

States Increase Scrutiny of Independent Contractor Usage

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States have an economic interest in classifying workers as employees rather than independent contractors to collect withholding and employment tax contributions. Certain states have increased their enforcement efforts in this area, particularly against companies operating in the “gig economy,” and state lawmakers are exploring new legislation in many states across the country, including New York. Most recently, the State of New Jersey demanded that Uber pay \$649 million in unpaid employment taxes due to the alleged misclassification of its drivers as independent contractors. The total consists of approximately \$530 million in back taxes for unemployment and disability insurance from 2014 to 2018, plus approximately \$119 million in interest on the unpaid taxes. We expect that Uber will vigorously challenge New Jersey’s determination.

Although not every company operates like Uber, it is critical in the current environment that public and privately held companies alike ensure that their independent contractors are properly classified under the myriad of applicable state and federal employment and tax laws. The cost of misclassification can be significant as evidenced in the New Jersey Uber matter.

Independent contractor misclassification explained. Independent contractors are not protected by most federal, state or local laws intended to protect employees. Their earnings are reported on Form 1099’s and are not subject to tax withholding or employment tax remittances, such as FICA and state unemployment and disability insurance contributions, and independent contractors are not eligible for employee benefits, making it considerably more cost efficient for companies to retain workers as independent contractors. For these reasons, among others, the focus on workers’ rights and the “gig economy” is gaining steam across the country and is also the subject of rhetoric in the 2020 presidential campaign.

The specific legal tests for determining if a service provider is an independent contractor or an employee differ by jurisdiction and are subject to change over time. The legal tests generally require multiple factors to be considered and weighed. While there are some common factors across tests, it is possible for a service provider to be deemed an employee under one law (e.g., federal tax law) and an independent contractor under

another (e.g., state labor law). This spring, the U.S. Department of Labor and the National Labor Relations Board each issued guidance suggesting that they did not plan to reclassify Uber drivers as employees. However, states like New Jersey appear to be taking a different path.

New Jersey, like many other states, determines whether a worker is an employee or an independent contractor through an “ABC” test. An ABC test generally provides that a worker is an employee rather than an independent contractor unless the hiring entity can establish that (A) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; (B) the worker performs work that is outside the usual course of the hiring entity’s business; and (C) the worker is customarily engaged in an independently established trade, occupation or business. Some states, including New Jersey, California and Massachusetts, utilize a form of the ABC tests for wage and hour purposes, and many others apply a form of the test when determining state-mandated insurance benefit eligibility.

Federal and state tax and labor regulators may audit for independent contractor misclassifications and seek to collect retroactive tax liabilities and interest as New Jersey has done in Uber’s case. Service providers who are misclassified may have grounds to sue the service recipient on an individual or collective basis for failure to provide employee treatment, and Uber has long been facing such civil litigation brought by its drivers.

Potential legislative action in New York. In the last two months, New York State has proposed new legislation aimed at protecting workers in the gig economy, and that may make New York State the next state to crack down on independent contractor arrangements.

- **Senate Bill S6699-A:** In September 2019, New York State introduced Senate Bill S6699-A, which seeks to implement an ABC Test for employee classification in New York for both wage payments and unemployment insurance in order to “reclassify more workers as employees rather than independent contractors in order for them to receive benefits such as healthcare and retirement.”
- **Senate Bill S6538:** In October 2019, the New York State Senate introduced S6538 with the goal of extending wage payment and collective bargaining protections to a new category of so-called “dependent workers,” defined as individuals that provide personal services to a consumer through a private third party who establishes the amounts earned by the worker or charged to the consumer, or collects payment from the consumer, or pays the individual, or any combination thereof.

The New York Senate also held a four-hour public hearing on October 16, 2019 to hear from stakeholders in the gig economy to identify the needs of workers and employers operating outside the traditional employee-employer dynamic. It is therefore highly likely that New York will enact some form of legislation in this area in the near future.

Recommended actions to ensure proper independent contractor classifications.

Even absent further legislative movement in this area, compliance with existing independent contractor laws is critical, and noncompliance can lead to significant liabilities. Companies should consider taking protective steps to prevent independent contractor misclassification, including:

- Conducting a privileged self-audit to ensure proper classifications, particularly with regard to long-tenured independent contractors;
- Evaluating the degree of control that the company maintains over its independent contractors;
- Reviewing and updating independent contractor agreements or implementing them if none were previously in existence;
- Considering requiring mandatory arbitration agreements with these workers that include class action waivers;
- Reviewing ERISA benefit plans to ensure misclassified independent contractors are not covered; and
- Monitoring for legal developments in those jurisdictions where independent contractors are providing services.

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