35th Annual

Tax Symposium

NAVIGATING WORKER CLASSIFICATION

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OVERVIEW

- Understanding the key factors used by both federal and state agencies to classify workers
- Recognizing the real-world consequences of misclassification
- Practical steps to assess current workforce arrangements, correct misclassifications before an audit, and build compliant engagement structures going forward

KEY FACTOR

Control: The Unifying Principle

With respect to the work to be done by the worker . . .

Employees:
the employer controls both the “what” and the “how”

Independent Contractors:
employers control only the “what.” The “how” remains at the discretion of the independent contractor

THE TESTS

IRS COMMON LAW 20 FACTOR TEST

- Revenue Ruling 87-41
- Weighs all 20 factors in determining whether a worker is an employee or independent contractor
- No one factor is determinative

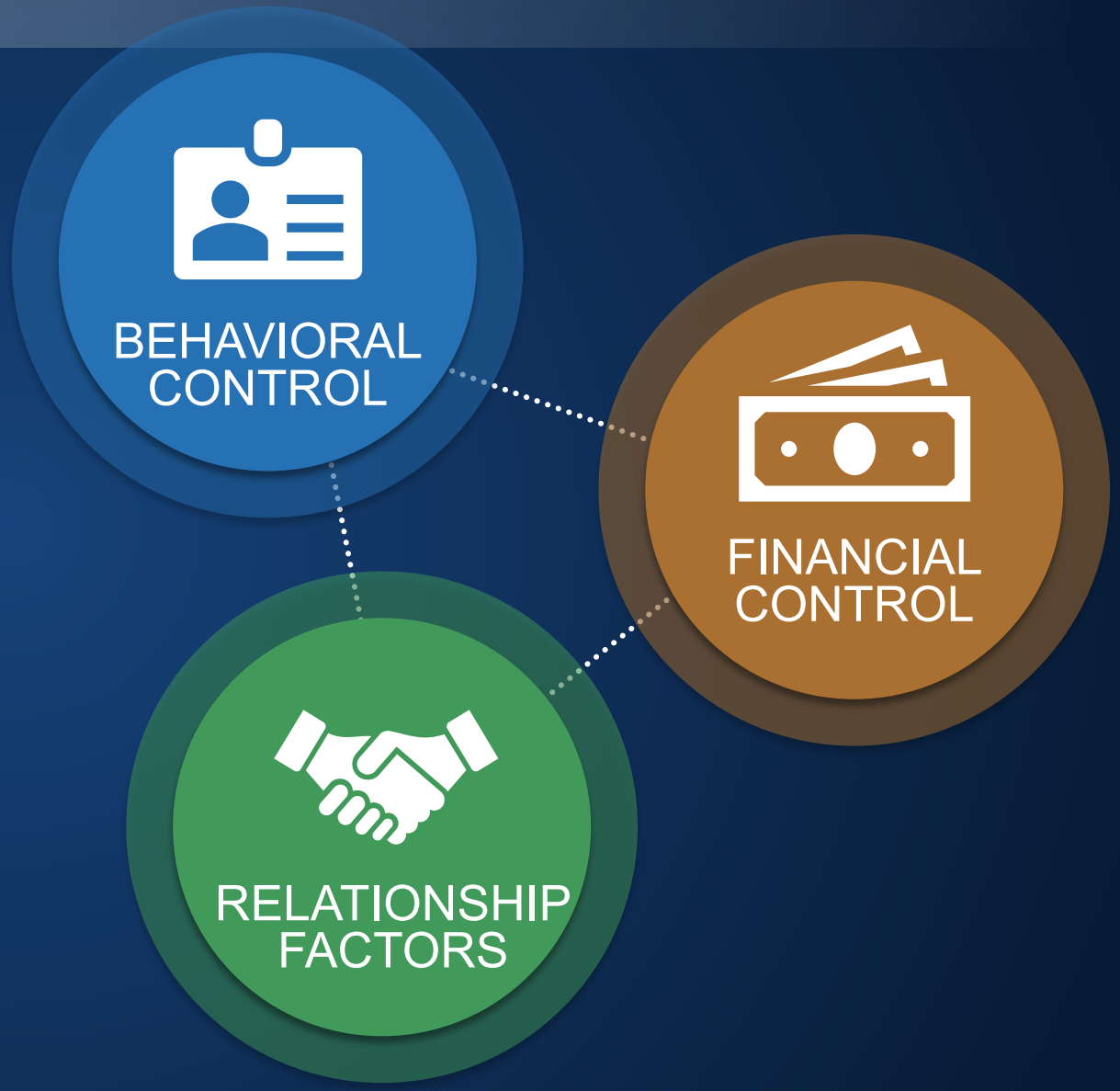


IRS COMMON LAW 20 FACTOR TEST

1. Instructions
2. Training
3. Integration
4. Services rendered personally
5. Hiring, supervising and paying assistants
6. Continuing relationship
7. Set hours of work
8. Full-time required
9. Work done on premises
10. Order or sequence set
11. Oral or written reports
12. Payment by hour, week or month
13. Payment of expenses
14. Furnishing of tools and materials
15. Significant investment
16. Profit or loss
17. Working for more than one firm at a time
18. Making service available to the general public
19. Right to discharge
20. Right to terminate (by worker)

IRS 3-FACTOR TEST

- New and Improved!
- Groups the 20 factors into three categories:
  - Behavioral control
  - Financial control
  - Relationship factors



IRS 3-FACTOR TEST

Behavioral Control –
Does the employer control:

- When and where the work is performed?
- What tools or equipment are used?
- What workers are hired to assist?
- What order or sequence will the work be completed?



IRS 3-FACTOR TEST

Financial Control –
Does the employer control:

- The worker's reimbursement for expenses?
- The worker's investment in the work?
- The worker's ability to work for others?
- How and when the work is paid?



IRS 3-FACTOR TEST

Relationship Factors –
Between the worker and employer:

- Is there a written agreement?
- Is the worker eligible for benefits?
- Is the working relationship permanent?
- Are the services provided a key aspect of the employer's business?



FLSA

- **2021 Rule** – two “core” factors, plus additional factors to be considered
- **2024 Rule** (“Economic Reality Test”) – abandoned the two “core” factors in favor of totality of circumstances where no one factor controls
- **Proposed 2026 Rule** – returns to “core factors” essentially reaffirming the 2021 Rule



FLSA – 2024 RULE

Economic Reality Test:

1. Opportunity for profit or loss depending on managerial skill;
2. Investment by worker and potential employer;
3. Degree of permanence of the work relationship;
4. Nature and degree of control over performance of the work and working relationship;
5. Extent to which the work performed is an integral part of the potential employer's business; and
6. Skill and initiative of worker.

*Additional factors may be relevant in determining whether the worker is an employee or independent contractor under the FLSA.

NLRB AND ERISA – COMMON LAW AGENCY TEST

Restatement (Second) of Agency s. 220:

- Extent of control by employer
- Whether or not individual is engaged in a distinct occupation or business
- Whether the work is usually done under the direction of employer or by a specialist without supervision
- Skill required
- Whether the employer or individual supplies instrumentalities, tools, and place of work
- Length of time for which individual is employed
- Method of payment
- Whether or not work is part of the regular business of the employer
- Whether or not the parties believe they are creating an independent contractor relationship
- Whether the principal is or is not in business
- Whether the evidence tends to show that the individual is, in fact, rendering services as an independent business

STATE TESTS - MICHIGAN

- Michigan Unemployment Insurance Agency – IRS 3-Factor Test
- Michigan Workers' Disability Compensation Act (MCL 418.161(1)(n)):
  - Worker does not maintain a separate business
  - Worker does not hold themselves out to and render service to the public
  - Worker is not employed under the MWDCA

CONSEQUENCES

CONSEQUENCES OF MISCLASSIFICATION

- Tax liabilities
- Wage claims under FLSA
- ERISA claims
- FMLA issues
- I-9 violations



WAGE CLAIMS

An employer can be liable for wage and hour claims under FLSA.

Back pay and “liquidated damages” in an amount equal to the amount of back pay unless employer can show

(i) actions were taken in good faith, and

(ii) they had reasonable grounds to believe they were complying with FLSA.

PROACTIVE STEPS

TO MITIGATE MISCLASSIFICATION ISSUES . . .

- Advise your clients to audit their workforce
- Aim to satisfy all classification tests, if possible
  - If all else fails, remove control wherever possible
- If engaging with an independent contractor, consider requesting the individual establish their own LLC prior to engaging

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QUESTIONS

Submit questions for presenters

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THANK YOU



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