



*This article presents general guidelines for Georgia nonprofit organizations and should not be construed as legal advice. Always consult an attorney to address your particular situation.*

## CLASSIFYING WORKERS AS EMPLOYEES OR INDEPENDENT CONTRACTORS

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### Overview

In this tough economic climate, many employers are trying to cut costs. For most employers, the biggest bottom line expenses are related to their work force: wages, benefits, insurance, and payroll costs. Some employers are trying to lower labor costs by classifying workers as “independent contractors” rather than employees. Studies have shown that employers can save as much as 30 percent of payroll and related taxes by classifying workers as independent contractors. That is so because employers are not required to withhold federal or state income taxes or F.I.C.A. contributions from the pay of independent contractors. Properly classified independent contractors are not considered “employees” and, accordingly, are not qualified to participate in employee benefit plans and are not covered by workers’ compensation insurance or unemployment or disability insurance programs.

However, the consequences of misclassifying employees as independent contractors can be extremely costly to employers. Employers who are found to have misclassified workers may be on the hook for back taxes, interest, back contributions to F.I.C.A. (social security), contributions for unemployment insurance, lost benefits, fines, and other penalties. Moreover, enforcement efforts are ramping up: the United States Department of Labor has included \$25 million in its fiscal year 2011 budget to address independent contractor misclassification, including \$12 million to hire 90 new investigators and increase enforcement. State governments are also placing a renewed focus on enforcement.

### How to Classify Workers

Unfortunately, determining whether a worker is an employee or independent contractor isn’t always simple. Even if an employer and worker agree that he or she is an independent contractor, verbally or by written contract, that agreement is not determinative. Classification must be done on a job-by-job and case-by-case basis, and there is no one test or formula used. Ultimately, the most important factor in classifying a worker as an employee or independent contractor is the amount of control the employer exercises over a worker. More specifically, the general rule that an individual is an independent contractor if the employer has the right to control or direct only the **result** of the work and not the **means and method** of accomplishing that result.

The Internal Revenue Service (“IRS”) uses a 20-factor test to determine whether a worker is an employee or independent contractor. Those factors, which provide a guideline for a more detailed analysis of worker status, are as follows:

- **Level of instruction.** If the organization directs when, where, and how work is done, this control indicates a possible employment relationship.

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- **Amount of training.** Requesting workers to undergo employer-provided training suggests an employment relationship because the organization is directing the methods by which work is accomplished.
- **Degree of business integration.** Workers whose services are integrated into their organization's operations or significantly affect business success are likely to be considered employees.
- **Extent of personal services.** Organizations that insist on a particular person performing the work assert a degree of control that suggests an employment relationship. In contrast, independent contractors typically are free to assign work to anyone.
- **Control of assistants.** If the organization hires, supervises, and pays a worker's assistants, this control indicates a possible employment relationship. If the worker retains control over hiring, supervising, and paying helpers, this arrangement suggests an independent contractor relationship.
- **Continuity of relationship.** A long-term relationship between an organization and a worker indicates a possible employment relationship. However, an independent contractor arrangement can involve an ongoing relationship for multiple, sequential projects.
- **Flexibility of schedule.** People whose work hours or days of work are dictated by the organization are apt to be found to be employees.
- **Demands for full-time work.** Full-time work gives the organization control over most of a person's time, which supports a finding of an employment relationship.
- **Need for on-site services.** Requiring someone to work on the organization's premises—particularly if the work can be performed elsewhere—indicates a possible employment relationship.
- **Sequence of work.** If the organization requires work to be performed in specific order or sequence, this control suggests an employment relationship.
- **Requirements for reports.** If a worker regularly must provide written or oral reports on the status of a project, this arrangement indicates a possible employment relationship.
- **Method of payment.** Hourly, weekly, or monthly pay schedules are characteristic of employment relationships, unless the payments simply are a convenient way of distributing a lump-sum fee. Payment on commission, a flat fee basis, or upon project completion is more characteristic of independent contractor relationships.
- **Payment of business or travel expenses.** Independent contractors typically bear the cost of travel or business expenses, and most contractors set their fees high enough to cover these costs. Direct reimbursement of travel and other costs by an organization suggests an employment relationship.
- **Provision of tools and materials.** Workers who perform most of their work using employer-provided equipment, tools, and materials are more likely to be considered employees. Work largely done using independently obtained supplies or tools supports an independent contractor finding.
- **Investment in facilities.** Independent contractors typically invest in and maintain their own work facilities. In contrast, most employees rely on their employer to provide work facilities.
- **Realization of profit or loss.** Workers who receive predetermined earnings and have little chance to realize significant profit or loss through their work generally are employees.
- **Work for multiple companies.** People who simultaneously provide services for several unrelated companies or organizations are likely to qualify as independent contractors.

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- **Availability to public.** If a worker regularly makes services available to the general public, this supports an independent contractor determination.
- **Control over discharge.** An organization's unilateral right to discharge a worker suggests an employment relationship. In contrast, an organization's ability to terminate independent contractor relationships generally depends on contract terms.
- **Right of termination.** Most employees unilaterally can terminate their work for an organization without liability. Independent contractors can generally terminate a relationship only as provided in their contract.

It is important to remember that no one factor in the IRS test is determinative; the IRS looks at the totality of the circumstances and weighs all of these factors. Where more factors weigh in favor of the employer having significant control over the worker, the worker is more likely to be found to be an employee.

### **Tips for Avoiding Liability**

If your organization does retain independent contractors, the following tips may be useful:

- Carefully draft written agreements outlining the independent contractor's responsibilities, confirming the worker's status as an independent contractor, and defining the terms of the relationship.
- Pay independent contractors by the project rather than by the hour, month or year.
- Insist that independent contractors provide their own equipment and supplies and pay their own expenses.
- Use independent contractors for special projects rather than regular work, and avoid using independent contractors to perform work that is similar to that performed by regular employees.
- Develop project or contract specifications and monitor the general progress of the independent contractor, but allow independent contractors to set their own hours and schedules and avoid supervising the details of their work.
- Do not provide employee-type benefits to independent contractors.

Now more than ever, employers must be careful to ensure that they have correctly classified their workers. The consequences of misclassification are costly and, in these difficult financial times, could prove to be devastating to nonprofit organizations on tight budgets. This is the time to carefully examine your worker classifications to prevent penalties, lawsuits, and other unforeseen costs. If you are unsure how a worker should be classified, consider seeking legal assistance.

8/12/2010

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