

EMPLOYEE OR INDEPENDENT CONTRACTOR?

Many businesses, both small and not-so-small, are attracted to the idea of meeting their personnel needs by engaging independent contractors to provide services, rather than hiring employees. After all, with employees come a host of regulations and responsibilities-- overtime compensation, benefits administration, employer FICA contributions, withholding taxes, unemployment compensation participation, purchase and maintenance of equipment, immigration status inquiries – the list goes on and on. Similarly, a worker may prefer the independence and self-direction of independent contractor status. While both business and worker may agree that independent contractor status works for them, agencies of both the federal and state governments may have different ideas.

Merely classifying a worker as an independent contractor, even where both business and worker agree to that status, will not make it so. Several government departments and agencies have a vested interest in what they consider to be correct classification, and they do not agree on what constitutes a valid independent contractor.

While the key element in determining a worker's status is the amount of independence he exercises, different regulatory agencies use different tests to determine that. A particular arrangement may meet the requirements according to the United States Department of Labor, but not the New Jersey Department of Labor. The Internal Revenue Service has its own criteria for classification. In short, once a business begins to treat as independent contractors service providers other than those practicing what has traditionally been an independent profession, such as doctors, lawyers, accountants, real estate brokers, it has entered a minefield.

The United States Department of Labor (DOL). The DOL uses a seven-part test to determine whether a worker classified as an independent contractor is entitled to that status or is really an employee. The primary over-arching consideration is whether the worker is financially independent of the company. None of the seven factors is in and of itself dispositive; there are no guarantees or safe harbors.

The Internal Revenue Service (IRS). Until recently, the IRS used a twenty-factor test to determine the validity of a particular independent contractor status. This has been replaced with an approach which attempts to ascertain the degree of control over the worker exercised by the company in three categories: behavioral control, financial control, and the relationship between the parties.

The New Jersey Department of Labor (NJDOL). The guiding principle of the NJDOL appears to be that every worker in New Jersey deserves the protections of being an employee. The NJDOL applies what is known as the A-B-C test. The arrangement must satisfy each of three factors: the worker's profession must be one usually practiced independently; the worker must exercise independent professional judgment and not work under the direct supervision of the company or according to

company standards; and the worker must have his own place of business, equipment, licensing or other attributes necessary to perform the work.

All this means that each putative independent contractor arrangement must be evaluated on a case-by-case basis. There is a continuum, with one end being the traditional independent contractors retained by a business, such as an outside attorney or accountant. These have their own places of business, tools and equipment; work for more than one client; are not financially dependent on any one client; use their own professional judgment in providing services; and bill for the particular services rendered.

At the other end of the continuum is the individual who was formerly an employee of the company and, having been reclassified as an independent contractor, is now performing the same services exclusively for the company, on the company's premises, supervised as before. If the only meaningful change is the way he is paid - 1099 rather than W-2 - the arrangement will not pass muster if scrutinized by any of the agencies discussed above.

Small businesses using independent contractors in New Jersey are more likely to run afoul of the NJDOL than the Federal agencies. The NJDOL generally investigates industry by industry. Over the last several years, it has gone after carpet installers, newspaper deliverers, massage therapists and delivery truck drivers, among others. In these investigations, the way the money flows has been a key ingredient. For example, if an installer collects a fee from a homeowner for installing a carpet and gives the carpet company which sold the homeowner the carpet and located the job for the worker a referral fee, that is more likely to be accepted as an independent contractor relationship than a situation where the carpet company collects money from its homeowner customer ("\$49.99 per yard installed") and then dispatches an installer to whom the company pays a fee.

The NJDOL's industry-by-industry approach can create a false sense of security in a business owner, who may figure that everybody he knows in the business is designating personnel as independent contractors without any apparent ill effect, so he can too. If his industry is never targeted, everybody might continue to get away with it; if the industry is targeted, they won't.

Finally, another potential pitfall is definitions of eligibility set forth in a company benefits plan. It is important to define employees narrowly and carefully, or the company may find that it has inadvertently designated as employees workers who might otherwise meet all the requirements set forth above to qualify as independent contractors.