

3 federal tests: Are workers employees or independent contractors?

Some employers unknowingly misclassify some of their employees as independent contractors.

In doing so, they risk suffering severe consequences, including liability for misclassified employees' back wages and overtime compensation as well as all applicable taxes. They may also have to pay liquidated damages, payroll tax penalties and penalties for wage-and-hour and immigration violations. They may even face criminal charges.

Avoid the consequences of misclassifying workers by understanding what constitutes an independent contractor. Be forewarned: This involves a fact-intensive analysis, and there's no simple test or standard under the law that fits every situation and provides an easy classification answer.

By becoming familiar with the following tests, you minimize the chances of misclassifying an employee. Once you are familiar with the tests, consult your attorney to make sure you have applied them correctly.

IRS' 20-factors test

Use this test to see whether a worker is an employee under most federal laws, such as statutes involving income tax, Social Security taxes and federal unemployment taxes. It also applies to the Employee Retirement Income Security Act, the National Labor Relations Act, the ADA, Title VII and some OSHA cases.

Under this test, a worker is more likely to be an employee and not an independent contractor if the worker:

1. Is required to comply with the employer's instructions about the work.
2. Receives training from the employer.
3. Provides services that are integrated into the business.
4. Provides services that must be rendered personally.

Suffer or permit to work test

In addition to the economic-reality test, courts and federal agencies also use this test to determine who is covered under the FLSA, AWP, EPA and the FMLA. A worker is more likely to be an employee if the individual:

1. Works in a production process or service that is an integrated part of the employer's business.
2. Works on the premises and equipment of the business.
3. Works for another business that is integrated into the business of the employer due to the:
 - a. Low-skill or piecework nature of the work, or
 - b. Small investment of capital in that integrated business.
5. Hires, supervises and pays assistants for the employer.
6. Has a continuing relationship with the employer.
7. Follows set hours of work.
8. Works full time for the employer.
9. Works on the employer's premises.
10. Does the work in a sequence established by the employer.
11. Submits regular reports to the employer.
12. Receives payments of regular amounts at set intervals.
13. Receives payments for business or traveling expenses.
14. Relies on the employer to furnish tools and materials.
15. Lacks a major investment in facilities used to perform the service.
16. Cannot make a profit or suffer a loss from the services.
17. Works for one employer at a time.
18. Does not offer services to the general public.
19. Can be fired.
20. Can quit at any time without liability.

The economic-reality test

This test is used to determine whether an employee is covered under the FLSA, Agricultural Worker Protection Act (AWPA), Equal Pay Act (EPA) and the FMLA.

Its actual focus is on determining whether the worker is economically dependent on an employer or someone else (a subcontractor) for his or her earnings and working conditions. A worker is more likely to be an employee if:

1. The individual works in a production process or service that is an integrated part of the employer's business.
2. The individual works on the employer's premises and equipment.
3. The individual performs most of his or her work for the employer.
4. The worker has a steady, consistent working relationship with the employer.
5. The employer retains the right to control or in fact controls or supervises the work.
6. The subcontractor changes its name or ownership but still performs the same work.
7. The worker does not seek out his or her own work.
8. The employer and the subcontractor share personnel.
9. The employer absorbs losses for unsatisfactory merchandise.
10. The employer determines the pay rates or method of payment.
11. The employer has the right, directly or indirectly, to hire and fire the workers.
12. The employer prepares the payroll and pays the wages.
13. The individual performs work that is not highly skilled, or is more like piecework.
14. The employer invests more in the equipment and facilities than the worker.