



Independent Contractor Or Employee?

Insights

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A perennial issue for businesses both in and out of the healthcare industry is the classification of individuals as independent contractors or employees. In an effort to save money in a tight economy and limit liability, many businesses attempt to use independent contractors to serve functions typically served by employees. Classifying someone as an independent contractor can save money on federal and state taxes, and it often means the business does not have to pay minimum wage or overtime to the individual.

Additionally, an independent contractor typically cannot claim rights under the various discrimination laws, such as Title VII, the ADA, the Age Discrimination in Employment Act, and others. It is critical, however, that if you are going to make use of independent contractors, you do so legitimately: the consequences of misclassification can be severe. In the healthcare industry, the legitimate use of independent contractors can be more difficult to determine than in other industries because of the many and varied functions in a single healthcare business.

Interested Agencies

Who cares whether a business classifies someone as an independent contractor or an employee? At the federal level, the U.S. Labor Department and the IRS are the primary agencies that care. The DOL regulates and enforces, among other things, the federal minimum wage and overtime laws. Of course, the IRS regulates and enforces the federal tax laws.

At the state level, the interested agencies vary from state to state, but typically include some form of unemployment division, state labor board, and workers' compensation insurance division. The consensus seems to be that, no matter which agency is performing an investigation, their investigators are specially trained to make the experience as enjoyable as a root canal, without the painkiller.

To further complicate matters, each agency has its own test to determine whether someone is truly an independent contractor. The tests of the state agencies are beyond the scope of this article, but they generally track one or more of the tests used by the federal agencies.

The DOL

In the DOL's 2011 budget it dedicated approximately \$25 million to its initiative of investigating and correcting what it perceives as a problem of "employee misclassification," which means individuals classified as independent contractors who should have been classified as employees. In its 2012 budget, the DOL has nearly doubled the amount of money dedicated to this initiative, earmarking \$46 million for it.

The DOL, in determining whether someone is an independent contractor or an employee for purposes of minimum wage and overtime, uses what is known as the "Economic Realities Test." The courts have distilled this test into the following factors:

- the degree to which the person's work is controlled by the organization;
- the individual's investment in facilities and equipment, if any;
- the individual's opportunities for profit or loss, if any;
- the amount of any initiative, judgment, or foresight the person uses in open-market competition;
- the permanency of the relationship; and
- whether and to what extent the individual's work is an integral part of the organization's business or activities.

No one factor is determinative, but the DOL typically finds an employment relationship, rather than a true independent contractor relationship.

The IRS

In September 2011, the IRS and the DOL entered into a Memorandum of Understanding, which states as its purpose, "The sharing of information and collaboration between the parties will help reduce the incidence of misclassification of employees as independent contractors, help reduce the tax gap, and improve compliance with federal labor laws." Businesses should be conscious that an investigation by one of these agencies will almost certainly result in an inquiry by the other.

Until recently, the IRS used a 20-factor test to determine whether someone is an independent contractor or employee. The test has been streamlined a bit into 11 factors that are grouped into specific categories:

Behavioral Control

1. Instructions that the business gives the worker
2. Training that the business gives the worker

Financial Control

3. The extent to which the worker has unreimbursed business expenses
4. The extent of the worker's investment

5. The extent to which the worker makes his or her services available to the relevant market
6. How the business pays the worker
7. The extent to which the worker can realize a profit or loss

Type of Relationship

8. Written contracts describing the relationship the parties intend to create
9. Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay
10. The permanency of the relationship
11. The extent to which services performed by the worker are a key aspect of the regular business of the company

Several of the factors the IRS uses overlap with the DOL's test, but it's important to understand that the IRS and DOL come at the problem from different perspectives. The DOL is attempting to ensure that individuals misclassified as independent contractors are paid what they are entitled to under the federal minimum wage and overtime laws. The IRS, on the other hand, is concerned with whether a business is paying its "fair share" of taxes, such as FICA (social security), FUTA (federal unemployment), and Medicare. Not surprisingly, the IRS typically finds an employment relationship.

Unlike the DOL, however, the IRS provides businesses some assistance in a misclassification situation. The IRS utilizes a Voluntary Classification Settlement Program, which can reduce a business's liability in the event of misclassification.

A Thumbnail Approach

Most situations are unique, and it is difficult to say that a particular position, in all circumstances, is appropriately classified as an independent contractor or an employee. In a hospital setting, for example, courts have held physicians to be appropriately classified as independent contractors in some cases and hospital employees in others. The same is true of nurses. It can be overwhelming for businesses to go through each person who does work for the business and apply each of the various tests from the multiple agencies. To expedite the process a bit, a business could ask the following questions:

- is the individual economically dependent on your business for his or her livelihood?
- is the service being provided integral to your business?

If either is true, you likely have an employee and not an independent contractor. Of course, this thumbnail approach is no substitute for a thorough analysis, but it can assist in making a rapid decision when there is insufficient time to go through each test in detail. It is also important not to forget about the interested agencies in your state, which will have their own tests and, in some circumstances, may have specific obligations for businesses even when someone is appropriately classified as an independent contractor.

For more information, contact the author at agolden@laborlawyers.com or (702) 252-3131.