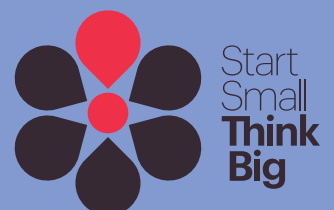




**Legal Program**  
**Guide to**  
**Understanding**  
**Worker**  
**Classifications:**  
Employee vs. Independent Contractor





# Introduction

As your small business grows, you may want to hire workers to help with operations and other tasks. A key question to ask before you hire someone is whether they should be treated as an employee or an independent contractor – the answer will determine your obligations and responsibilities as an employer and your legal and tax liability, among other things.

Generally, an employee is an individual who works under the supervision or control of an employer, and is otherwise not in business for themselves. An independent contractor, on the other hand, is self-employed and is contracted (usually temporarily) to perform discrete work for another party.





## Misclassifying a worker can result in considerable consequences and penalties for employers.

Misclassifying a worker as an independent contractor can result in various consequences for employers, even if it was unintentional or done in good faith. Employers can be found to have misclassified a worker even if the worker agrees they are an independent contractor and/or the parties sign an independent contractor agreement; what matters are the specific facts and circumstances of the working relationship, not just the formalities.<sup>1</sup>

Worker classifications matter because employees – both part-time and full-time – are generally entitled to certain benefits and protections by law, including the right to receive a certain wage, overtime, or unemployment and workers' compensation benefits.<sup>2</sup> Moreover, employees and employers contribute various taxes to federal and state agencies, including income, disability, and payroll taxes. As a result, if a worker should have been classified as an employee (but wasn't), businesses may owe various state and federal taxes, back wages,<sup>3</sup> paid sick leave,<sup>4</sup> and other benefits.

To avoid potential problems down the road, it is important to correctly classify workers and ensure a business is in compliance with federal and state labor and employment laws.

<sup>1</sup> U.S. Dep't of Labor, [Get the Facts on Misclassification Under the Fair Labor Standards Act - Employee or Independent Contractor?](#) (last accessed Apr. 5, 2023).

<sup>2</sup> E.g., in New York, see NYS Department of Labor, [Workplace Rights FAQs](#) (last accessed Apr. 5, 2023).

<sup>3</sup> E.g., in New York, see NYS Department of Labor, [Unpaid/Withheld Wages and Wage Supplements](#) (last accessed Apr. 5, 2023).

<sup>4</sup> E.g., in New York, see NYS Department of Labor, [New York Paid Sick Leave](#) (last accessed Apr. 5, 2023).



## **Whether a worker is an employee or independent contractor will depend on the jurisdiction and law at issue.**

For example, your business may be subject to certain federal laws – such as federal tax laws – if the person you hire is deemed an “employee” under federal law.<sup>5</sup> Depending on the state in which your business operates, you will likely also be subject to state and local employment laws, including laws related to mandated minimum wage, overtime, and paid sick leave. Because of the various laws and regulations that can apply to employers, it is important to correctly determine whether your workers should be classified as employees or independent contractors.

## **To determine a worker’s status, governments look at the specific facts and circumstances of a working relationship.**

Generally, there are two tests used by the federal government and most states to determine whether a worker is an employee or independent contractor: the “economic realities” and “control” tests. Both tests look at factors that determine whether the employer is the one setting or controlling the details of the working relationship, or whether the worker has agency over their own work.

Below is a non-exhaustive list of factors considered when determining whether a worker is an employee or independent contractor:<sup>6</sup>

**A WORKER MAY BE AN  
EMPLOYEE IF:**

**A WORKER MAY BE AN  
INDEPENDENT CONTRACTOR IF:**

|   |  |
|---|--|
| Worker is working for someone else's business   | Worker is running their own business and advertises their services   |
| Worker is paid hourly or paid a salary, and their wage and work schedule is determined by the employer  | Worker sets their own pay rate and is paid upon completion of a project (rather than hourly)   |
| Employer provides the worker with materials, tools, and equipment they are allowed to use in the course of their work   | Worker uses their own materials, tools, and equipment to complete the work   |
| Worker typically works for only one employer at a time, and the employer requires exclusivity (i.e., the worker is not allowed to work for others or competitors) | Worker contracts with multiple clients simultaneously  |
| Worker has an ongoing, indefinite relationship with the same employer   | Working relationship is temporary, until the project is completed  |
| Employer decides when and how the work will be performed  | Worker decides when and how they will perform the work   |
| Employer assigns the work to be performed   | Worker decides what work they will do without needing the employer's prior approval  |
| Employer provides training and instruction to the worker, and directly supervises and evaluates the worker's performance  | Employer does not receive any instruction or training materials in order to complete their work  |
| Worker receives vacation, sick pay, health insurance or other benefits through their employer   | Worker does not receive any benefits or pays for their own benefits (e.g., health insurance, workers' compensation, disability coverage) |
| Worker needs permission from the employer for any absences  | Worker is able to take time off without prior approval   |
| Worker's services are a critical aspect of the business's operations  | Worker's services are not necessary to run the business day-to-day   |

<sup>5</sup> Note: whether a specific federal or state law relating to employer obligations applies to your small business depends on the scope of the law in question. That is a separate legal question that is not addressed in this Guide.

<sup>6</sup> For more information, see U.S. Dep't of Labor, [Misclassification of Employees as Independent Contractors](#) (last accessed April 13, 2023); IRS, [Financial Control](#) (last updated Apr. 4, 2023); IRS, [Type of Relationship](#) (last updated Mar. 17, 2023); IRS, [Topic No. 762 Independent Contractor vs. Employee](#) (last updated Oct. 14, 2022); NYS Dep't of Labor, [Independent Contractors](#) (last accessed Apr. 5, 2023).





## California's "ABC test" makes it much harder to classify workers as "independent contractors" in California.

Under California law's "ABC test", workers are **presumed** to be employees **unless the hiring entity** can show that:

- (A) The worker is free from control and direction of the company when performing the work, both under contract and in fact;
- (B) The worker's services must be performed 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 of the same nature as the work performed for the hiring entity.<sup>7</sup>

While part A of the ABC test is similar to the requirements of the "economic realities" and "control" tests, parts B and C involve broader and unique requirements that make it very difficult to establish that a worker is an independent contractor in California.

Some job categories are excluded from the ABC test; however, workers in those categories must still meet the "economic realities" test to qualify as independent contractors. Some of the excluded worker types include:

- Contracts for professional services (e.g., marketing, graphic design, grant writing, fine art);
- Photographers, photojournalists, videographers, photo editors, or digital content aggregators;
- Freelance writers, translators, editors, copy editors, illustrators, or cartoonists;
- Workers in the music and performance art industry (e.g., recording artists, producers, music engineers, musicians);
- Insurance brokers and certain workers in the insurance industry (e.g., underwriters, inspectors, auditors); and
- Doctors and other certain licensed professionals (e.g., lawyers, architects, engineers, accountants)<sup>8</sup>

**Contact us at Start Small Think Big  
if you have questions  
about worker classifications!**

In summary, if you are considering hiring a worker to assist you with your small business, it is important to think about the types of tasks and responsibilities that worker will be charged with, among other things. Depending on the specifics of the working relationship, you may be required to classify that worker as an employee or independent contractor.

If you have questions about whether a current or prospective worker is an employee or independent contractor, please contact Start Small Think Big at [hello@startsmallthinkbig.org](mailto:hello@startsmallthinkbig.org) to schedule an intake. Depending on your business location (specifically California or New York), Start Small may be able to provide legal assistance and/or advice regarding the proper classification of workers that you currently employ or are considering employing.

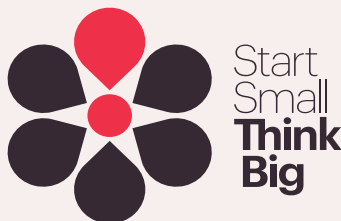
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<sup>7</sup> California Dep't of Indus. Relations, [Independent Contractor vs Employee](#) (last updated January 2023)

<sup>8</sup> Cal. Lab. Code §§ 2776–2784; see also resources from the California Employment Development Department (EDD) on [Employment Status](#) (last accessed April 12, 2023) and the California Labor & Workplace Development Agency on [Independent Contractor vs Employee](#) (last accessed April 12, 2023).