SMITH ANDERSON

LEGAL RAMIFICATIONS OF WORKER CLASSIFICATION

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Table of Contents

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The Law	Employees	Joint Employees	Independent Contractors	Effect Of Misclassification	Comments
1. Income Tax Withholding, Employment Taxes (FICA, FUTA, N.C. Employment Security Tax)	**Employer must withhold income and FICA taxes and pay FICA, FUTA and state employment security taxes. 26 U.S.C. §§ 3402 (income tax), 3101, 3111, 3112 (FICA), 3301 (FUTA); N.C. Gen. Stat. §§ 105-163.2(a) (state income tax), 96-9 (state employment security tax). Generally, the employer is the recipient of the services; however, for tax withholding and liability purposes, the person controlling wage payment is the "employer." 26 U.S.C. § 3401 (d) (federal income tax); N.C. Gen. Stat. § 105-163.1(b) (state income tax); Otte v. United States, 419 U.S. 43 (1974) (FICA); In re Southwest Restaurant Systems, Inc., 607 F.2d 1237 (9th Cir. 1979) (FUTA); cf. N.C. Gen. Stat. § 96-8(5)(r) (employee leasing organization is treated as employer.)**	**Joint employer who controls the wage payment is solely liable for withholding and taxes.** **Note: Responsibility will not shift from service recipient to wage payer unless wage payer has exclusive control over wage payment. Century Indemnity Co. v. Riddell, 317 F.2d 681 (9th Cir. 1963)**	**No withholding/tax obligations.**	**Service Recipient controls wage payment: employer liable for employee income tax, employer and employee FICA tax and FUTA taxes. Penalties, interest, possible individual liability.** **Service provider may be eligible for employer pension/benefit plans.** **Third party controls wage payment: no effect.**	**Control over workers or the work performed is irrelevant. GM v. United States, U.S. Dist. Lexis 17986 (E.D.Mi. Dec. 20, 1990).**

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2. Employee Benefit Plans (Pension and certain welfare plans)	**a. To maintain tax qualification, plans must satisfy nondiscrimination rules. 26 U.S.C. §§ 410(b) (pension), 105(n) (self-insured medical), 79(d) (group term life insurance), 129 (d)(2) (dependent care), 125(b) (cafeteria), 117(d) (3) (tuition reduction), 120(c)(1) (group legal services), 127 (b)(2) (educational assistance). Total number of employees (including certain leased employees) must be taken into account in applying rules.**	**a. Certain "leased employees" must be considered the service recipients' employees for nondiscrimination rules purposes. 26 U.S.C. § 414(n). A "leased employee" is a person whose services: (I) are provided pursuant to agreement between service recipient and third party; (ii) are of the type historically performed by employees; and (iii) are provided on a substantially full-time basis for at least one year. Id.**	**a. Independent contractors are not employees for nondiscrimination testing purposes.**	**a. Increased likelihood that plans will not satisfy nondiscrimination requirements and, thus, be disqualified (i.e., no deduction for plan contributions, earnings for plan assets taxable as income, highly compensated plan participants taxed for value of vested benefits).**	**a. If the leased employee rules currently are followed, then effect of reclassification on satisfying nondiscrimination rules may be mitigated.**
	b. Eligible employees may participate in employee benefit plans.	**b. As long as a person is merely a leased employee, he will not be entitled to participate in plans. See Prop. Reg. 1.414(n)-2(a)(2).**	**b. Independent contractors are not eligible for participation in employee benefit plans.**	**b. Benefit liability to misclassified individuals, unless plan language expressly excludes misclassified workers or otherwise renders individual ineligible.**	**b. See Nationwide Mut. Ins. Co. v. Darden, 112 S.Ct. 1344 (1992) (adopting a general common law of agency test ("right to control" test) for determining employee status under ERISA and rejecting broader test which construes "employee" in light of the mischief to be corrected and the end to be attained).[1]**

[1]Darden also set forth two principles relevant to determining employer status in other contexts. First, general common law of agency principles will apply in determining employee status unless the statute (i) expressly defines the term otherwise or (ii) contains language that suggests applying such principles would thwart congressional intent or lead to absurd result. In setting forth this principle, the Court expressly abandoned an approach in earlier cases (NLRB v. Hearst Publications, Inc., 322 U.S.111 (1944); United States v. Silk, 331 U.S. 704 (1947)) which determined employee status by construing the term "in the light of the mischief to be corrected and the end to be attained." Second, the broad FLSA test for determining employee status (commonly known as the "economic realities" test) does not apply to statutes which share the FLSA definition of employee but not its expansive definition of the term "employ."

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3. Fair Labor Standards Act (FLSA), 29 U.S.C. § 201 et seq.	**Employees must be paid minimum wage and, in certain circumstances, overtime pay.**	**Joint employers are individually and jointly responsible for FLSA compliance. See 29 C.F.R. 791.2; DOL Opinion Ltr No. 874 (October 1, 1968) (recipient of services jointly responsible for overtime and minimum wage payments).**	**FLSA does not cover independent contractors.**	**Liability for unpaid wages, liquidated damages, attorneys' fees.**	**Employee status determined using liberal "economic realities" test. Rutherford Food Corp. v. McComb, 331 U.S. 722 (1947) (citing NLRB v. Hearst Publications, Inc., 322 U.S. 111 (1944) (acknowledging the FLSA applies to individuals who are not employees within the meaning of general agency principles). Right to control is not necessary for employer status.** **Joint employer status may exist where entity seeking to avoid such status has substantial control over the terms and conditions of the work. Falk v. Brannon, 414 U.S. 190 (1973).**

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4. National Labor Relations Act (NLRA), 29 U.S.C. § 151 et seq.	**a. Employees have the right to organize.**	**a. Joint employers are prohibited from engaging in unfair labor practices; however, they are not liable for other joint employer's conduct unless they:** **- knew or should have known that other employer acted against the joint employee for unlawful reasons; and** **- acquiesced in the unlawful action by failing to protest it or exercise any contractual right to resist it.** **Capitol EMI Music, Inc., 311 N.L.R.B. No. 103 (May 28, 1993).**	**NLRA does not cover independent contractors. 29 U.S.C. § 152(3).**	**Misclassification in connection with a response to protected activity/ bargaining can lead to unfair labor practice charges.**	**Employer status determined using general agency principles ("right to control" test). NLRB v. United Ins. Co., 390 U.S. 254 (1968).** **Joint employer status may exist where both entities share or co-determine the essential terms and conditions of employment. NLRB v. Browning-Ferris Industries, 691 F.2d 117 (3rd Cir. 1982) (landmark NLRA joint employment case) (citing Boire v. Greyhound Corp., 376 U.S. 473 (1964)).**
	b. Employers must bargain with employee representative.	**b. Joint employers must bargain.**			

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5. Equal Employment Opportunity laws (e.g., Title VII, ADEA, ADA)	**Employment opportunities must be provided without regard to protected class status.**	**Joint employers also must provide equal employment opportunities; including, in some cases, reasonable accommodations for another entity's employee, such as changes to physical structures, etc.**	**Independent contractors generally are not covered by EEO laws; however, EEO liability has been found against entities whose discriminatory conduct impairs an individual's employment relationship with his employer or interferes with his opportunity to engage in his business. See, e.g., Sibley Memorial Hospital v. Wilson, 488 F.2d 1338 (D.C.Cir. 1970).**	**EEO liability -- backpay, reinstatement, compensatory and punitive damages, attorneys' fees.**	**For EEO purposes, an individual may have more than one employer.** **The Fourth Circuit employs a hybrid test for determining employee/independent contractor status which incorporates elements of the "economic realities" and "right to control" tests. Garrett v. Phillips Mills, Inc., 721 F.2d 979 (4th Cir. 1983).** **Under this test, control is the most important factor. Other important considerations include: (1) the kind of occupation, whether the work usually is done under a supervisor's direction or by a specialist without supervision; (2) the skill required; (3) who furnishes the equipment used and the place of work; (4) the length of time during which the individual has worked; (5) the method of payment; (6) the manner in which the work relationship is terminated; (7) whether annual leave is afforded; (8) whether the work is an integral part of the business of the "employer"; (9) whether the worker accumulates retirement benefits; (10) whether the "employer" pays social security taxes; and (11) the intention of the parties.**

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6. Family and Medical Leave Act (FMLA), 29 U.S.C. § 2654 et seq.	**Covered employers must provide eligible employees up to 12 weeks unpaid leave for qualifying circumstances.**	**"Primary employers" are responsible for complying with FMLA notice, leave, benefit continuation and job restoration requirements. 29 C.F.R. 825.106.** **"Secondary employers" are prohibited from interfering with joint employees' exercise of FMLA rights or from otherwise discriminating against those who exercise them. Id.**	**FMLA does not cover independent contractors.**	**FMLA liability -- backpay, job restoration, benefits continuation, and attorneys' fees.**	**The FMLA regulations set forth factors for determining whether an employer/employee or joint employment relationship exists. 29 C.F.R. 825.106. Among other things, these factors include: (i) control over workers and supervision over work; (ii) power to determine pay rate or method; (iii) right to hire or fire or modify employment conditions; and (iv) preparation of payroll and payment of wages.**
7. Occupational Safety and Health Act (OSHA), 29 U.S.C. §651 et seq.	**Employers have a duty to:** **- provide a safe workplace;** **- comply with OSHA regulations; and** **- keep records.**	**See Comments.**	**See Comments.**	**Liability for OSHA violations, including injunctive orders and civil and criminal penalties.**	**In allocating OSHA responsibility, OSHRC considers which entity:** **- created the hazard;** **- supervised the workers;** **- possessed knowledge of the hazard;** **- whose business was being furthered;** **- the individuals believed was their employer; and** **- paid the wages.** **Manpower Temporary Svcs., Inc., 5 O.S.H. Cas. (BNA) 1803 (1977) (emphasizing liability for entity that created hazard or supervised workers); Del-Monte Construction Co., 9 O.S.H. Cas. (BNA) 1703 (1981) (noting recent cases considered remaining four factors cited above).**

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8. Immigration and Reform Control Act (IRCA), 8 U.S.C. § 1324	**Employers must require that employees provide verification of authorization to work in the U.S.**	**Under IRCA, it appears that the entity that provides the individuals to perform services, and <u>not</u> the recipient of the services, is required to comply with verification obligations. 8 C.F.R. 274a.1(g).**	**IRCA does not govern independent contractors. 8 C.F.R. 274a.1(f).**	**If misclassified individual is employed by contractor, then service recipient may not have IRCA liability.** **If he is not employed by another employer, then service recipient may incur civil or criminal penalties.** **8 U.S.C. § 1324a (e) and (f).**	**The IRCA regulations set forth a non-exclusive list of factors for determining whether an independent contractor relationship exists. 8 C.F.R. 274a.1(j).** **These include whether the individual supplies the tools or materials; makes services available to the general public; works for a number of clients at the same time; has an opportunity for profit or loss as a result of labor or services provided; invests in the facilities for work; directs the order or sequence in which the work is to be done and determines the hours during which the work is to be done.**
9. Wrongful Discharge	**Under state common law, employers may be subject to wrongful discharge claims.**		**To date, no wrongful discharge claim for independent contractors has been recognized; however, a tortious interference with contractual relationship claim exists.**		

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10. Tort Liability	**Under respondeat superior, employers can be vicariously liable for an employee's torts.**	**Liability exists under the "borrowed servant doctrine." Harris v. Miller, 335 N.C. 379 (1994).**	**Persons are not vicariously liable for the torts of an independent contractor whom they have retained.**	**Tort Liability**	**Under North Carolina law, an explicit agreement between the parties regarding right of control is dispositive. Harris, 335 N.C. at 387. Absent such an agreement, numerous factors are considered, e.g., special skills, suppliers of tools, length of service, whether borrower has skill or knowledge to control the manner in work is performed, whether borrower exercise such skill. Id.**
11. Workers Compensation, N.C. Gen. Stat. § 97-1 et seq.	**Employers must provide employees with workers' compensation coverage. Such coverage is the employees' exclusive remedy for workplace injuries. N.C. Gen. Stat. § 97-10.1.**	**Under North Carolina law, a "special" employer is liable for workers' compensation only if:** **(a) the lent employee has made a contract of hire, express or implied, with the "special" employer;** **(b) the work being done is essentially that of the "special" employer; and** **(c) the "special" employer has the right to control the details of the work.** **Weaver v. Bennett, 259 N.C. 16, 27 (1963) (quoting Larson, Workmen's Compensation Law, § 48.00)**	**Independent contractors are not covered by Workers' Compensation.**	**Workers' compensation liability.**	