were those of the corporation
- The providers' hours were mostly regularly scheduled rather than occasional or sporadic
- Appointments were made by the corporation's receptionist
- The fees charged were fixed by the corporation, with only occasional reduction made by the provider
- The services were rendered at the corporation's premises and with the use of its equipment and facilities
- Billings and collections were done by corporation, and patient records were kept and insurance and Medicare forms were prepared by the corporation's staff

2. Other Professionals

The overall control test has been applied to workers in other professions or services where the details of the work performed are difficult to control because of considerations such as professional and ethical responsibilities.

In Matter of Empire State Towing & Recovery Ass'n, Inc. v. Comm'r of Labor, 938 N.E.2d 984 (2010), the court applied the test in determining that no employer-employee relationship existed between an attorney and an association representing members in the tow truck operating business as there was no evidence of control exercised by the association over the attorney.

The third department reached a different conclusion in applying the overall control test in Matter of Philip (Brody-Commissioner of Labor), 82 N.Y.S.3d 249 (App. Div. 3rd Dept. 2018). There, an attorney who performed document review services for a law firm was declared an employee because of the sufficient overall control exercised by the law firm on her services. Matter of Philip, 82 N.Y.S.3d at 251. The factors noted by the court include the fact that the attorney was paid an hourly set wage, required to work at least 10 hours

a day (Monday through Friday), required to obtain approval to take time off, required to undergo training, and required to document her hours and meet with her supervisor to review the submitted hours and receive updates on the case. Id.

In Matter of Walsh (Taskrabbit Inc.-Commissioner of Labor), 92 N.Y.S.3d 750 (App. Div. 3rd Dept. 2019), on the other hand, a state appellate court applied the overall control test in finding that a tasker using an online job platform was not controlled by the platform in any aspect of the jobs the tasker performed for clients, and was therefore not an employee of the platform.

The overall control test was also used in a case involving a music management company and certain musicians. There, the court found that no employment relationship existed between the parties based on the company's broad overall control over the musicians' performances. Matter of Columbia Artists Mgmt. LLC (Commissioner of Labor), 972 N.Y.S.2d 343 (App. Div. 3rd Dept. 2013).

3. Models, Artists and Musicians

In classifying models, artists and musicians as employees or independent contractors, the pertinent areas of inquiry are the following:

1. Does the employer control their selection;
2. Does the employer determine their compensation and pay their expenses;
3. Does the employer supply the materials and premises they use;
4. Are they required to follow the direction of the employer; and
5. Does the employer select and deal with the client or customer.

Note: Models, artists and musicians would not seem to be particularly amenable to classification as employees under the traditional control test because their work requires independence and artistic freedom. Models, artists and musicians are considered to render "professional services."

Thus, as in the case of professionals, the control test is applied more loosely. As a result, the fact that the model, artist or musician controls the details of the performance of the work will not preclude a finding that control is exercised by an employer.

Federal Courts have also dealt extensively with these issues in considering the copyright law work for hire doctrine.

III. Recent Cases/Decisions of Interest

NY Cases

- New York courts have readily imposed liability for supposed independent contractor relationships that fail to satisfy the increasingly rigorous classification standards applied by state and federal agencies. Consequently, private employers have found themselves defending long established relationships and practices.
- These claims of misclassification arise either when workers file claims for unemployment insurance benefits, unpaid wages, and workers' compensation

benefits, or when state investigators audit wage payments, workers' compensation coverage, and unemployment insurance fund contributions.

- New York has heightened its scrutiny of independent contractor relationships and has increased its misclassification enforcement efforts.

Note: Classifying whether a worker is an independent contractor or an employee is crucial for businesses. However, although most employers try to do it right, many of them still misunderstand the legal distinctions between the two. This typically results in worker misclassification, making employers at risk of enforcement actions and financial penalties.

(NY) Golf Caddie Independent Contractor Misclassification Lawsuit Filed in New York

A proposed class and collective action filed in a New York federal court against the Hudson National Golf Club for **minimum wage and overtime compensation violations under the FLSA and New York Labor Law.**

The plaintiff, who seeks to represent other caddies at the Hudson National Golf Club, alleges that he worked between 70 to 80 hours per week yet did not receive the overtime compensation to which he claims to be entitled as an employee.

The complaint claims that the Club and its caddie masters maintained formal and functional control over the caddies; had the power to hire and fire caddies; supervised the caddies and threatened them with "punishments" for perceived infractions; controlled the caddies' work schedules; assigned caddies to specific golfers without the caddies' ability to reject the assignments; directed the caddies to provide services other than caddying; punished caddies by assigning them to undesirable golfers; required the caddies to wear uniforms; and controlled the caddies' rates and method of payment.

The complaint also alleged that the caddies used the Club's equipment such as golf carts and rakes; were not required to make large up-front investments to provide their services; did not bear a significant risk of loss; did not have to possess special skills; performed a "discrete line job that was integral" to the Club's business as a golf course; had no independent caddie businesses; and worked exclusively for the Club. *Anderson v. Hudson National Golf Club Inc.*, No. 7:23-cv-00522 (S.D.N.Y. Jan. 20, 2023).

(NY) New York Independent Contractor Cases Affecting the Gig Economy

New York's highest court, the New York Court of Appeals, weighed in on gig workers in Matter of Vega, 2020 N.Y. LEXIS 655 (Mar. 26, 2020). The company tracked couriers' locations on the app for the customers' benefit, but did not require couriers to follow a certain route for delivery. Matter of Vega, 2020 N.Y. LEXIS 655, at *31. The company unilaterally set delivery fees, and handled all customer complaints and payments. Matter of Vega, 2020 N.Y. LEXIS 655, at *7.

In a split decision, the court determined that the **company "has complete control over the means by which it obtains customers, how the customer is connected to the delivery person, and whether and how its couriers are compensated."** Matter of Vega, 2020 N.Y. LEXIS 655, at *10.

(NY) New York Court of Appeals: In re Yoga Vida NYC, Inc.

The high court reached the opposite conclusion in In re Yoga Vida NYC, Inc., 64 N.E.3d 276 (N.Y. 2016). There, a yoga studio employed staff yoga instructors but also contracted with independent instructors for classes.

The court reversed the Appellate Division's decision that the independent instructors were eligible for unemployment compensation. In re Yoga Vida NYC, Inc., 64 N.E.3d at 278. Among the factors it considered in determining that no employment relationship existed were that non-staff instructors made their own schedules, determined whether they would be paid on an hourly or percentage basis, could work for a competing studio, and encourage their students to follow them to competing studios. Id.

Federal

(AGENCY) US Department of Labor Exacts $5.6 Million from Arizona Auto Parts Distributor in Independent Contractor Misclassification Case

The U.S. Department of Labor obtained a judgment ordering an Arizona auto parts distributor and logistics firm to pay $5.6 million in back wages and liquidated damages to hundreds of delivery drivers misclassified as independent contractors and not employees.

Principal Deputy Wage and Hour Administrator Jessica Looman remarked: "Parts Authority, Diligent Delivery Systems and [the owner] misclassified nearly 1,400 delivery drivers as independent contractors, denying them of their rights to minimum wage, overtime pay and other benefits and protections [under the FLSA]. *Secretary of Labor v. Arizona Logistics Inc.*, No. 16-cv-04499 (D. Ariz. Jan. 9, 2023).

IV. HRtelligence TIPS

- Remember 1099 employees are not a thing – make sure the people performing tasks as independent contractors are not performing the same tasks as employees.

- Think about preparing standardized forms, agreements and checklists for independent contractors.

- Identify certain roles/areas in your business that are truly independent in nature
- Avoid having "Job advertisements" – be careful, when advertising for independent contractors, to avoid using phrases such as salary, wages, or steady work when you are recruiting.

- Have an independent contractor agreement that has a scope of work and fee structure outlined.

- When you engage in IC, keep a record of invoices and their business cards or website. (Use contractors who normally advertise their services in some manner).

- When establishing the relationship, avoid setting a regular pattern of daily or weekly hours. A self-employed individual presumably has the opportunity to select when and where they will work in relation to all their customers.

- Allow contractors to supply their own tools, supplies, and equipment wherever possible in the performance of the services required. This will demonstrate that there is a risk of loss as well as an opportunity for profit.

- Allow contractors to hire their own assistants, if necessary. Insist that the contractor pay the payroll taxes normally required for such employees.

- Don't include contractors under the insurance coverage for workers' compensation, health insurance, or other benefits that are provided for employees.

- If possible, compensate independent contractors on a per-job basis rather than by hour or by week.

- Always ask for an invoice or statement before paying for any work that has been performed. If possible, make checks payable to a company rather than to an individual.

- Do not directly reimburse contractors for any expenses they might have, for gasoline, meals, etc. Such expenses should stand as part of the contractor's set fees.

- Put it in writing! It is best, of course, to have a contract in writing with an independent contractor. This can be used on your behalf to demonstrate the

validity of an independent contractor relationship (although it isn't conclusive evidence of one).