PBPA Podcast Transcript
Worker Classification:
W2 Employee, 1099 Contractor or Legal Liability?
(21:25 minutes)

[00:00:00] **Sireesha:** Classifying a worker as an independent contractor instead of an employee might seem like a simple administrative choice, but getting it wrong can expose a nonprofit to back taxes, penalties, and legal liability. In this episode of the PBPA Podcast, Sarah Stephens will unpack how the IRS and Department of Labor actually evaluate worker classification, the factors nonprofits often overlook, and the steps organizations can take to protect themselves. Whether you're bringing on a consultant, a contract therapist, or summer help, this conversation will help you understand the legal line between employee and contractor and why that matters for your organization

Hello and welcome to the PBPA Podcast. In each episode of the PBPA Podcast, we explore legal questions relevant to Georgia nonprofits. I'm your host Sireesha Ghanta, Counsel and Education Director at the Pro Bono Partnership of Atlanta. PBPA strengthens our community by engaging volunteer attorneys to provide nonprofits with free business legal services. We provide numerous free resources via our website, including articles and webcasts specific to Georgia nonprofits and their business legal concerns. We also provide direct legal services to our clients. For more information on client eligibility requirements, to apply to be a client or to access our vast learning center, visit our website at pbpatl.org. Before we jump into this episode's topic, keep in mind that this podcast is general information, not legal counsel, contact your attorney for guidance on your nonprofits' specific situation.

Sarah Stephens is an employment attorney with over 18 years of in-house and law firm experience. She is currently serving as Senior Director of Global Employment Practices at Cox Automotive, the largest division at Cox Enterprises. In addition to advising major corporations and clients on employment matters in her day job, Sarah also volunteers with PBPA, where she's been a volunteer for over a decade advising our nonprofit clients.

I'm so excited to be able to speak with you today, Sarah, coming from your background and experience with nonprofits and from the employment law side. Thanks so much for being here today.

[00:02:51] **Sarah:** Thank you so much for having me. I'm excited to help.

[00:02:55] **Sireesha:** Now, Sarah, when we were talking about this topic before, this is an issue that we see very, very frequently amongst our nonprofit clients, and they usually don't even realize that it's something that should be on their radar or something that might be an issue.

So can we start off by talking about why is it so important for employers to classify their workers correctly? And for some of our nonprofits, they may think of it more as 1099 versus W-2 workers.

[00:03:30] **Sarah:** Sure. So it's important to classify workers correctly as either employees or independent contractors because it ensures that employees get fairly treated, that they get access to overtime pay if they're eligible, or employee benefits, and also because there can be considerable liability for employers who mistakenly classify employees as independent contractors.

Employers who misclassify a worker can have liability, as you said in the introduction, for back taxes, unpaid benefits claims, overtime, and other forms of wage and hour liability, as well as civil penalties. There can even be personal liability for company officers who knowingly or intentionally misclassify their employees as independent contractors.

And the cost of getting this wrong is very expensive. The claims can come from individuals, they can come from departments of labor or state attorneys general, as well as other government agencies like the IRS. So you should also keep in mind that once a government regulator starts looking into this issue of misclassification, they may audit other areas of your business and your pay practices for your regular employees, for example.

Misclassification is easy to get wrong and difficult to unwind, so we wanna be really careful and get it right at the front end.

[00:05:04] **Sireesha:** Is it all on the employer to figure out if someone, a worker's an independent contractor or not? For example, if a worker requests to be treated as an independent contractor, can't a nonprofit abide by that request? After all, the employee isn't seeking employee benefits, so it will be cheaper for the employer.

[00:05:30] **Sarah:** Yeah. So classification is a matter of law and not a matter of contract or agreement between the worker and the employer. That means that they can't decide between themselves whether to treat someone like an independent contractor when they're really an employee.

If the underlying facts look like employment, the classification can be challenged regardless of what each of you may have wanted. There are multiple tests to determine if somebody is an employee, um, a test for unemployment insurance benefits based on state law, which can vary for tests for the IRS, which can vary from wage and hour tests.

And as we talked about a little earlier, it's... it can be very expensive if you get it wrong. So the idea that it can kind of be cheaper if you don't have to pay employee benefits, or it can be better for the worker, may not ultimately be true for your organization.

And just because the worker wants to be treated like an independent contractor today, doesn't mean they won't change their mind later and file a claim in a court or with the Department of Labor or another government agency

[00:06:46] **Sireesha:** So how does an employer who wants to make sure they're getting this right, how do they figure out who is an employee versus an independent contractor?

[00:06:57] **Sarah:** Right. So this is where we get back to these different tests for different purposes. Because the tests vary, that means technically the same person can be an employee for one purpose and a contractor for another, and that's bad news, it's awful, it's confusing. But don't worry too much. The good news is that these tests are largely similar, with one exception that I'll mention.

At the federal level, there are three tests, the common law test under ERISA, which is for retirement savings, the right of control test that the IRS uses, and the economic reality test that the Department of Labor uses.

And each of these tests are looking at whether the employee or the worker is economically dependent on the employer for their work, or if they are instead in a business for themselves.

So the kinds of factors we look at are opportunity for profit or loss, who provides the tools, and what kind of investment is made by the worker or by the employer?

The permanence of the relationship. Is this somebody who has been providing you with services for years, or is this somebody who is providing you with services on a full-time basis?

The nature and degree of control over the work. Are you telling them how to do the work on a daily basis?

Whether the work itself is really integral to what your organization does.

And the level of skill and initiative that that worker has. Are they a professional in their own right, for example?

And so while these various tests may weigh these factors in different ways, ultimately they're all looking at the totality of the relationship. Does this look like an employee, or does it look like someone you've contracted who runs a legitimate business on their own?

One item to be aware of is that as political administrations cycle in and out, the weight of these factors may vary over time, which is why it can be really important to consult with counsel.

In Georgia, we use these federal tests, and we look at the totality of the relationship. Just for your awareness, in in different states, there is something called the ABC test, which is a little bit stricter. Under that test, the worker will be presumed to be an employee unless they meet these three prongs, the ABC prongs. A being, is the worker free from direction and control? B, is the work outside the usual course of the business? And C, is the worker customarily engaged in an independently established trade of the same nature?

And the difference between an ABC test and the test we've talked about at the federal level and in Georgia is that the ABC test, you must meet each factor, and if you fail to meet one of these prongs, typically you will fail the test, and the worker will be classified as an employee, versus in Georgia or under federal law, where one factor is not a determining factor. It's the totality of the factors

[00:10:14] **Sireesha:** Okay, thanks for sharing that about the ABC test. Most of our listeners are Georgia nonprofit organizations, but we have clients who might have remote workers in other states. So, could you give me an example of some of those other states that might use that ABC test just in case we have listeners who have employees in these other states?

They probably want to reach out to an attorney about their remote workers.

[00:10:41] **Sarah:** Sure. So the big ones include California, Massachusetts, and New Jersey. Um, you'll be looking at those jurisdictions where you're familiar they are more protective of employees.

[00:10:53] **Sireesha:** Okay. This was some great outline that you provided of the different tests, but could you give me some examples? There's a lot that is covered in these tests.

[00:11:02] **Sarah:** Yeah. So the classic example of who is an independent contractor is that of a plumber. In the employment trade, we hear this example a lot. So let's say you run a small nonprofit food bank, and your bathroom sink isn't working. So instead of hiring a full or a part-time maintenance person, you bring in a local plumber who runs their own business.

That's a classic independent contractor relationship. The plumber sets their own work hours and work methods, they have their own tools and equipment, and they have multiple clients. You are just one job for them, and they may keep you waiting. So they're hired for that specific outcome, to fix your sink, and after that gets done, the relationship is concluded.

Critically, this is not related to the nature of your work, which is to run a food bank. So when we look at these different factors, the right of control, who brings the tools, is it integral to your business, we can see that this plumber is truly an independent contractor and not someone that you are employing.

Conversely, we could think about the people who solicit food donations or who distribute food to your clients at the food bank. If you were to classify those individuals as independent contractors, you will probably have gotten it wrong. Because as we think about who provides the equipment or the phones to contact the donors or the email system, who is directing to whom the food is distributed, and what are the hours of operation, and who needs to be at the food bank at what time, these are all decisions that you're making, equipment that you're providing, and it-- the work itself is integral to your mission. And so we know that these people are employees.

[00:12:53] **Sireesha:** And the plumber versus the folks who help solicit donations or distribute food at the food bank are either ends of the spectrum. A lot of workers fall somewhere in between, and it can be a little tricky to figure out whether to classify them as an independent contractor or an employee. And that's where it can be helpful to have an attorney guide an organization to figure that out.

We also recommend that our clients carry D&O (Directors & Officers' insurance, to mitigate risk for nonprofit board members) and EPLI (which stands for employment practices liability insurance, to mitigate risk for your organization). I will share more information about both of those risk mitigations tool in the show notes. Now, let's talk about what that risk could potentially looks like. Sarah, what are the penalties if an employer gets this classification wrong?

[00:14:01] **Sarah:** In addition to things like back overtime pay, income tax withholdings, FICA withholdings, back payments for employee benefits, for healthcare or 403 B matching, employers can be liable for civil penalties.

And where it was an unintentional -misclassification, a mistake, you're looking at penalties like one and a half percent of wages for income tax withholding, forty percent for FICA withholding, fifty dollars per unfiled W-2, and failure to pay penalties on a monthly basis of half a percent, up to a cap of twenty-five percent.

If the misclassification is found to be willful, that you knowingly were misclassifying your workforce, those numbers increase. Twenty percent of wages, one hundred percent of FICA withholding, and there can be criminal penalties, thousands of dollars per worker and up to a year of imprisonment. You could also be looking at punitive damages or longer look-back periods for purposes of wage and hour claims. So typically, under federal law, there's a two-year look-back for wage and hour claims, but where there's a willful misclassification, you'll be looking three years. And as I mentioned, there's also personal liability for company officers under the tax code.

And there are many enforcement actions that happen every day across the country.

So a few recent examples. In 2025, New Jersey recovered more than $19million from Lyft for misclassifying more than a 100,000 drivers as independent contractors. In 2024, DC secured a $3.7million recovery from a company that was misclass-classifying their construction workers so that they could avoid sick time and payroll taxes. And in 2025, Massachusetts reached an $865,000 settlement with an online supermarket for misclassifying around a 160 delivery drivers

[00:16:12] **Sireesha:** Wow. And I know for our nonprofit audience, some of those numbers and some of those big organizations may feel like they're so far removed.. And for our listeners who may be hearing those numbers and thinking, "Oh, but that only applies to huge companies," keep in mind that even smaller nonprofits can be subject to employment claims, and those claims can significantly impact them financially at their own level. So now, Sarah, I'm wondering, do you think it's a good idea for an employer to have every employee and every contractor sign an agreement?

[00:16:54] **Sarah:** So it's pretty atypical in the United States, as we know, for employers to sign employment contracts with employees. And there can be some pitfalls to this. If you're gonna sign in a, a contract with your employee, I would consult with counsel to make sure that they remain at-will employees, and you haven't given them some guarantees inadvertently or not intentionally.

However, for your independent contractors, I absolutely do recommend that you have a written contract with each of your contractors. This can be really helpful in communicating the expectations of the parties, but you should just keep in mind what we've talked about, that the contract itself doesn't make them an independent contractor. It's the totality and the nature of the relationship that determines the classification.

[00:17:46] **Sireesha:** And what if we have a nonprofit that's in a situation where they have a worker that they have historically treated as an independent contractor, and now that independent contractor is claiming that they're an employee? What should an organization do in that situation?

[00:18:06] **Sarah:** Well, they definitely wanna consult with counsel. That would be the first step, to assess the actual relationship against the applicable tests. Just because the person is claiming they are misclassified doesn't necessarily mean that they are. But the attorney can help you assess this and also help you to assess the risk. What kinds of claims that person may be able to make, for what kinds of tests might they be classified as an employee versus independent contractor, 'cause we talked about it may be the case that for unemployment purposes, they could be considered an employee, but for other purposes, they may not be considered an employee. And help you identify your exposure, the potential fines and other risks your organization may have.

And they can talk with you about what kind of resolutions are available to you. Is there some kind of agreement that you can reach with that individual?

Now, we, we do have to keep in mind that not all claims can be waived, that a person who is misclassified may bring. For example, federal wage and hour claims cannot be waived in a settlement.

That has to be approved by the government to waive those claims. And so you may not be able to mitigate all of your liability, but an attorney can help you mitigate some of your liability or practically mitigate your liability. And by that, I mean you reach a resolution where everyone is happy, and so they may not make a claim against you.

You also, though, do wanna work with counsel to assess the rest of your workforce. Do you have other pockets of risk? Are you engaging other independent contractors who may be misclassified? And they can help you identify that as well. And to set up some sort of regular or routine audit process so that you can reassess these types of relationships on an ongoing basis and document the decisions that you've made.

[00:20:03] **Sireesha:** This has all been such great information that you have shared, Sarah. It's a really helpful broad overview of what is involved with classifying employees and why it's so important for employers to get it right. I wanna let our audience know we do have a webcast that goes into a little more detail, so if you wanted to listen to that as well, if Sarah has piqued your interest, I'm going to share a link to that in the episode notes.

But thank you so much, Sarah, for sharing your time and expertise with us today.

[00:20:39] **Sarah:** Thank you for having me.

[00:20:43] **Sireesha:** We hope that you found this episode of the PBPA Podcast to be informative and helpful. We add new episodes every month with short conversations about general, yet important legal information for Georgia nonprofits. Remember that this is not legal counsel. Talk to your attorney about your organization's specific concerns. Thanks for tuning into the PBPA Podcast. And to all nonprofits listening out there, thank you for all the good work you continue to do in our community.