INDEPENDENT CONTRACTORS

Presented by

Julie A. Pace
David A. Selden
Heidi Nunn-Gilman
Jennifer L. Sellers
The Cavanagh Law Firm PA
jpace@cavanaghlaw.com
602-322-4046

FOR:

ARIZONA IN-HOME CARE SYMPOSIUM
(AZNHA)

August 13, 2014
Phoenix, Arizona

©2014 The Cavanagh Law Firm PA
This document provides information of a general nature regarding legislative or other developments. None of the information contained herein is intended as legal advice or opinion relative to specific matters, facts, situations or issues. Additional facts and information or future developments may affect the subjects addressed in this document.
JULIE A. PACE

JULIE A. PACE is a partner in the Phoenix office of The Cavanagh Law Firm PA. Ms. Pace’s practice is concentrated in representing companies in immigration compliance, commercial litigation, construction, and employment law, with particular emphasis in the defense of sexual harassment, employment discrimination, wrongful discharge suits, EEOC and ACRD charges, matters involving OSHA, ICE, OFCCP, DOL, DOT, NLRB, ADA, FMLA, ERISA, I-9s, E-Verify, Davis-Bacon, wage and hour laws, conducting sexual harassment investigations, and providing training to managers and employees. She also counsels employers on noncompete contracts, confidentiality agreements, employee discipline, drug testing, accommodation of disabled individuals, safety policies, affirmative action plans, wage conformance and wage determinations, and other related human resource policies and procedures.

Ms. Pace also handles issues involving the Affordable Health Care Act and addresses the changes and options it presents to companies. Her Davis-Bacon and prevailing wage practice includes counseling and training on state and federal prevailing wages and benefits requirements, coverage and applicability of prevailing wage laws, coverage exemptions, worker classification and pay issues, addressing wage determinations, wage surveys, and representation of employers before the Department of Labor Wage and Hour Division and similar state agencies.

Ms. Pace has been described by Arizona Business Magazine as the "go to" lawyer in Arizona for businesses on immigration issues. She has handled hundreds of I-9 audits, addresses E-Verify issues, and has provided I-9 and immigration compliance training for thousands of supervisors. She has chaired the Immigration Committee of the Arizona Chamber of Commerce and Industry.


For over the past two decades, Ms. Pace has regularly represented companies in OSHA proceedings. She has been working on fall protection issues since the fall protection standard went into effect in 1995. She has handled hundreds of OSHA matters and numerous fatalities in the workplace.

Ms. Pace is a frequent speaker and author on a variety of employment topics. She is Co-Editor-in-Chief of three books on immigration and employment law -- Employment Verification: An Employer's Guide to Immigration, Form I-9 and E-Verify; Arizona Human Resources Manual; Model Policies and Forms for Arizona Employers, all published by American Chamber of Commerce and Industry HR Compliance Library.

Ms. Pace is a recipient of Arizona Business Magazine’s 2008 Centers of Influence Award, which recognizes the ten leading attorneys, accountants, and bankers in Arizona. Ms. Pace is also a Fellow of the Litigation Counsel of America. She has served as Judge Pro Tem for the Arizona Court of Appeals and is a former judicial law clerk to the Honorable Joe W. Contreras of the Arizona State Court of Appeals. Ms. Pace is a fourth generation Arizonan.

Ms. Pace is a recipient of Arizona Business Magazine’s 2008 Centers of Influence Award, which recognizes the ten leading attorneys, accountants, and bankers in Arizona. Ms. Pace is also a Fellow of the Litigation Counsel of America. She has served as Judge Pro Tem for the Arizona Court of Appeals and is a former judicial law clerk to the Honorable Joe W. Contreras of the Arizona State Court of Appeals. Ms. Pace is a fourth generation Arizonan.

She received her J.D. degree, cum laude, from Arizona State University, where she was also Symposium and Articles Editor of the Arizona State Law Journal. She received her B.S. degree in Business Administration, magna cum laude, from Arizona State University. Ms. Pace can be reached at 602.322.4046 or jpace@cavanaghlaw.com.
DAVID A. SELDEN

DAVID A. SELDEN is a partner with The Cavanagh Law Firm in Phoenix, Arizona. Mr. Selden received his J.D. degree, magna cum laude, from Georgetown University Law Center, where he was also an editor of The Tax Lawyer. He received his B.A. and M.A. degrees from George Washington University in Washington, D.C.

Mr. Selden’s practice is concentrated in representing management in a wide variety of employment law matters, including immigration compliance, discrimination, wrongful discharge, workplace torts, OSHA, EEOC, ACRD, DOL, NLRB, ICE, OSC, DOT, collective bargaining, and other employment litigation.


He has served as the Chair or Co-Chair of the Employment Committee of the Arizona Chamber of Commerce and Industry for 20 years, representing the interests of Arizona employers before the Arizona Legislature on immigration and employment issues. He drafted the 1996 Arizona Employment Protection Act and the 1997 Constructive Discharge Law.

He has been Co-Editor-in-Chief of three books on immigration and employment law – Employment Verification: An Employer's Guide to Immigration, Form I-9 and E-Verify, Arizona Human Resources Manual; and Model Policies and Forms for Arizona Employers, all published by American Chamber of Commerce and Industry HR Compliance Library. He served on the Editorial Review Board of the Arizona Labor Letter and the Board of Editors of the Arizona Employment Law Handbook, which is published by the State Bar of Arizona. He is a contributing author to Legal Briefs on Immigration Reform from 25 of the Top Legal Minds in the Country.

He has been listed in The Best Lawyers in America for more than 20 years and has been listed in every edition of Chambers USA: America’s Leading Lawyers for Business. Mr. Selden is also a Fellow of the Litigation Counsel of America.

Mr. Selden also serves on the Board of Directors of the Phoenix Symphony and Arizona Chamber of Commerce and Industry and has served as General Counsel to both the Arizona Chamber and the Phoenix Symphony. He has been an Adjunct Professor of Law at Phoenix School of Law, teaching courses in Employment Law and Employment Discrimination Law. He is a frequent speaker before professional groups.

Before practicing law in Arizona, Mr. Selden worked in Washington, D.C. from 1971 through 1982 as a legislative and administrative assistant to several members of Congress. Mr. Selden may be reached at (602) 322-4009 or dselden@cavanaghlaw.com.
HEIDI NUNN-GILMAN

HEIDI NUNN-GILMAN is a partner with The Cavanagh Law Firm in Phoenix, Arizona. Ms. Nunn-Gilman’s practice focuses on employment litigation and human resource matters. She has experience in working with both public and private employers. She advises clients on matters relating to labor and employment law, including I-9 and immigration compliance strategies, E-Verify, ICE and worksite enforcement, Title VII, FLSA, FMLA, ADA, leaves, drug and alcohol, NLRB, wrongful discharge, non-competition and confidentiality agreements, wage and hour laws for both public and private employers, employee handbooks, and executive agreements.

Ms. Nunn-Gilman also handles issues involving the Affordable Health Care Act and addresses the changes and options it presents to companies. Her Davis-Bacon and prevailing wage practice includes counseling and training on state and federal prevailing wages and benefits requirements, coverage and applicability of prevailing wage laws, coverage exemptions, worker classification and pay issues, addressing wage determinations, wage surveys, and representation of employers before the Department of Labor Wage and Hour Division and similar state agencies.

Ms. Nunn-Gilman is a frequent speaker on a number of employment law topics, including I-9 and immigration compliance strategies and wage and hour compliance. She is a contributing author of three books on immigration and employment law -- Employment Verification: An Employer's Guide to Immigration, Form I-9 and E-Verify; Arizona Human Resources Manual; Model Policies and Forms for Arizona Employers, all published by American Chamber of Commerce Resources.

Ms. Nunn-Gilman received her J.D., summa cum laude, from Lewis & Clark Law School in Portland, Oregon in 2005, where she graduated first in her class, was on the Trustee’s Fellowship Scholar List, and was a member of the Cornelius Honor Society. While at Lewis & Clark, she served as Editor in Chief of the Lewis & Clark Law Review. Ms. Nunn-Gilman earned an M.A. degree in Philosophy, Teaching Ethics Emphasis, summa cum laude, from the University of Montana in 2000. She earned a B.A. degree in political science, history and philosophy, summa cum laude, from Ouachita Baptist University in 1998. Ms. Nunn-Gilman can be reached at (602) 322-4080 or hnunngilman@cavanaghlaw.com.
# TABLE OF CONTENTS

FACTORS IN IDENTIFYING INDEPENDENT CONTRACTORS AND POTENTIAL PENALTIES FOR MISCLASSIFICATION ................................................................. 1

I. INTRODUCTION ..............................................................................................................1

II. DEFINITION OF EMPLOYEE. ........................................................................................1

III. ARIZONA MINIMUM WAGE ACT & EMPLOYEES/INDEPENDENT CONTRACTORS ................................................................................................................2

IV. INDEPENDENT CONTRACTOR FACTORS AND TESTS. ...........................................2

A. FLSA Economic Realities Test ..................................................................................2

B. IRS Guidelines for Identifying an Independent Contractor versus an Employee – Control of the Relationship ........................................................................4

C. Former I.R.S. Twenty Factor Test for Determining if Individual is Independent Contractor or Employee ...........................................................................7

V. INDEPENDENT CONTRACTOR AND WORKERS’ COMPENSATION IN ARIZONA 9

VI. INDEPENDENT CONTRACTORS UNDER ARIZONA’S UNEMPLOYMENT COMPENSATION SYSTEM. ..........................................................................................10

VII. POTENTIAL CONSEQUENCES OF MISCLASSIFYING AN EMPLOYEE AS AN INDEPENDENT CONTRACTOR ...........................................................................12

VIII. THE DOL EMPLOYEE MISCLASSIFICATION INITIATIVE AND ENFORCEMENT ACTIONS .................................................................................................13

IX. DO EMPLOYERS NEED TO VERIFY AN INDEPENDENT CONTRACTORS EMPLOYMENT AUTHORIZATION? .................................................................14

X. CHILD SUPPORT ORDERS FOR INDEPENDENT CONTRACTORS .......................15

NEW CHANGES AT DOL WAGE AND HOUR DIVISION AND ICE .............................. 16

I. PHOENIX DOL WAGE AND HOUR OFFICE ROLLING OUT EMPLOYEE MISCLASSIFICATION COMPLIANCE ASSISTANCE PROGRAM (EMCAP) ...............16

II. ICE ENFORCEMENT UPDATES ..................................................................................18
FACTORS IN IDENTIFYING INDEPENDENT CONTRACTORS
AND POTENTIAL PENALTIES FOR MISCLASSIFICATION

By
Julie A. Pace
David A. Selden
Heidi Nunn-Gilman
The Cavanagh Law Firm PA

I. INTRODUCTION.

This section discusses the rules and requirements regarding determining when a worker is an independent contractor. It is important to note that even if a company labels an individual as an “independent contractor,” the individual must meet certain criteria before the government will accept the classification of the person as an independent contractor exempt from employment laws. Although essentially similar, each government agency and each law has its own definition or standards for an independent contractor. It is even possible for different agencies to reach different conclusions about the status of the same individual.

This section analyzes the different tests and factors a company must examine to properly characterize their working relationship with an individual. The trend in the past few years has been for courts and government agencies to find more and more often that the individual was an employee, rather than an independent contractor.

Whether an individual is an independent contractor or an employee is determined on a case-by-case basis based on the totality of the circumstances. There is no fool-proof method to ensure that an individual is deemed to be an independent contractor. It is a balancing test, and the more factors that lean toward an independent contractor, the greater the chances that the Company will prevail if there is a challenge to the individual’s status as an independent contractor. There is always a risk that a judge or hearing officer may decide that the factors favor employee status when dealing with government agencies on the questions of whether a person is an independent contractor, so the Company should ensure that it does the most that it can to correctly classify employees and independent contractors.

This section also briefly summarizes some of the risks and penalties for misclassifying an employee as an independent contractor. In addition to having to pay the payroll taxes, FICA, SSA, and FUTA that were not paid, the employer may have to pay additional penalties. These and other penalties are discussed later in this section.

II. DEFINITION OF EMPLOYEE.

The full range of employment statutes and regulations apply only where an employee/employer relationship exists. Such an arrangement exists wherever an employer "suffers or permits" another person to work. Although the primary consideration is the amount of control or supervision exercised by the employer over the work of the individual, any worker who is "economically dependent" upon the employer is covered. In this regard, the following factors are important:
1. Does the employer have the right to hire and fire the worker?

2. Does the employer determine the wage rates of the worker?

3. Does the employer provide equipment or tools for the workers to use? and

4. Does the employer control the result of the work performed?

III. ARIZONA MINIMUM WAGE ACT & EMPLOYEES/INDEPENDENT CONTRACTORS

An employer is required to pay all employees in Arizona a minimum wage fixed by statute. The minimum wage is increased every January 1 to reflect the increase in the cost of living. As of January 1, 2014 the minimum hourly wage in Arizona is $7.90.

The Arizona Minimum Wage Act applies only to employees, not independent contractors. Under the Minimum Wage Law, “whether a person is an independent contractor or an employee shall be determined according to the standards of the Fair Labor Standards Act (FLSA), but the burden of proof shall be upon the party for whom the work is performed to show independent contractor status by clear and convincing evidence.” Although the “economic realities” test used under the FLSA will be used under the Arizona Minimum Wage Act, the business employing the worker must meet a higher standard of proof – “clear and convincing” – that the worker is an independent contractor. Therefore, if it is a close question about the worker’s status as employee or independent contractor, the issue will be decided against the employer and employment relationship will be found.

IV. INDEPENDENT CONTRACTOR FACTORS AND TESTS.

A. FLSA Economic Realities Test.

There is no single rule or test for determining whether an individual is an independent contractor or an employee. Under the federal Fair Labor Standards Act, courts typically apply an “Economic Realities” test. The Economic Realities test springs out of the United States Supreme Court decision Goldberg v. Whitaker House Cooperative, 366 U.S. 28 (1961) and has been applied by DOL in substantially similar form for decades.

The six factors that are usually reviewed when considering the economic realities of an employment situation, which are summarized in DOL WHD Fact Sheet #13, include:

1. Whether the work constitutes an integral part of the hiring party’s business.
   a. According to the DOL, the more integral a worker’s task is to the employer’s business, the more likely the worker is financially dependent upon the employer and the less likely that the worker is independently in business for himself or herself.
b. DOL will often find that work is integral to an employer’s business if it is part of the production process or if it is the service that the employer is in the business of providing.

2. The nature and degree of control exercised by the hiring party over the worker.
   a. DOL will look at who sets the pay, who sets the work hours, and who determines the method of performing the work.
   b. DOL’s fact sheet advises that the fact that an individual can set their own work hours or works from home or offsite will not determine whether an individual is an employee or independent contractor.

3. The investment made by the worker in the enterprise versus the investment by the employer.
   a. DOL examines whether the worker has made an investment and has the risk of a loss, and recently has stated that the investment must be large enough in relation to the employer’s investment to show that the worker is an independent business owner and shares the risk of loss.
   b. In DOL’s view, the purchase by a worker of the tools necessary to perform the work does not necessarily indicate independent contractor status because the tools are necessary for either an employee or independent contractor to perform the work.

4. The worker’s opportunity for loss or profit and whether the workers’ managerial skills affect his or her opportunity for profit or loss.
   a. Managerial skills may be demonstrated by the hiring of employees to work for the worker or by the purchase of equipment or goods, paid for by the worker.
   b. When analyzing this fact, DOL focuses on whether the worker exercises managerial skills, such as hiring and supervision of workers or purchase of equipment, and whether his or her skill in this area affects his or her opportunity for profit or loss.

5. The permanency of the arrangement – an employee’s relationship is often indefinite or open ended, while an independent contractor is often on a contract for a limited term until a single project is completed.

6. The skill, training or certification required for the work.
a. According to DOL, to indicate independent contractor status, a worker’s skills should demonstrate that he or she exercises independent business judgment.

b. If a worker is competing with others on the open market, this can help support independent contractor status.

DOL has taken the position that certain factors are irrelevant when determining whether an individual is an employee or independent contractor, including the fact that work might be performed away from the company's primary place of business, the absence of a formal written agreement, or whether the alleged independent contractor is independently licensed by a state or local government. Additionally, payment on a project basis is not determinative of independent contractor status.

Application of the independent contractor tests is no simple matter. The facts of each case will control. A security guard may be found to be an independent contractor in one case and an employee in another case. Carpet layers have been found to be independent contractors in certain situations and employees in other situations. The facts and circumstances of each case must be carefully analyzed to determine if an independent contractor or employment relationship exists.

B. IRS Guidelines for Identifying an Independent Contractor versus an Employee – Control of the Relationship.

Determining whether someone is an independent contractor or employee is a totality of the circumstances evaluation. For all employment tax purposes, the Internal Revenue Code and the Treasury Regulations had previously specifically adopted the common law test for determining the existence of an employer-employee relationship, utilizing 20 factors to determine whether an individual is an independent contractor or an employee.

In January 1997, the IRS issued new guidelines to determine whether an individual is an employee or an independent contractor. Now, the entire relationship between the worker and the business must be examined. All evidence of control and independence must be considered. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties, as described below.

1. Behavioral Control.

Behavioral control refers to facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include:

a. The type of instructions the business gives the worker. An employee is generally subject to the business' instructions about when, where, and how to work, what tools and equipment to use, what workers to hire to assist in the work, and what
order or sequence to follow when performing the work. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved.

b. The degree of instructions the business gives the worker. The more detailed the instructions, the more control the business exercises over the worker. More detailed instructions on how to perform the work generally indicates that the worker is an employee. Less detailed instructions reflect less control. Again, however, even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved.

c. Evaluation systems. If an evaluation system measures the details of how the work is performed, this is more indicative of an employee. If the evaluation focuses just on the end result, this can indicate either an employee or an independent contractor.

d. Training the business gives the worker. An employee may be trained to perform services in a particular manner. Periodic or ongoing training about a company's procedures and methods is strong evidence of an employee/employer relationship. Independent contractors ordinarily use their own methods.

2. **Financial Control.**

Financial control refers to facts that show whether the business has a right to control the business aspects of the worker's job include:

a. The extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees also may incur unreimbursed expenses in connection with the services they perform for their business.

b. The extent of the worker's investment. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not required. Note as well that in many occupations, such as construction, workers spend thousands of dollars on the tools and equipment they use and are still considered to be employees. There are no precise dollar limits that must be met in order to have a significant investment

c. The extent to which the worker makes services available to the relevant market. For example, does the worker have business cards and does the individual participate in advertising his or her services? An independent contractor is generally free to provide his or her services to two or more unrelated persons or companies at the same time.
d. How the business pays the worker. An employee is generally paid a regular wage amount by the hour, week, or month. An independent contractor is usually paid by the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

e. The extent to which the worker can realize a profit or incur a loss. An independent contractor can make a profit or loss. If a worker has a significant investment in the tools and equipment used and if the worker has unreimbursed expenses, the worker has a greater opportunity to lose money (i.e., their expenses will exceed their income from the work). Having the possibility of incurring a loss indicates that the worker is an independent contractor.

3. Type of Relationship.

Facts that show the parties' type of relationship include:

a. Written contract describing the relationship the parties intended to create. It is crucial to have a written contract to help support an individual's status as an independent contractor. A contract alone, however, is not determinative of independent contractor status if other factors demonstrate that the company controls the method of work.

b. Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay. Businesses generally do not grant these types of benefits to independent contractors. The lack of benefits, however, does not necessarily mean a worker is an independent contractor.

c. The permanency of the relationship. If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was to create an employer-employee relationship.

d. The extent to which services performed by the worker are a key aspect of the regular business of the company. If a worker provides services that are a key aspect of the regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

The employer bears the burden of establishing an individual's independent contractor status. The IRS is willing to make a determination for you as to whether a worker is an employee if you file a Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding.
C. Former I.R.S. Twenty Factor Test for Determining if Individual is Independent Contractor or Employee.

As mentioned above, the I.R.S. previously identified twenty factors it thinks are relevant in determining if an individual is an employee or an independent contractor. Although it has moved away from the twenty factor list to the control test discussed above, the factors still help to examine the relationship and determine whether an individual is an independent contractor or employee. In general, the more factors demonstrate that a business controls the daily working of an individual, the more likely the I.R.S. will conclude the individual is an employee.

The twenty factors are as follows:

1. Instructions: if a worker is required to follow the instructions of another regarding when, where, and how he or she is to work, this indicates an employer/employee relationship.

2. Training: if a company provides training to a worker, through either mentorship, classes, or other methods, this indicates an employer/employee relationship.

3. Integration: if a worker’s services are integrated into the business operations, such that the success of the business depends to an appreciable degree on the success of that worker’s services, the worker is more likely an employee.

4. Services rendered personally: if an individual must perform services personally, there is likely an employer/employee relationship, whereas if the individual can employ another to do his or her task, the individual is likely an independent contractor.

5. Hiring, supervising, and paying assistants: if the individual hires and pays his or her own assistants, the individual is likely an independent contractor, whereas if the business hires and pays an individual’s assistants, the individual is more likely an employee.

6. Continuing relationship: a continuing relationship is considered an indicia of an employer/employee relationship, whereas a job-by-job or task-by-task relationship indicates the worker is an independent contractor.

7. Set hours of work: the requirement of set hours of work, determined by the business, is an indicia of an employer/employee relationship.

8. Full time required: if a worker must work for a business full time, leaving no opportunity to provide services to others, the worker is more likely an employee, whereas an if a worker may work when and for whom he or she chooses, the worker is more likely an independent contractor.
9. Doing work on employer’s premises: having the work performed on the business’s premises is an indicator that the worker is an employee, rather than an independent contractor.

10. Order or sequence set: if the business requires the work be done in a certain order, this indicates the control required to establish an employee/employer relationship.

11. Oral or written reports: if the worker is required to submit regular reports, this suggests the worker is an employee.

12. Payment by hour, week, month: regular salaried payments or a guaranteed minimum salary suggest a worker is an employee, whereas straight commissions or percentages of revenue suggest the worker is an independent contractor.

13. Expenses: if the business reimburses business and travel expenses, this suggests the individual is an employee. In contrast, independent contractors are usually expected to cover their own overhead expenses.

14. Furnishing tools and materials: if the business provides the tools and materials necessary for the work, this indicates an employer/employee relationship.

15. Significant investment: if the worker invests in the facilities he is using, this suggests he or she is an independent contractor.

16. Realization of profit or loss: a worker who can realize a profit or suffer a loss as a result of the worker’s services is generally an independent contractor.

17. Working for more than one firm at a time: if a worker provides services for more than one business, this generally indicates the individual is an independent contractor.

18. Making services available to the general public: if a worker can make his or her services available to the general public independent of the business for which the individual is providing services, the individual is generally an independent contractor.

19. Right to discharge: if the individual can be discharged with notice, this usually demonstrates the control necessary for an employer/employee relationship.

20. Right to terminate: if the individual has the right to terminate his or her relationship with the business without notice, this indicates the person is an at-will employee rather than an independent contractor.
V. INDEPENDENT CONTRACTOR AND WORKERS’ COMPENSATION IN ARIZONA

Historically under Arizona workers’ compensation law, there is generally a presumption against finding that a worker is an “independent contractor” and, therefore, not a covered employee for purposes of workers’ compensation. Arizona statutes define when an employer is responsible for such workers as follows:

1. An employer is liable when “an employer procures work to be done by him by a contractor over whose work he retains supervision or control, and such work is a part or process in the trade of business of the employer.” “Part or process in the trade of the employer” means that a particular work activity in a regular, ordinary or routine process in the operation of the business or is routinely done by the business’ own employees. A.R.S. § 23-902(B).

2. An employer is not liable when “a person engaged in work for another, and who while so engaged is independent of the employer in the execution of the work and not subject to the rule or control of the person for whom the work is done, but is engaged only in the performance of a definite job or piece of work, and is subordinate to the employer only in effecting a result in accordance with the employer’s design.” A.R.S. § 23-902(C).

Pursuant to A.R.S. § 23-902, for purposes of workers' compensation, a company and an independent contractor can create a rebuttable presumption of an independent contractor relationship by executing a written agreement that demonstrates that the business does not supervise or control the work of the independent contractor and contains a disclaimer that the independent contractor is not entitled to workers' compensation. The written agreement must contain additional required elements identified in A.R.S. § 23-902, which requires the agreement to state that the business:

1. Does not require the independent contractor to perform work exclusively for the business;
2. Does not provide any business licenses or registrations;
3. Does not pay a salary or hourly rate instead of a fixed amount;
4. Will not terminate the contractor absent breach of the contract or illegal conduct;
5. Does not provide tools;
6. Does not dictate time of performance;
7. Pays the contractor in its name as it appears on the contract;
8. Will not combine business operations with the contractor.
If the presumption is not rebutted then the carrier cannot collect premiums on amounts paid to the contractor, provided the carrier receives a copy of the agreement.

In Arizona, courts consider the totality of the circumstances when evaluating the indicia of control, and no single factor is itself conclusive.

The right to control or supervise the method of reaching a specific result determines whether an individual is an employee or an independent contractor. To determine the right to control, courts look to the totality of the facts and circumstances of each case, examining various indicia of control. These indicia, as articulated by the cases, include: the duration of the employment; the method of payment; who furnishes necessary equipment; the right to hire and fire; who bears responsibility for workmen’s compensation insurance; the extent to which the employer may exercise control over the details of the work, and whether the work was performed in the usual and regular course of the employer’s business.

*Home Ins. Co. v. Industrial Commission*, 599 P. 2d 801 (1979). In order to possess a “statutory employment relationship” under Arizona law, the employer must retain supervision or control over the employee’s work and the work entrusted must be a part or process in the trade or business of the employer. *Growers Co.*, 173 Ariz. at 313. Courts use the same “right to control” test that is used in determining if a person is an employee or an independent contractor, following the factors outlined in *Home Ins. Co.* Id. at 314. These factors have remained the dominant test in Arizona for purposes of workers’ compensation.


The ultimate right to control the work, not the exercise of that right, is the determinative question. The control test is "delimited by the test of 'nature of the work,' that is, by the question whether the work is part of the employer's regular business or operation." *Anton v. Indust. Comm'n*, 141 Ariz. 566, 572, 688 P.2d 192, 198 (App. 1984). If the individual's work is core or integral to the employer's regular business operations, it is inferred that the employer has reserved the right to control the details of the operation to the extent necessary to ensure that the business runs smoothly. Id. Therefore, the more core to the company's business that a worker's work is, the more likely that they will be found to be an employee, even if the company is not exercising direct control, because the company has the right to exercise control.

**VI. INDEPENDENT CONTRACTORS UNDER ARIZONA'S UNEMPLOYMENT COMPENSATION SYSTEM.**

The Arizona unemployment tax requirements exclude independent contractors. A.R.S. § 23-316.01. While the law does not define independent contractor, the definition of employee helps to limit the definition of an independent contractor. Under the Arizona unemployment tax system, an employee is:
someone performing services for an employing unit who is under the direction and control of the employing unit both as to the method of performing the work and the result to be accomplished. Indications of control by the employing unit include controlling the individual's hours of work, location of work, right to perform services for others, tools, equipment, materials, expenses, and use of other workers and other indicia of employment.

A.R.S. § 23-316.01. Similar to the independent contractor tests in other areas of employment law, the key is the right or ability to control the means and method of the work being performed, as opposed to only directing the ultimate result. The Arizona Court of Appeals held in Smith v. Ariz. Dept. of Economic Security that the Arizona law defines employee much in the same manner as the Federal Unemployment Tax Act, and therefore, like the FUTA, the common law test for independent contractor applies. 128 Ariz. 21, 623 P.2d 810 (App. 1980). This test is similar to the IRS 20 factor test.

Again, the determination of whether an individual is an independent contractor or employee is based on the totality of the circumstances. Factors that the Department of Economic Security and courts often review include:

1. Authority over the individual's assistants – authority of the employing unit over the assistants hired by an individual indicate that the employing unit is exercising control over the methods by which the individual performs the work. If the individual can hire and direct his or her own assistants, this is more indicative of an independent contractor.

2. Compliance with instructions – if the individual is required to follow the instructions of the employing unit regarding when, where, and how to work, this indicates direction and control by the employing unit. If the individual sets his or her own hours, determines the method of performing the work, etc. this is more indicative of an independent contractor.

3. Oral or written reports – requiring written reports regarding the method by which services are performed indicates control of the method by which work is performed.

4. Personal performance – if services are required to be rendered personally, this indicates that the individual is more likely an employee, as is suggests that the employing unit is interested in the method of how the work is performed, as well as the result.

5. Establishment of work sequence – a requirement that services be performed in a specific order established by the employing unit is indicative of control of the method of work. Note, however, that in some industries the work sequence is established as a necessity of the type of project. For example, in construction some elements must be installed and completed before other elements can be installed.

6. Right to discharge – the right to discharge at any time generally indicates an employer/employee relationship, while a fixed contract for a project with the right to terminate only for breach of contract is more indicative of an independent contractor relationship.
7. Set hours of work – if the employing unit sets the hours of work, this indicates control of the individual, while if the individual sets his or her own hours of work, this is more indicative of an independent contractor.

8. Training – if the employing unit provides training on its specific means and methods, this is suggestive of control of the methods of work and suggests an employment relationship.

9. Amount of time – if a worker is required to dedicate his or her full time to the employing unit, this indicates control that suggests an employment relationship. If the worker is free to select his or her assignments and work intermittently, this is more indicative of an independent contractor relationship.

10. Expense reimbursement – If a worker is reimbursed for business expenses, this suggests the employer is controlling those expenses and suggests an employment relationship. If a worker is paid on a job basis and covers his or her own expenses, this suggests a lack of control that is indicative of an independent contract relationship.

11. Tools and materials – if the employing unit furnishes the tools, materials, etc. this indicates control by the employing unit. If the individual supplies his or her own tools and materials, this is more indicative of an independent contractor.

12. Availability to public – the fact that an individual makes his or her services available to the general public on a continuing basis is indicative of an independent contractor relationship.

13. Compensation on a job basis – payment by the hour or other fixed salary based on hours is indicative of an employment relationship. Payment on a per project basis is more indicative of an independent contractor relationship.

14. Realization of profit or loss – the ability to realize a profit or suffer a loss generally supports independent contractor status.

15. Significant investment – if an individual makes a significant investment into the project, such as providing their own vehicles, tools, supplies, etc., this is indicative of independent contractor status.


VII. POTENTIAL CONSEQUENCES OF MISCLASSIFYING AN EMPLOYEE AS AN INDEPENDENT CONTRACTOR.

If the Company misclassifies an employee as an independent contractor, the Company could be liable to the IRS for payroll and FICA taxes that should have been paid and may have to submit corrected tax forms. The Company could be liable not only for the Company’s share of the employee’s FICA taxes, but also for the employee’s contribution that would normally be
deducted as a payroll deduction from an employee’s paycheck but is not withheld from payments made to independent contractors. Additionally, employers who misclassify an employee and fail to pay FUTA contributions can be liable for the contributions plus additional penalties imposed by the State.

If the Company misclassifies an employee as an independent contractor, the Company could be liable to the misclassified individual for any benefits that would have been provided to the individual if the individual had been an employee, including compensation for work-related injuries, insurance benefits, and overtime pay. This includes but is not limited to medical insurance, workers’ compensation insurance, life insurance, retirement benefits and any other benefits provided to employees. It also includes overtime. A leading case, which came out of California, found that FedEx drivers that FedEx had classified as independent contractors were not independent contractors. FedEx was required to pay back wages for overtime and provide retroactive benefits.

In addition, if the Company treats an individual as an independent contractor but they are actually an employee, the Company could be liable for failing to complete an I-9 for the individual -- which could lead to fines and a charge of knowingly employing an undocumented worker. Under the Legal Arizona Workers Act, the result could be revocation of a Company’s business license. Additionally, if an employer pays cash and fails to withhold comply with income tax, workers’ compensation, unemployment tax, and new hire reporting requirements, then the Company may be liable for a fine of $5,000 per employee for which these requirements were not followed or treble the amount of the insurance or tax payments that the Company fails to make, whichever is greater.

Therefore, it is important that a company fully evaluate its independent contractor relationships. We also strongly recommend having a written independent contractor agreement with all independent contractors that sets forth the details of the relationship and each parties’ responsibilities. The written agreement is not conclusive, but can be used as evidence of the intent to form an independent contractor relationship. The determination of whether an individual is an independent contractor is generally a fact specific determination.

VIII. THE DOL EMPLOYEE MISCLASSIFICATION INITIATIVE AND ENFORCEMENT ACTIONS

DOL has identified the misclassification of employees as independent contractors as one of its leading enforcement initiatives. In September 2011, DOL launched its Employee Misclassification Initiative by signing a Memorandum of Understanding with the IRS that allows the two agencies to share information about companies who have been found to have misclassified employees as independent contractors and to coordinate enforcement efforts. Additionally, DOL has signed MOUs with 15 states to share information and coordinate enforcement efforts with state agencies. DOL is actively seeking MOUs with more states. In addition, DOL has hired additional investigators to “detect and deter” companies from misclassifying employees as independent contractors.

One of the largest DOL misclassification investigations occurred right here in Arizona. Paul Johnson Drywall had employed workers through Arizona Tract, a company that classified
individuals as “member/owners” rather than employees. DOL determined that the individuals were not truly independent business owners, but were rather employees. In May 2014, Paul Johnson Drywall agreed to pay $556,000 in overtime wages and liquidated damages to 445 current and former workers who were misclassified as independent contractors. Paul Johnson Drywall also agreed to pay $44,000 in civil monetary penalties, for a total of $600,000. In addition, the Company agreed to hire a third part to monitor and ensure compliance, to ensure training for its subcontractors, and to implement an educational campaign in the construction community to promote awareness of and the importance of compliance with the FLSA.

"This case exemplifies our commitment to eradicating unfair competition and pay schemes that result in employees not getting their fair pay for honest, hard work," said Administrator of the Wage and Hour Division Dr. David Weil in a DOL press release. "Employers in this industry and others should take notice that we will not tolerate the misclassification of employees as independent contractors, and we will use all legal remedies available to recover unpaid wages for these workers."

IX. DO EMPLOYERS NEED TO VERIFY AN INDEPENDENT CONTRACTORS EMPLOYMENT AUTHORIZATION?

The federal Immigration Reform and Control Act (“IRCA”) prohibits employers from knowingly employing undocumented workers. It also requires employers to verify employment authorization and complete a Form I-9 for each new employee. Additionally, the Legal Arizona Workers Act prohibits an employer from knowingly or intentionally employing an unauthorized alien. The term “employee” excludes an independent contractor. Under the Legal Arizona Workers Act, independent contractor means: any individual or entity that carries on an independent business, that contracts to do a piece of work according to the individual’s or entity’s own means and methods and that is subject to control only as to results. Whether an individual or entity is an independent contractor is determined on a case-by-case basis through analysis of various factors, including whether the individual or entity:

1. supplies tools or materials
2. makes services available to the general public
3. works or may work for a number of clients at the same time
4. has an opportunity for profit or loss as a result of labor or service provided
5. invests in the facilities for work
6. directs the order or sequence in which work is completed
7. determines the hours when the work is completed.

The I-9 and E-Verify requirements apply to employees only, not independent contractors. Therefore, it is imperative that companies correctly classify workers. If an individual is misclassified as an independent contractor and the company fails to complete an I-9, it could result in penalties to the employer under both IRCA and the Legal Arizona Workers Act.
IRCA and the Legal Arizona Workers Act, however, also prohibits using an independent contractor agreement to knowingly or intentionally contract with an unauthorized alien or entity that employs an unauthorized alien.

X. CHILD SUPPORT ORDERS FOR INDEPENDENT CONTRACTORS.

Companies that use independent contractors may receive child support orders for individuals engaged by the company as an independent contractor. Because independent contractors do not receive “wages” per se, companies often question whether they have an obligation to withhold child support from payments due to independent contractors.

For purposes of Arizona’s child support determinations, income is defined as “any form of payment owed to an individual, regardless of the source . . . .” A.R.S. § 25-500. The Department of Economic Security Income Withholding Orders are addressed to “employers or income withholders.” Additionally, the DES Frequently Asked Questions re Income Withholding Orders specifically states that the Income Withholding Order applies to monies owed to independent contractors. Therefore, companies who engage individuals as independent contractors must comply with a child support withholding order.
NEW CHANGES AT DOL WAGE AND HOUR DIVISION AND ICE

By
Julie A. Pace
David A. Selden
Heidi Nunn-Gilman
The Cavanagh Law Firm PA

I. PHOENIX DOL WAGE AND HOUR OFFICE ROLLING OUT EMPLOYEE MISCLASSIFICATION COMPLIANCE ASSISTANCE PROGRAM (EMCAP)

The Department of Labor Wage and Hour Division (WHD) is introducing a new pilot program called the Employee Misclassification Compliance Assistance Program (EMCAP), that is being started by the Phoenix District Office of the DOL Wage and Hour Division. The program is currently available only in Arizona.

EMCAP is a self-reporting program, in which employers can self-report misclassification violations of the FLSA. By conducting a self-audit and self-reporting to the DOL WHD violations in which the employer misclassified employees as independent contractors, an employer can avoid the assessment of liquidated damages or civil monetary penalties, if DOL accepts the employer’s self-audit. DOL WHD may reject the employer’s self-audit if it discovers that the employer lied or misrepresented during the self-audit or in reporting to DOL or otherwise not acting in good faith. If the DOL rejects the employer’s self-audit, then the employer is subject to all backwages, fines, and penalties that are available under the Fair Labor Standards Act. DOL may conduct additional investigation, and participation in EMCAP will be treated as a DOL audit for future compliance purposes.

Only Arizona-based companies that are covered by the FLSA are eligible for EMCAP. An employer with a history of FLSA violations or the subject of a current Wage and Hour investigation is not eligible for EMCAP. Further, the program applies to FLSA minimum wage, overtime, and recordkeeping violations. It does not apply to child labor violations.

To enroll in the program, a company must complete an application. DOL WHD has created a form that can, but is not required, to be used. The applications requests the business name, address, EIN number and contact information, and for the contact information for any third-party (such as an attorney or accountant) who will be working on the EMCAP initiative on behalf of the employer. Currently, DOL WHD intends to accept applications for the program for only a 60-day period between October 1, 2014 and Friday, November 28, 2014. These dates may be subject to change. Only mailed applications are acceptable. DOL WHD will not accept applications via fax, email, or in person.

After the employer is accepted into the program, a WHD investigator is assigned. The employer must conduct a self-audit following guidelines provided by the DOL WHD. The self-audit will cover a two-year period, unless otherwise agreed by DOL. The self-audit must also include an audit of all employees that the company has classified as salaried exempt from overtime. In addition to conduct a self-audit, the employer must attend an FLSA training that
will include training on FLSA coverage, recordkeeping requirements, the employment
relationship, hours worked, exemptions, and payment methods.

As part of the program, the employer must agree to the following:

1. Compensate employees identified in the self audit for any unpaid minimum wages
   or overtime that would have been paid if the employee was properly classified;

2. Sign a compliance agreement that specifies specific future steps to help ensure
   compliance. What these steps are is yet to be determined. We expect that such
   compliance steps may include additional internal audits or oversight of
   classification practices, timecard language, additional policies and notices to
   employees, or potentially additional reporting to DOL WHD.

Participating in the program DOES NOT:

1. Protect the employer from any private right of action brought by employees under
   Section 16(b) of the FLSA.

2. Supersede or waive any other employer-related obligations the employer must
   meet under federal labor, tax, licensing, workers’ compensation or other laws and
   regulations.

An employer who participates in EMCAP may have the benefit of avoiding civil
monetary violations (which can be $110-$1,100 per violation) and liquidated damages (which
are equal to the minimum wage or overtime amount due to employees). Employers may,
however, open themselves up to additional liability if other state or federal agencies learn of the
misclassification, or if employees/independent contractors bring claims for additional wages or
benefits. For example, DOL has a Memorandum of Understanding that allows it to share
information with the Internal Revenue Service regarding companies who have misclassified
employees. Nothing in the EMCAP guidelines guarantees participants any confidentiality for the
information they are providing. Additionally, the backwages paid will be subject to employment
taxes and reporting. EMCAP does not address how employers are to handle the state and
federal employment tax wages.

After reclassifying individuals from independent contractor to employee, an employer
will need to report the individuals through the Arizona New Hire Reporting system. If the
Arizona Department of Economic Security learns that employees have been misclassified, they
can conduct an audit and require payment of unemployment insurance contributions to the
Company. If a company’s workers’ compensation carrier learns that employees were
misclassified as independent contractors, it may conduct an audit of past premiums and increase
premiums. Because of these risks, employers should consult with experienced counsel before
enrolling in the EMCAP initiative.

The local DOL WHD office has stated that next year it intends to increase the number of
audits in the construction industry, and focus on misclassification issues. Therefore, companies
should take steps now to review their payroll practices, including but not limited to independent
contractor classification, minimum wage, overtime (which can be especially tricky with piece
rate), recordkeeping and time cards, and classification of employee as exempt. Companies can conduct internal audits, or engage third parties who specialize in wage and hour compliance. Companies should review and update any independent contractor agreements, after assuring that it is an independent contractor and not an employee.

II. ICE ENFORCEMENT UPDATES

ICE is stepping up enforcement and implementing practices that could result in greater fines to employees. They are also bringing more criminal actions against employers and their representatives. Among other enforcement initiatives, ICE is focusing on repeat offenders and conducting audits of companies that have previously been audited. If violations are found during a second audit, the fines and penalties are increased. In a new enforcement practice, ICE has indicated that employers who have committed technical or procedural paperwork violations (i.e. missing start date) will not be provided with an opportunity to correct such forms and will be fined up to $1,100 per form if the employer was notified of similar technical or procedural errors during a previous audit. Therefore, employers who have been through an audit, even if they did not receive any fines in the first audit, may be subject to tens of thousands of dollars in fines just for minor errors on the Form I-9.

Companies should conduct an internal review of their I-9 forms or hire experienced counsel to review I-9 compliance and conduct I-9 and immigration compliance training. The attorneys in the Employment, Labor, Immigration and OSHA Group at the Cavanagh Law Firm have worked on thousands of I-9 reviews, and regularly conduct immigration compliance training. For more information, please contact Julie A. Pace, 602-322-4046.

The attorneys in the Employment, Labor, Immigration and OSHA Group at the Cavanagh Law Firm have extensive experience representing employers before the DOL, as well as conducting audits and helping employers establish compliant policies and practice before the DOL comes into the picture.