

# **INDEPENDENT CONTRACTORS, INTERNS, TEMPORARY WORKERS, AND LEASED EMPLOYEES**

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# INDEPENDENT CONTRACTORS

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# INDEPENDENT CONTRACTOR

- For a variety of reasons, including convenience or to save money, businesses engage someone to provide a good or a service as an Independent Contractor (IC)
- This is likely to happen especially when both sides anticipate a short engagement. The independent contractor relationship is advantageous:
  - Independent contractors are by definition not employees. Having an independent contractor instead of an employee relieves the business of the need to withhold or match federal and state taxes, unemployment benefits, Social Security and Medicare.

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# INDEPENDENT CONTRACTOR

- The business can avoid including the independent contractor in any employee benefit plans and can hire and fire the independent contractor at will without worrying about any potential discrimination claims or employment lawsuits. State and federal anti-discrimination laws don't prohibit illegal actions against workers who are not employees.
- Businesses are not liable for overtime pay since the independent contractor is not an employee under the Fair Labor Standards Act or related state laws
- The independent contractor is not covered for work-related injuries so there is no need to provide workers' compensation insurance
- A group of independent contractors may not organize or try to certify a bargaining representative since the National Labor Relations Act only applies to employees

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# INDEPENDENT CONTRACTOR

- Independent contractors are a pretty good deal for business owners who get the benefit of the independent contractor's knowledge and skill without having to worry about complying with employment laws
- But having the status of an independent contractor is not a bad deal for the independent contractors either
  - He or she retains the ability to take his or her services anywhere and charge as much as the market will bear
  - The independent contractor also has the right to turn down business, take time off whenever circumstances permit, and to control work on his or her own terms
  - Many people, given the option, choose to remain as independent contractors for these reasons among others

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## IF BUSINESS AND INDEPENDENT CONTRACTOR AGREE ON THE RELATIONSHIP, WHY IS IT AN ISSUE?

- Government is watching!!
- When a business uses independent contractors there is a commensurate loss of revenue to a host of government bodies, state and federal or in some instances local. These agencies that depend on a steady source of withholding from employees' salaries to fund programs and enforce laws are stretched thin and are instituting compliance programs to recover lost revenue due to misclassification.
- The Internal Revenue Service launched its National Research Program, which will randomly select and audit 6,000 employers. The IRS is looking at employers' compliance regarding worker classifications and various other "grey" areas.

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## IF BUSINESS AND IC AGREE ON THE RELATIONSHIP, WHY IS IT AN ISSUE?

- The United States Department of Labor (DOL) says it intends to continue its focus on employee misclassification as part of enforcement and outreach efforts under the federal Fair Labor Standards Act (FLSA). To that end, DOL has stepped up its FLSA enforcement efforts considerably, having hired approximately 250 new investigators.
- In this era of continued unemployment, the Illinois Department of Employment Security (IDES) is reacting harshly to employers who protest unemployment claims on the grounds that terminated workers were "independent contractors." These protests are being rejected, and employers are being subjected to seemingly random audits to assess whether employees have been misclassified as independent contractors.

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# TAX AND WAGE IMPLICATIONS

- Worker classifications may have tax and/or wage implications
- For employees, a business generally must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages
- On the other hand, a business generally does not need to withhold or pay any taxes on payments to independent contractors
- Likewise, employees generally must be paid at least minimum wage, and non-exempt employees must be paid overtime compensation. Minimum wage and overtime requirements, however, do not apply to independent contractors.
- Before determining how to treat payments you make to workers for their services, you must first know the business relationship that exists between you and the individual performing the services



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# HOW DOES A BUSINESS DECIDE WHO IS AN EMPLOYEE OR AN IC?

- There is no single answer to this question. There are no “magic words” or documents to sign that will ensure that someone you classify as an independent contractor will be found to be one by the investigating agency or in a civil court.
- A government body investigating whether your independent contractors should be classified as employees will look at the “totality of circumstances” and will impose various tests in making its decision
- Courts take the lead from how various government agencies determine proper classification. What applies in a government investigation will help you in a civil case as well.

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## IRS VIEW

- The IRS has the power to impose penalties, fines and bring criminal charges and also require full payment for failure to withhold taxes even if the independent contractor has already paid his or her share
- Should the IRS determine that your contractors are employees, the business can be liable for unpaid taxes, penalties and interest for three years even if the independent contractor paid his or her own taxes in full
- In determining whether a worker is an employee or an independent contractor, the IRS has developed a “twenty factor” test that takes into account all information that provides evidence of the degree of control or independence
- There is no magic number of factors that tips the scales regarding whether a worker is an employee or an independent contractor, and no one factor is determinative
- The key is to look at the relationship as a whole and consider the degree to which you have the right to direct and control the worker

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# IRS VIEW

- The facts that provide evidence of control fall into three categories:
  - **Behavioral Control:** Does the business control or have the right to control not only what the worker does, but also how the worker does his or her job?
    - Does the employer require the worker to arrive at a certain time and sign in using the company time management system?
    - Does the company require the worker to wear clothing identifying himself/herself as affiliated with the company?
    - Does the company impose any restrictions on outside work?
      - Example: For years, FedEx employed delivery personnel who wore company uniforms, drove FedEx trucks and looked to the public like employees of the company. Despite these indicia of employment, FedEx classified these workers as independent contractors. Ultimately, the Department of Labor overturned this status and FedEx was stuck with back pay and benefits going back two years.

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## IRS VIEW

- **Financial Control:** Are the business aspects of the worker's job controlled by the company?
  - Is the worker paid by the hour or on a “per job” basis?
  - Does the company reimburse the worker for expenses related to the job?
  - Does the worker provide his own tools or does the company require use of its own?
  
- **Type of Relationship:** Is the worker separately incorporated, insured and holding himself out to the public as a business entity?
  - Evidence can include business cards, yellow pages listings and computer web pages
  - Does the company include the worker under any of its employee benefits? If so, this is almost conclusive evidence of an employment relationship.

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## DOL VIEW

- Since 2011, the US Department of Labor has established the “Misclassification Initiative” to address the issue of improper use of independent contractors and has entered into “Memoranda of Understanding” with related agencies, both state and federal, in order to share enforcement efforts
- A business audited over its use of independent contractors by DOL may find the results of that investigation forwarded to the IRS or the state unemployment office which will then seek their own remedies against the company
- In addition to government enforcement, employees may bring civil claims for unpaid overtime, minimum wage and employee benefits

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## DOL VIEW

- To determine whether an individual is an employee, DOL looks to the “Totality of the Circumstances” of the parties’ business relationship as a whole
- The government will ignore any written agreements between both business and independent contractor that describe the relationship
- Titles, job descriptions and organization charts are meaningless
- A written contract in which the independent contractor explicitly waives the right to be treated as an employee and to give up any claim for employee benefits is worthless if the economic circumstances don’t demonstrate independent contractor status
- An investigating body will generally look to how the employer “controls” the day to day activities of the independent contractor or whether the nature of the service the independent contractor provides is similar to that of the employer

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# DOL VIEW

- The focus is on the following six factors:
  - **The extent to which the worker's services are an integral part of the employer's business**
  - **The permanency of the relationship**
  - **The amount of the worker's investment in facilities and equipment**
    - Don't provide equipment, email address, business cards, uniform, etc.
  - **The nature and degree of control by the business**
    - Cannot control schedules or manage work IC's perform
    - Cannot give training or instruction
    - Cannot prohibit IC from working with other companies
    - Don't charge an hourly rate – have fee schedule
    - Don't track hours worked
  - **The worker's opportunities for profit and loss**
  - **The level of skill required in performing the job and the amount of initiative, judgment or foresight in open-market competition with others required for the success of the worker**

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## IDES VIEW

- Under the Illinois Unemployment Insurance Act, an individual who performs work for a business is generally presumed to be an employee. The Act, however, carves out an exemption for services performed by independent contractors. In order to meet the exemption, the worker must satisfy all three prongs of the so-called “ABC Test”:
  - The worker must be free from control or direction over the performance of the services
  - The services must be either outside the company's usual course of business or performed outside its place of business
  - The worker must be engaged in an independently established trade, occupation, profession or business



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## IDES VIEW

- A strict burden of proof is placed upon any business seeking exemption from unemployment contributions under the Act, and all three conditions must be established before an exemption is allowed
- When interpreting the term “independent contractor” under the Act, the actual relationship of the parties must be considered. Designations and terminology used in any agreements are not controlling, nor are the mechanics of compensation.
- The third prong of the ABC Test is the most difficult to satisfy
- “Engaged in an independently established trade, occupation or business” is interpreted by IDES to mean that the individual has a proprietary interest in the business that he or she can sell, give away or operate without hindrance from any other party. In other words, the individual truly must be operating his or her own business.

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## NLRB VIEW

- NLRB tests is qualitative vs. quantitative
- The Board does not merely count up the common-law factors that favor independent contractor status to see if they outnumber the factors that favor employee status, but instead it must make a qualitative evaluation of those factors based on the particular factual circumstances of each case. Factors are the following:
  - The extent of control, which by agreement, the master may exercise over the details of the work
  - Whether or not the one employed is engaged in a distinct occupation or business
  - The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision
  - The skill required in the particular occupation

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## NLRB VIEW

- Factors (cont.):
  - Whether the employer or the workman supplies the instrumentalities, tools and the place of work for the person doing the work
  - The length of time for which the person is employed
  - The method of payment, whether by the time or by the job
  - Whether or not the work is part of the regular business of the employer
  - Whether or not the parties believe they are creating the relation of master and servant
  - Whether the principal is or is not in business

# UNPAID STUDENT INTERNS

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# UNPAID STUDENT INTERNS

- What about unpaid student interns? Can they be considered employees?
- January 5, 2018, the DOL adopted a new 7 factor “primary beneficiary test” for determining whether interns are employees
- The DOL abandoned its prior rigid 6-part test where all six parts had to met for someone to be considered an unpaid intern and not an employee
- New test does not require each of its 7 factors to be met, just a consideration of each of the factors
- Any determination over whether an intern qualifies as an employee under the FLSA depends on the unique circumstances of each case
- If analysis of those circumstances reveals that an intern is actually an employee, then he or she is entitled to both minimum wage and overtime pay under the FLSA, and has the protections of federal and state discrimination/harassment/retaliation laws

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# UNPAID STUDENT INTERNS

- The extent to which the intern and the employer clearly understand that there is no expectation of compensation. Any promise of compensation, express or implied, suggests that the intern is an employee—and vice versa.
  - It is critical for your business to have a signed, written understanding with the university and the student intern that explains the purpose of the internship, the duties involved, and that it is unpaid
  - It should also have a specific representation from the university and the intern that the internship is integral to the student's field of study
- The extent to which the internship provides training that would be similar to that which would be given in an educational environment, including the clinical and other hands-on training provided by educational institutions
- The extent to which the internship is tied to the intern's formal education program by integrated coursework or the receipt of academic credit
  - Many businesses now require interns to receive college credit (and sometimes pay tuition for the internship) to further their argument that the intern is not an employee

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## UNPAID STUDENT INTERNS

- The extent to which the internship accommodates the intern's academic commitments by corresponding to the academic calendar
- The extent to which the internship's duration is limited to the period in which the internship provides the intern with beneficial learning
- The extent to which the intern's work complements, rather than displaces, the work of paid employees while providing significant educational benefits to the intern
- The extent to which the intern and the employer understand that the internship is conducted without entitlement to a paid job at the conclusion of the internship

# TEMPORARY/LEASED EMPLOYEES

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# TEMPORARY/LEASED EMPLOYEES

- What is a temporary or leased employee?
  - A worker who seeks employment through a temporary agency is the most common type of leased employee
  - A temporary agency is a company that contracts with businesses to provide workers on a contingent basis. These temporary agencies handle all payroll, tax, and other human resources functions for the workers.
  - Other leased employees (other than workers from temporary agencies) are employed by employee leasing firms (also called "professional employer organizations") that supply companies with an entire work force of employees for extended amounts of time, rather than on day-to-day basis. The leasing firm takes over all payroll, tax, and other human resources functions for the workers.

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# TEMPORARY/LEASED EMPLOYEES

- Why do employers use temporary or leased employees?
  - Employers hire contingent workers for a number of legitimate reasons:
    - to accommodate workload fluctuations, fill temporary absences, meet employees' requests for part-time hours, screen workers for permanent positions, and save on wage and benefit costs, among other reasons
  - However, some employers may use contingent workers for less praiseworthy reasons, such as to avoid paying benefits, reduce their workers' compensation costs, and prevent workers' attempts to unionize, or allow them to lay off workers more easily
  - When a workplace uses contingent workers, it shifts costs traditionally borne by employers. From the employer's viewpoint, treating workers as non-employees immediately saves payroll costs ranging from 15 to 30%.

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# TEMPORARY/LEASED EMPLOYEES

- Are temporary or leased employees covered by employment laws?
  - Temporary workers and other leased employees are covered by the same employment laws as regular workers
  - However, because of the short-term, often project-oriented nature of their work, temporary workers are sometimes misclassified as independent contractors and, as a result, denied their rights as employees
- Who is considered the employer of a temporary or leased worker?
  - Workers who work for companies or businesses through a temporary agency or other employee-leasing firm could be considered to be employees of both the temporary agency/leasing firm and the business
  - The application of “joint-employer test” normally depends on whether the employer using the leased employees is considered to be a “joint employer” with the leasing agency

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# TEMPORARY/LEASED EMPLOYEES

- On April 1, 2019, the DOL proposed a new, clear-cut test for determining “joint employment” under the FLSA
- According to the DOL, the proposed changes are designed to promote certainty for employers and employees, reduce litigation, promote greater uniformity among court decisions, and encourage innovation in the economy
- Current Joint Employer Rule: The existence of a joint employment relationship depends on whether two entities are acting “entirely independently of each other” and are “completely disassociated” with respect to the “employment of a particular employee”
- When an employee either (a) performs work that simultaneously benefits two or more employers or (b) works for two or more employers at different times during the workweek, a joint employment relationship “generally” exists if:
  - The employers have an arrangement to share the employee’s services
  - One employer is acting directly or indirectly in the interest of the other employer
  - The employers directly or indirectly “share control of the employee,” because one employer controls, is controlled by, or is under common control with the other employer

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# TEMPORARY/LEASED EMPLOYEES

- The DOL proposed four-part test considers whether the potential joint employer actually exercises the power to:
  - Hire or fire the employee
  - Supervise and control the employee's work schedules or conditions of employment
  - Determine the employee's rate and method of payment
  - Maintain the employee's employment records
- This four-part balancing test would replace antiquated FLSA guidance that had vaguely suggested that two entities may be joint employers if they are “not completely disassociated from each other”

# BEST PRACTICES

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# WHAT ARE THE RED FLAGS I SHOULD BE WORRIED ABOUT?

- Does your company have a large group of independent contractors regularly on the premises?
- Are their daily activities subject to supervision by the company?
- Do they record their time using a company system?
- Does the company provide tools, transportation, uniforms, or business cards?
- Do the independent contractors perform the same duties as regular employees?
- Do you reimburse the independent contractors for their expenses?
- If you answered yes to any of these questions, you should seriously consider reclassifying these people as employees

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## WHAT CAN YOU DO TO PROTECT YOUR BUSINESS?

- It is critically important that an employer has a valid basis for classifying a worker as an independent contractor. The following steps, while by no means a guarantee, should help the independent contractor classification withstand government scrutiny:
  - Do a thorough review of the individuals classified as contractors with an honest, critical assessment of the nature of their relationship with your business, the service they provide and all the other factors listed above to determine whether they are employees or contractors
  - Calculate the cost involved with reclassification. Look at the potential liability for unpaid overtime, Social Security contributions and payments to state unemployment accounts.



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## WHAT CAN YOU DO TO PROTECT YOUR BUSINESS?

- If you conclude that some or all must be reclassified as employees, do not hesitate. Don't wait for a government agency to order your business to make the switch. You will be in a much better position if you have taken steps on your own to rectify any potential errors.
- Making someone an employee is easy. Just tell your contractors that effective on a certain date or immediately, they will be treated as employees.
- The new employees will need to complete Forms I-9 and W-4. Treat them as new hires for issues like drug screening, background checks and benefit enrollments.
- Keep in mind that reclassification of a worker mid-year (so that the individual receives both a Form W2 and a Form 1099 in the same tax year) may be a red flag to the IRS

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# WHAT CAN YOU DO TO PROTECT YOUR BUSINESS?

- Draft a written agreement that references the worker's independent contractor status to establish the intent of the parties and lists pertinent factors describing the nature of the relationship
- Require the worker to form an entity so that you are contracting with another business, rather than an individual (i.e., "John Smith Painting, LLC" vs. "John Smith")
- Establish policies that require individuals who are deemed "independent contractors" to be treated differently than employees
- Prepare documentation of all factors considered in classifying a worker as an independent contractor and require the individual to provide documentation to establish that status. Examples include insurance certificates, a business license, property and equipment leases, a business card, a website, promotional brochures or other advertising materials, listings in trade publications, contracts with other businesses and an IDES account number.

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## WHAT CAN YOU DO TO PROTECT YOUR BUSINESS?

- When challenging unemployment benefits on the grounds that a terminated worker was an independent contractor, be aware that such protests may lead to an audit
- For any worker whom you are considering characterizing as an independent contractor, analyze the factors considered by the IRS, DOL and IDES. If there are not enough indications that the worker is an independent contractor, consider whether the classification is proper.
- Ensure that your actual practices conform to the factors considered by the IRS, DOL and IDES.

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# EXAMPLES OF INDEPENDENT CONTRACTORS AND EMPLOYEES

- A worker who is hired to paint the exterior of a software business office will assuredly be an independent contractor, absent other factors. He provides a service and is engaged in an activity which is different from the core business of the company.
- A worker who writes software code for this same business as a temporary for a week will likely still be considered an independent contractor if the engagement ends after a week. This is particularly true if the person was referred by a temporary staffing agency and was paid as an employee of that agency or the worker has an independent business which is separately insured and incorporated.
- Another code writer who has worked at this software company as a “temporary” for two years, arriving at a scheduled time to receive his assignments will be classified as an employee. The worker’s skill, knowledge and experience are used by the company to further its business purpose and the company controls the person’s activities on a daily basis. This is what happened in *Vizcaino v. Microsoft* and cost MS close to a billion dollars in unpaid salary, withholding and benefits.

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# QUESTIONS?



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# THANK YOU

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