

Employing Independent Contractors and Other Gig Workers

July 9, 2021

Editor's Note: The U.S. Department of Labor officially withdrew the final rule issued under the prior administration that would have clarified who is an independent contractor versus an employee under the Fair Labor Standards Act (FLSA). No new rule is expected in the immediate future. For more information, see [DOL Withdraws Independent-Contractor Rule \(www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/dol-withdraws-independent-contractor-rule.aspx\)](http://www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/dol-withdraws-independent-contractor-rule.aspx).

Overview

The use of temporary, nonemployees to fill short term or changing workplace needs is nothing new for employers. Independent contractors have long been used as freelancers or consultants, such as writers, musicians, IT professionals and trainers. Today, we see project-based "gig work" in almost every industry and profession. Still referred to as independent contractors under most employment laws, today's gig worker includes the student pet-sitter working around a school schedule, the mid-career travel nurse wanting to broaden his work experience and the retired teacher turned rideshare driver looking to remain active and engaged. Research indicates that between 25 and 35 percent of workers in the U.S. participate in the gig economy in some capacity.¹

See [The Alternative Workforce: Not So Alternative Anymore](http://www.shrm.org/executive/membership/Documents/2019%20Research_HRPS_Bersin.pdf)

(www.shrm.org/executive/membership/Documents/2019%20Research_HRPS_Bersin.pdf).

Employee or Independent Contractor?

The most basic question about the employment relationship is whether a worker is, in fact, an employee or an independent contractor. As with so many employment law issues, the answer is it depends. In this case, it depends on who is asking: the Internal Revenue Service (IRS), the U.S. Department of Labor (DOL), a workers' compensation hearing officer and so on. Even courts have admitted that the distinction is not always clear. Regardless of what the employer calls the worker; contractor, freelancer, consultant or gig worker, the same principles apply. See [Navigating Employment Law in the Gig Economy \(www.shrm.org/hr-today/news/hr-magazine/0618/pages/navigating-employment-law-in-the-gig-economy.aspx\)](http://www.shrm.org/hr-today/news/hr-magazine/0618/pages/navigating-employment-law-in-the-gig-economy.aspx).

Employee status triggers employer obligations under various federal and state laws that do not apply to independent contractors, and the responsibility for classifying a worker correctly falls squarely on the employer. HR professionals must understand the practical and legal differences between employees and independent contractors.

No bright-line test exists to determine when a worker should be classified as an employee rather than as an independent contractor. However, a wealth of information is readily available to help organizations make the necessary case-by-case determinations. Once the decision has been made to meet a staffing need through independent contractors, organizations can take several practical steps to manage independent contractors effectively.

See BLS: Contingent and Alternative Employment Arrangements Summary (<https://www.bls.gov/news.release/conemp.nr0.htm>) and Gigs Are the Future of Work: A Q&A with Sarah Kessler (www.shrm.org/hr-today/news/hr-magazine/0518/pages/gigs-are-the-future-of-work-kessler-qa.aspx).

How to Classify Properly

No legal test applies in every situation when deciding to classify a worker as an independent contractor. For example, the IRS and DOL use different, although similar, analytical frameworks. In fact, the multiplicity of tests defining independent contractor status applied across federal and state laws makes it possible for a worker to be classified as an independent contractor under one law but as an employee under another.

To minimize legal risk, employers are well-advised to ensure that classification as an independent contractor would satisfy every test that may be applicable where the organization does business.

TESTS FOR INDEPENDENT CONTRACTOR STATUS

Various federal government agencies and some states have their own tests to determine independent contractor status.

DOL. According to the DOL's Fact Sheet 13: Employment Relationship Under the Fair Labor Standards Act (<https://www.dol.gov/whd/regs/compliance/whdfs13.htm>), "The U.S. Supreme Court has on a number of occasions indicated that there is no single rule or test for determining whether an individual is an independent contractor or an employee for purposes of the FLSA. The Court has held that it is the total activity or situation which controls." The following factors have been considered significant in determining independent contractor classification:

- The extent to which the services rendered are an integral part of the principal's business.
- The permanency of the relationship.
- The amount of the alleged contractor's investment in facilities and equipment.
- The nature and degree of control by the principal.
- The alleged contractor's opportunities for profit and loss.
- The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
- The degree of independent business organization and operation.

See Misclassification of Employees as Independent Contractors (<https://www.dol.gov/whd/workers/misclassification/>) and DOL Issues Guidance on Independent Contractors (www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/dol-issues-guidance-on-independent-contractors.aspx).

Additionally, some statutes enforced by the DOL, such as the federal Service Contract Act, contain their own definitions of what constitutes an employee for purposes of the statute. See Employee coverage does not depend on form of employment contract (<http://www.gpo.gov/fdsys/pkg/CFR-2001-title29-vol1/xml/CFR-2001-title29-vol1-sec4-155.xml>).

IRS. As reflected in Section 2 of its Publication 15-A: Employer's Supplemental Tax Guide (<https://www.irs.gov/publications/p15a/>), the IRS now looks at 11 factors (rather than the previous 20 factors) within three areas:

- Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
- Financial: Are the business aspects of the worker's job controlled by the payer? (These include such considerations as how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
- Type of Relationship: Are there written contracts or employee-type benefits (e.g., pension plan, insurance, vacation pay, etc.)? Will the relationship continue, and is the work performed a key aspect of the business?

See Independent Contractor (Self-Employed) or Employee? (<https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>)

Organizations or individuals can request an official determination of a worker's status under the IRS test by filing IRS Form SS-8 (<https://www.irs.gov/uac/about-form-ss8>).

Workers' compensation laws. The test for independent contractor status under workers' compensation laws varies from state to state. To find out more about the workers' compensation test in a given state, employers may contact the state department of industrial relations or the state labor department.

State laws. Some states may have different or more-restrictive independent contractor classification rules. Several states, such as California, use their own three-factor test, also known as an "ABC" test, where three main criteria must be met. Each employer should check the laws in the states in which they wish to hire independent contractors to ensure compliance. See [How do I know if an individual is considered an employee or independent contractor in California?](http://www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/california-independent-contractor-in-california.aspx) (www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/california-independent-contractor-in-california.aspx)

Legal Ramifications of Misclassification

Classifying a gig worker as an independent contractor should always be an informed and bona fide business decision, not a subterfuge to avoid the employer's obligations to employees. Misclassification of an individual as an independent contractor can give rise to a variety of liabilities. See [Misclassification of Independent Contractors Can Be Remedied](http://www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/misclassification-independent-contractors-remedied.aspx) (www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/misclassification-independent-contractors-remedied.aspx).

If the purported independent contractor arrangement is between two organizations, that is, between the organization receiving the services and the organization that actually engages the workers, there is a risk of being found to be a joint employer—a legal relationship in which *both* client and contractor can be liable for violations of employment laws. See [How to Minimize Staffing Agency Snags](http://www.shrm.org/hr-today/news/hr-magazine/1117/pages/how-to-minimize-staffing-agency-snags.aspx) (www.shrm.org/hr-today/news/hr-magazine/1117/pages/how-to-minimize-staffing-agency-snags.aspx).

TAX CONSEQUENCES

Employers are required to withhold income taxes based on information employees provide on IRS Form W-4. If an employer fails to withhold income taxes on behalf of a worker improperly classified as an independent contractor, and the individual has failed to pay the taxes, the employer may be liable for federal or state taxes that were required to be withheld but were not.

Furthermore, independent contractors are not eligible to receive tax-free benefits from the organization. If the company chooses to offer health care benefits to an independent contractor, the contractor must pay income taxes on the value of the benefit. If the company includes an independent contractor in its defined benefit pension plan, it risks losing the tax-exempt status of the plan. See [Regulation of Employee Benefits](#)

(http://www.dol.gov/oasam/programs/history/herman/reports/futurework/conference/staffing/9.6_benefits.htm) and What Benefits Can Companies Offer Gig Workers? (www.shrm.org/resourcesandtools/hr-topics/benefits/pages/what-benefits-can-companies-offer-gig-workers.aspx)

Additionally, beginning with tax year 2020, employers must use Form 1099-NEC (<https://www.irs.gov/forms-pubs/about-form-1099-nec>) to report nonemployee compensation rather than the 1099-MISC. See What is the difference between IRS Form 1099-NEC and Form 1099-MISC? (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/What-is-the-IRS-Form-1099-NEC-and-Form-1099-MISC.aspx)

EMPLOYEE BENEFITS OBLIGATIONS

In *Vizcaino v. Microsoft Corporation*, the court found that Microsoft had mischaracterized certain workers as independent contractors and freelancers. Although the workers had been hired for specific projects, some continued to work on successive projects for several years. They were fully integrated into Microsoft's workforce, and worked onsite and on work teams along with Microsoft's regular employees. They also shared the same supervisors, performed identical functions and worked the same core hours as regular employees. Microsoft provided them with admittance card keys, office equipment and supplies. However, as independent contractors, these workers were not eligible for the same employee benefits that Microsoft's regular employees received. Microsoft reached a settlement for \$96.89 million and was subsequently assessed approximately \$27.13 million in attorney fees and costs.

WORKERS' COMPENSATION

A misclassified gig worker can result in the supposed employer being held liable for on-the-job injuries outside the protections of the workers' compensation system, and for penalties as well.

UNEMPLOYMENT COMPENSATION

A worker may file a claim for unemployment compensation and be granted benefits if the unemployment agency believes that the worker was misclassified as an independent contractor. If the organization misclassified the worker, it may be liable for penalties and interest in addition to unpaid unemployment insurance premiums. See New York Uber Drivers Can Collect Unemployment Benefits (www.shrm.org/resourcesandtools/legal-and-compliance/state-and-local-updates/pages/new-york-uber-drivers-can-collect-unemployment-benefits.aspx).

WAGE AND HOUR LIABILITY

The widespread use of gig workers invites the scrutiny of plaintiffs' attorneys who may be eager to bring a class- or collective-action suit for unpaid overtime or minimum wage violations under the Fair Labor Standards Act (FLSA) or state wage and hour laws. See Wage and Hour Class Actions Can Cost Employers Millions (www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/wage-and-hour-class-actions.aspx).

VICARIOUS LIABILITY

An employer may incur liability for wrongful acts of a worker who it has mistakenly classified as an independent contractor. Even when an individual has been correctly classified as an independent contractor, an employer may still be liable for work that is considered "inherently dangerous activity," or if the employer exercises control over the work or the activity that caused harm to a third party.

The Staffing Decision: Employees or Independent Contractors?

Organizations cannot use independent contractors indiscriminately to avoid the tax, equal employment opportunity and other legal requirements applicable to employees. An employer should consider a variety of factors—none of them in isolation—in deciding whether to meet a staffing need by means of independent contractors versus employees. Weighing the requirements of the job in combination with other factors will enable the employer to judge whether an independent contractor will both meet the employer's staffing needs and withstand legal scrutiny.

Some common situations when gig workers may be appropriate include:

- Projects of short or specific duration.
- Where specialized knowledge or experience is needed for a specific complex project.
- Exigent circumstances such as meeting needs when an employee goes on an extended leave of absence.

Organizations can take the following proactive steps to ensure that they effectively use independent contractors within the bounds of the law:

- Involve HR upfront in deciding whether to meet a staffing need through independent contractors or employees and in making sure that the arrangement qualifies as a bona fide independent contractor relationship.
- Use written independent contractor agreements containing language that helps establish the bona fides of the classification as an independent contractor. See *Sample Independent Contractor Agreement*. (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-forms/Pages/1cms_006447.aspx)
- Ask the worker to indemnify the organization for any losses resulting from misclassification or to regularly provide the organization with proof that the independent contractor is timely in paying all employment taxes due.
- Adopt a formal policy concerning the use of independent contractors. See *Contingent Staff: Contract and Temporary Employees Policy*. (www.shrm.org/ResourcesAndTools/tools-and-samples/policies/Pages/temporary-staffing-policy.aspx)
- Use a checklist to make sure all details regarding management of independent contractors are being handled. See *Independent Contractor: Hiring Checklist*. (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-forms/Pages/cms_010200.aspx)
- Do not treat independent contractors like regular employees, but do ensure that they understand and adhere to the organization's policies and procedures.

See: *Audit Checklist for Maintaining Independent Contractor (IC) Status* (www.shrm.org/ResourcesAndTools/tools-and-samples/hr-forms/Pages/independent_contractor_checklist.aspx).

Tools and Samples

SHRM's Independent Contractor Resource Center (www.shrm.org/ResourcesAndTools/Pages/Independent-Contractors.aspx)

HR Q&AS

Contingent Staffing: Can an independent contractor or a consultant manage company employees?

(www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/contingent-staffing-can-an-independent-contractor-or-a-consultant-manage-company-employees.aspx#sthash.r91s4ivJ.dpuf)

Independent Contractor: Can an employer terminate and rehire an employee as an independent contractor doing the same job?

([www.shrm.org/ResourcesAndTools/tools-and-samples/hr-](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/cananemployertterminateandrehireanemployeeasanindependentcontractorddoingthesamejob.aspx)

[qa/Pages/cananemployertterminateandrehireanemployeeasanindependentcontractorddoingthesamejob.aspx](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/cananemployertterminateandrehireanemployeeasanindependentcontractorddoingthesamejob.aspx))

Independent Contractor: Is there any guidance for employers when managing the relationship with an independent contractor?

([www.shrm.org/ResourcesAndTools/tools-and-samples/hr-](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/isthereanyguidanceforemployerswhenmanagingtherelationshipwithanindependentcontractor.aspx)

[qa/Pages/isthereanyguidanceforemployerswhenmanagingtherelationshipwithanindependentcontractor.aspx](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/isthereanyguidanceforemployerswhenmanagingtherelationshipwithanindependentcontractor.aspx))

Independent Contractor: May an employee also work as an independent contractor for the same employer?

(www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/employeeasindependentcontractorandstaffemployee.aspx)

Independent Contractor: What is a statutory employee? ([www.shrm.org/ResourcesAndTools/tools-and-samples/hr-](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/whatisastatutoryemployee.aspx)

[qa/Pages/whatisastatutoryemployee.aspx](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/whatisastatutoryemployee.aspx))

Interns: Can interns be independent contractors? ([www.shrm.org/ResourcesAndTools/tools-and-samples/hr-](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/caninternsbeindependentcontractors.aspx)

[qa/Pages/caninternsbeindependentcontractors.aspx](http://www.shrm.org/ResourcesAndTools/tools-and-samples/hr-qa/Pages/caninternsbeindependentcontractors.aspx))

AGENCIES AND ORGANIZATIONS

U.S. Department of Labor (<http://www.dol.gov/>)

U.S. Internal Revenue Service (<http://www.irs.gov/>)

Endnotes

¹GigEconomyData.org. n.d. *How many gig workers are there?*. [online] Available at: <<https://www.gigeconomydata.org/basics/how-many-gig-workers-are-there>> [Accessed 8 July 2021].

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