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Classifying Independent Contractors

Robert M. Warzel



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Introduction

- This presentation discusses how to properly classify workers as independent contractors vs. employees.
- Specifically, this presentation covers:
 - The difference between independent contractors and employees.
 - The tests used to determine independent contractor status.
 - The benefits of using independent contractors.
 - The consequences of misclassifying employees as independent contractors.
 - Best practices



What is an Independent Contractor?



What is an Independent Contractor?

An independent contractor typically:

- Charges a fee for their services.
- Is engaged only for the term required to perform a specified service or task.
- Retains control over the method and manner of work.
- Retains economic independence and is free to offer their services to more than one company.
- Is responsible for paying their own income, social security, and Medicare taxes.
- Is not covered by most federal, state, or local laws designed to protect employees.

What is an Independent Contractor?

An independent contractor typically does not:

- Receive company-sponsored benefits, such as paid vacation, health insurance, or retirement benefits.
- Perform the same work as the company's employees.
- Have the “indicia” of an employee, such as company uniforms, name badges, or business cards.

Independent Contractor v. Employee

An employee, by comparison, is subject to significant oversight and control by the company and:

- Is paid wages and receives company-sponsored benefits.
- Is employed for a continuous period and performs whatever tasks the company requires.
- Generally pays their income, social security, and Medicare taxes through the amounts their employer is obligated to withhold from their wages.
- Is economically dependent on the employer.
- Is protected by applicable federal, state, and local employment laws.

Classification: Overview

- Do not rely on generalizations or labels to determine employee or independent contractor status.
- Simply referring to a worker as an independent contractor, even if they agree to that designation, is not enough.
- Classification depends on:
 - The facts of each case.
 - Application of the appropriate independent contractor tests.
 - Differences in how courts and government agencies interpret those tests.

Tests for Independent Contractor Status



Tests for Independent Contractor Status

- There is no single test to determine independent contractor status for all purposes.
- The various tests include:
 - The Economic Realities Test.
 - The Control Test.
 - Common law and other federal law tests.
 - State law tests.
- **Familiarize yourself with the different federal and state tests that may apply.**

Tests for Independent Contractor Status

- Economic Realities Test
- The Control Test: The IRS Standard
- The Common Law Darden Test
- The Common Law 20-Factor Test
- State Law Tests (ABC Test)
- Special IRS Classifications

Benefits of Using Independent Contractors



Benefits of Using Independent Contractors

Because independent contractors are not employees, companies that use them can avoid certain obligations and expenses, including:

- Tax and insurance obligations.
- Employment law compliance.
- Employee benefits.
- Immigration law compliance.
- Affordable Care Act (ACA) compliance.

Tax and Insurance Obligations

By engaging independent contractors, companies can generally avoid tax payments, withholdings, and insurance obligations required on behalf of employees, including:

- Federal, state, and local income taxes.
- Social security and Medicare taxes.
- Federal unemployment insurance taxes.
- State unemployment insurance taxes.
- Workers' compensation insurance.

Employment Law Compliance

Federal employment laws that cover employees, but generally not independent contractors, include:

- Fair Labor Standards Act (FLSA).
- Title VII of the Civil Rights Act (Title VII).
- Equal Pay Act (EPA).
- Age Discrimination in Employment (ADEA).
- Americans with Disabilities (ADA).
- Genetic Information Nondiscrimination Act (GINA).
- Uniformed Services Employment Reemployment Rights Act (USERRA).
- Occupational Safety and Health Act (OSH Act).
- Worker Adjustment Retraining Notification Act (WARN).
- Family and Medical Leave Act (FMLA).
- Employee Retirement Income Security Act (ERISA).
- National Labor Relations Act (NLRA).

Employee Benefits

Companies often provide benefits to their employees that are not available to independent contractors including, for example:

- Health insurance, including cafeteria plans.
- Retirement or pension plans.
- Stock options.
- Paid vacations.
- Sick days.
- Life insurance.
- Disability insurance.
- Fringe benefits, such as tuition reimbursement.

Immigration Law Compliance and Affordable Care Act (ACA) Compliance

Employers are not required to:

- Verify work authorization (by completing Form I-9) for independent contractors.
- Provide coverage under the ACA for independent contractors who do not meet the common law definition of "employee."

Consequences of Misclassification



Consequences of Misclassification

The penalties for misclassification can be serious. If a company misclassifies an employee as an independent contractor, it must ensure compliance going forward and may be liable for:

- Back wages and overtime pay.
- Employee benefits, including stock options, retirement benefits, and health plan coverage (or the value of those benefits).
- Disability payments and workers' compensation.
- Tax and insurance obligations.
- Liquidated damages.
- Civil monetary penalties.

Employment Law Compliance

Improperly classifying an employee as an independent contractor could lead to claims for:

- Unpaid overtime compensation and reimbursement of work-related expenses.
- Reasonable accommodation and return to work benefits under the ADA and its state equivalents.
- Leaves of absence under the FMLA and its state equivalents.
- Plant closure and mass layoff notice and penalties under WARN and its state equivalents.
- Discrimination under Title VII, ADEA, and other federal, state, and local anti-discrimination laws.

The Affordable Care Act

Misclassification of employees as independent contractors directly impacts both:

- A company's compliance obligations under the ACA.
- Its exposure to related penalties.

Case Study: Exotic Dancers

- *Exotic dancers brought action against Texas club alleging they had not been paid overtime or minimum wage.*
 - *Jury found that dancers were not employees, and therefore not entitled to overtime or minimum wage.*
 - *Affirmed on appeal*
 - *Nelson v. Texas Sugars, Inc, 838 Fed. App'x 39 (5th Cir. 2020).*
- *Exotic dancers brought action against Pennsylvania club alleging they were not paid minimum wage.*
 - *Jury found that dancers were employees and awarded \$4.5 Million.*
 - *Affirmed, in full, on appeal*
 - *Verma v. 3001 Castor, Inc., 937 F.3d 221 (3d Cir. 2019).*

Why?

Case Study: Exotic Dancers

Texas Sugars Inc. (Texas)

- Dancers set own schedule
- Free to work at other clubs
- Picked own costume and routine
- Set own rates
- Kept all money they earned

3001 Castor, Inc. (Penn)

- Dancers could choose own shifts
- Free to work at other clubs
- Club exercised control over:
 - Physical Appearance
 - Song Choice
 - Rates
 - Duration of Shifts and Dances
- Club fined dancers for being late

Best Practices



Best Practices

To ensure that the independent contractor classification requirements are satisfied:

- Use an independent contractor agreement to establish the terms of the working relationship.
- Avoid using former employees as independent contractors and having independent contractors do the same work as employees.
- Avoid using independent contractors to perform work that is integral to the business.
- Require independent contractors to complete a Form W-9, Request for Taxpayer Identification Number and Certification.
- Keep independent contractor files with vendor files, not employee files.

Best Practices

- Pay contractors by the project or by an agreed-on flat fee at regular intervals, not by the hour, week, or month.
- Do not reimburse independent contractors for business expenses.
- Do not provide contractors with employee-type benefits like paid vacation, paid holidays, sick leave, and retirement benefits.
- Do not schedule hours or days of work for contractors or their employees.
- Avoid requiring uniforms, grooming standards, and similar workplace requirements typically imposed on employees.
- Issue separate guidelines for independent contractors, vendors, and other third parties instead of providing them with a copy of the employee handbook.

Best Practices

- Do not invite contractors to employee-only events or meetings.
- Do not provide contractors with company business cards.
- Do not give independent contractors job titles.
- Deal with performance problems as contract modification or breach issues, not as disciplinary issues. Do not conduct performance evaluations for independent contractors. Do not involve Human Resources in the business relationship with independent contractors.
- Determine if the company's competitors classify similar workers as employees instead of independent contractors.
- Regularly audit the company's independent contractor arrangements and template agreements.
- Do not control the details of how the independent contractor performs the work. Focus on the end result rather than the details.

Thank you!



Robert M. Warzel

Senior Associate

Phoenix, AZ

602-333-5469

rwarzel@spencerfane.com