Independent Contractors vs. Employees

Whether a worker is covered by a particular law or is entitled to receive a particular benefit often depends on his or her classification as an employee or an independent contractor. In general, employment laws, labor laws and related tax laws do not apply to independent contractors. For this reason, many employers have seen an advantage in hiring independent contractors to avoid the costs of employee benefits, unemployment compensation contributions and workers’ compensation liability.

As a result, misclassifying an employee as an independent contractor has become an increasing issue of concern to governments, courts and regulatory agencies. Employers that misclassify employees as independent contractors expose themselves to expensive fines and litigation if an individual can prove he or she did not receive a benefit or protection he or she was entitled to by law.

Consequently, employers must make a conscientious effort to determine the true nature of their relationship with their workers. Whether they think a worker is an independent contractor is immaterial. The courts and regulatory agencies consistently look beyond the formality of a relationship to determine its true substance and character.

However, classifying an individual as either an employee or an independent contractor is not a simple task. No standard test has emerged to determine the true character of an independent contractor relationship. In fact, employers may have to apply a different test each time they need to determine how issues of employment benefits, workers’ compensation, unemployment compensation, wage and hour laws, taxes or protection under Title VII of the Civil Rights Act, the American with Disabilities Act and the Family and Medical Leave Act affect their working relationship.

In addition, employers should be aware that state and local variations of these tests also apply to any given situation. Nevertheless, the recurring theme in all these tests is control, and in different ways, they all seek to determine the amount of control that an employer exerts over its workers. Factors in these tests look at behavioral control, financial control and the overall relationship between the parties.

The most common tests are the common law test, the economic realities test, the hybrid test and the IRS 20-point test.

**THE COMMON LAW AGENCY TEST**

The common law test is also known as the agency test because it assumes that unless Congress has defined the terms “employee”, “employer” and “scope of employment” these terms are best understood under the context of the laws of agency. Several courts in the United States have favored this test for issues related to the Copyright Act, ERISA and the NLRA.
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The Common Law Agency Test requires an intense consideration of 13 different factors that individually may not determine the character of the relationship between the employer and the worker, but as a whole allow for an understanding of how much control an employer exerts over a particular individual. These 13 factors, also known as the Reid factors, evaluate the following:

1. The duration of the relationship between the parties;
2. How much discretion the worker has over when and how long to work;
3. The worker’s role in hiring and paying assistants;
4. The employer’s right to control the manner and means by which the product is accomplished;
5. The location of the work;
6. The method of payment;
7. The skill level required to complete the job or services;
8. Who provides the tools and equipment to complete the job;
9. How the employer reports payment of the worker’s compensation for tax purposes;
10. Whether the employer is in business;
11. Whether the employer provides employee benefits to the worker;
12. Whether the employer has the right to assign additional projects to the worker; and
13. Whether the work is part of the employer’s regular business.

THE ECONOMIC REALITIES TEST

The economic test also requires a thorough analysis of the relationship between the parties and evaluates the level of financial dependency that the worker has on an employer. Generally, under the economic realities test, the more an individual depends on an employer, the more likely it is that the individual should be categorized as an employee. The courts have favored this test when the term employee is used in a very broad sense, for example in issues related to the FLSA and the FMLA.

The economic realities test outlines several factors an employer may consider to determine the level of financial dependency. As with the common law agency test, one factor standing alone is insufficient to establish dependency, but as a whole enables the employer to evaluate the nature of an employment relationship. These factors evaluate:

1. The degree of the employer’s right to control the manner in which work is performed;
2. The degree of skill required to perform the work;
3. The worker’s investment in the business;
4. The permanence of the working relationship;
5. The worker’s opportunity for profit or loss; and
6. The extent to which the work is an integral part of the business.

THE HYBRID TEST

As the name suggests, the hybrid test combines elements from the common law agency and the economic realities tests. The factors under this test are a combination of the ones described above but consider special details in the relationship between an employer and a worker, such as:

1. The kind of occupation the individual is performing (does it require the supervision of an expert or can it be done by a specialist working alone);
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2. Whether a termination procedure exists for terminating the work relationship and does it resemble the procedure used for terminating employees;
3. Whether the worker accrues time off; and
4. The parties’ intentions.

Though some lower courts have used this test to deal with issues related to Title VII, ADEA and the ADA, the Supreme Court has criticized this approach and is leaning more toward using the common law test for similar issues.

**THE INTERNAL REVENUE SERVICE 20-POINT TEST**

The Internal Revenue Service (IRS) has also developed its own test to determine whether an employment relationship exists between a worker and an employer. The IRS developed this test to determine the tax liability of employers and individuals.

The IRS test is sometimes referred to as the control test and it expands and classifies factors from the common law test into three categories: a sphere of behavioral control, a sphere of financial control and factors that determine the type of relationship that exists between parties. For more information, instructions and commentaries on this test, employers can rely on the IRS publication located on its website.

**CONSTANT RE-EVALUATION**

Employers must evaluate current working relationships on a regular basis. Working relationships are dynamic and the changes that occur over time may impact the nature of the relationship between a worker and an employer. Employers that do not review the nature of their relationships with independent contractors run the risk of expensive fines and litigation procedures.