Determining Whether a Worker Is an Independent Contractor or an Employee

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Following the lead of the private sector, which is increasingly outsourcing core functions, government employers are more often turning to independent contractors (sometimes referred to as "contract employees") to perform work traditionally done by employees. Some of the advantages that employers see are these:

- **Having more flexibility in matching workers' skills to employers' needs.** Engaging workers as independent contractors allows employers to add and subtract personnel on an as-needed basis for shorter-term projects requiring specific skills.
- **Not having to pay benefits.** Employees are generally entitled to participate in the fringe benefit plans that the employer offers. In North Carolina this includes participation in the Local Government Employee Retirement System (LGERS) or the Teachers and State Employees Retirement System (TSERS), as well as in the employer's health insurance benefit plan. Independent contractors are not generally eligible for participation in benefit plans.
- **Being able to tap the expertise of retired employees.** Engaging former employees as independent contractors allows employers to obtain the services of experienced workers familiar with the organization who do not want to jeopardize their retirement benefits by returning to work full-time as employees.

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Not just any worker can be classified as an independent contractor, however. "Independent contractor" is a distinct legal status determined by factors that go beyond an employer and an employee's common desire to contract for work on that basis. For example, both the U.S. Department of Labor, which administers federal overtime law, and the Internal Revenue Service (IRS), which oversees employee federal income tax withholding and Social Security and Medicare payroll contributions, have specific tests for determining whether a worker is an employee or an independent contractor for overtime and tax purposes. Federal and state antidiscrimination laws and state statutes governing who qualifies

for workers' compensation and unemployment benefits use similar tests.

Few hiring relationships meet the legal test for independent contractor status. Employers who misclassify workers as independent contractors may incur significant (and unbudgeted) liabilities, such as back overtime pay, IRS penalties, and liability for the value of lost benefits.

This article summarizes the factors that a public employer should consider in determining whether a worker legally qualifies for independent contractor status or must be classified as an employee.[1] Each of the relevant legal factors is discussed through the example of a hypothetical North Carolina county that has just engaged the services of three new workers. The article concludes with a discussion of certain government positions whose correct classification is sometimes difficult.

Agreement to Work as an Independent Contractor Not Legally Significant

Paradise County's Dilemma

Paradise County needs an additional sanitation worker in its public works department, an additional visiting nurse in its health department, and an additional accounting technician in its finance department. In each case the new position would have the same job duties as already-existing positions. The county commissioners do not think it possible to fund all three requests. Rather than choose among the requests, they allocate enough money for each of the three departments to add an additional worker on what the commissioners call an "independent contractor" basis: the workers are to be paid at an hourly rate but will not receive any benefits from the county. The public works, health, and finance departments advertise for and hire workers, who sign agreements stating that they understand they have been hired as independent contractors and, as such, will not receive benefits. The payroll office, seeing that the workers are not receiving benefits, does not withhold income or Social Security and Medicare (Federal Insurance Contributions Act, or FICA) taxes or make employer-required FICA contributions.

After the new workers have been on the job for several months, one of them approaches the head of the payroll office and complains that she often works more than forty hours per week but does not receive overtime. She also complains that the county has not withheld Social Security and Medicare taxes from her paycheck. The worker is concerned that she is not receiving credit with the Social Security Administration for her time working for Paradise County and that she will not receive all the Social Security benefits to which she would otherwise be entitled at retirement.

The head of the payroll office tells the worker that because she was classified as an independent contractor, (1) she is not covered by the Fair Labor Standards Act (FLSA) and is not entitled to overtime pay and (2) the county is not required to withhold Social Security and Medicare taxes. Dissatisfied with this answer, the worker complains to her supervisor. The supervisor reminds her that she agreed to work as an independent contractor and tells her that if she does not like the arrangement, she can quit.

The worker files complaints with the U.S. Department of Labor and the IRS. They each begin an investigation into Paradise County's worker classifications.

Independent contractors are not entitled to overtime pay, and employers do not have to withhold Social Security and Medicare taxes.

This hypothetical situation illustrates one of the most common misconceptions about who is and who is not an independent contractor. Many employers believe that as long as a worker wants or agrees to be paid as an independent contractor, the employer is not responsible for paying for overtime or for withholding taxes for that worker. That simply is not so. All three workers whom Paradise County has hired as independent contractors are, as far as the law is concerned, employees.

The Right-to-Control Test

To determine whether a worker is an employee or an independent contractor for purposes of tax withholding and Social Security and Medicare contribution withholdings, the courts use a common-law test generally known as the "right-to-control" test. For FLSA overtime purposes, the courts use a version of the right-to-control test called the "economic reality" test.[2] Under both the right-to-control and the economic reality test, the essence of the relationship between a hiring organization and an independent contractor is the agreement by the independent contractor to do a discrete job according to the independent contractor's own judgment and methods, without supervision by the hiring organization. The hiring organization retains approval only of the results of the work. In contrast, an employer may require an employee to perform his or her duties in particular ways using particular methods at particular times. An employee may be disciplined—even discharged—for failing to follow the employer's instructions about how to perform a task. An independent contractor may not.

The Classic Independent Contractor

Imagine that a city wants to build a swimming pool. Officials of the city have opinions about what features they want in a swimming pool, but they do not know how to construct a swimming pool, and no one in the city's regular employ has experience in swimming pool construction. So the city engages a swimming pool contractor.

This is a classic example of the independent contractor relationship. The city will tell the swimming pool contractor what result it wants: a swimming pool of a particular size, in a particular layout, with specified depths, complete with certain accessories like diving boards, stairs, and ladders. The city and the contractor will agree on a price for the final product. Although the city may negotiate with the contractor and even have a price above which it will not go, the city will not be able to set the price unilaterally. The contractor, who will supply all the materials, equipment, and workers needed to construct the swimming pool, will estimate the time it will take to construct the pool, and the cost. The contractor will then determine how

much or how little profit he is willing to make to take this job.

Contrast this with the hypothetical Paradise County situation set forth earlier. The county did not set out to hire someone with specialized skills for a discrete job with respect to either the sanitation worker, the visiting nurse, or the accounting technician. What each department head asked for was funding to hire one additional employee. What each got was permission to hire someone to perform the job functions of an employee under an alternative compensation arrangement.

Five Key Factors

The test for independent contractor status looks at a number of factors, which may be grouped into five general categories: (1) the nature and the degree of the hiring organization's control over the worker; (2) the nature of the work performed—whether it is an integral part of the hiring organization's business; (3) the worker's opportunity for profit or loss; (4) the exclusivity and the duration of the relationship between the hiring organization and the worker; and (5) the hiring organization's right to discharge the worker. No single factor is ever controlling. Instead, the importance of a given factor varies depending on both the occupation at issue and the circumstances under which the services are rendered.[3]

A closer look at these factors makes clear that unlike the swimming pool contractor, the Paradise County workers cannot be classified as independent contractors. They must be classified as employees.

The Nature and the Degree of Control over the Worker

The more control that a hiring organization has over a worker, the more likely it is that the worker is an employee. A hiring organization has control over a worker when it has the right unilaterally to assign the worker a task or to require something of the worker at any given time. The hiring party does not have to exercise that right for the worker to be an employee as a matter of law.[4]

Working conditions that indicate employer control include the following:

- **Training** in the actual methods that the worker is to use or, more generally, in the hiring organization's policies and procedures.[5]
- **A requirement that the worker submit written or oral reports.** These may be reports of time spent on certain tasks or on the project as a whole. The worker may be required to give a detailed description of the work performed, or of clients or patients seen in a given period. A hiring organization does not have to monitor a worker's performance on a daily basis in order to exercise control.[6]
- **Payment of any kind of regular wage,** whether by the hour, the week, or the month. In contrast, payment by the job or on a commission basis is evidence of an independent contractor relationship.[7] Courts also consider the fact that the hiring organization has unilaterally set a worker's hourly wage as evidence that the hiring organization controls the worker.[8]

Think again about the construction of the swimming pool. Although city officials will no doubt be curious about how the work is progressing and may well visit the job site, they will not be telling the contractor how to excavate the earth or what method to use in mixing the concrete. Nor do they have the right to tell the contractor that when he is done with this swimming pool, they have another one for him to construct at the same price on the other side of town—although they and the contractor

may well come to some agreement on a second job. City officials may worry that the contractor is not working fast enough, but until the contractor misses a contractual deadline, they must hold their tongues.

Now think about Paradise County's "independent contractors." The sanitation worker, the visiting nurse, and the accounting technician each work under the supervision of another county employee. The sanitation worker has a route, a truck, and co-workers assigned to him by a supervisor. The visiting nurse has to follow the health department's guidelines for patient care and is required to adhere to applicable state and federal regulations governing the treatment and the billing of patients.[9] The accounting technician is told how the county tracks and records accounts payable and must use the software program already in place.[10]

All three workers have to abide by county work rules governing personal behavior. All are expected to work scheduled hours. They are not allowed to take care of personal or other business while working for Paradise County. Further, they are held to the same workplace standards for job performance and personal conduct as employees working for the county.

The conditions under which Paradise County's so-called independent contractors work make clear that in each case the county has the right to control the performance of their work.

An Integral Part of the Hiring Organization's Business

Whenever a worker performs services that are a core or integral part of the hiring organization's operation, the worker is more likely to be an employee than an independent contractor.[11] The courts use two measures to determine whether a specific job is central to an organization. One is whether the worker provides services that the employing organization exists to provide. For example, one federal court ruled that nurses who were hired by a crisis clinic to provide mental health crisis intervention and referral services to the public were performing the core services of the clinic.[12] Another federal court ruled that a housing coordinator who supervised one of three programs administered by a housing authority was an integral part of the housing authority's organization.[13] In a third case, a court found that treating patients was the reason that a group of psychologists had created a professional practice.[14] None of the positions in these examples were entitled to independent contractor status; all the workers were employees.

Another measure that courts use to determine whether a specific job is central to a hiring organization's business is whether the person doing the job performs the same work as people who are classified as employees. When "independent contractors" perform the same work as employees, they are considered to be integrated into the employer's hierarchy and are likely to be employees.[15]

In the case of the swimming pool contractor, the contractor clearly does not provide services that are basic to the employer's mission (because even if providing recreational services is basic to a city's business, building swimming pools is not). Nor does the contractor do work similar to that done by employees. Indeed, the whole point of bringing in the swimming pool contractor is to tap into expertise and experience that are both lacking in the city's workforce and unlikely to be needed again.

The situation in Paradise County is markedly different. Two of the new workers perform some of the "mission work" of the county (sanitation and public health), and the third performs work essential to the county's business operations (paying its bills). All three perform the same work as others hired as employees. A court would likely find all three to be integral parts of the county's operations. This factor also weighs heavily in favor of employee status.

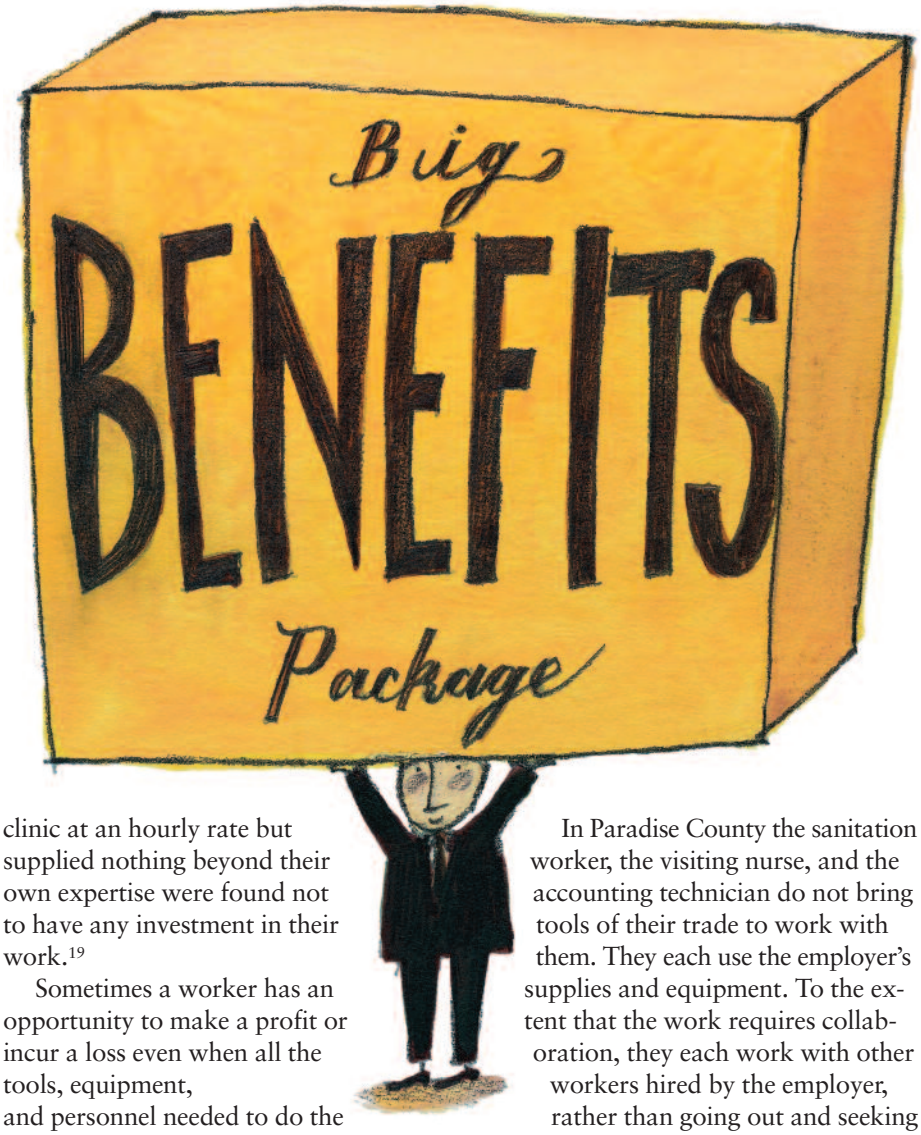
The Worker's Opportunity for Profit or Loss

Consider again the construction of the city swimming pool. The contractor will come to work having already purchased everything he needs to do the job. The city is unlikely to supply anything. Because the construction of a pool usually requires more labor than that of a single worker, the contractor will supply and pay his own assistants. He will factor the cost of the material, the equipment, and the assistants into the price of the job. Whether the contractor accurately assesses his direct and indirect costs determines whether he makes a profit or incurs a loss on the job.

When a worker has the opportunity to make a profit or incur a loss on a job—either by completing the work faster or more slowly than the worker anticipated, or at greater or lesser cost than estimated—the courts are likely to find that the worker is an independent contractor. Employees do not typically have the opportunity to make a profit or incur a loss because they are usually paid a straight salary or an hourly wage and do not normally supply their own materials, equipment, and personnel. A worker who has no investment in the work cannot make a profit or incur a loss.[16]

The facts of *Chao v. Mid-Atlantic Installation Services,* a Fourth Circuit Court of Appeals case, illustrate a real-world application of this factor. At issue was whether cable installers were independent contractors or employees entitled to overtime pay. The cable installers' opportunity for profit or loss manifested itself in a number of ways. First, the hiring company could charge the installers if they failed to comply with either the technical requirements of an installation or local ordinances regulating cable installation. Second, the installers' supplying their own trucks and tools, and having responsibility for their own liability and automobile insurance, showed that they incurred expenses of a type that was not normally borne by employees and that affected the amount they ultimately earned from a set of jobs. So too did their having responsibility for paying any assistants that they hired and for reporting payments made to the assistants to the IRS. These factors weighed heavily in the court's conclusion that the cable installers were independent contractors.[17]

In contrast, in another case a court found that when a hospital provided psychologists with staff, office space, and all the supplies necessary for them to see patients, the psychologists were employees, not independent contractors.[18] Similarly, in *Richardson v. Genesee County Community Mental Health Services,* nurses who worked at a crisis



clinic at an hourly rate but supplied nothing beyond their own expertise were found not to have any investment in their work.[19]

Sometimes a worker has an opportunity to make a profit or incur a loss even when all the tools, equipment, and personnel needed to do the job are supplied by the hiring organization. This is the case with certain kinds of service providers who control how many clients or patients they will see in a given day (physicians, for example) and thus how much the hiring organization may bill third-party payors like insurance companies. In two contrasting cases, the IRS found that a hospital physician whose compensation consisted solely of a percentage of his department's gross receipts was an independent contractor, whereas a hospital physician whose compensation also was a percentage of charges attributable to his department but who was guaranteed a minimum salary as well, was an employee.[20] The distinction was that the first physician ran a risk that his compensation might not be enough to cover his expenses, whereas the second physician ran no such risk.

In Paradise County the sanitation worker, the visiting nurse, and the accounting technician do not bring tools of their trade to work with them. They each use the employer's supplies and equipment. To the extent that the work requires collaboration, they each work with other workers hired by the employer, rather than going out and seeking assistants themselves. Their individual lack of investment in the resources needed to perform their respective jobs also weighs in favor of employee status for each of these workers, as does the fact that their compensation is entirely a function of the number of hours worked. They have no opportunity for profit or loss.[21]

The Exclusivity and the Duration of the Relationship

Independent contractors usually have a special skill and exercise initiative in seeking out assignments or clients. For example, electricians, carpenters, and construction workers, like swimming pool contractors, have special skills.[22] Registered nurses also are skilled workers.[23]

However, having a special skill is not in and of itself indicative of independent contractor status. What counts is whether the worker exercises significant initiative in locating work opportunities or clients. Thus, electricians and carpenters who serve the needs of a single hiring organization (like a city or a county) over a long period will likely be considered employees, rather than independent contractors. But when a worker advertises his or her services to the public on a regular and consistent basis, and performs services for a number of unrelated persons or businesses at the same time, that fact generally indicates that the worker is an independent contractor.[24] The swimming pool contractor is a case in point: The relationship between the city and the contractor will not be exclusive and long-lasting. It will last only as long as constructing the pool takes, although the contractor will continue to construct swimming pools for others.

Neither the job of sanitation worker nor the job of accounting technician requires any special skill or initiative. Individual sanitation workers do not generally offer their services to the public: trash collection is usually a municipal service or a service provided by a company under contract. If an accounting technician provided services to a variety of different clients at the same time, he or she could be an independent contractor. In Paradise County, however, the technician's working a regular forty-hour week for the county under direct supervision argues against such status.

The visiting nurse does have a special skill. This factor will not weigh heavily in favor of independent contractor status, however, because the nurse does not seek out clients on her own. Rather, she is assigned patients by the health department and is paid by the county, rather than by the patient.

Paradise County's expectation of a continuing relationship with its three new workers further indicates that they should be classified as employees.

The Right to Discharge the Worker

An employer typically exercises control over an employee through the threat of dismissal, which causes the employee to obey the employer's instructions. A true independent contractor, on the other hand, cannot be fired as long as he or she produces a result that meets the

hiring organization's specifications. So a hiring organization's right to fire a worker is usually treated as evidence that the worker is an employee, not an independent contractor.[25]

Summing Up: Three New Employees in Paradise County

In engaging the services of the sanitation worker, the visiting nurse, and the accounting technician, Paradise County has taken on three new employees, notwithstanding how the county or the workers describe the relationship. Why? Because Paradise County has (1) retained the right to control their work, (2) has the right to fire each of them, and (3) has not provided them with the opportunity to make a profit or incur a loss.

Further, for their part the workers (1) individually have made no investment in the performance of their services for the county and (2) do not seek out client opportunities on their own.

Finally, with respect to each of the workers, (1) both Paradise County and the worker envision a continuing relationship, and (2) the work done is an integral part of the business of county government.

As a matter of law, the workers are employees, not independent contractors.

Some Hard Cases

Positions Funded through Grants

Most workers hired to fill grant-funded positions will be employees rather than independent contractors. The IRS found that even when a worker paid out of grant funds had discretion with respect to the means and the methods of carrying out the grant activity, the employing organization had broad general supervision over the way the grant money was spent and a right to exercise direction and control. The worker, the IRS held, was an employee.[26]

Except for certain kinds of scientific research, most grants are made to an organization—sometimes to the individual who will carry out the project *and* the organization but rarely to the individual alone. This means that the hiring organization will usually have the right to exercise direction and control over the activities funded by the grant. As explained earlier, the right to control a worker's activities weighs heavily in favor of employee status, even if the hiring organization does not exercise that right.

Adjunct or Part-Time Instructors

Although educational institutions make the greatest and most obvious use of adjunct or part-time instructors, local governments also hire part-time workers to teach physical education and activity classes and other subjects. Use of adjunct instructors such as these appears, on its face, to be a textbook example of the proper classification of a worker as an independent contractor. First, adjunct instructors are generally engaged for a limited duration to do a defined job. Second, adjunct instructors typically have a particular expertise for which they are hired, and usually perform similar or related services for other organizations or individuals. Third, for both colleges and local government recreation programs, the hiring organization charges a fixed fee for the courses or sessions that adjunct instructors teach and typically pays them some percentage of that as a fixed fee for their services.

The IRS takes a different view, however. It has held that part-time instructors are employees when (1) the hiring organization (a) determines the courses that are offered, (b) determines the content and the hours of each course, (c) enrolls the students, and (d) provides the facilities at which the instruction is offered; and (2) the instructor (a) is required to perform his or her services personally, (b) has no investment in the facilities, and (c) does not bear a risk of profit or loss (that is, he or she is paid the same amount whether or not tuition and fee payments cover the hiring organization's expenses).[27]

Physicians in Local Health Departments

In the case of physicians, the right to control is a less important factor than is the extent to which they are economically independent of the hiring organizations. Because they have a high level of specialized training, physicians generally exercise almost complete discretion in their treatment of patients and are subject to relatively little day-to-day supervision.

The most significant factors in determining physicians' status are (1) how they are paid for their services—that is, on a percentage basis, a salary basis, or a percentage basis with a guaranteed minimum; (2) whether they are permitted to employ associate physicians or to engage substitutes when they are absent from work; (3) if they are permitted to engage substitutes, whether they or the hiring organizations are responsible for compensating the substitutes; and (4) whether they are permitted to engage in the private practice of medicine or to perform professional services for others.[28] When a physician's compensation from a local health department is a percentage of billings, and therefore variable and not guaranteed, the physician may usually be classified as an independent contractor. When the physician is paid a salary, either in whole or in part, or is paid an hourly wage, he or she almost always is an employee.[29]

A Price to Pay

An employer that misclassifies workers as independent contractors when they do not meet the legal test for that status may be subject to significant penalties under both the FLSA and the Internal Revenue Code. For workers covered by the FLSA, penalties include the following:

- Liability for overtime compensation going back two years—or three years if the employer has reason to know it has misclassified the worker
- Liquidated damages in an amount equal to the amount of overtime pay owed[30]

When the IRS determines that a worker previously classified as an independent contractor does not meet the right-to-control test and is legally an employee, the employer will be liable for the following:

- 1.5 percent of each worker's federal income tax liability when the misclassification was unintentional
- Both the employer's share of the FICA contribution and up to 20 percent of the employee's missing FICA contribution
- Interest on the amounts not withheld and other IRS penalties

The employer may not seek reimbursement from the worker for taxes, penalties, or fines imposed by the IRS.[31]

These liabilities make illusory the projected savings that caused the organization to engage workers as independent contractors in the first place.

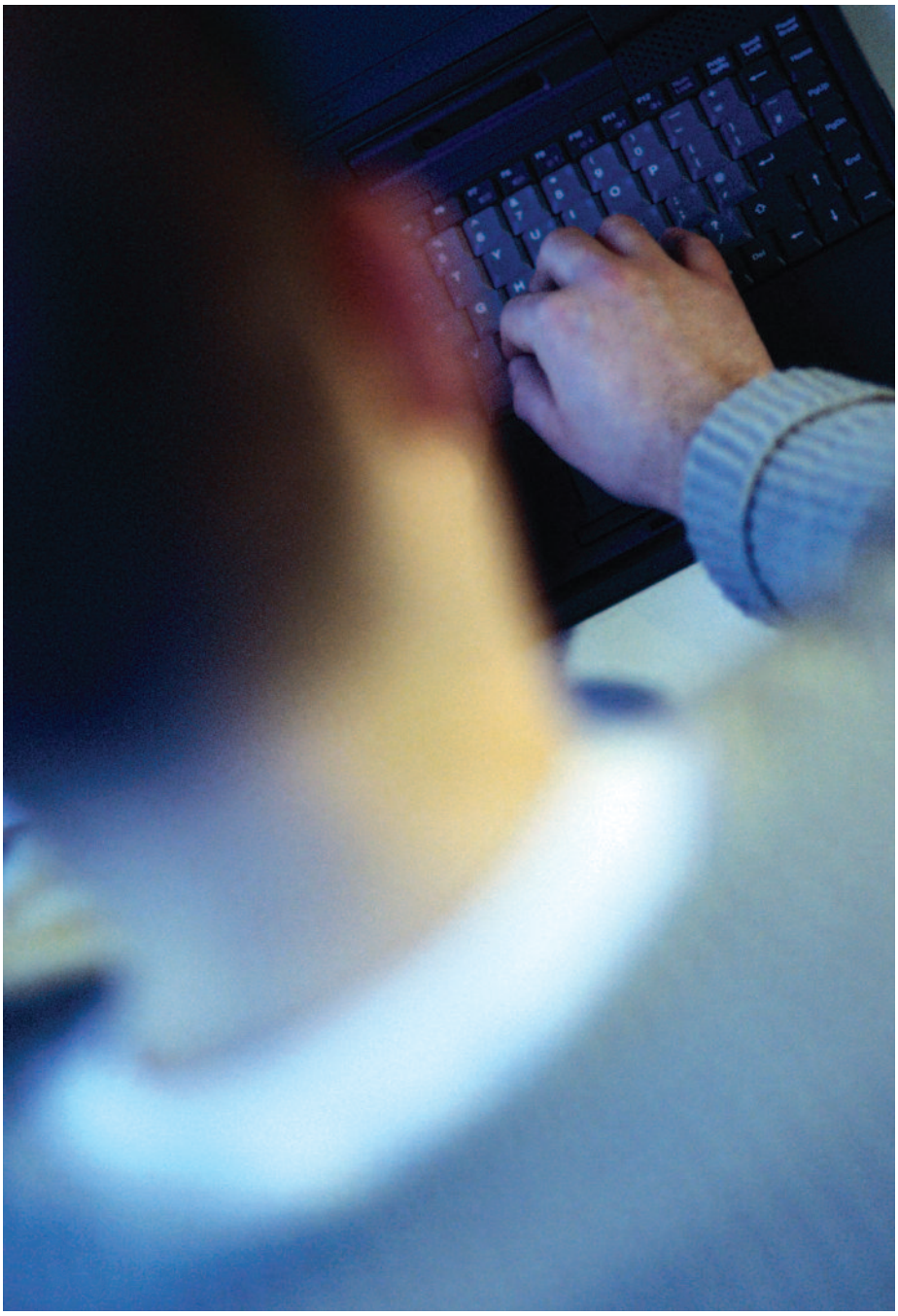
A Possible Defense

Section 530 of the Revenue Act of 1978 provides employers with a complete defense against liability for failure to withhold employees' federal income taxes. To avail itself of the Section 530 defense (known as the "Section 530 Safe Harbor"), an employer must show that it has (1) treated a worker as an independent contractor, (2) filed all required federal employment tax returns on a basis consistent with the classification as an independent contractor (that is, the employer has filed Form 1099), and (3) had a reasonable basis for not treating the worker as an employee.[32] Section 530 relief is not available, however, for past-due Social Security and Medicare contributions.[33] Nor is it available when the employer has treated another worker holding a substantially similar position as an employee.[34]

Worker Classification and Employee Benefits

In several private-sector cases, workers engaged as independent contractors have sued their hiring organizations, claiming that they are common-law employees and therefore entitled to participate in the hiring organization's employee benefit plans.[35] In some cases the workers have sought the value of benefits retrospectively.

Whether such a suit could be successful against a North Carolina public employer is unclear. There are no reported cases from North Carolina state courts or federal courts involving claims of this kind against a public employer. But public employers should consider the following: Although TSERS, LGERS, the North Carolina Workers' Compensation Act, and the North Carolina Employment Security Act require workers to be employees before they are entitled to benefits, the North Carolina Supreme Court has defined "employee" in the context of workers' compensation and unemployment benefits by recourse to the common-law right-to-control test for employee status.[36] It would likely do the same in the case of TSERS and LGERS, as it would in interpreting a promise of retiree health benefits to "employees" meeting certain eligibility requirements.



Conclusion

Most people performing services for a public-sector organization are employees within the common-law definition of that term. True independent contractors are few. Government employers can unwittingly accrue substantial unfunded liabilities in unpaid overtime, unpaid employer FICA contributions, penalties for violating the FLSA and the Internal Revenue Code, and the value of unpaid benefits, when they misclassify employees as independent contractors. For this reason it is crucial that each public employer establish a procedure for individually analyzing any proposed relationship with a worker whom it plans to engage as an independent contractor. Whether that worker legally qualifies as an independent contractor will depend on

A Model Checklist to Help Determine Independent Contractor or Employee Status

Employers should modify this checklist as appropriate to the nature of their organization as a whole or the nature of a particular department. Every proposal to engage a worker as an independent contractor must be assessed individually. Whether that worker legally qualifies as an independent contractor will depend on the facts and the circumstances of the individual situation.

PART 1: Yes indicates that the factor weighs in favor of employee status. No indicates that the factor weighs in favor of independent contractor status.

Yes No Factor

Y__ N__ 1. Does the hiring organization have the right to control when, where, and how the worker will do the job, or the order and the sequence in which the worker will perform services? (Check yes if the organization has the right, even if it does not intend to exercise that right.)

Y__ N__ 2. Does the hiring organization set the worker's hours and schedule?

Y__ N__ 3. Must the work be performed personally by the worker (as opposed to the worker subcontracting it out or furnishing his or her own substitute)?

Y__ N__ 4. Is the hiring organization providing training of any kind?

Y__ N__ 5. Does the hiring organization provide the worker with the tools, the supplies, and/or the equipment needed to do the job (as opposed to requiring the worker to bring his or her own tools, equipment, and supplies to the job)?

Y__ N__ 6. Does an employee of the hiring organization supervise the worker?

Y__ N__ 7. Does the worker have to submit written reports or make oral reports?

Y__ N__ 8. Is the work performed on the hiring organization's premises or at a site controlled or designated by the hiring organization?

Y__ N__ 9. If the worker is performing services off-site, does the hiring organization have the right to send supervisors to the site to check up on the worker? (Check yes if the organization has the right, even if it does not intend to exercise that right.)

Y__ N__ 10. Can the worker be fired at the will of the hiring organization?

Y__ N__ 11. Can the worker quit the job at will without incurring any liability?

Y__ N__ 12. Will the hiring organization hire, fire, and pay the worker's assistants?

Y__ N__ 13. Will the worker be paid by the hour, the week, or the month (as opposed to being paid for the successful completion of the job or the piece)?

Y__ N__ 14. Has the hiring organization unilaterally set the worker's rate of pay?

Y__ N__ 15. Does the hiring organization reimburse the worker for expenses and travel?

Y__ N__ 16. Is the relationship between the hiring organization and the worker going to be a continuing one?

Y__ N__ 17. Does anyone else perform the same or similar services for the organization as an employee?

Y__ N__ 18. Are the services performed by the worker part of the core or day-to-day operations of the hiring organization?

Y__ N__ 19. Is the worker a current employee of the hiring organization in another capacity?

Y__ N__ 20. Was the worker an employee of the hiring organization at any time during the past year, and if so, did the worker provide the same or similar services as an employee?

PART 2: Yes indicates that the factor weighs in favor of independent contractor status. No indicates that the factor weighs in favor of employee status.

Yes No Factor

Y__ N__ 21. Does the worker perform similar services for others as an independent contractor?

Y__ N__ 22. Does the worker advertise his or her services to the public?

Y__ N__ 23. Has the worker made any investment in facilities or equipment needed to do the work?

Y__ N__ 24. Does the arrangement between the hiring organization and the worker allow the worker to make a profit or suffer a loss?

the particular facts and circumstances of the arrangement. Employers might consider using a checklist to help guide their evaluations of individual positions (see sidebar on page 32).

Notes

1. For a more detailed discussion of the factors applicable to an independent contractor analysis and of the consequences of misclassification, *see* Diane M. Juffras, *Independent Contractor or Employee? The Legal Distinction and Its Consequences,* PUBLIC EMPLOYMENT LAW BULLETIN no. 32 (May 2005).

2. For the Internal Revenue Code, *see* 26 U.S.C. § 3121(d)(2). The code does not formally define the term "employee" for the purpose of determining federal income tax liability. Instead, it provides that the usual common-law rules apply in determining the employer-employee relationship. *See also* Weber v. Comm'r, 60 F.3d 1104, 1110 (4th Cir. 1995); Eren v. Comm'r, 180 F.3d 594, 596–97 (4th Cir. 1999) (holding that because Internal Revenue Code section addressing tax exclusion for foreign earned income does not define "employee," common-law rules apply in distinguishing employees and independent contractors under federal tax law), *citing* Nationwide Mutual Ins. Co. v. Darden, 503 U.S. 318, 322–23 (1992). For the FLSA, *see* Rutherford Food Corp. v. McComb, 331 U.S. 722, 726–28, 730 (1947).

3. *See* Rev. Rul. 87-41 (1987), 1987-1 C.B. 296 (listing twenty factors that courts have considered over time in applying right-to-control test); *see also Weber*, 60 F.3d at 1110 (looking at seven of twenty factors to determine whether minister was employee of church); Hospital Resource Personnel, Inc. v. United States, 68 F.3d 421, 427 (11th Cir. 1995) ("Although no one factor is definitive on its own, collectively the factors define the extent of an employer's control over the time and manner in which a worker performs. This control test is fundamental in establishing a worker's status").

4. *See* 26 C.F.R. § 31.3401(c)-1(b) (employment tax regulations); *Weber*, 60 F.3d at 1110.

5. An architect was required to follow the procedures and the directives in the hiring organization's handbook, could not exceed budget, and had his hours, leave, and pay set by the employer. The court found that (1) the hiring organization had a right to control the architect's activities and (2) the architect was an employee for tax purposes. *See Eren,* 180 F.3d at 597. Similarly the IRS has held that a park attendant hired on a seasonal basis by a government agency was an employee, in part because the agency provided training and instructions on methods to be used, and set specific hours. *See* Priv. Ltr. Rul. 200323023 (Feb. 24, 2003). In the context of medical professionals, the right of the hiring organization to require compliance with its general policies is indicated by whether or not a physician or a registered nurse is subject to the direction and the control of a chief of staff, a medical director, or some other authority. *See* Rev. Rul. 66-274, 1966-2 C.B. 446 (holding that physician director of hospital pathology department was not subject to direction and control of any hospital representative such as chief of staff and thus was independent contractor); *see also* Rev. Rul. 73-417, 1973-2 C.B. 332 (holding that physician director of hospital laboratory was employee, in part because he had to comply with all rules and regulations of hospital); Richardson v. Genesee County Comty. Mental Health Serv., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999) (holding that employing agency providing nurses with guidelines for patient care as well as work rules governing employee conduct, exercised supervisory control for purposes of determining whether nurses were employees within meaning of FLSA).

6. *See* Brock v. Superior Care, 840 F.2d 1054, 1057, 1060 (2d Cir. 1988) (holding that when nurses work off-site with individual patients needing home or specialized care, employer still exercises control and supervision when it visits job sites even as infrequently as once or twice a month and requires nurses to keep and submit to it patient care notes required by federal and state law); *see also* Donovan v. DialAmerica Marketing, 757 F.2d 1376, 1383–84 (3d Cir.), *cert. denied,* 474 U.S. 919 (1985) (holding that home researchers who distributed research cards to other home researchers were subject to minimal control and thus were not employees under FLSA); Mathis v. Hous. Auth. of Umatilla County, 242 F. Supp. 2d 777, 783 (D. Or. 2002) (holding that housing coordinator was under housing authority's control when she worked at housing authority offices, she was subject to direction of executive director, and housing authority reserved right to change or reassign job duties). On the IRS side, *compare Weber*, 60 F.3d at 1110.

7. *See* Priv. Ltr. Rul. 9320038 (Feb. 22, 1993) (holding that department of corrections medical director paid hourly rate was employee); *see also* Priv. Ltr. Rul. 200339006 (June 9, 2003) (holding that accounting technician paid hourly wage was employee); Priv. Ltr. Rul. 9728013 (Apr. 9, 1997) (holding that part-time lifeguard paid hourly wage was employee); Priv. Ltr. Rul. 9326015 (Mar. 31, 1993) (holding that physician in university health clinic was employee); *Eren*, 180 F.3d at 597 (holding that payment of architect on salary basis was evidence of employee status); *Weber*, 60 F.3d at 1111 (holding that payment of minister on salary basis weighed in favor of employee status).

8. *See Brock*, 840 F.2d at 1060; *see also* U.S. Dep't of Labor Wage and Hour Op. Ltr. dated Dec. 7, 2000, 2000 WL 33126542 (holding that company's control of rate at which package-delivery drivers were compensated was factor leading to conclusion that drivers were employees rather than independent contractors); *Eren*, 180 F.3d at 597 (holding that architect whose pay and leave were set by hiring organization was employee).

9. *See* U.S. Dep't of Labor Wage and Hour Op. Ltr. dated Aug. 24, 1999, 1999 WL 1788146 (holding that hospital was likely joint employer of private-duty nurses with nurse registry).

10. *See* Priv. Ltr. Rul. 200339006 (June 9, 2003) (holding that accounting technician who was paid hourly wage; was given all necessary supplies and equipment and materials needed to perform her services; and received assignments from supervisor who determined methods by which services were to be performed was employee rather than independent contractor); Priv. Ltr. Rul. 200222005 (Feb. 15, 2002) (holding that clerical worker who was hired because she submitted lowest bid, but who worked under similar conditions to accounting technician in Priv. Ltr. Rul. 200339006, was employee).

11. *See* Thomas v. Global Home Prod., 617 F. Supp. 526, 535 (W.D. N.C. 1985), *aff'd in part, modified, and remanded*, 810 F.2d 448 (4th Cir. 1987) (holding that local distributor for cookie and candy company was employee).

12. *See* Richardson v. Genesee County Comty. Mental Health Serv., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999); *see also* U.S. Dep't of Labor Wage and Hour Op. Ltr. dated Aug. 24, 1999, 1999 WL 1788146 (holding that hospital was likely joint employer of private-duty nurses with nurse registry).

13. *See* Mathis v. Hous. Auth. of Umatilla County, 242 F. Supp. 2d 777, 785 (D. Or. 2002).

14. *See* Priv. Ltr. Rul. 8937039 (Sept. 15, 1989).

15. *See* Brock v. Superior Care, 840 F.2d 1054, 1057–58 (2d Cir. 1988); *Mathis*, 242 F. Supp. 2d at 785.

16. *See Richardson*, 45 F. Supp. 2d at 614 (FLSA case holding that nurses at mental health crisis clinic who had no opportunity for profit or loss were employees); Eren v. Comm'r, 180 F.3d 594, 597 (4th Cir. 1999) (Internal Revenue Code case holding that salaried architect who was not paid commission or percentage of profits had no opportunity for profit or loss); Weber v. Comm'r, 60 F.3d 1104, 1111 (4th Cir. 1995)

(Internal Revenue Code case holding that minister paid salary and provided with parsonage, utility expense allowance, and travel allowance had no opportunity for profit or loss); *see also* Rev. Rul. 70-309, 1970-1 C.B. 199 (holding that oil-well pumpers who worked in field and assumed no business risks were employees); Priv. Ltr. Rul. 9251032 (Sept. 21, 1992) (holding that nurse in state tuberculosis outreach program who assumed no risk of profit or loss was employee).

17. *See* Chao v. Mid-Atlantic Installation Serv., 16 Fed. Appx. 104, 107, 2001 WL 739243 *3 (4th Cir. 2001); *see also* U.S. Dep't of Labor Wage and Hour Op. Ltr. dated Sept. 5, 2002, 2002 WL 32406602.

18. *See* Kentfield Med. Hosp. Corp., 215 F. Supp. 2d 1064, 1070 (N.D. Cal. 2002).

19. *See Richardson,* 45 F. Supp. 2d at 614; *see also Weber*, 60 F.3d at 1111 (holding that church's providing minister with office weighed in favor of employee status).

20. *See* Rev. Rul. 66-274, 1966-2 C.B. 446 (independent contractor); Rev. Rul. 73-417, 1973-2 C.B. 332 (employee).

21. *See* Priv. Ltr. Rul. 200339006 (June 9, 2003) (holding that accounting technician who was paid by hour and could not hire assistants or substitutes had no opportunity for profit or loss).

22. *See Chao*, 16 Fed. Appx. at 107, 2001 WL 739243 at *3; *see also Richardson*, 45 F. Supp. 2d at 614 (holding that nurse working after regularly scheduled hours at crisis clinic run by same employer did not locate clients independently), *citing* Brock v. Superior Care, 840 F.2d 1054, 1060 (2d Cir. 1988) (holding that nurses paid hourly rate by employing organization, rather than directly by patient, were likely to be employees); Mathis v. Hous. Auth. of Umatilla County, 242 F. Supp. 2d 777, 784 (D. Or. 2002) (holding that special-skills factor weighed toward employee status when housing coordinator's work and client contact took place at housing authority during regular business hours; coordinator did not use skills in any independent way).

23. *See Richardson*, 45 F. Supp. 2d at 614.

24. Performing services for two or more persons or businesses simultaneously, however, is not conclusive evidence of independent contractor status: a person can work for two organizations or persons as an employee of each.

25. The right of the worker to terminate his or her services at any time without incurring any liability is also characteristic of an employment relationship. In contrast, an independent contractor who quits without completing the job for which he or she was hired might have to forfeit some of the contract price. The hiring party also could sue the independent contractor either for specific performance (an order from the court to the worker to do the work agreed on) or for breach of contract, provided that the hiring party could show damages resulting from the failure to complete the work as agreed. S*ee* Weber v. Comm'r, 60 F.3d 1104, 1111, 1113 (4th Cir. 1995) (holding that although minister could not be fired at will, his failure to follow Book of Discipline could have resulted in termination by fellow members of clergy); Rev. Rul. 75-41, 1975-1 C.B. 323 (holding that physicians working for physician services corporation who could be fired at will were employees); Priv. Ltr. Rul. 9320038 (Feb. 22, 1993) (holding that medical director who could be fired with thirty days' notice was employee).

26. *See* Rev. Rul. 55-583, 1955-2 C.B. 405.

27. *See* Rev. Rul. 70-308, 1970-1 C.B. 199; Tech. Adv. Mem. 91-05-007 (Feb. 1, 1991); Tech. Adv. Mem. 89-25-001 (June 23, 1989); Priv. Ltr. Rul. 8728022 (Apr. 10, 1987).

28. *See* Rev. Rul. 66-274, 1966-2 C.B. 446; *see also Weber*, 60 F.3d at 1112 (holding that minister's work clearly was part of regular work of United Methodist Church); Priv. Ltr. Rul. 9320038 (Feb. 22, 1993) (holding that department of corrections medical director paid hourly rate was employee); Priv. Ltr. Rul. 8937039 (Sept. 15, 1989) (holding that psychologists treating patients for professional firm were employees).

29. *See* Rev. Rul. 66-274, 1966-2 C.B. 446; Rev. Rul. 73-417, 1973-2 C.B. 332.

30. *See* 29 U.S.C. §§ 216(b), 255(a); *see also* Brock v. Superior Care, 840 F.2d 1054, 1061 (2d Cir. 1988). Conduct that is merely unreasonable or negligent with respect to ascertaining an employer's obligations under the FLSA is not considered to be willful. *See* McLaughlin v. Richland Shoe Co., 486 U.S. 128, 131, 133–35 (1988), *overruling* Donovan v. Bel-Loc Diner, 780 F.2d. 1113 (4th Cir. 1985); *see also* Troutt v. Stavola Bros., 905 F. Supp. 295, 302 (M.D. N.C. 1995), *aff'd,* 107 F.3d 1104 (4th Cir. 1997) (holding that failure to seek legal advice, standing alone, was insufficient to establish willfulness when there was no pattern of complaints to employer or in industry that could establish knowledge or recklessness on part of employer). But an employer's failure to investigate whether its policies violate FLSA when employees have questioned those policies would be reckless. *See* Davis v. Charoen Pokphand (USA), Inc., 302 F. Supp. 2d 1314, 1327 (M.D. Ala. 2004); LaPorte v. Gen. Elec. Plastics, 838 F. Supp. 549, 558 (M.D. Ala. 1993). In the Fourth Circuit, whether a violation was willful or not under Title 29, Section 255(a), of the U.S. Code and thus whether the employer's liability for overtime pay extends back three or merely two years, will be determined by a jury. *See* Fowler v. Land Mgmt. Group, 978 F.2d 158, 162–63 (4th Cir. 1992); Soto v. McLean, 20 F. Supp. 2d 901, 913 (E.D. N.C. 1998) (denying defendants' motion for summary judgment).

31. *See* 26 U.S.C. §§ 3509, 6601, 6651, 6662, 6721.

32. Section 530(a)(2) provides that a taxpayer has a reasonable basis for not treating an individual as an employee if it has relied on either (1) judicial precedent, published rulings, technical advice with respect to the employer, or a letter ruling to the employer; (2) a past IRS audit of the employer in which there was no assessment attributable to the employer's treatment of individuals holding positions substantially similar to the position in question, as independent contractors; or (3) longstanding recognized practice of a significant segment of the industry in which the individual was engaged.

33. Private-sector employers may assert a Section 530 defense against liability for past-due FICA contributions. For the IRS reasoning behind denying this defense to the public sector with respect to FICA liability, *see* IRS Tech. Adv. Mem. 91-05-007 (Feb. 1, 1991) and Tech. Adv. Mem. 91-51-004 (Dec. 20, 1991). *See also* Internal Revenue Serv., Independent Contractor or Employee? Training Materials, Training 3320-102 (10-96), at 1–37 (Washington, D.C.: IRS, Oct. 1996), available at www.irs.gov/pub/irs-utl/emporind.pdf.

34. *See* Kentfield Med. Hosp. Corp., 215 F. Supp. 2d 1064, 1068 (N.D. Cal. 2002); Select Rehab, Inc. v. United States, 205 F. Supp. 2d 376, 380 (M.D. Pa. 2002); Halfhill v. U.S. Internal Revenue Serv., 927 F. Supp. 171, 175 (W.D. Pa. 1996).

35. *See, e.g.*, Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998). For a detailed discussion of the arguments that workers might make for the value of benefits they should have received if they had been properly classified as employees, rather than as independent contractors, *see* Juffras, *Independent Contractor or Employee?*

36. *See* N.C. Gen. Stat. §§ 135-3(1), -1(10) (hereinafter G.S.) (TSERS); G.S. 128-21(10) (LGERS); G.S. 97-2(2), McGown v. Hines, 353 N.C. 683, 686 (2001), and Hughart v. Dasco Transp., 606 S.E.2d 379, 385 (N.C. App. 2005) (N.C. Workers' Compensation Act); G.S. 96-8(6)a and Employment Security Comm'n v. Huckabee, 120 N.C. App. 217, 219 (1995), *aff'd,* 343 N.C. 297 (N.C. Employment Security Act). For the right-to-control test under North Carolina law, see Hayes v. Elon College, 224 N.C. 11, 15 (1944).