

Employment Tip of the Month – January 2025

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Q: Can an employer who hires several independent contractors to work on projects throughout the year maintain their independent contractor status throughout the year?

A: Misclassifying employees as independent contractors has become a hot-button issue for businesses across industries. While the independent contractor model offers flexibility and cost savings, misclassification can expose employers to significant legal, financial, and reputational risks. Understanding the consequences of misclassification – and the legal standards used to determine worker status – is essential for businesses seeking to remain compliant.

Key Legal Standards for Classification

The distinction between an employee and an independent contractor can be determined by multiple tests, depending on the jurisdiction and applicable law. Commonly used frameworks include:

The IRS Test

The IRS focuses on three factors: **behavioral control, financial control, and the nature of the relationship**. If a business has significant control over how, when, and where work is performed, the worker is more likely to be classified as an employee.

The “ABC” Test

Increasingly popular in state laws, the ABC test presumes workers are employees unless the employer can prove:

- A. The worker is free from the employer’s control.
- B. The work performed is outside the usual course of the employer’s business.
- C. The worker is engaged in an independently established trade or business.

The Economic Realities Test

Under federal law, including the Fair Labor Standards Act (FLSA), courts assess the worker’s economic dependence on the employer. **If a worker depends primarily on one employer for income, they are likely to be classified as an employee.**

Legal Consequences of Misclassification

Employers who misclassify workers can face legal challenges from both government agencies and

the workers themselves. Below are the major risks.

Wage-and-Hour Violations

Employees are entitled to a minimum wage, overtime pay, meal and rest breaks, and other protections under laws such as the FLSA and state labor codes. Misclassification denies workers these benefits, and employers may be liable for:

- Back wages, including overtime
- Liquidated damages (often double the unpaid wages)
- Civil penalties for violating wage laws.

Tax Liability

Independent contractors are responsible for paying self-employment taxes, while employers must withhold income taxes and pay Social Security, Medicare, and unemployment taxes for employees. Misclassification can result in:

- Back taxes owed to the IRS and state tax authorities
- Interest and penalties for failure to withhold and remit taxes
- Audits and further scrutiny of employment practices.

Penalties Under Employment Laws

Misclassification could potentially lead to claims where the contractors assert they are being improperly denied legally mandated leaves under laws such as the Family and Medical Leave Act (FMLA). Additionally, contractors could argue that they were improperly classified and should be deemed covered by discrimination prevention laws including Title VII, the ADA, and the ADEA.

Conclusion

To avoid the potential exposures that can arise from a misclassification, it is essential to clearly understand the indicia and requirements for independent contractors.

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