Worker Classification: Employee vs. Independent Contractor

Scope

Local education agencies (LEAs) must properly classify workers as employees or independent contractors, according to state and federal laws, regulations, and/or rules. LEAs must ensure that grant budgets submitted to the department for approval include the correct account codes based on the proper classification of workers.

Fair Labor Standards Act (FLSA) Worker Classification Analysis[1]

The U.S. Department of Labor issued final guidance, effective March 11, 2024, on how to analyze employee or independent contractor status under FLSA.

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

While the final rule provides detailed guidance regarding the application of each of these six factors, it is important to note that these factors are tools to conduct a totality-of-the-circumstances analysis. Consistent with a totality-of-the-circumstances analysis, 29 C.F.R. § 795.110 directs that these six factors are not exhaustive and the weight given to each factor may depend on the facts and circumstances of the particular relationship.

IRS Worker Classification Analysis[2]

IRS regulations for worker classifications are not spelled out in terms of any one law. The IRS determination tests three categories of evidence of control.

1. Behavioral control: Does the company control or have the right to control what the worker does and how the worker does the job?
2. Financial control: Are the business aspects of the worker's job controlled by the payer?
3. Relationship of the parties: Will the relationship continue and is the work performed a key aspect of the business?

Generally, someone is self-employed if any of the following apply to them:

1. They carry on a trade or business as a sole proprietor or an independent contractor.
2. They are a member of a partnership that carries on a trade or business.
3. They are otherwise in business for themselves, including a part-time business.

Tips for Classifying Workers

- One worker should not get both a Form W-2 (employee) and Form 1099 NEC (independent contractor) in the same year, as this can trigger an IRS audit for misclassification of workers.
- Worker classification is not determined by a job title, full-time or part-time status, or existence of a written contract.

- A worker cannot voluntarily waive employment status and choose to be classified as an independent contractor.
- An independent contractor generally advertises to the public to secure work.
- Under the IRS Code and laws in some states, monetary penalties may be assessed for misclassification of workers.

Resources

- Internal Revenue Service (IRS) Form SS-8 Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
    - IRS will review and give ruling on forms that are filed.
    - LEA may complete and apply the results without filing the form with the IRS
- The IRS offers the Voluntary Classification Settlement Program (VCSP) that provides an opportunity for taxpayers to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes.
- Resources for Employers | U.S. Department of Labor (dol.gov)

References

1. Frequently Asked Questions - Final Rule: Employee or Independent Contractor Classification Under the FLSA | U.S. Department of Labor (dol.gov)

2. Worker Classification 101: employee or independent contractor | Internal Revenue Service (irs.gov)

Contact

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