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ALERT

Revisiting Employee vs. Independent Contractor Status in the Digital Age

By Bennett Pine

Last week, a *Wall Street Journal* article spotlighted research showing that in many industries, software and other forms of technology have increasingly taken over workplace functions traditionally performed by managers. Specifically, software programs performing “demand or predictive scheduling” often exert a “level of control and surveillance ... far greater than human managers would” (“At Uber, the Algorithm Is More Controlling than the Real Boss,” November 4, 2015).

In June 2014, the California Labor Commission issued a highly controversial decision classifying Uber drivers as employees rather than independent contractors. Testing that ruling, a closely watched and related class action in which Uber drivers claim the electronic ride-sharing and hailing company misclassified them as independent contractors, rather than employees, is scheduled to go before a federal court jury in June 2016.

The employee vs. independent contractor determination is especially significant (and costly) to employers because it affects whether individual workers are entitled to receive such things as minimum wage, overtime compensation, unemployment insurance benefits, family and medical leave, OSHA and related safety protections, Social Security and Medicare benefits and other employee benefits.

The Uber “employee” issue, in particular, highlights, the federal government’s ongoing struggle to fit the “square peg” of the 2015 economy, dominated by the service sector and high-tech jobs, into the “round hole” of federal laws such as the National Labor Relations and the Fair Labor Standards acts — enacted to address issues confronting a 1930’s and ’40’s factory and manufacturing-based economy.

The U.S. Department of Labor Makes its Intentions Clear

In July 2015, the U.S. Department of Labor’s Wage and Hour Division declared that “the misclassification of employees as independent contractors presents one of the most serious problems facing affected workers, employers and the entire economy.” The Labor Department stated that many employers intentionally misclassify workers as independent contrac-

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tors as a means to cut costs and compliance with labor laws, and that such misclassification “results in lower tax revenues for government and an uneven playing field for employers who properly classify their workers.” The Labor Department strongly signaled its intention to heighten enforcement efforts against offending employers who wrongly classify individuals as independent contractors.

The Labor Department made quite clear that “most workers are employees under the ... very broad definition of employment under the FLSA as ‘to suffer or permit to work’,” as well as the “intended expansive coverage for workers ... when applying the economic realities factors.”

Streamlined Test for Employee Status

In view of this climate of heightened enforcement by the Labor Department, employers are well advised to re-examine the IRS-issued abbreviated test, which looks primarily to three factors to better determine employee classifications in the 21st century economy: behavioral control, financial control, and the relationship of the parties.

1. Control Over Behavior: Does the employer control or have the right to control how and when the worker does his or her job?

A worker is an employee when the business has the right to direct and control the worker and the means and methods of performing the work. The business does not have to actually direct or control the way the work is done — as long as the employer has the right to do so.

- **Instructions:** If the individual receives extensive instructions on how work is to be done this suggests employee status. Instructions can cover a wide range of topics, such as
 - how, when or where to do the work;
 - what tools or equipment to use;
 - what assistants to hire to help with the work; and
 - where to purchase supplies and services.
- **Training:** If the business provides extensive training about required procedures and methods, this indicates that the business wants the work done in a certain way, and generally is consistent with employee status.

2. Financial Control: These factors show whether there is a right to direct or control the business part of the work. Consider:

- **Significant Investment:** If the individual has significant investment in the work performed, she may well be an independent contractor. While there is no precise dollar test, the investment must have substance. However, a significant investment is not necessary to be a contractor.



- **Expenses:** If the individual is not reimbursed for some or all business expenses, then he may be an independent contractor, especially if the unreimbursed business expenses are high.
- **Opportunity for Profit or Loss:** If an individual can realize a profit or incur a loss, this suggests that she is in business for herself and that she may be an independent contractor.

3. Relationship of the Parties: These facts illustrate how the business and the worker view their relationship. For example:

- **Employee Benefits:** If benefits, such as insurance, pension or paid leave are received, this is an indication that the individual may be an employee. If the individual does not receive benefits, however, he could be either an employee or an independent contractor.
- **Written Contracts:** A written contract may show what both the individual and the business intend and understand. However, both the Labor Department and the IRS make expressly clear that it is the actual duties performed and the true relationship of the parties that will determine whether an employer-employee relationship exists and not what a self-serving agreement may provide.

Conclusion

The Labor Department has sent strong signals that it intends to intensify its enforcement efforts against employers who wrongfully misclassify individuals as independent contractors in order to avoid tax and employee benefit payments in an effort to reduce costs. In their view, the “default” is that most workers are employees, and not independent contractors.

At the same time, new business models and ways of performing work, such as those represented by Uber, test the limits of the application of traditional labor and employment laws to new workplaces. Because employers face significant liabilities (e.g., tax withholding, social security, unemployment and workers compensation taxes, employee benefits, and other costs), they are well-advised to carefully consider whether individuals, especially those performing nontraditional workplace functions, are properly classified under the tests established by the Labor Department and the IRS. ▲

