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The Misclassification Minefield: The Legal Standards for Independent Contractor Status

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Government employers sometimes turn to independent contractors (occasionally referred to as "contract employees") to perform work traditionally done by regular employees. Below are some of the advantages that employers see for doing so.

- *No overtime pay.* Independent contractors are not subject to the Fair Labor Standards Act (hereinafter FLSA) overtime requirements.
- *No benefits.* Independent contractors are generally ineligible for employer-provided benefits plans such as health insurance and retirement benefits provided by membership in the Local Governmental Employees' Retirement System (hereinafter LGERS) or the Teachers' and State Employees' Retirement System (hereinafter TSERS).
- *No income tax withholding or FICA contributions*. Independent contractors are not subject to subject to income-tax or FICA (which funds the social security and Medicare programs) withholding. Employers are not responsible for making FICA contributions for independent contractors.
- *No workers' compensation*. Independent contractors are not covered by the North Carolina Workers' Compensation Act.

The difference between compensation and benefits provided to an employee and those offered to an independent contractor doing the same work can be substantial.

But classifying a worker as an independent contractor also involves significant risk. There are legal standards for determining whether a worker may be treated as an independent contractor or must be classified as an employee. Which legal standard to apply depends on context.

- For FLSA and overtime purposes, the United States Department of Labor (hereinafter DOL) applies an "economic-reality test," newly incorporated into its FLSA regulations.
- For federal tax-reporting purposes, the Internal Revenue Service (IRS) uses a common-law test of twenty factors, grouped into three major themes.
- For determining worker classification under North Carolina law, courts use a common-law test similar to the IRS test.

Misclassifying an employee as an independent contractor under any one of these tests can result in significant penalties. This *Public Employment Law Bulletin* examines the DOL's 2024 independent contractor regulations, the IRS's twenty-factor test, and the North Carolina common-law test, as well as a misclassified worker's rights to health insurance benefits. It concludes with a consideration of the potential penalties for worker misclassification.

A Beginning Hypothetical

Paradise County needs an additional sanitation worker in the public works department, an additional visiting nurse in the health department, and an additional accounts payable clerk in the finance department. In each case, the new position would have the same job duties as already-existing positions. County commissioners do not think it is possible to fund all three requests, but rather than choose among them, 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 that they are hired as independent contractors and that, as such,

they will not receive benefits. The county payroll office, seeing that the workers are not receiving benefits, does not withhold income or FICA taxes or make FICA contributions on behalf of the new hires.

After the new workers have been on the job for several months, one of them approaches 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 (FICA) 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 of the social security benefits to which she would otherwise be entitled at retirement.

The payroll office tells the worker that because she was classified as an independent contractor (1) she is not covered by the FLSA and is not entitled to overtime and (2) the county is not required to withhold FICA 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 doesn't like it, she can quit.

The worker files complaints with the DOL and the IRS. Each federal agency begins an investigation into Paradise County's worker classifications.

Agreement to Work as an Independent Contractor Has No Legal Significance

The Paradise County hypothetical illustrates a common misconception about independent contractor status. Many employers believe that a worker's agreement to be paid as an independent contractor exempts the employer from paying overtime and from withholding taxes for that worker. This is incorrect. The three workers that Paradise County has hired as "independent contractors" are—as far as the law is concerned—employees.

"Independent contractor" is a distinct legal status determined by factors beyond the mutual desire of an employer and a worker to contract on this basis. In addition to the FLSA's economic-reality test, the IRS twenty-factor test, and North Carolina's common-law test, other statutes such as anti-discrimination laws use still other tests for determining a worker's status.

These tests, while differently named, are all variants of the common-law test for determining employee status and share common principles. The key distinction lies in the nature of the working relationship.

- An *independent contractor* agrees to do a discrete job using their own judgment and methods, without supervision. The hiring organization retains approval only over the final results.
- An *employee* may be required to perform duties in specific ways, using particular methods, at set times. The employer may discipline or discharge the employee for failing to follow the employer's instructions about how to perform a task.

Even if an employer rarely gives assignments, the right to control how work is performed distinguishes an employee from an independent contractor.

The FLSA's Economic-Reality Test

The FLSA defines "employee" broadly as "any individual employed by an employer."[1] It defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee,"[2] and to "employ" as "to suffer or permit [individuals] to work."[3] On its face, it is hard to see what sort of worker would not fall within the FLSA's definition of employee—it would seem to cover everybody. Nevertheless, there are people who perform work who simply cannot be called employees of an organization. Courts developed the "economic reality" test to distinguish employees from independent contractors under the FLSA.

The economic-reality test assesses whether a worker is economically dependent upon the organization for which they render services.[4] It examines whether a worker depends upon an "employer" for the opportunity to work or whether the worker is in business for themself. The courts developed, and the DOL has incorporated into its FLSA regulations, a six-factor test to make this determination.

1. *Profit or Loss Opportunity.* Is the worker able to make a profit or a loss based on their own business skills and initiative? This is a key indicator of independent contractor status.[5]
2. *Investment.* Has the worker made a capital or entrepreneurial investment in the materials, equipment, or other personnel required to perform the work? How does this compare to the hiring organization's investment? When a worker supplies the materials or equipment needed for the job or directly hires others to assist them in performing the work, this factor will weigh heavily in favor of independent contractor status.[6]
3. *Duration of the Relationship.* Is the working relationship indefinite or project based? Long-term relationships or relationships of indefinite length suggest employee status. Independent contractor relationships are usually for a limited duration, as the worker is running their own business and is usually working for other organizations when they are not working for the hiring organization.[7]

1. 29 U.S.C. § 203(e)(1).
2. 29 U.S.C. § 203(d).
3. 29 U.S.C. § 203(g).
4. *See* Rutherford Food Corp. v. McComb, 331 U.S. 722, 726–28, 730; Salinas v. Com. Interiors, Inc., 848 F.3d 125, 150 (4th Cir. 2017).
5. *See* 29 C.F.R. § 795.110(b)(1). *See also* Hobbs v. Petroplex Pipe & Constr., Inc., 946 F.3d 824, 832–34 (5th Cir. 2020) (hiring organization's setting of workers' rate of pay and schedule and fact that workers did not work for anyone else could weigh in favor of employee status); Bolden v. Callahan, 595 F. Supp. 3d 727, 737 (E.D. Ark. 2022) (where worker bore risk of not being able to work or not having enough clients and could work longer hours and see more clients, factor weighed in favor of independent contractor status).
6. *See* 29 C.F.R. § 795.110(b)(2).
7. *See* 29 C.F.R. § 795.110(b)(3). *See also Hobbs*, 946 F.3d at 834–35 (workers were hired to do all of hiring organization's pipe-welding work and not on a project-by-project basis, weighing in favor or employee status); *Bolden*, 595 F. Supp. 3d at 739 (where it was common for cosmetologists to work at more than one salon at a time and to move from salon to salon, there was no written agreement between plaintiff cosmetologist and defendant salon owner, and plaintiff had been with salon for only eighteen months, evidence weighed in favor of independent contractor status).

4. *Control.* What is the nature and degree of control that the hiring organization has over the worker's day-to-day duties and over their compensation? The greater the control, the more likely it is that the worker is an employee.[8]
5. *Integral Nature of the Work.* How central is the work to the hiring organization's mission and operations? Does the worker perform the same or similar work to workers classified as employees? Independent contractors usually perform work that is peripheral to the hiring organization's operations. Where a worker is doing a job that is essential to an organization's operations, this factor will weigh in favor of employee status.[9]
6. *Skill and Initiative.* Does the work require specialized skills and independent initiative? Independent contractors market their special skills in seeking out assignments or clients.[10]

These factors are guides, not definitive tests. No single factor determines worker status and additional factors may be considered. Each situation is evaluated considering all the circumstances of a particular hiring organization–worker relationship.[11] This approach aligns with the courts' framing of the economic-reality test.[12]

The Internal Revenue Code Test

The IRS has a vested interest in the accurate classification of workers as employees or independent contractors. Under the Internal Revenue Code (hereinafter IRC),

- employers must withhold estimated federal income taxes from each employee's wage payments and
- employers and employees must both pay social security and Medicare taxes on the wages of employees, which the employer remits to the IRS through payroll deduction.

The contrast with a hiring organization's IRS responsibilities for an independent contractor is striking.

- A hiring organization is not required to withhold income or FICA taxes from its payments to an independent contractor.
- A hiring organization does not pay any social security or Medicare taxes on an independent contractor's fee.

8. *See* 29 C.F.R. § 795.110(b)(4). *See also Hobbs*, 946 F.3d at 830–31 (oil and gas service company exercised control over pipe welders where it assigned the workers' day-to-day tasks, disciplined them for lateness, provided more-detailed diagrams for them to use than manufacturer did, and sometimes assigned workers to tasks other than pipe welding); *Bolden*, 595 F. Supp. 3d at 737 (where cosmetologist set her own schedule, set fees she would charge for her services, and determined how to perform those services, degree-of-control factor weighed in favor of independent contractor status).

9. *See* 29 C.F.R. § 795.110(b)(5).

10. *See* 29 C.F.R. § 795.110(b)(6). *See also Hobbs*, 946 F.3d at 834 (5th Cir. 2020) (although workers had specialized skills, they did not use initiative).

11. *See* 29 C.F.R. § 795.110. *See also* McFeeley v. Jackson St. Ent., LLC, 825 F.3d 235, 241 (4th Cir. 2016); Chao v. Mid-Atl. Installation Servs., Inc., 16 F. App'x 104, 106 (4th Cir. 2001).

12. *See, e.g., Mid-Atl.*, 16 F. App'x at 106.

- A hiring organization's legal responsibilities end with the filing of annual information returns (Form 1099) with both the independent contractor and the IRS that show the money paid to the contractor during the tax year.

An independent contractor is responsible for directly paying both income and FICA taxes to the IRS.[13]

Misclassification of employees as independent contractors can result in significant revenue loss for both federal and state governments. This occurs through both the loss of employer contributions to Medicare and FICA and the potential underreporting of income by independent contractors.

Degree of Control and Independence: The IRS Right-to-Control Test

The IRC does not formally define the term "employee" for the purposes of determining federal income tax liability but instead relies on common-law rules to determine the employer-employee relationship.[14] The common-law test, known as the "right to control" test, looks at whether a hiring organization has the right to control or direct a given worker. In a 1987 Revenue Ruling, the IRS identified twenty factors that the courts had considered in applying the test.[15] Those twenty factors guided the employee–independent contractor analysis for more than thirty years. Recently, the IRS reorganized the twenty factors into three categories: behavioral control, financial control, and the type of relationship the parties have with one another.

Behavioral Control

An employee is generally subject to a hiring organization's instructions about when, where, and how to work. Factors that illuminate the degree of behavioral control that the hiring organization has over a worker include

1. whether the worker must comply with another person's instructions about the work;
2. whether the worker requires training to do the work;
3. whether the work must be performed during set hours;
4. whether the work must be performed on the hiring organization's premises or can be done elsewhere;
5. whether the worker must perform services in an order or sequence set by the hiring organization;

13. The IRS has increased its efforts to identify employees incorrectly classified as independent contractors in recent years, as independent contractors tend to understate their income—sometimes erroneously, sometimes consciously—resulting in revenue loss for the federal government from underpayment of both federal income and employment taxes. Thus, when an employer is both withholding an employee's share and contributing its own share, federal tax revenues are both greater and more predictable.

14. *See* 26 U.S.C. § 3121(d)(2). *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) (citing Nationwide Mutual Ins. Co. v. Darden, 503 U.S. 318, 322–23 (1992)) (because foreign-earned income-tax exclusion section of IRC does not define employee, common-law rules apply in distinguishing employees and independent contractors under federal tax law).

15. *See* Rev. Rul. 87-41, 1987-1 C.B. 296. Most of these factors appear in the summary of the common-law test set forth by the United States Supreme Court in *Darden*, 503 U.S. at 323–24 (applying common-law test to determine who qualifies as employee under Employee Retirement Income Security Act [ERISA]) and *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 751–52 (1989) (applying common-law test to determine who is employee for purposes of Copyright Act). *See also* Clackamas Gastroenterology Assocs., P.C. v. Wells, 538 U.S. 440 (2003) (Equal Employment Opportunity Commission focus on common-law test is appropriate for determining who is "employee" for purposes of Americans with Disabilities Act).

6. whether the worker must perform the services personally or whether the worker can assign the work to others;
7. who hires, supervises, and pays the worker's assistants, if any; and
8. who decides what tools or equipment are used to perform the work.[16]

Financial Control

An employee generally has little negotiating power over the financial aspects of the work relationship. Factors that show whether a hiring organization has a right to control the financial aspects of this relationship include

1. whether a worker is paid by the hour, week, or month;
2. whether the worker's business or traveling expenses are paid by the hiring organization;
3. whether the worker furnished the tools, material, and equipment needed to perform the work;
4. whether the worker has a significant investment in facilities needed to do the work;
5. whether the worker can make a profit or suffer a loss as a result of performing the services for the hiring organization;
6. whether the worker can work for more than one firm at a time; and
7. whether the worker makes their services available to the general public.[17]

Type of Relationship

Factors that help make clear the type of relationship that exists between a worker and a hiring organization include

1. written contracts describing the relationship the parties intended to create;
2. whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay;
3. whether the worker and hiring organization have a continuing relationship;
4. whether the work performed by the worker is a key aspect of and is integrated into the regular operations of the hiring organization's operations, and whether the worker must devote most of their time to the work for the hiring organization; and
5. whether the hiring organization can discharge the worker and whether the worker has the right to terminate the relationship with the hiring organization.[18]

Both the IRS and the courts emphasize that no single factor is controlling in defining the worker–hiring organization relationship, and the importance of each factor will vary depending on both the occupation and the circumstances under which the services are rendered.[19]

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16. *See* Rev. Rul. 87-41, *supra* note 15, and the current year's IRS Publication 15-A, Employer's Supplemental Tax Guide, *available at* https://www.irs.gov/publications/p15a.

17. *See* Rev. Rul. 87-41, *supra* note 15, and the current year's IRS Publication 15-A, *supra* note 16.

18. *See* Rev. Rul. 87-41, *supra* note 15, and the current year's IRS Publication 15-A, *supra* note 16.

19. *See* Rev. Rul. 87-41, *supra* note 15, and the current year's IRS Publication 15-A, *supra* note 16. *See also Weber*, 60 F.3d at 1110 (looking at seven of the twenty factors to determine whether minister was employee of church); Hosp. Res. Pers., 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."); Gen. Inv. Corp. v. United States, 823 F.2d 337, 341 (9th Cir. 1987); REAG, Inc. v. United States, 801 F. Supp. 494, 501 (W.D. Okla. 1992); Critical Care Reg. Nursing, Inc. v. United States, 776 F. Supp. 1025, 1028–29 (E.D. Pa. 1991); Cardiovascular Ctr., LLC v. Comm'r, T.C.M. (RIA) 2023-064 (T.C. 2023); Santos v. Comm'r,

In *Weber v. Commissioner*, the federal Fourth Circuit Court of Appeals examined seven factors in determining a minister's employment status with a church: (1) the degree of control the church exercised over details of the minister's work, (2) whether the church or the minister had invested in facilities used in the work (primarily the church building and grounds), (3) the minister's opportunity for profit or loss, (4) whether the church had the right to discharge the minister, (5) the relationship of the minister's work to the church's regular mission and business, (6) the permanency of the relationship, and (7) the relationship the parties believed they were creating.[20] Regarding the right to control, the court noted that both the church's *actual* control and its *right* to assert control were relevant.[21]

While the DOL and the IRS use different tests to determine worker status—the economic-reality test and the three-pronged right-to-control test, respectively—these tests consider similar factors. A worker subject to control is typically economically dependent on the hiring organization. Research has not revealed any case law, DOL Wage and Hour Division Opinion Letters, or IRS Revenue Rulings where these tests led to conflicting conclusions. For that reason, the following sections will discuss factors indicative of worker status under both tests together.

Determining Worker Status

Imagine that a city wants to build a swimming pool. The city council and the management team have opinions about what features they want in a swimming pool but do not know how to construct one, and no one in the city's regular employ has experience in swimming-pool construction. So the city engages a swimming-pool contractor to construct the pool. This is a classic example of a hiring organization–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 upon a price for the final product. While 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 how much time it will take to construct the pool and how much it will cost. It will then determine how much or how little profit it is willing to make to take this job.

Contrast this with the Paradise County hypothetical discussed at the beginning of this bulletin. The county did not set out to hire someone with specialized skills for a discrete, time-limited job. Each department head originally asked for funding to hire one additional employee. What each got was permission to hire an independent contractor to perform the job of an employee (some hiring organizations try to fudge the distinction by referring to these independent contractors as "contract employees").

Is it legal to classify the three new Paradise County workers as independent contractors? For FLSA purposes, the issue is whether each worker is, as a matter of "economic reality," dependent on the county for the work it provides or whether each is in business for himself or herself. For

119 T.C.M. (CCH) 1589 (T.C. 2020); Hampton Software Dev., LLC v. Comm'r, 115 T.C.M. (CCH) 1490 (T.C. 2018). *See also* Pediatric Impressions Home Health, Inc. v. Comm'r, 123 T.C.M. (CCH) 1184, T.C.M. (RIA) 2022-035 (T.C. 2022) (articulating the economic-reality test in a tax court case).

20. *See Weber*, 60 F.3d at 1110.

21. *See id*.

IRC purposes, the issue is whether the county has the right to control their work. A close look at the factors that comprise the economic-reality and right-to-control tests makes clear that these workers cannot be classified as independent contractors for either FLSA or IRC purposes. They must be classified as employees.

Nature and Degree of the Hiring Organization's Control over the Worker

The more control a hiring party has over a worker, the more likely the worker is an employee. A hiring party 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 its right to control for that worker to be an employee as a matter of law.[22] Where a hiring party may change a given worker's job duties or reassign duties among several workers, it has supervisory control over the workers.[23] Generally, where a hiring party has rules governing a worker's personal conduct, it is exercising control over the worker.[24]

A hiring party is considered to have control over its workers when it sets the workers' schedules, may prohibit workers from switching shifts, or disciplines workers who deviate from an assigned schedule. In a case where the employment status of house cleaners was at issue, the fact that the hiring organization dictated which cleaning products were to be used, the cleaning methods to be used (hands and knees, mops versus no mops), and the specific order in which tasks were to be completed made clear that the cleaners were subject to a high degree of control. The court held that they were employees.[25]

In a case brought under the FLSA on behalf of seasonal farm workers, the DOL successfully argued that farm workers were employees rather than independent contractors where the workers did not hold other full-time jobs and the farm owner scheduled the length of each worker's shift and the total length of time the workers would be employed.[26] In a New York case, the court found that HVAC installers were employees where the hiring organization set the installers' schedules and directed their work each day. The hiring organization also required the installers to wear company t-shirts, hats, and sweaters and to use the equipment and materials it provided.[27]

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22. *See* 29 C.F.R. § 795.110(b)(4); 26 C.F.R. § 31.3401(c)-1(b) (employment tax regulations); *Weber*, 60 F.3d at 1110.

23. *See* 29 C.F.R. § 795.110(b)(4) (FLSA regulations); Mathis v. Hous. Auth. of Umatilla Cnty., 242 F. Supp. 2d 777, 783 (D. Or. 2002) (Section 8 housing coordinator was subject to housing authority's control where she worked at housing authority offices, was subject to direction of executive director, and housing authority reserved right to change or reassign job duties); Cardiovascular Ctr., LLC v. Comm'r, T.C.M. (RIA) 2023-064 (T.C. 2023) (medical practice controlled the location of the work, the work performed, the products used to complete the work, and the amount workers were paid).

24. *See* Richardson v. Genesee Cnty. Cmty. Mental Health Servs., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999) (employing agency that provided nurses with patient-care guidelines, as well as with work rules governing "employee conduct," exercised supervisory control for purposes of determining whether nurses were "employees" within the meaning of the FLSA). *See also* U.S. Dep't of Labor, Emp. Standards Admin., Wage & Hour Div., Wage & Hour Opinion Letter, FLSA (Aug. 24, 1999), 1999 WL 1788146 (hospital was likely joint employer with nurse registry of private-duty nurses).

25. *See* Perez v. Super Maid, LLC, 55 F. Supp. 3d 1065, 1077 (N.D. Ill. 2014).

26. *See* Perez v. Howes, 7 F. Supp. 3d 715, 723–27 (W.D. Mich. 2014).

27. *See* Kalloo v. United Mech. Co. of N.Y., Inc., 977 F. Supp. 2d 187, 202 (E.D.N.Y. 2013).

Training in Required Methods

Training in specific methods or in a hiring party's policies and procedures is indicative of an employment relationship. For example, the Fourth Circuit Court of Appeals found an employment relationship where an architect had to follow the procedures in a project director's handbook; adhere to budget constraints; and had his hours, leave, and pay set by the hiring organization.[28] Similarly, the IRS found that a park attendant was an employee, in part because the agency employer provided training and instructions on methods to be used in the work and set specific hours.[29] In a case involving a nurse-staffing service, the court found that required initial and substantial ongoing training weighed heavily in favor of employee status—even though nurses are skilled professionals not generally in need of close supervision.[30]

A requirement that services be performed personally by a worker generally indicates an employment, rather than an independent contractor, relationship. The implication is that the hiring organization has an interest in how the work is performed.[31]

Providing safety training and requiring drug testing of individuals performing particular services or working at a particular job site does not necessarily indicate employer control—especially in high-risk industries. The Fifth Circuit Court of Appeals found that safety training and drug testing were reasonable requirements for both employees and independent contractors because independent contractors who engaged in unsafe work practices would endanger a hiring party's employees and put it in violation from the Occupational Safety and Health Administration's (OSHA's) requirement that employers "furnish a place of employment free from hazards likely to cause death or physical harm to employees."[32]

Monitoring Worker Performance

A hiring party need not monitor a worker's performance daily to exercise control over the worker. Even infrequent oversight, such as monthly site visits, can indicate control over the worker and an employment relationship.[33] In *Hampton Software Development, LLC*

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28. *See* Eren v. Comm'r, 180 F.3d 594, 597 (4th Cir. 1999).

29. *See* I.R.S. Priv. Ltr. Rul. 200323023 (Feb. 24, 2003). *See also* Rev. Rul. 66-274, 1966-2 C.B. 446 (in the context of medical professionals, the right of a hiring organization to require compliance with its general policies is indicated by whether or not a physician is subject to the direction and control of a chief of staff, medical director, or some other authority; a physician director of a hospital pathology department who was not subject to the direction and control of any hospital representative such as chief of staff was an independent contractor). *See also* Rev. Rul. 73-417, 1973-2 C.B. 332 (physician director of hospital laboratory was employee, in part because he had to comply with all rules and regulations of hospital).

30. *See* Gayle v. Harry's Nurses Reg., Inc., 594 F. App'x 714, 717 (2d Cir. 2014).

31. *See* Rev. Rul. 55-695, 1955-2 C.B. 410, 1955 WL 9366 (retired employee who was retained as a "consultant" by her former employer on a retainer-fee basis for the purpose of training her replacement was an employee). *See also* I.R.S. Priv. Ltr. Rul. 8937039 (Sept. 15, 1989), 1989 WL 596203 (psychologists who were required to perform services personally were employees); I.R.S. Priv. Ltr. Rul. 9326015 (Mar. 31, 1993), 1993 WL 238477 (physician employed in a university health clinic who was required to perform services personally was an employee). *See also Gayle*, 594 F. App'x at 717.

32. Parrish v. Premier Directional Drilling, L.P., 917 F.3d 369, 382 (5th Cir. 2019), *citing* 29 U.S.C. § 654.

33. *See* Brock v. Superior Care, Inc., 840 F.2d 1054, 1057, 1060 (2d Cir. 1988) (where nurses worked off-site with individual patients needing home-based or specialized care, the employer was found to have exercised control and supervision over the nurses where it visited job sites as infrequently as once or twice a month and required the nurses to keep and submit to it patient-care notes required by federal and state law). *See also* Donovan v. DialAm. Mktg., Inc., 757 F.2d 1376, 1383–84 (3d Cir. 1985); Mathis v. Hous. Auth. of Umatilla Cnty., 242 F. Supp. 2d 777, 783 (D. Or. 2002). On the IRS side, *cf.* Weber v. Comm'r, 60 F.3d 1104, 1110 (4th Cir. 1995).

v. Commissioner,[34] an apartment manager was deemed an employee of a building owner despite minimal on-site supervision of his performance of routine tasks in which he had experience. The owner gave the manager instructions about non-routine work, telling him what to do, when and how to do it, and how to prioritize tasks.[35]

Requiring written or oral reports is another form of performance monitoring that suggests employee status. These reports may set out time spent on tasks or projects, detailed descriptions of the work performed, or descriptions of client interactions.[36]

But where workers are experienced and require minimal training and oversight, they may be independent contractors. In a 2020 case, the U.S. Tax Court found that workers for a company that provided cleaning services were independent contractors because the company allowed the workers to use their own discretion in deciding how to fulfill cleaning assignments, including what equipment and products to use. The cleaning company did not regularly go to job sites either during or after jobs. If a customer found fault with the cleaning services provided, the company relayed the complaint and told the worker to make any needed corrections.[37]

Regular Wages

Payment of a regular wage—whether by the hour, the week, or the month—weighs in favor of employee status. This is true both where the payment is based on the amount of time spent performing services (hourly worker) and where the wage is not directly linked to the actual amount of time spent working during the pay period (salaried worker). However, if regular payments are made merely as a convenience—a way of spreading out the payment of a lump sum that has been agreed upon as the cost of a job—then this practice would not weigh in favor of employee status.[38] When a hiring party unilaterally sets a worker's pay, the courts consider this evidence of control over the worker.[39]

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34. 115 T.C.M. (CCH) 1490 (T.C. 2018).

35. *See id.* at *26–*29.

36. *See* 29 C.F.R. § 795.110(b)(4) (FLSA regulations); *Hampton Software*, 115 T.C.M. (CCH) 1490 (T.C. 2018), at *26–*29 (finding an apartment manager to be an employee); *see also* Pediatric Impressions Home Health, Inc. v. Comm'r, 123 T.C.M. (CCH) 1184, T.C.M. (RIA) 2022-035 (T.C. 2022), at *5 (nurses required to keep daily detailed case notes were employees); Kentfield Med. Hosp. Corp. v. United States, 215 F. Supp. 2d 1064, 1070 (N.D. Cal. 2002) (hospital psychologists required to submit daily reports of their work were employees); Rev. Rul. 73-591, 1973-2 C.B. 337 (beautician required to submit daily work reports to owner of salon was employee); Rev. Rul. 70-309, 1970-1 C.B. 199 (oil-well pumpers who worked in field and seldom saw employing corporation's agents were employees, in part because they were required to submit written reports on a regular basis). I.R.S. Priv. Ltr. Rul. 9326015, *supra* note 31 (physician in university health clinic was employee); I.R.S. Priv. Ltr. Rul. 9320038 (Feb. 22, 1993) (department of corrections medical director required to submit time reports was employee); I.R.S. Priv. Ltr. Rul. 200323023, *supra* note 29 (seasonal park attendant required to keep logbook was employee).

37. *See* Santos v. Comm'r, 119 T.C.M. (CCH) 1589 (T.C. 2020), at * 5.

38. *See* 29 C.F.R. §§ 795.110(b)(1), (4) (FLSA regulations); *Hampton Software*, 115 T.C.M. (CCH) 1490 (T.C. 2018), at *13 (apartment manager paid flat monthly salary was employee); I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (department of corrections medical director paid hourly rate was employee). *See also* I.R.S. Priv. Ltr. Rul. 200339006 (June 9, 2003) (accounting technician paid hourly wage was employee); I.R.S. Priv. Ltr. Rul. 9728013 (Apr. 9, 1997) (part-time lifeguard paid hourly wage was employee); I.R.S. Priv. Ltr. Rul. 9326015, *supra* note 31 (physician in university health clinic was employee); I.R.S. Priv. Ltr. Rul. 8937039, *supra* note 31 (psychologists treating patients for professional firm were employees).

39. *See* Brock v. Superior Care, Inc., 840 F.2d 1054, 1060 (2d Cir. 1988). See also a U.S. Department of Labor, Wage and Hour Division Opinion Letter dated Dec. 7, 2000 (fact that company controlled rate

Job-based or commission-based pay, on the other hand, often indicates a hiring organization–independent contractor relationship. In two contrasting Revenue Rulings, the IRS found that a hospital physician whose compensation consisted *solely* of a percentage of his department's gross receipts was an independent contractor, while a hospital physician who was *guaranteed a minimum salary* in addition to a percentage of receipts was an employee.[40]

Paradise County's Control Over Its New Workers

Think again about the construction of the swimming pool discussed in the text above. While the city will no doubt be curious about how the work is progressing and city officials will likely visit the job site, the city will not be telling the contractor how to excavate the earth or what method to use in mixing the concrete. Nor does the city have the right to tell the contractor that when the contractor is done with this swimming pool, the city has another one for him to construct at the same price on the other side of town—although the city and the contractor may well come to some agreement on a second job. The city may worry that the contractor is not working fast enough, but until the contractor misses a contractual deadline, the city must bite its tongue.

Now think about Paradise County's "independent contractors," introduced at the beginning of this bulletin. The sanitation worker, visiting nurse, and accounts payable clerk would each work under the supervision of another county employee. The sanitation worker will not choose his own routes but will instead have routes, a truck, and co-workers assigned to him by a supervisor. The visiting nurse will have to follow the health department's patient-care guidelines and will be required by the county to adhere to applicable state and federal regulations governing the treatment and billing of patients—all of which are indicia of employer control.[41] The accounts payable clerk will be told how the county tracks and records accounts payable and will have to use a software program that is already in place.[42]

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

Clearly, the county has the right to control the performance of its so-called independent contractors' work. Their working conditions are in marked contrast to those in *Chao v. Mid-Atlantic Installation Services, Inc.*,[43] a Fourth Circuit Court of Appeals FLSA case in which the

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at which package-delivery drivers were compensated was factor leading to conclusion that drivers were employees rather than independent contractors). *See also* Eren v. Comm'r, 180 F.3d 594, 597 (4th Cir. 1999) (architect whose pay and leave were set by hiring party was employee).

40. *See* Rev. Ruling 66-274, *supra* note 29 (independent contractor); Rev. Ruling 73-417, *supra* note 29 (employee).

41. *See* U.S. Dep't of Labor, Emp. Standards Admin., Wage & Hour Div., Wage & Hour Opinion Letter, FLSA, *supra* note 24 (hospital was likely joint employer of private-duty nurses with nurse registry). *See also* 29 C.F.R. §§ 795.110(b)(4), (5).

42. *See* I.R.S. Priv. Ltr. Rul. 200339006, *supra* note 38 (accounting technician who was paid an hourly wage; who was given all necessary supplies, equipment, and materials needed to perform her services; and who received assignments from a supervisor who determined the methods by which the services were to be performed was an employee rather than an independent contractor); I.R.S. Priv. Ltr. Rul. 200222005 (Feb. 15, 2002) (clerical worker who was hired because she submitted lowest bid but who worked under conditions similar to those covering accounting technician position at federal agency employer was employee). *See also* 29 C.F.R. § 795.110(b)(4).

43. 16 F. App'x 104 (4th Cir. 2001).

court held that cable installers were independent contractors rather than employees. In *Mid-Atlantic*, the fact that the defendant company assigned daily routes to the plaintiff cable installers and required them to report to a dispatcher on a regular basis did not establish employer control. The installers were free to complete their assigned jobs in whatever order they chose and were allowed to attend to personal affairs and to conduct other business during the day. They were also permitted to hire and manage other workers to help them complete their daily assigned installations. This freedom to complete their work at any time during the day and in any manner they chose weighed heavily in the court's determination that they were independent contractors.[44]

Control over Professional Employees

The degree of control necessary to establish a worker's status varies with the nature of the worker's services. Professionals like physicians, CPAs, lawyers, registered nurses, and electrical and building contractors require specialized skills to do their work. The methods these skilled professionals use are frequently dictated by the standards of their professions rather than by the hiring organization. The high level of knowledge and skill needed to perform their respective services often precludes direct supervision of their work. Nevertheless, when skilled workers like these are paid a set salary and follow prescribed routines during set hours, they lose some of the independence that characterizes their usual status as independent contractors and they become employees.[45]

Paradise County's new visiting nurse illustrates this point. The IRS generally recognizes registered nurses as independent contractors when they are performing private-duty nursing, where they have full discretion in administering services. However, when they are part of an organization's medical staff, nurses are usually subject to the control of physicians or senior nurses, indicating employee status. The IRS distinguishes between registered nurses on one hand and licensed practical nurses (LPNs), nurses' aides, and home health aides on the other. LPNs and aides, who primarily assist with personal and domestic care, do not render professional care and are typically subject to almost complete direction and control, regardless of the setting in which they perform their services; they are almost always employees.[46]

The Right to Discharge the Worker

An employer's control over an employee is often exercised through the threat of dismissal, which compels the employee to follow the employer's instructions. In contrast, a true independent contractor cannot be fired as long as they produce a result that meets the hiring party's

44. *See id.* at 106.

45. *See* 29 C.F.R. §§ 795.110(4), (6). *See also* Eren v. Comm'r, 180 F.3d 594, 596 (4th Cir. 1999) (architect); Weber v. Comm'r, 60 F.3d 1104, 1111 (4th Cir. 1995) (minister); Kentfield Med. Hosp. Corp., 215 F. Supp. 2d 1064, 1070 (N.D. Cal. 2002) (psychologists). *See also* Rev. Rul. 87-41, 1987-1 C.B. 296 (discussing IRS' twenty-factor test); Rev. Rul. 58-268, 1958-1 C.B. 353 (dental hygienist); I.R.S. Priv. Ltr. Rul. 9323013 (Mar. 11, 1993) (psychiatrist at state psychiatric facility who served as a court-appointed examiner charged with examining individuals who had been involuntarily committed to the facility was an employee; I.R.S. Priv. Ltr. Rul. 9201033 (Jan. 3, 1992) (x-ray technician).

46. *See* Rev. Rul. 61-196, 1961-2 C.B. 155. *But see* Pediatric Impressions Home Health, Inc. v. Comm'r, 123 T.C.M. (CCH) 1184, T.C.M. (RIA) 2022-035 (T.C. 2022) (private-duty nurses for disabled children were employees of nurse-staffing agency). This is like the distinction made by the DOL in its regulations governing the classification of exempt and nonexempt employees: RNs may be classified as exempt professionals, while LPNs may not. *See* 29 C.F.R. § 541.301(e)(2).

specifications. Thus, a hiring party's right to fire a worker is typically viewed as evidence of an employee relationship.

For example, the IRS examined a case where a medical staffing corporation claimed workers it supplied to medical practices and hospitals were independent contractors. But because the corporation could direct workers' performance and fire them if clients were dissatisfied, the IRS classified these workers as employees.[47]

A worker's right to terminate their services at any time without incurring any liability also indicates an employment relationship. In contrast, an independent contractor who quits prematurely might forfeit part of the contract price or face legal action for specific performance or breach of contract, provided the hiring party can demonstrate damages. [48]

Opportunity for Profit or Loss

Courts are more likely to classify workers as independent contractors when the workers have the opportunity to make a profit or incur a loss on a job. This can occur by completing work faster or slower than anticipated, or at greater or lesser cost than estimated. Employees do not typically have the possibility of making a profit or loss: they are usually paid a fixed salary or hourly wage. Courts do not consider an increase in take-home pay to be "profit" when it is the result of working a greater number of hours.[49] In addition, the Fourth Circuit Court of Appeals has clarified that the risk that a hiring organization might not pay a worker is not an opportunity for loss.[50]

The *Mid-Atlantic* case illustrates how cable installers' opportunity for profit or loss manifested itself. First, the hiring company could charge installers for non-compliance with technical requirements or local ordinances. Second, installers supplied their own equipment and bore liability and insurance costs. Third, installers were responsible for hiring and paying assistants and reporting the assistants' earnings to the IRS. These factors affected the installers' earnings and demonstrated expenses not typically incurred by employees. [51]

Similarly, in *Santos v. Commissioner*, the U.S. Tax Court deemed cleaning company workers independent contractors. The workers could accept or reject assignments, use their own

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47. *See* Rev. Rul. 75-41, 1975-1 C.B. 323 (physicians working for physician services corporation who could be fired at will were employees). *See also* 29 C.F.R. § 795.110(b)(4); *Weber*, 60 F.3d at 1111, 1113 (although minister could not be fired at will, his failure to follow church's Book of Discipline could have resulted in termination by fellow members of clergy); I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (medical director who could be fired with thirty days' notice was employee).

48. *See* Hampton Software Dev., LLC v. Comm'r, 115 T.C.M. (CCH) 1490 (T.C. 2018), at *32 (apartment building owner's right to fire manager at any time weighed in favor of employee status); Rev. Rul. 70-309, 1970-1 C.B. 199 (oil-well pumpers could quit at any time); I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (department of corrections medical director who could be fired with thirty days' notice and could quit at any time was employee); I.R.S. Priv. Ltr. Rul. 200339006, *supra* note 38 (accounting technician who could quit without incurring liability or penalty was employee).

49. *See* 29 C.F.R. § 785.110(b)(1); Richardson v. Genesee Cnty. Cmty. Mental Health Servs., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999) (FLSA case; nurses at mental-health crisis clinic who had no opportunity for profit or loss were employees); *Eren*, 180 F.3d at 597 (IRC case; salaried architect who was not paid commission or percentage of profits had no opportunity for profit or loss); *Weber*, 60 F.3d at 1111 (IRC case; minister paid a salary and provided with a parsonage, a utility expense allowance, and a travel allowance had no opportunity for profit or loss).

50. *See Eren*, 180 F.3d at 597.

51. *See* Chao v. Mid-Atl. Installation Servs., Inc., 16 F. App'x 104, 107 (4th Cir. 2001).

transportation, work at their own pace, hire assistants, and clean for other clients. These factors created opportunities for profit or loss.[52]

In contrast, nurses paid an hourly wage by a staffing agency have been found to have had no opportunity for profit or loss whatsoever, as they had "no downside exposure." The staffing agency paid the nurses promptly regardless of whether the agency had been reimbursed by patients' insurance companies.[53]

The compensation of Paradise County's new sanitation worker, visiting nurse, and accounts payable clerk depends solely on the number of hours each individual works. None has an opportunity for profit and loss. This factor weighs strongly in favor of employee status in each of their cases.[54]

Worker Investment

Worker investment in materials, equipment, or additional workers is closely related to the opportunity for profit or loss. These factors are often analyzed together, since investment in supplies, equipment, and assistants is a form of risk-taking, and a worker who has not invested in a job cannot incur a loss or make a profit.[55]

Courts favor independent contractor status when workers supply materials or equipment or hire assistants. Conversely, when the hiring party provides these resources, it suggests an employment relationship.[56]

- Psychologists provided with staff, office space, and supplies by a hospital were deemed employees.
- A minister's use of a personal home computer for church work was not considered a significant investment when his church employer provided an office and the minister worked from home for his own convenience. The court found that the minister was an employee.[57]

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52. *See* Santos v. Comm'r, 119 T.C.M. (CCH) 1589 (T.C. 2020), at *5–*6.

53. *See* Gayle v. Harry's Nurses Reg., Inc., 594 F. App'x 714, 717–18 (2d Cir. 2014).

54. *See* 29 C.F.R. § 795.110(b)(1); Cardiovascular Ctr., LLC v. Comm'r, T.C.M. (RIA) 2023-064 (T.C. 2023) (medical practice workers who were paid an hourly rate and earned overtime had no opportunity for profit or loss); *see also* Pediatric Impressions Home Health, Inc. v. Comm'r, 123 T.C.M. (CCH) 1184, T.C.M. (RIA) 2022-035 (T.C. 2022) (nurses paid a fixed hourly wage during hours they were prohibited from working anywhere else had "negligible or nonexistent" opportunity for profit or loss).

55. *See* 29 C.F.R. § 795.110(b)(2); Rev. Rul. 70-309, 1970-1 C.B. 199 (oil-well pumpers who worked in field and who assumed no business risks were employees). *See also* I.R.S. Priv. Ltr. Rul. 9251032 (Sept. 21, 1992) (nurse in state tuberculosis outreach program who assumed no risk of profit or loss was employee).

56. *See* Weber v. Comm'r, 60 F.3d 1104, 1111 (4th Cir. 1995) (fact that minister used his own computer at home for church work did not mean he had investment in equipment used for his work, when church provided him with office; he chose to work at home for his own convenience); Kentfield Med. Hosp. Corp., 215 F. Supp. 2d 1064, 1070 (N.D. Cal. 2002) (where psychologists were provided with staff, office space, and all tools and equipment necessary for their work, and where psychologists performed their work at hospital, this factor weighed in favor of employee status); *Cardiovascular Ctr.*, T.C.M. (RIA) 2023-064 (medical practice provided workers with phones, computers, and medical supplies required to complete their jobs, which court found to be typical of employment relationship); Rev. Rul. 71-524, 1971-2 C.B. 346 (drivers of tractor-trailer rigs were found to be employees of a truck-leasing company that supplied rigs and drivers to a common carrier where the truck-leasing company owned the rigs; furnished major repairs, tires, and license plates to the drivers; generated all jobs; and bore major expenses and financial risks); I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (department of corrections medical director provided with all necessary supplies and equipment was employee).

57. *See Weber*, 60 F.3d at 1111.

When both parties contribute supplies or tools, their relative investment is important in determining worker status.[58] In one case, traffic flaggers' investment in personal protective gear was deemed insignificant compared to their employer's provision of vehicles and equipment.[59] Similarly, an apartment manager's personal tools were outweighed by the apartment building owner's provision of office space and additional equipment.[60]

Consider again the construction of the swimming pool in the city of Paradise. The contractor selected by the city typically supplies all necessary materials, equipment, and labor for the jobs he undertakes, factoring these costs into the job price. Whether the contractor accurately assesses these direct and indirect costs impacts whether he makes a profit or takes a loss on the job.

In the *Mid-Atlantic* case, cable installers' investment in tools, trucks, assistants, and insurance weighed heavily in the court's conclusion that they were independent contractors.[61] In contrast, in *Richardson v. Genesee County Community Mental Health Services*, hourly-paid nurses who only supplied their expertise were found to have no investment in their work.[62]

For Paradise County's new workers (sanitation worker, visiting nurse, and accounts payable clerk), their lack of investment in tools, supplies, and equipment supports their classification as employees. They will use county-supplied equipment and collaborate with other county-hired workers rather than hire their own assistants.

Work Requiring Special Skills and Initiative; Offering Services to Others

Independent contractors typically possess special skills and actively seek out assignments or clients. For example, electricians, carpenters, and construction workers, like swimming-pool contractors, have special skills.[63] Registered nurses are also skilled workers.[64] But having a special skill alone doesn't determine independent contractor status. The key factor is whether the worker exercises significant initiative in finding work opportunities or clients.[65]

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58. *See* 29 C.F.R. § 785.110(b)(2).

59. *See* Randolph v. Powercomm Constr., Inc., 309 F.R.D. 349, 358 (D. Md. 2015).

60. *See* Hampton Software Dev., LLC v. Comm'r, 115 T.C.M. (CCH) 1490 (T.C. 2018), at *26–*29 (finding apartment manager to be an employee).

61. *See* Chao v. Mid-Atl. Installation Servs., Inc., 16 F. App'x 104, 107 (4th Cir. 2001). *See also* U.S. Dep't of Labor, Emp. Standards Admin., Wage & Hour Div., Wage & Hour Opinion Letter, FLSA (Sept. 5, 2002), 2002 WL 32406602.

62. *See* Richardson v. Genesee Cnty. Cmty. Mental Health Servs., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999).

63. *See Mid-Atl.*, 16 F. App'x at 107.

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

65. *See* 29 C.F.R. § 795.110(b)(6); Hobbs v. Petroplex Pipe & Constr., Inc., 360 F. Supp. 3d 571 (W.D. Tex. 2019) (although pipe welding requires specialized skills, plaintiffs had limited opportunities to display initiative in performance of their jobs, as they were given work assignments with strict specifications); *Richardson*, 45 F. Supp. 2d at 614 (citing Brock v. Superior Care, Inc., 840 F.2d 1054, 1060 (2d Cir. 1988) (where nurse are paid hourly rate by employing organization rather than directly by patients, they are likely to be employees)) (nurses working after regularly scheduled hours at crisis clinic run by same employer do not locate clients independently). *See also* Mathis v. Hous. Auth. of Umatilla Cnty., 242 F. Supp. 2d 777, 784 (D. Or. 2002) (special-skills factor weighed toward employee status where Section 8 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).

For instance, electricians and carpenters serving a single organization over an extended period are likely employees rather than independent contractors.[66] Conversely, when workers regularly advertise their services to the public and work for multiple unrelated clients simultaneously, this generally indicates independent contractor status. However, working for two or more organizations simultaneously isn't conclusive evidence of independent contractor status, as one can be an employee of multiple organizations.[67]

Applying these principles to Paradise County's new hires, the following becomes clear:

- Neither the job of sanitation worker nor accounts payable clerk requires any special skills or initiative. Sanitation workers rarely offer services to the public individually, and the accounts payable clerk's regular forty-hour week under direct supervision argues against independent contractor status.
- The visiting nurse does have a special skill. This factor will not weigh heavily in favor of independent contractor status because the nurse doesn't seek out clients independently but is instead assigned patients by the health department and paid by the county rather than by patients.[68]

Duration of the Relationship

Although it is possible for an independent contractor to have a long-term relationship with a hiring party, the typical independent contractor–hiring party relationship is usually for a limited duration.[69] The swimming-pool contractor is a case in point: the relationship between the city of Paradise and the contractor lasts only as long as it takes to construct the pool; once payment is made for the finished product, the relationship ends.

A continuing relationship, on the other hand, is strong evidence of employee status.[70] Employers should note that for both FLSA and IRC purposes, a continuing relationship can exist where work is performed at frequently recurring, but nonetheless irregular, intervals, such as

66. Where a job does not require any special skills but requires only initiative for success, this factor will not weigh strongly in either direction. *See* Thomas v. Global Home Prods., Inc., 617 F. Supp. 526, 535 (W.D.N.C. 1985), *aff'd in part, modified, and remanded*, 810 F.2d 448 (4th Cir. 1987) (local distributor for cookie and candy company was employee).

67. *See* 29 C.F.R. § 795.110(b)(6) (FLSA regulations); Rev. Rul. 70-572, 1970-2 C.B. 221 (race-horse jockey who offered services to horse-racing public was independent contractor). *Cf.* I.R.S. Priv. Ltr. Rul. 9251032, *supra* note 55 (nurse for state tuberculosis outreach program did not represent herself as offering services to the public and was an employee).

68. *See, e.g.*, Pediatric Impressions Home Health, Inc. v. Comm'r, 123 T.C.M. (CCH) 1184, T.C.M. (RIA) 2022-035 (T.C. 2022), at *10–*11 (although job of nurse hired through staffing agency required special skills, once on job, patient's plan of care specified how nurse was to perform assigned work; initiative not required to receive consistent work from staffing agency).

69. *See* Chao v. Mid-Atl. Installation Servs., Inc., 16 F. App'x 104, 107 (4th Cir. 2001) (fact that many cable installers had worked with employer for a number of years was neutral factor in independent contractor analysis, since it is possible for independent contractors to have a long-term relationship with an employer). *See also* Cardiovascular Ctr., LLC v. Comm'r, T.C.M. (RIA) 2023-064 (T.C. 2023) (medical practice and workers had transitory relationship); *Brock*, 840 F.2d at 1060 (nurses were employees even though most nurses received referrals from other sources and few had continuing relationships with defendant employer).

70. *See* 29 C.F.R. § 795.110(b)(3). *See also* Hampton Software Dev., LLC v. Comm'r, 115 T.C.M. (CCH) 1490 (T.C. 2018), at *26–*29 (apartment manager had worked for apartment building owner for more than ten years).

when a person works on an on-call basis. One example of such a relationship would be that of a physician who sees patients at a clinic only when needed. Another would be a lifeguard who returns to work every summer season.[71]

The projected continuing relationship of Paradise County with its three newest workers further indicates that these workers should be classified as employees.

Integral Part of the Hiring Organization's Business

Workers performing tasks integral to an organization's operations are more likely to be classified as employees rather than independent contractors.[72] Courts assess this by considering whether a worker provides services that an employing organization exists to provide. Workers who perform the mission work of an agency are an integral part of an employer's business. Examples of workers providing services that are an integral part of a hiring organization's operations include

- nurses hired by a crisis clinic to provide mental-health crisis intervention and referral services to the public;[73]
- a medical practice's workers who scheduled appointments, completed prior authorizations, faxed prescriptions, and checked the vital signs of patients;[74]
- a Section 8 housing coordinator who worked for a housing authority;[75]
- a minister who worked for a church;[76]
- psychologists who treated patients for a professional practice;[77] and
- a property manager for an apartment building who accepted, rejected, and evicted tenants; processed rent payments; and performed maintenance work.[78]

None of the positions in the examples above were entitled to independent contractor status; all of the workers were employees.

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71. *See* 29 C.F.R. § 795.110(b)(3); United States v. Silk, 331 U.S. 704 (1947); Eren v. Comm'r, 180 F.3d 594, 597 (4th Cir. 1999) (worker who had performed services for hiring party exclusively for more than twenty years was employee rather than independent contractor); Weber v. Comm'r, 60 F.3d 1104, 1113 (4th Cir. 1995) (minister's relationship with his church employer was clearly envisioned as permanent where church paid salaries to ministers even where there were no positions available locally); Kentfield Med. Hosp. Corp., 215 F. Supp. 2d 1064, 1070 (N.D. Cal. 2002) (psychologists were required to work forty-eight weeks per year and had ongoing relationships with hospital employer); I.R.S. Priv. Ltr. Rul. 9326015, *supra* note 31 (physician in university health clinic had continuing relationship with employer despite fact that he only worked when needed). *See also* I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (department of correction medical director was continuing position).

72. *See* 29 C.F.R. § 795.110(b)(5); Thomas v. Global Home Prods., Inc., 617 F. Supp. 526, 535 (W.D.N.C. 1985).

73. *See* Richardson v. Genesee Cnty. Cmty. Mental Health Servs., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999). *See also* U.S. Dep't of Labor, Emp. Standards Admin., Wage & Hour Div., Wage & Hour Opinion Letter, FLSA, *supra* note 24 (hospital was likely joint employer of private-duty nurses with nurse registry).

74. *Cardiovascular Ctr.*, T.C.M. (RIA) 2023-064.

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

76. *See Weber*, 60 F.3d at 1112 (minister).

77. *See* I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (psychologists).

78. *See* Hampton Software Dev., LLC v. Comm'r, 115 T.C.M. (CCH) 1490 (T.C. 2018), at *26–*29 (finding apartment manager to be an employee).

In addition, "independent contractors" doing the same work as individuals the employer considers employees are more likely to be considered employees themselves.[79]

Similarly, where workers are independent contractors "after hours" for their regular employers but perform the same job duties as they do during "regular hours," they are most certainly going to be deemed employees.[80] Indeed, for FLSA purposes, even where regular employees are hired to perform different jobs "after hours," they almost always must be treated as employees. As the DOL advised one company that desired to hire an employee (the lead designer of its monthly magazine) as an independent contractor (to do the typesetting and laying out of books) through the designer's private business,

> it is our opinion that the graphic designer when performing work for your company in her freelance graphic design capacity would also be an employee of your company and not an independent contractor. This is so even though the work that she would perform as a freelance artist would be different than her normal job responsibilities at the company. *It has long been the position of the Wage and Hour Division that it is unrealistic to assume that an employment and "independent contractor relationship" may exist concurrently between the same parties in the same workweek.*[81]

In the case of the swimming-pool contractor, it is clear that the contractor does not provide services that are basic to the city 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 like that done by city employees—indeed, the whole point of bringing in the swimming-pool contractor was to tap into expertise and experience that is both lacking in the city's workforce and unlikely to be needed again.

The situation of the Paradise County workers is markedly different. Two perform some of the "mission work" of the county (sanitation work, provision of public health services), while one (accounts payable clerk) performs work essential to the county's business operations (paying its bills). All three perform the same work as others hired by the county as employees. A court would likely find all three to be an integral part of the county's operations. These factors weigh heavily in favor of employee status.

Summing Up: Paradise County Has Three New Employees

In engaging the services of the sanitation worker, visiting nurse, and accounts payable clerk, Paradise County has taken on three new employees, notwithstanding how the county or each worker might describe the relationship. Why is that the case? Because Paradise County

- has retained the right to control the work of the sanitation worker, visiting nurse, and accounting clerk;
- has the right to fire each of them; and
- has not provided the workers with the opportunity to make a profit or suffer a loss.

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79. *See* 29 C.F.R. § 795.110(b)(5); Brock v. Superior Care, Inc., 840 F.2d 1054, 1057–58 (2d Cir. 1988); *Mathis*, 242 F. Supp. 2d at 785.

80. *See* Richardson v. Genesee Cnty. Cmty. Mental Health Servs., 45 F. Supp. 2d 610, 614 (E.D. Mich. 1999).

81. *See* U.S. Dep't of Labor, Wage & Hour Div., Wage & Hour Opinion Letter, FLSA (July 5, 2000), 2000 WL 33126569 (emphasis added).

The workers, for their part,

- individually have made no investment in the performance of their services for the county and
- do not seek out client opportunities on their own.

Finally, with respect to each of the workers,

- both Paradise County and the worker envision a continuing relationship and
- the work done is an integral part of the business of county government.

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

What Happens When a Worker Desires to Be an Independent Contractor?

Sometimes a worker will want to be hired as an independent contractor. The worker may "waive" his or her rights to overtime, social security contributions, and other benefits. This does not work. The worker's desire to be classified as an independent contractor is irrelevant. Workers cannot waive their status as "employees" for either FLSA or IRS purposes. If a worker is, as a matter of economic reality, dependent upon the hiring party, or if the hiring party has the right to control the worker, the fact that the parties have called their relationship one of principal and independent contractor will not alter the worker's legal status as an employee.[82]

Some Difficult Cases

Part-Time Instructors in Parks and Recreation Departments or Employee Training and Development Programs

While educational institutions make the greatest use of adjunct or part-time instructors, local government parks and recreation departments also hire part-time workers to teach physical education and activity classes and other subjects. Similarly, employers offering employee training and development programs frequently use outside workers to lead training sessions. Use of instructors such as these would, on its face, appear to be a textbook example of the proper classification of a worker as an independent contractor.

- Adjunct instructors are engaged for a limited duration to do a defined job.
- Adjunct instructors typically have a particular expertise and perform similar or related services for other organizations or individuals.
- For local government and college recreation programs, the hiring organization charges a fixed fee for the courses or sessions that adjunct instructors teach and typically pays the instructors some percentage of that as a fixed fee for their services.

82. *See* Thomas v. Global Home Prods., Inc., 617 F. Supp. 526, 534 (W.D.N.C. 1985), *citing* Robichaux v. Radcliff Material, Inc., 697 F.2d 662, 667 (5th Cir. 1983), and Real v. Driscoll Strawberry Assocs., Inc., 603 F.2d 748 (9th Cir. 1979) (FLSA cases). *See also Mathis*, 242 F. Supp. 2d at 786 (Section 8 housing coordinator's request to be treated as independent contractor does not alter "economic reality" that she is housing authority employee) (FLSA). *See also* Weber v. Comm'r, 60 F.3d 1104, 1113 (4th Cir. 1995) (IRC).

The IRS, however, takes a different view. In a series of revenue rulings, private letter rulings, and technical advice memoranda, the IRS has held that part-time instructors are employees where the hiring organization

- determines the courses that are offered,
- determines the content and hours of each course,
- enrolls the students, and
- provides the facilities at which the instruction is offered

and where the instructor

- is required to perform his or her services personally;
- has no investment in the facilities; and
- does not bear a risk of profit or loss (that is, the instructor is paid the same amount whether or not tuition and fee payments cover the hiring organization's expenses).

The fact that an instructor provides teaching services or services related to the subject of expertise to others and may devote only a small percentage of work time to the instruction performed for the hiring organization is irrelevant.[83] The IRS analysis focuses on the fact that the hiring organization controls everything about the way in which the "teaching services" are performed—that is, in each of the cases the IRS considered, the hiring organization controlled everything except the actual delivery of the material.

Would the FLSA economic-reality test provide a different result? Probably not. As discussed above, the FLSA economic-reality test and the IRS right-to-control test consider essentially the same factors. Research for this bulletin has not revealed any cases that address the issue of an adjunct instructor's status as an employee or independent contractor under the FLSA. This lack of cases is not surprising. Most instructors would have little reason to bring an FLSA claim. Few FLSA-nonexempt part-time instructors are likely to work the more than forty hours that would make overtime an issue.

Physicians

Classifying physicians hired for health clinics, on-site occupational health offices, or public hospitals presents challenges like those encountered when classifying registered nurses. Physicians' high level of specialized training typically allows them almost complete discretion in patient care, with minimal day-to-day supervision. Where there is such supervision, it is generally provided by another physician.

While the extent to which a worker's services are integral to a hiring organization's regular business is important in determining whether a worker is an employee or independent contractor, this factor carries less weight in the case of physicians. As noted in IRS Revenue Ruling 66-274, organizations often engage physicians because medical services are necessary for their operation. More important than the question of whether a physician's services are integral to a hiring organization, therefore, is the way the services of the physician are integrated into the hiring organization's operations.

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

Significant factors in analyzing this integration include

1. the manner in which a physician is paid for their services—that is, whether the physician is paid on a percentage basis, salary basis, or percentage basis with a guaranteed minimum;
2. whether the physician is permitted to employ associate physicians or to engage substitutes when they are absent from work;
3. if the physician is permitted to engage substitutes, whether the physician or the hiring organization is responsible for compensating them; and
4. whether the physician is permitted to engage in the private practice of medicine or to perform professional services for others.[84]

For physicians, the IRS places less emphasis on the right to control and more on the physician's economic independence from the hiring organization.

Applying these factors, the IRS has made contrasting determinations in the hospital setting. A hospital pathology department director was classified as an independent contractor where he received a percentage of the department's gross receipts as his only compensation, personally paid his associates or substitutes, was permitted to engage in the private practice of medicine, and was not subject to the direction and control of any hospital representative, such as a chief of staff.[85] But a physician director of a hospital laboratory was found to be an employee where he was guaranteed a minimum salary in addition to a specified percentage of charges attributable to his department and could not pursue outside business or provide pathology services to others without written consent.[86]

A Price to Pay

An organization that misclassifies workers as independent contractors when those workers do not meet the legal test for independent contractor status may be subject to significant penalties under both the FLSA and the IRC. Penalties include

- liability for overtime compensation going back for a period of two years (FLSA);
- liquidated damages in an amount equal to the amount of overtime owed (FLSA);[87]
- liability for 1.5 percent of each worker's federal income tax liability where the misclassification was unintentional and the employer filed a Form 1099 (IRC);
- liability for both the employer's share of missed FICA contributions and up to 20 percent of the employee's missed FICA contributions where the employer filed a Form 1099 (IRC); and
- interest on the underwithheld amounts and other IRS penalties (IRC).[88]

These penalties make illusory the projected savings that likely would cause an organization to engage workers as independent contractors in the first place.

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84. *See* Rev. Rul. 66-274, *supra* note 29. *See also Weber*, 60 F.3d at 1112 (minister's work clearly part of regular work of United Methodist Church); I.R.S. Priv. Ltr. Rul. 9320038, *supra* note 36 (department of corrections medical director paid hourly rate was employee); I.R.S. Priv. Ltr. Rul. 8937039, *supra* note 31 (psychologists who treated patients for professional firm were employees).

85. *See* Rev. Rul. 66-274, *supra* note 29.

86. *See* Rev. Rul. 73-417, *supra* note 29.

87. *See* 29 U.S.C. §§ 216(b), 255(a).

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

Section 530: An IRC Safe Harbor

Employers facing tax and FICA consequences due to their misclassification of workers may avail themselves of the "safe harbor" defense offered by section 530 of the Revenue Act of 1978.[89]

Under section 530, an employer meeting the following conditions will not be held liable for failure to withhold employee federal income taxes or for past-due FICA taxes: (1) the employer has treated a worker as an independent contractor; (2) it has filed all required federal employment tax returns on a basis consistent with the classification of the worker as an independent contractor (that is, the employer has filed Form 1099); and (3) it had a *reasonable basis* for not treating the worker as an employee.[90] Section 530 relief is not available, however, where the employer has treated another worker holding a substantially similar position as an employee.[91]

Section 530 provides that a taxpayer had a *reasonable basis* for not treating an individual as an employee if it had relied on

- judicial precedent, published rulings, technical advice with respect to the employer, or a letter ruling to the employer;
- 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
- a long-standing recognized practice of a significant segment of the industry in which such individual was engaged.[92]

Courts have held that an employer can satisfy the reasonable basis requirement by establishing that it relied on the advice of an attorney in making the decision to treat a worker as an independent contractor.[93]

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89. Section 530 of the Revenue Act of 1978 has never been codified, although it is valid law. *See* I.R.S., *Worker Reclassification – Section 530 Relief*, IRS.GOV (last updated Mar. 18, 2024) https://www.irs.gov/government-entities/worker-reclassification-section-530-relief; I.R.S. Gen. Couns. Mem. 202038010, "[Social Security Act] Section 218 Workers and [Revenue Act of 1978] Section 530 Relief" (July 24, 2020), *available at* https://www.irs.gov/pub/irs-wd/202038010.pdf.

90. *See* 26 U.S.C. § 3401 note (section 530(a)(1)(B)); Ahmed v. United States, 147 F.3d 791, 797 (8th Cir. 1998) ("Section 530 does not confer eternal immunity from employment tax liability . . . it merely eliminates liability for those discrete periods of time during which the employer erroneously but reasonably failed to treat an individual as an employee"); Springfield v. United States, 88 F.3d 750, 753 (9th Cir. 1996); REAG, Inc. v. United States, 801 F. Supp. 494, 502 (W.D. Okla. 1992).

91. *See* I.R.S., *Worker Reclassification, supra* note 89; 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. IRS, 927 F. Supp. 171, 175 (W.D. Pa. 1996).

92. Revenue Act of 1978, Section 530(a)(2); I.R.S., *Worker Reclassification*, *supra* note 89. *See also* Pediatric Impressions Home Health, Inc. v. Comm'r, 123 T.C.M. (CCH) 1184, T.C.M. (RIA) 2022-035 (T.C. 2022), at *11–*12 (rejecting employer's section 530 defense because employer had treated workers as employees previously).

93. *See* I.R.S., *Worker Reclassification*, *supra* note 89; Hosp. Res. Pers., Inc. v. United States, 68 F.3d 421, 426–27 (11th Cir. 1995) (temporary nurses); *Select Rehab, Inc.*, 205 F. Supp. 2d at 383 (medical directors); N. La. Rehab. Ctr., Inc., v. United States, 179 F. Supp. 2d 658, 669 (W.D. La. 2001) (physician medical and program directors); Queensgate Dental Fam. Prac., Inc. v. United States, Nos. 1:CV–90–0918, 1:CV–90–1290, 1:CV–90–1291, 1991 WL 260452 (M.D. Pa. Sept. 5, 1991), *aff'd*, 970 F.2d 899 (3d Cir. 1992) (dentists); Déjà vu Ent. Enters. of Minn., Inc. v. United States, 1 F. Supp. 2d 964, 969 (D. Minn. 1998) (adult-entertainment club performers).

Determining Worker Status under Other Employment Statutes

A worker's classification as an employee or independent contractor has implications beyond overtime and tax withholding. It affects various employment-related situations.

- What happens when a worker is subjected to sexual harassment? Title VII of the Civil Rights Act of 1964 prohibits sexual harassment but only protects "employees."
- What happens when a worker is injured on the job? The North Carolina Workers' Compensation Act covers "employees," not independent contractors.
- When a worker is dismissed unexpectedly, they usually apply for unemployment benefits, but the North Carolina Employment Security Law provides these benefits only to "employees."
- What of a worker who grows too old to work? Workers classified as "independent contractors" are ineligible for benefits from public retirement systems like the LGERS or the TSERS, which are limited to "employees."

Employers should keep in mind that when things go unexpectedly wrong and independent contractors suffer physical injury in the workplace, emotional distress from harassment or financial difficulties from layoff or retirement, they may challenge their status as "non-employees" and seek to enjoy the benefits and remedies provided to employees under various employment statutes. These challenges may arise even if workers initially agreed to perform services as "independent contractors" and understood their exclusion from workers' compensation insurance, unemployment insurance, and retirement-system benefits.

Public employers must understand how worker status is determined under each relevant statutory scheme. As the following sections show, interpretation of each of these statutes requires use of a common-law test to determine whether a worker is an employee.

Federal Anti-Discrimination Law: Title VII, the Americans with Disabilities Act, and the Age Discrimination in Employment Act

Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act (ADA), and the Age Discrimination in Employment Act (ADEA) prohibit employers from discriminating against employees on the basis of race, color, gender, religion, national origin, disability, and age. These anti-discrimination statutes provide circular definitions of the term "employee": an employee is "an individual employed by an employer."[94] Title VII and the ADA define "employer" as a "person . . . who has fifteen or more employees" during a specified period, while the ADEA includes "a State or political subdivision of a State and any agency or instrumentality of a State or a political subdivision of a State" in its definition of "employer."[95]

It is a general rule of federal statutory construction that when Congress uses the term "employee" without further definition, it intends to describe the typical employer-employee

94. 42 U.S.C. § 2000e(f) (Title VII); 42 U.S.C. § 12111(4) (ADA); 29 U.S.C. § 630(f) (ADEA).
95. 42 U.S.C. § 2000e(b) (Title VII); 42 U.S.C § 12111(5) (ADA); 29 U.S.C. § 630(b) (ADEA).

relationship as understood at common law.[96] Thus, for Title VII, ADA, and ADEA purposes, the degree of control exercised by a hiring party determines whether a worker is an employee or independent contractor.[97] The relevant factors generally align with those used in the IRC right-to-control test.[98] A worker who is an employee under the FLSA and IRC tests will almost certainly also be an employee for Title VII, ADA, and ADEA purposes.

The North Carolina Workers' Compensation Act and the North Carolina Employment Security Law

Under the North Carolina Workers' Compensation Act, "employees" are entitled to medical benefits and compensation for lost wages for job-related injuries and occupational diseases. The Act defines the term "employee" as "every person engaged in an employment under any appointment or contract of hire or apprenticeship, express or implied, oral or written," including state and local officers and elected officials.[99] Given this circular definition, the North Carolina Supreme Court has held that the appropriate test to determine worker status is the traditional common-law test.[100]

The North Carolina Employment Security Law, which governs unemployment insurance benefits, adopts the same definitions of "employment" and "employee" as the IRS (*see* 26 U.S.C. § 3306). The North Carolina Court of Appeals interprets these terms using a common-law right-of-control test.[101]

The common-law right-of-control test as developed under North Carolina law and applicable to both the Workers' Compensation Act and the Employment Security Act is

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96. *See* Nationwide Mutual Ins. Co. v. Darden, 503 U.S. 318, 322–23 (1992) (construing the undefined term "employee" under ERISA); Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 739–40 (1989) (construing the undefined term "employee" under the Copyright Act of 1976); United States v. Rafiekian, 991 F.3d 529, 539 (4th Cir. 2021) (construing the undefined term "agent" under a criminal law prohibiting individuals from serving as unregistered agents of foreign governments); Day v. Johns Hopkins Health Sys. Corp., 907 F.3d 766, 776–77 (4th Cir. 2018) (RICO statute incorporated common-law understanding of witness immunity).

97. *See, e.g.*, Smith v. CSRA, 12 F.4th 396, 412–13 (4th Cir. 2021) (using economic-reality and common-law tests to determine worker was not employee under ADA); Butler v. Drive Auto. Indus. of Am., Inc., 793 F.3d 404, 414 (4th Cir. 2015) (common-law element of control most important factor in determining employee status in joint employment situation under Title VII); Farlow v. Wachovia Bank of N.C., 259 F.3d 309, 313 (4th Cir. 2001); Cilecek v. Inova Health Sys. Servs., 115 F.3d 256, 260 (4th Cir. 1997), *cert. denied*, 522 U.S. 1049 (1998) (Title VII); Clackamas Gastroenterology Assocs., P.C. v. Wells, 538 U.S. 440, 449–50 (2003) (holding that common-law test was appropriate standard by which to determine whether physician shareholders were employees of professional corporation for ADA purposes); Mangram v. Gen. Motors Corp., 108 F.3d 61, 62–63 (4th Cir. 1997); Garrett v. Phillips Mills, Inc., 721 F.2d 979, 980 (4th Cir. 1983) (ADEA).

98. The factors, as set forth in *Reid*, 490 U.S. 730, are as follows: the hiring party's right to control the manner and means by which the work product is accomplished; the skill required for the work; the source of the instrumentalities and tools used in the work; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision/non-provision of employee benefits; and the tax treatment of the hiring party. *See Reid*, 490 U.S. at 751–52; *Darden*, 503 U.S. at 322–23. *See also Farlow*, 259 F.3d at 313; *Cilecek*, 115 F.3d at 260; *Clackamas*, 538 U.S. at 445, 449–50; *Mangram*, 108 F.3d at 62–63; *Garrett*, 721 F.2d at 982.

99. *See* Chapter 97, Section 2(2) of the North Carolina General Statutes (hereinafter G.S.).

100. *See* McGown v. Hines, 353 N.C. 683, 686 (2001); Hughart v. Dasco Transp., Inc., 167 N.C. App. 685 (2005).

101. *See* State *ex rel.* N.C. Dep't of Commerce v. Aces Up Expo Sols., LLC, 275 N.C. App. 170 (2020).

outlined in the 1944 case of *Hayes v. Elon College*.[102] The *Hayes* factors mirror those found in the FLSA economic-reality and IRC right-to-control tests. These factors consider whether the person employed

1. engages in an independent business, calling, or occupation;
2. has independent use of their special skills or knowledge in carrying out the work;
3. performs a specified piece of work at a fixed price or for a lump sum;
4. can adopt whatever work method they choose without risk of being discharged;
5. is not in the regular employment of the hiring party;
6. may use assistants freely;
7. has full control over assistants; and
8. selects his or her own time to do the work.

As is the case under the FLSA and IRC tests, no one factor is determinative.[103] A worker who is an employee under these tests is very likely to be an employee for workers' compensation and unemployment insurance purposes as well.

Retirement Systems

For LGERS purposes, the North Carolina General Statutes define "employee" as "any person who is regularly employed in the service of and whose salary or compensation is paid by the employer as defined [below] . . . whether employed or appointed for stated terms or otherwise."[104] TSERS requires all teachers and state "employees" to enroll, defining "employees" as "all full-time employees, agents or officers of the State of North Carolina . . . provided that the term 'employee' shall not include . . . any part-time or temporary employees."[105]

While no case has required North Carolina courts to determine worker status for retirement-system eligibility, it's likely that the North Carolina Supreme Court would apply the common-law meaning of "employee" and use the *Hayes* test for retirement-systems purposes, as it does for the Workers' Compensation Act.

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 that they are therefore entitled to participate in their hiring organizations' employee benefit plans.[106] In some cases,

102. 224 N.C. 11 (1944).

103. *See id.* at 15. *See also Hughart*, 167 N.C. App. at 694; *Aces Up Expo Sols.*, 275 N.C. App. at 182–93.

104. *See* G.S. 128-21(10).

105. *See* G.S.135-3(1), -1(10).

106. *See, e.g.*, Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998) (workers' status as common-law employees made them eligible for participation in employee benefit plans despite being labeled independent contractors in employment agreements). *See also* Epright v. Env't Res. Mgmt., Inc. Health & Welfare Benefit Plan, 81 F.3d 335 (3d Cir. 1996) (where employee benefit plan eligibility was predicated on "full-time employment," company could not exclude full-time temporary employees from participation); Daughtry v. Honeywell, Inc., 3 F.3d 1488 (11th Cir. 1993) (if worker was common-law employee for period of consulting agreement, then she was entitled to participate in employer's ERISA benefit plans); Eldredge v. Asarco Inc., 252 P.3d 182, 192 (Mont. 2011) (work done under "consulting agreement" constituted employment for which worker earned time to be credited toward retirement benefit).

the employees have sought the value of benefits retrospectively. Could such a suit be successful against a North Carolina public employer? The answer is unclear.

The Law Governing Public Employee Benefits

In private-sector cases, workers engaged as independent contractors have sued their hiring organizations, claiming they are common-law employees entitled to participate in employee benefit plans. Some have sought benefits retrospectively. As stated above, the potential success of such a suit against a North Carolina public employer remains unclear, as no reported cases exist in North Carolina state or federal courts or in other jurisdictions. However, considering North Carolina law on public-sector employee benefits and the Ninth Circuit Court of Appeals decision in *Vizcaino v. Microsoft Corp.*,[107] workers meeting the common-law employee test may have a right to participate in a hiring organization's benefit plans on par with recognized "employees."[108]

Apart from the Affordable Care Act's employer mandate,[109] federal law doesn't require employers to provide employees retirement, disability, or any other type of benefits. The North Carolina General Statutes require state, community college, and local school board employees to participate in either TSERS or an alternative program and offer employees State Health Plan enrollment.[110] Local government employers aren't required to offer retirement or other benefits,[111] though most do to attract and retain employees.

Public employers, like private employers, can create separate classes of employees with varying benefit eligibility, provided that exclusions aren't based on protected categories like race, color, gender, religion, national origin, age, disability, or any other distinction prohibited by law.[112] Public-employer retirement and welfare-benefit plans are governed by state contract law, unlike private-sector plans, which are governed by ERISA.[113]

Cf. Kalksma v. Konica Minolta Bus. Sols. U.S.A., Inc., No. 10–2829 (DRD), 2011 WL 3703471, at *7 (D.N.J. Aug. 22, 2011) (even if a worker who had signed an independent contractor agreement were to be found to be a common-law employee, the worker would still have been excluded from eligibility for benefits under the terms of the employer's benefit agreements); Sturgis v. Mattel, Inc., 525 F. Supp. 2d 695 (D.N.J. 2007) (same).

107. 120 F.3d 1006 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998).

108. *Id.* (workers' status as common-law employees made them eligible for participation in benefit plans despite being labeled independent contractors in employment agreements). *See also Epright*, 81 F.3d 335 (where employee benefit-plan eligibility was predicated on "full-time employment," company could not exclude full-time temporary employees from participation); *Eldredge*, 252 P.3d at 192 (work done under "consulting agreement" constituted employment for which worker earned time to be credited toward retirement benefit). *Cf. Kalksma,* 2011 WL 3703471, at *7 (even if a worker who signed an independent contractor agreement were to be found to be a common-law employee, the worker still would not have been eligible for benefits under the terms of the employer's benefits agreements).

109. *See* 26 U.S.C. § 4980H.

110. For retirement, see G.S. Chapter 135, especially sections 135-1(10) and (11); for health insurance, see *id.* Chapter 135, especially sections 135 through 140 and following. For additional benefits, see G.S. 115C-341, -342, and -343.

111. *See, e.g.*, G.S. 160A-162(b), which grants to a municipal council the authority to "purchase life, health, and any other forms of insurance for the benefit of all or any class of city employees and their dependents." G.S. 153A-92(d) grants identical authority to county boards of commissioners with respect to county employees.

112. *See, e.g.*, 42 U.S.C. § 2000e-2 (Title VII); 29 U.S.C. § 623 (ADEA); 42 U.S.C. § 12112 (ADA); 38 U.S.C. § 4311 (Uniformed Services Employment and Reemployment Rights Act, which prohibits employment discrimination against persons serving in the armed forces).

113. For the exclusion of government pension and welfare-benefit plans from ERISA's coverage, see 29 U.S.C. sections 1002(32) and 1003(b)(1).

A Promise of Employee Benefits Is Enforceable

Under North Carolina contract law, when an employer's personnel policy has promised employees certain benefits, the promise is enforceable, and the employer must provide the benefits.[114] This is an exception to the general rule that says that an employer's issuance of a personnel policy manual or handbook for employees does not create an implied contract of employment incorporating the document's terms.[115] In *Brooks v. Carolina Telephone & Telegraph Co.*,[116] for example, the court held that when an employee manual promised severance pay to certain management employees terminated without cause, the employer had to prove it had eliminated the benefit and communicated this change to employees before termination. Similarly, in *White v. Hugh Chatham Memorial Hospital, Inc.*,[117] the court enforced a handbook promise allowing employees to maintain group health-plan coverage if they became permanently disabled during employment, even when plan changes made coverage more expensive than anticipated.

The rule that makes a promise of benefits enforceable would likely be the linchpin of worker arguments that, as common-law employees rather than independent contractors, they are entitled to employee benefits.

Consider the earlier hypothetical where Paradise County hired three new workers as "independent contractors." Imagine that a court has ruled that these workers satisfy both the FLSA economic-reality test and the IRC right-to-control test, holding that they are common-law employees. Following this ruling, the workers claim the right to participate in Paradise County's benefit plans and seek compensation for benefits they didn't receive while misclassified as independent contractors.

Would their claims succeed? Most likely, yes. Under North Carolina law, when an employer's personnel policy promises certain benefits to employees, that promise is enforceable. An employer must provide the benefits outlined in its personnel policy as long as the policy and relevant provisions remain in effect.[118] The Paradise County workers' argument would be that since they have been found to be employees, they were employees from the start. As such, they claim an enforceable right to participate in the county's benefit plans—a right the county has denied them.

Typically, personnel policies offer benefit-plan participation to all full-time "employees" without further defining that term. If asked to interpret "employee," a North Carolina court

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114. *See, e.g.*, Brooks v. Carolina Tel. & Tel. Co, 56 N.C. App. 801 (1982); Hamilton v. Memorex Telex Corp., 118 N.C. App. 1, *discretionary review denied*, 340 N.C. 260 (1995); White v. Hugh Chatham Mem'l Hosp., Inc., 97 N.C. App. 130, *discretionary review denied*, 326 N.C. 601 (1990).

115. *See* Rucker v. First Union Nat'l Bank, 98 N.C. App. 100, *discretionary review denied*, 326 N.C. 801 (1990); Smith v. Monsanto Co., 71 N.C. App. 632 (1984); Griffin v. Hous. Auth. of Durham, 62 N.C. App. 556 (1983).

116. 56 N.C. App. 801.

117. 97 N.C. App. 130.

118. *See, e.g., Brooks*, 56 N.C. App. 801 (where an employee manual represented that certain management employees would be entitled to severance pay if their employment were terminated without cause, it was the employer's burden to prove that it had in fact eliminated the benefit and communicated that change to the employees prior to the plaintiff's termination); *Hamilton*, 118 N.C. App. at 11; *White*, 97 N.C. App. 130 (where an employer promised in its handbook that employees could maintain coverage under the employer's group health plan in the event they became permanently disabled during the period of their employment, the promise was enforceable even where changes in the terms of the employer's group health plan made the cost of covering a disabled employee much more expensive than anticipated).

would likely apply the common-law right-of-control test from *Hayes v. Elon College*,[119] as it has for the state Workers' Compensation Act and the Employment Security Law. The court would probably apply the same test to interpret "employee" under G.S. Chapter 135 (governing LGERS participation) and Chapter 128 (governing TSERS participation).

Given this, a court would likely find that the Paradise County workers are employees within the meaning of the county's personnel policy and thus are entitled to participate in its benefit plans.

Conclusion

Most people performing services for a public-sector organization are "employees" under the common-law definition of that term. True independent contractors are rare. Government employers can inadvertently accrue significant unfunded liabilities when misclassifying employees as independent contractors, including unpaid overtime, unpaid employer FICA contributions, and penalties for violating the FLSA and IRC, as well as liability for unpaid benefits.

To avoid these risks, it is crucial that each public employer establish a procedure for an individualized analysis of any proposed relationship with a worker it plans to engage on an independent contractor basis. Few will meet the criteria for independent contractor status.

The appendix to this bulletin provides a model checklist of factors public employers should consider when evaluating whether a worker is an independent contractor or common-law employee. Employers should adapt this checklist as is appropriate to the nature of their organization as a whole or to 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 particular facts and circumstances of the arrangement. When in doubt, err on the side of classifying workers as employees.

119. 224 N.C. 11 (1944).

Appendix

A Model Checklist to Help Determine Independent Contractor or Employee Status

The answer "yes" indicates that the factor in question weighs in favor of employee status, while the answer "no" indicates that the factor weighs in favor of independent contractor status.

Factor	Yes	No
1. Does the hiring organization have the right to control (a) when, where, and how the worker will do the job or (b) the order and sequence in which the worker will perform services? (Check "yes" even if the organization does not intend to exercise that right.)	☐	☐
2. Does the hiring organization set the worker's hours and schedule?	☐	☐
3. Must the work be performed personally by the worker (as opposed to the worker subcontracting it out or furnishing their own substitute)?	☐	☐
4. Is the hiring organization providing training of any kind?	☐	☐
5. Does the hiring organization provide the worker with the tools, supplies, and/or equipment needed to do the job (as opposed to requiring the worker to bring their own tools, equipment, and supplies to the job)?	☐	☐
6. Does an employee of the hiring organization supervise the worker?	☐	☐
7. Does the worker have to submit written or make oral reports?	☐	☐
8. Is the work performed on the hiring organization's premises or at a site controlled or designated by the hiring organization?	☐	☐
9. If the worker is performing services offsite, does the hiring organization have the right to send supervisors to the site to check up on the worker? (Check "yes" even if the organization has no intention of exercising that right.)	☐	☐
10. Can the worker be fired at the will of the hiring organization?	☐	☐
11. Can the worker quit the job at will without incurring any liability?	☐	☐
12. Will the hiring organization hire, fire, and pay the worker's assistants?	☐	☐
13. Will the worker be paid by the hour, week, or month (as opposed to being paid for the successful completion of the job or piece)?	☐	☐
14. Has the hiring organization unilaterally set the worker's rate of pay?	☐	☐
15. Does the hiring organization reimburse the worker for expenses and travel?	☐	☐