

management matters

Independent Contractor or Employee

Employer Beware

By Jonathan A. Wexler, Esq.

Designating someone an "independent contractor" does not make him or her one for legal purposes. Nor does simply issuing a 1099 Form, rather than a W-2, in connection with compensation paid. The misclassification of an employee as an independent contractor can result in significant problems, including claims for unemployment benefits prompting liability for unpaid payroll taxes; penalties for failing to pay FICA and withhold taxes; and claims for employer-sponsored benefits under the Employee Retirement Income Security Act (ERISA), for overtime pay under the Fair Labor Standards Act, and for discrimination under federal, state and local law.

Proper workforce classification is essential because incorrectly identifying an employee as an independent contractor can lead to significant problems. In a recent case, the United States Court of Appeals for the Second Circuit (which covers New York, Connecticut and Vermont), clarified the test to be used to

determine independent contractor status.

In *Eisenberg v. Advance Relocation & Storage, Inc.*, two managers of the defendant company asked an acquaintance of theirs whether she would be interested in working at the company. She began in the warehouse, doing manual labor. Two months after she started working, she complained that she was being sexually harassed. Shortly thereafter, she was discharged.

The issue of her employee/independent contractor status arose when the company defended against her complaint under Title VII of the Civil Rights Act and the New York State Human Rights Law by asserting that, as an independent contractor, Eisenberg was not covered by those statutes.

The district court granted summary judgment in favor of the company on this issue and dismissed the complaint.

Eisenberg then appealed to the U.S. Court of Appeals for the Second Circuit.

Relying on a 1989 U.S. Supreme Court decision, the Second Circuit stated

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that 13 factors determine whether an individual is an employee under the common law of agency. They include the following:

- (i) the hiring party's right to control the manner and means by which the product is accomplished;
- (ii) the skill required;
- (iii) the source of the instrumentalities and tools;
- (iv) the location of the work;
- (v) the duration of the relationship between the parties;
- (vi) whether the hiring party has the right to assign additional projects to the hired party;
- (vii) the extent of the hired party's discretion regarding dates and duration of work;
- (viii) the method of payment;
- (ix) the hired party's role in hiring and paying assistants;
- (x) whether work is part of the regular business of the hiring party;
- (xi) whether the hired party is in business;
- (xii) the provision of employee benefits; and
- (xiii) the tax treatment of the hired party.

The Second Circuit made it clear that the first factor — the extent to which the hiring party controls the manner and means by which the worker completes his or her tasks — is the most important and should receive the greatest emphasis in such an analysis. At the same time, the Court of Appeals noted that the employer's treatment of the individual for employee benefit and tax purposes (the twelfth and thirteenth factors) should receive little weight, because of the ease with which these elements can be controlled by the terms of individual employment agreements.

The court's analysis makes clear that the touchstone of independent contractor status is control by the hiring party versus autonomy of the individual. As a result, the employer must carefully and candidly assess its relationship with the worker in accordance with the factors

listed above. Thus, the employer's closely supervising the individual and his or her work, directing how and when the work is done, dictating hours and sequence of work, and having the right to assign additional work suggest an employment relationship rather than independent contractor status. If the individual is in business for himself and performs work for a number of companies, he is more likely also supplying the instrumentalities and tools for the performance of the work in question, and probably has discretion as to the hiring and compensation of assistants.

These factors militate in favor of an independent contractor relationship. Where the work in question is part of the hiring party's regular business, the individual performing it is more likely to be an employee. For example, compare an individual retained by an accounting firm to upgrade the firm's computer system to a staff accountant brought in to help during tax season. Repair to the computer system is not part of the accounting firm's regular business, while the performance of tax work is.

In determining the employee/independent contractor status, there are still more aspects to consider. For instance, a high skill level suggests an independent contractor and work performed at the employer's premises indicates employment while offsite work suggests independence. Relationships of extended duration typify employment while a brief project-oriented relationship is more likely to occur with an independent contractor. And an independent contractor usually receives project-based, rather than hourly, compensation.

Employers who wish to avoid the difficulties attendant to the misclassification of an employee as an independent contractor must not attempt to define the relationship by tax treatment, but should evaluate the economic realities of the relationship in accordance with the factors outlined by the second circuit court. ▀

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