



## Determine the Type of Employee for Locally-funded Employees

This document will help you determine if the individual you want to hire should be classified as an independent contractor or an employee, and if an employee, whether he/she should be classified as an hourly (non-exempt) employee or a salaried (exempt) employee.

### Independent Contractor or Employee?

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The following is a document produced by James H. Kizziar Jr., Partner at Bracewell & Giuliani LLP in July 2009. There are four different tests that can be used to determine if an individual is an independent contractor or an employee. Facilities must carefully analyze whether workers are properly classified as independent contractors or employees under any of the below tests. If there is any uncertainty about the proper classification, consult with legal counsel before making a final decision.

#### I. THE RESTATEMENT (SECOND) OF AGENCY “TEN-POINT” TEST

At common law, a “servant” or employee is “a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other’s control or right to control.” Restatement (Second) of Agency, ~ 200. The following ten factors are to be considered in determining whether a worker is an independent contractor or employee:

1. The extent of control which, by the agreement, the master may exercise over the details of the work;
2. Whether or not the employed is engaged in a distinct occupation or business;
3. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
4. The skill required in the particular occupation;
5. Whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;
6. The length of time for which the person is employed;
7. The method of payment, whether by the time or by the job;
8. Whether or not the work is part of the regular business of the employer;
9. Whether or not the parties believe they are creating the relation of master and servant;
10. Whether the principal is or is not in business.

Courts generally agree that although no one factor is determinative, the most important factor

is the right of control. It is the right to control, not the actual exercise of that right, that is analyzed by courts. Similarly, the existence of an agreement providing that the worker is an independent contractor is not determinative and often is given little weight.

## II. THE SUPREME COURTS'S DARDEN TEST

In 1992, the U.S. Supreme Court issued a decision in *Nationwide Mut. Ins. Co. v. Darden*,<sup>1</sup> in which it outlined a 12-factor test (similar to the 10-factor Restatement test) to determine employee or independent contractor status. In determining whether a hired party is an employee under the general common law of agency, the Supreme Court held that it considers “the hiring party’s right to control the manner and means by which the product is accomplished.” The court listed the following 12 factors that are relevant to this inquiry:

1. The skill required;
2. The source of the instrumentalities and tools;
3. The location of the work;
4. The duration of the relationship between the parties;
5. Whether the hiring party has the right to assign additional projects to the hired party;
6. The extent of the hired party’s discretion over when and how long to work;
7. The method of payment;
8. The hired party’s role in hiring and paying assistants;
9. Whether the work is part of the regular business of the hiring party;
10. Whether the hiring party is in business;
11. The provision of employee benefits;
12. The tax treatment of the hired party.

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<sup>1</sup> 503 U.S. 318 (1992).

## III. THE IRS TEST

For purposes of tax withholding and payment of Social Security, Medicare, and federal unemployment insurance taxes, the IRS formerly used a 20-factor test. However, “[u]nder pressure from Congress and from representatives of labor and business,” it consolidated the twenty factors into an eleven-point test, which is divided into three principal categories, as follows:<sup>2</sup>

### A. Behavioral control

This includes facts showing whether the business has a right to direct and control how the worker does the task for which he was hired, and include the type and degree of:

1. Instructions the business gives the worker, such as:
  - a. When and where to do the work;
  - b. What tools or equipment to use;
  - c. What workers to hire or to assist with the work;
  - d. Where to purchase supplies and services;
  - e. What work must be performed by a specified individual;
  - f. What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how

the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

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2 IRS Publication 15-A (2009) and Texas Workforce Commission website at <[http://www.twc.state.tx.us/news/eft/appx\\_d\\_irs\\_ic\\_test.html](http://www.twc.state.tx.us/news/eft/appx_d_irs_ic_test.html)>

2. Training the business gives the worker. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

## B. Financial control

Facts that show whether the business has a right to control the business aspects of the worker's job include:

1. The extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.
2. The extent of the worker's investment. An employee usually has no investment in the work other than his or her own time. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.
3. The extent to which the worker makes services available to the relevant market. An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.
4. How the business pays the worker. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.
5. The extent to which the worker can realize a profit or loss. Since an employer usually provides employees a workplace, tools, materials, equipment, and supplies needed for the work, and generally pays the cost of doing business, employees do not have an opportunity to make a profit or loss. An independent contractor can make a profit or loss.

## C. Type of relationship

Facts that show the parties' type of relationship include:

1. Written contracts describing the relationship the parties intended to create.
2. Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.
3. The permanency of the relationship. If the employer engages a worker with the

expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.

4. The extent to which services performed by the worker are a key aspect of the regular business of the company. If a worker provides services that are a key aspect of the employer's regular business activity, it is more likely that the employer will have the right to direct and control the engaged worker's activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

#### IV. THE FAIR LABOR STANDARDS ACT TEST

The definition of "employee," "employer," and "employ" in the FLSA are comprehensive in scope and are to be interpreted broadly. To determine whether an individual is an employee under the FLSA, courts focus on the "economic realities of the relationship." *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947); see also *Carrell v. Sunland Constr.*, 998 F.2d 330, 332 (5th Cir. 1993); *Reich v. Circle C. Investments*, 998 F.2d 324, 327 (5th Cir.1993).

More recently, in *Shultz v. Capital Int'l Securities*, 466 F.3d 298, 304-305 (4th Cir. 2006), the court set out the six factors:

1. the degree of control that the putative employer has over the manner in which the work is performed;
2. the worker's opportunities for profit or loss dependent on his managerial skill;
3. the worker's investment in equipment or material, or his employment of other workers;
4. the degree of skill required for the work;
5. the permanence of the working relationship; and
6. the degree to which the services rendered are an integral part of the putative employer's business.

## Hourly or Salary?

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An exempt employee is one who is exempt from overtime regulations and is a salaried employee. A non-exempt employee is *not* exempt from overtime regulations, and is an hourly employee. Generally, two requirements must be met to classify an employee as exempt: 1) They must earn a salary, and 2) They must hold a position with duties that the U.S. Department of Labor designates as appropriate for exempt positions. These positions fall into six categories: executive, administrative, learned professional, creative professional, computer professional, and outside sales.

The following tests will help you determine if the employee you wish to hire will be hourly (non-exempt) or salaried (exempt).

### Executive Employee

1. Is the employee's primary duty managing the enterprise or department or subdivision of the enterprise?
2. Does the employee customarily direct the work of two or more other employees or their equivalent?
3. Does the employee have the authority to hire or fire, and do the recommendations carry significant weight if unauthorized to make the final decision?
4. Is the employee paid the equivalent of at least \$455 per week?

If you answered "No" to any of these questions, the worker is not an exempt employee.

### Administrative Employee

1. Is the employee's primary duty performing office or non-manual work directly related to the management or general business operations of the employer or the employer's customers?
2. Does the employee exercise discretion and independent judgment with respect to matters of significance? That is, does he/she evaluate and compare possible courses of action and then make a decision or recommendation after considering various possibilities?
3. Is the employee paid the equivalent of at least \$455 per week?

If you answered "No" to any of these questions, the worker is not an exempt employee.

### Learned Professional Employee

1. Is the employee's primary duty to perform work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction?
2. Is the advanced knowledge obtained by completing an academic course of study resulting in a four-year college degree or leading to certification?
3. Is the employee paid the equivalent of at least \$455 per week?

If you answered "No" to any of these questions, the worker is not an exempt employee.

**Exception:** *Those who have completed the educational requirements for a law or medical degree need not meet the minimum salary requirement. Also, teachers need not be certified or meet the minimum salary requirement to qualify as learned professionals.*

### Creative Professional Employee

1. Is the employee's primary duty to perform work requiring invention, originality or talent in a recognized field of artistic endeavor such as music, writing, acting and the graphic arts?
2. Does the work require more than intelligence, diligence, and accuracy, i.e., does it require "talent"?
3. Is the employee paid the equivalent of at least \$455 per week?

If you answered "No" to any of these questions, the worker is not an exempt employee.

### Computer Professional

1. Is the employee paid at least \$455 per week on a salary or fee basis or, if paid hourly, at a rate of not less than \$27.6 per hour?
2. Is the employee's primary duty:
  - Application of system analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specification; or
  - Design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specification; or
  - Design, testing, documentation, creation or modification of computer programs related to machine operating system; or
  - A combination of the aforementioned duties requiring the same level of skills?

If you answered "No" to question #1 or were unable to answer "Yes" to any parts under question #2, the worker is not an exempt employee.

### Outside Sales Employee

1. Is the employee's primary duty to perform work requiring invention, originality or talent in a recognized field of artistic endeavor such as music, writing, acting and the graphic arts?
2. Does the work require more than intelligence, diligence, and accuracy, i.e., does it require "talent"?
3. Is the employee paid the equivalent of at least \$455 per week?

If you answered "No" to any of these questions, the worker is not an exempt employee.