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The Brave New World of Outsourcing

Independent Contractors v Employees

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Independent Contractors The New World of Outsourcing

- ▶ Expansion of outsourcing opportunities for school boards
 - ▶ Substitute employees
 - ▶ Bus Services
 - ▶ Nurses
 - ▶ Custodial/Support
- ▶ Contracts are critical
- ▶ How you handle the outsourced employees may be more critical

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Independent Contractors

- ▶ Sometimes need to contract with individuals, companies or small groups of individuals to provide services on periodic or sporadic basis.
- ▶ Do this through the use of a contract – we call them independent contractors.
- ▶ Contracts are critical – establish the relationship.

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Independent Contractor

- ▶ Often use a clause like the following:
 - ▶ Contractor agrees to provide all services as an independent contractor and both the Board and Contractor disclaim any and all employment relationship between the parties. As Contractor is not an employee, she is not entitled to the benefits provided by the Board to its employees, including, but not limited to, group health insurance and pension plan. Accordingly, fees, taxes, administrative costs and any other costs incurred by Contractor in the performance of any of the services mentioned herein shall be the sole responsibility of Contractor. For the purposes of this Agreement, Contractor, her employees, officers, agents, assigns or representatives shall not be considered as employees, officers, agents, assigns or representatives of Board.

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Potential Consequences of Ambiguity

- ▶ Attainment of tenure or continuing service status
- ▶ Right to benefits
- ▶ Due process
- ▶ Employment Laws
- ▶ FLSA
- ▶ Taxes
- ▶ Penalties

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Joint Employment

- ▶ Triggers obligations under laws applicable to public agencies (Federal civil rights laws, FMLA, FLSA)
- ▶ Worst of all worlds - both are "employers"
- ▶ Evaluate using "Economic Realities Factors"
 - ▶ Power to Hire and Fire
 - ▶ Control Over Wage or Other Employment benefits
 - ▶ "wage rate is so fundamental to the ultimate question that... (DOL believes) that any entity that sets a wage rate will likely be considered an employer."
 - ▶ Hours and Scheduling
 - ▶ Supervises, Directs or Controls the Work
 - ▶ Performs Payroll or Other Administrative Functions
 - ▶ Other Factors-they reserve the right to look at other factors

The Rules

- ▶ Internal Revenue Service drives the analytical train.
- ▶ If an Independent Contractor from a tax perspective, presumed to be from other perspectives as well.
- ▶ Do not pay FICA taxes or other employment taxes for independent contractors.

Independent Contractor Tests

- ▶ Common Law Test
- ▶ 20 Factor Test
- ▶ New "Relationship of the Parties" Test

Common Law Test

- ▶ Employee if the Board has the right to control the result of the services, the means and the methods of providing it
- ▶ Employee if the person providing the services is "subject to the will and control of the employer not only as to what shall be done but how it shall be done." (Tres.Reg)
- ▶ The factor is whether the Board has the right to control, not whether it actually did.
- ▶ Independent contractor decides the means and methods (how to get the result)-the Board will define the result or outcome expected

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The 20 Factor Test

- ▶ Before 1987, had to look at cases to see how the common law test was applied
- ▶ In 1987, IRS developed the 20 factor test
- ▶ How the factors are applied (the weight and importance of each) is contextual

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What are the factors?

- ▶ Instructions - If employer has right to require compliance with instructions, indicates employee status.
- ▶ Training - Required worker training shows that the work has to be done in a certain manner which indicates employee status.
- ▶ Integration - Integration of the worker's services into the business operations of the person for whom services are performed indicates employee status.
- ▶ Personal Service Required - If services are required personally, this indicates the intent to control the means and methods of the work (implies employee status).

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What are the factors?

- ▶ Hiring, Supervision and Paying Assistants - If employer hires, supervises or pays assistants, implies employee status. If worker hires and supervises others on own, implies independent contractor status.
- ▶ Continuing Relationship - Continuing relationship between worker and employer indicates employee status.
- ▶ Hours of Work - If employer sets hours of work, indicates employee status.

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What are the factors?

- ▶ Alienation (right to work for others) - Exclusive work or requirement that person work substantially full time indicates employee status. If worker is free to work for others when are for whom she chooses, indicates IC.
- ▶ Working on Premises - If work is performed on employers' premises (especially if the work could be done anywhere), indicates employee status.
- ▶ Order or Sequence of Work - If order or sequence is set by employer, this shows worker is not free to set own means and methods and indicates employee status.

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What are the factors?

- ▶ Reporting - Required regular reporting indicates employee status.
- ▶ Method of Payment - Payment by the hour, week or month implies employee status while payment by the job or commission indicates IC.
- ▶ Expenses - Payment of business or travelling expenses by employer implies employee status.
- ▶ Tools and Materials - Provision of tool and materials by employer generally implies employee status.

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What are the factors?

- ▶ Significant Investment - Investment in facilities used by worker (own office or workplace), implies IC.
- ▶ Profit or Loss - A worker who can realize a profit or a loss (who bears the risk) different from the profit or loss ordinarily borne by employee indicates IC.
- ▶ Multiple Clients - If worker performs work for more then one employer at a time, generally indicates IC.
- ▶ Availability - If worker makes service available to the public (other employers) regularly and consistently, indicates IC.

What are the factors?

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- ▶ Right to discharge - The right to discharge or discipline a worker indicates employee relationship.
- ▶ Right to terminate - If the worker has the right to terminate the relationship at any time without incurring liability (employee at will principle), indicates employee status.

Independent Contractor Test

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IRS previously used 20 factor test

- New test in 2006 - focuses on relationship of parties
 1. Behavioral control
 2. Financial control
 3. Type of relationship between the parties

Independent Contractor or Not Behavioral Control

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- ▶ Evaluate the extent to which the "employer" has a right to control and direct performance - whether employer has retained the right to control the details of performance or has given up that right...
 - ▶ Instructions to worker. If can tell when, where and how to work-employee
 - ▶ Examples:
 - ▶ When and where to do the work
 - ▶ Tools and equipment to use
 - ▶ Hiring assistants
 - ▶ Where to purchase supplies
 - ▶ Election of who performs work
 - ▶ Order or sequence to follow
 - ▶ Does business train worker? Employers generally train their workers, ICs use their own methods.

Independent Contractor or Not Financial Control

- ▶ Unreimbursed business expenses
 - ▶ Will look at fixed ongoing costs.
 - ▶ IC will have some unreimbursed expenses.
- ▶ Extent of independent contractor's investment
 - ▶ Significant investment is not determinative though.
- ▶ Free agency - whether services available to others
- ▶ Payment /compensation
- ▶ Who gets profit or bears loss?

Independent Contractor or Not Type of Relationship

- ▶ Written contracts - intent of parties
 - ▶ Not determinative but will be given weight
 - ▶ If don't have a written contract at all, will work against IC status.
 - ▶ Chance to make the case on the front end and define terms.
- ▶ Whether benefits provided
- ▶ Permanency of relationship
 - ▶ Fixed time = IC, Permanent or Open Ended = Employee
- ▶ Services key part of regular business or not?

Applying Tests

- ▶ DOL, IRS will use the factors and the tests that suit purposes - not bound exclusively by them
- ▶ IRS provides some examples in Publication 15-A
- ▶ Remember that no one single factor is determinative - they are subject to a balancing analysis

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Not Just the IRS...

- ▶ US is not just looking for unpaid employment taxes
- ▶ Also looking at failure to pay overtime, minimum wage or other benefits due employees but not independent contractors (such as Family Medical Leave, insurance under ACA, etc.)
- ▶ Misclassification can result in a number of headaches
- ▶ US expects that employers will use more ICs to avoid overtime, ACA and other federal mandates and have stepped up enforcement and audits

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Audits

- ▶ Some audits may come randomly
- ▶ DOL and IRS will collaborate in efforts and will share info
- ▶ So, a misclassification issue may result in overtime and back pay liability as well.

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Audit Red Flags

- ▶ 1099 and W-2 for the same worker from the same business
- ▶ 1099 from only one business or employer
- ▶ Unemployment request from a worker who got a 1099
- ▶ Rehiring worker as IC after retirement (there are revolving door and ethics law complications here as well)

On the Wage and Hour Front If the knock comes...

- ▶ DOL may investigate or audit as well.
- ▶ May come from a complaint, the IRS collaboration or otherwise being informed of a problem.
- ▶ Because of the collaboration and the common overlap between IC classification and overtime, an audit can result in a double whammy.

DISCUSSION
