



Summary

Correctly classifying workers is of significant importance in order to avoid litigation, damages, and penalties. Whether a worker is an independent contractor or employee depends on an analysis of the factors cited below. In summary, for an employer-employee relationship to exist the employer must have ‘the right to control and direct the work of an individual, not only as to the result to be achieved, but also as to the details by which that result is achieved.’” Courts have routinely evaluated the factors of physicians differently than other occupations.

Differences of Employee and Independent Contractor

An employer must withhold and pay income taxes, social security taxes, Medicare and unemployment tax on wages paid to an employee.¹ An employer is not required to withhold or pay taxes on payments to independent contractors. Failure to properly classify worker as employees can therefore result in substantial unpaid taxes, penalties and interest.

The Fair Labor Standards Act² (“FLSA”) requires employers to provide minimum wage and overtime pay to qualified employees – but not to independent contractors. Many employees, especially full-time employees, are also entitled to various statutory benefits, such as state law paid sick leave entitlements, workers’ compensation benefits, unemployment benefits, and to benefits under an employer’s ERISA-governed benefit plans, such as group health insurance policies and 401(k) plans. Failure to properly classify workers as employees can therefore result in substantial damages and penalties.

Classification

The determination of whether a worker is classified as an employee or independent contractor is regulated by the Internal Revenue Service, U.S. Department of Labor, state revenue agencies, and state attorneys general.

If an employee is incorrectly classified as an independent contractor, then the employer could be liable for employment taxes, back wages, unemployment insurance claims, workers’ compensation claims, claims involving benefits, penalties, interest and more. The regulatory agencies regularly audit companies for compliance.

There is no single established definition of an independent contractor under Federal law. Different tests are applied depending on the circumstances to determine whether a worker is an employee or an independent contractor for purposes of workers' compensation, unemployment insurance, tax liability and common law. The Circuit Courts each apply their own tests. The U.S. Department of Labor applies the “economic realities” test. The Tax Court applies the test of the Circuit Court to which an appeal would ordinarily lie. In substance, the tests are all materially similar. This memo will discuss the test generally applied by the Tax Court.

Tax Court

¹ §§ 6302, 6157; Treas. Reg. §§ 31.6302-1, 31.6302(c)-3.

² 29 U.S.C. § 201 et seq



The Tax Court determines a worker's employment status by applying common law concepts, while keeping in mind that doubtful questions should be resolved in favor of employment. The “relevant question is whether the alleged employee so economically depends upon the business to which he renders his services, such that the worker, as a matter of economic reality, is not in business for himself.”³

The Tax Court generally considers seven nonexhaustive factors to guide this inquiry:

1. the degree of control exercised by the alleged employer;
2. the degree to which the worker's opportunity for profit or loss is determined by the alleged employer;
3. the extent of the relative investments of the worker and the alleged employer;
4. the permanency of the relationship;
5. the skill and initiative required in performing the job; and
6. the type of business of the alleged employer.

No single factor is determinative. Rather, each factor is a tool used to gauge the economic dependence of the alleged employee, and each must be applied with this ultimate concept in mind. The factors are not necessarily weighted equally; rather, they are considered according to their significance in the particular case.

1. Degree of Control

The right of the principal to exercise meaningful control over the worker, i.e., whether the worker is independent of his manager's control or dependent for direction or control in carrying out his work, is the *crucial test* for determining the existence of an employer-employee relationship. For a worker to be considered an employee, the employer “must control not merely the end sought to be accomplished, but also the means and details of its accomplishment as well.” An employer-employee relationship exists when the principal retains the right to direct the manner in which the work is to be done, controls the methods to be used in doing the work, and controls the details and means by which the desired result is to be accomplished. The degree of control necessary to find employment status varies with the nature of the services provided by the worker. To possess a degree of control over a worker indicative of employment, the principal need not direct the worker's every move; rather, it is sufficient if the right to do so exists.

Examples of factors that indicate an employee.

- Principal acted as the gatekeeper between the workers and the customers.
- Principal controlled the working hours and the schedule of the workers, during which times principal barred the workers from accepting work from other agencies.
- Although the workers could decline to provide services to a particular customer, a worker's refusal to accept an assignment could, at the sole discretion of principal, jeopardize future assignments or even lead to termination.
- The worker was required to follow principal's directions and protocols.

³ Hobbs v. Petroplex Pipe & Constr., Inc., 946 F.3d 824, 829 (5th Cir. 2020) (quoting Thibault v. Bellsouth Telecomms., Inc., 612 F.3d 843, 845 (5th Cir. 2010)).



- Principal instructed the worker regarding when and where to perform his duties.

Examples of factors that indicate an independent contractor.

- Principal's role is more of an intermediary between the worker and the customer.
- Principal directed the workers as to the result to be accomplished and expects the result to be done in accordance with the contracts' specifications, but otherwise allows the workers to use their discretion as to the means and methods of accomplishing this result.
- The workers don't have to take any jobs offered them by the principal, but when they do take such a job, they travel to the job site using their own transportation, performed the job at their own pace, and used their own equipment and supplies.
- Principal rarely supervised the worker's services on site.
- Principal did not guarantee the workers a minimum amount or frequency of work and many of them provided services for other individuals or businesses, making it unnecessary for principal to ever formally discharge or terminate any of them.

2. Opportunity for Profit or Loss

An opportunity for profit or the risk of loss on the basis of the worker's own efforts and skill indicates independent contractor status. In contrast, earning an hourly wage or a fixed salary indicates an employer-employee relationship.

Examples of factors that indicate an employee.

- The worker's ability to control his own opportunities for profit or loss was negligible to nonexistent.
- Principal, not the worker, received payment for the services.

3. Relative Investments

The fact that a worker provides his own supplies, tools, and materials generally indicates independent contractor status. In considering this factor, the Tax Court will compare "each worker's individual investment to that of the alleged employer."

Examples of factors that indicate an employee.

- The worker had almost no capital investment in the job.
- Principal was responsible for providing the supervision, training, and supplies needed for the worker to perform his services.

4. Discharge Permanency of the Relationship and Right to Discharge

The Tax Court considers whether the worker worked exclusively for the alleged employer, the total length of the relationship, and whether the work was on a "project-by-project basis." The Tax Court also considers whether the alleged employer had the right to discharge a worker at will,



a typical employer right, and whether the worker had the right to quit at any time. A continuing relationship indicates an employment relationship, while a transitory relationship may be indicative of independent contractor status. The parties' contemplation of a continuing relationship indicates an employment relationship. In contrast, a relationship established to accomplish a specified objective is indicative of an independent contractor relationship.

Examples of factors that indicate an employee.

- The worker was hired on a permanent basis for an indefinite period, and principal required the worker to sign a contract for services.
- Although the worker was permitted to work for others, such work could be performed only during the worker's off-hours.
- While principal and the worker had the mutual ability to terminate their working relationship, only the worker was required to provide two weeks' notice.

5. Skill and Initiative Required

Relevant to this inquiry is “the extent of discretion the worker has over his daily tasks and whether he must take initiative to find consistent work.”

Examples of factors that indicate an employee.

- Greater skill and more demonstrated initiative counsel in favor of independent contractor status.
- Once a worker was on the job, principal's directions specified how the worker was to complete the assigned tasks.
- Significant initiative on the part of the worker was not necessary for them to receive consistent work as principal neither required nor permitted them to find new patients.

6. Integral Part of Business

Where a type of work is part of the principal's regular business, it is indicative of employee status.

Different Standards for Physicians

Courts have routinely evaluated the factors of physicians differently than other occupations.

Chicago Surgical Clinic, Ltd. V. Northwest Community Hospital

In *Chicago Surgical Clinic, Ltd. V. Northwest Community Hospital* the 7th Circuit held that a physician was an independent contractor. The physician owned and operated Chicago Surgical Clinic, Ltd., a private medical practice. From 2000 through early 2013, most of her revenue came from the work she performed at a hospital, where she maintained practice privileges. The physician billed her patients directly and filed taxes as a self-employed physician. The hospital did not provide the physician with employment benefits or pay her professional licensing dues. The 7th Circuit noted that the physician's work agreement with the hospital confirmed her independence.



She could set her own hours, subject only to operating-room availability; she could obtain practice privileges at other hospitals and redirect her patients to those locations; she could use her own staff in surgeries; and, most importantly, she made the treatment decisions for her patients.

The 7th Circuit noted that the hospital placed certain restriction on the physician, including on-call demands, medical-education standards, peer-review processes, and reporting requirements. The 7th Circuit has rejected claims of employment when physicians had even less flexibility (e.g., plaintiff couldn't use his own staff and the hospital assigned most patients; plaintiff couldn't associate with other hospitals; administrators told plaintiff "how often to perform physical examinations" and "what kind of questions to ask").

The 7th Circuit concluded: "For an employer-employee relationship to exist...the employer must have 'the right to control and direct the work of an individual, not only as to the result to be achieved, but also as to the details by which that result is achieved..." the hospital exercised no such control over the physician.

Henry v. Adventist Health Castle Med. Ctr.

In *Henry v. Adventist Health Castle Med. Ctr.*, the 9th Circuit held that a physician was an independent contractor. The physician joined the staff of a hospital and, with clinical privileges, performed surgeries at the hospital. While on call, The physician was not required to be present at hospital's facility unless an emergency intervention was needed. If he arranged backup emergency coverage, he could use that time to perform elective surgeries instead. The physician also leased space from hospital for elective surgeries on non-hospital patients. The physician was not required to refer his general surgery patients to hospital. In addition to his bariatric surgeries at hospital, he undertook non-bariatric surgeries at a competing hospital, where he also had clinical privileges. hospital decided which surgical assistants would support. The physician supervised their performance and pay, and determined which medical record system would be used for care provided at hospital. It also required The physician to comply with its "Code of Conduct," "Corporate Compliance Program," and other regulations and bylaws. hospital paid The physician \$100 per 24-hour on-call shift if there was no emergency intervention, or \$500 for each emergency that he handled. It issued The physician a 1099 tax form (an IRS form for independent contractor income)—never a W-2 (an IRS form for employee income). He reported his hospital earnings (which were only 10% of his 2016 income) on a Form 1040, which self-employed individuals use. hospital did not provide him any employee benefits, such as medical, insurance or retirement.

The 9th Circuit noted the following factors and precedent that lead to the conclusion that the physician was an independent contractor:

1. The physician's earnings from the hospital only accounted for 10% of his earnings is emblematic of an independent contractor relationship (concluding that physician was an independent contractor in part because physician's hours varied, and he did not receive a uniform salary);
2. The physician did not receive any typical employee benefits from the hospital (holding that doctor's lack of employee benefits weighed in favor of independent contractor status);
3. The physician reported his earnings on Form 1099 (holding that doctor was an independent contractor in part because he never received a W-2);



4. The physician's obligations to the hospital were limited, providing him the freedom to run his own private practice. The physician was required to be on call in the hospital only five days per month, the hospital was required to prioritize the physician's obligations when scheduling him. The physician was free to be elsewhere during his on-call shifts unless an emergency arose, and he could perform elective surgeries during his shifts if he coordinated backup coverage – both of which are consistent with independent contractor status (determining insurance agent was an independent contractor, as he “was free to operate his business as he saw fit without day-to-day intrusions”);
5. The physician also leased space from the hospital for elective surgeries on his own patients, performed general surgeries at a competing hospital, and could refer his patients to any hospital of his choosing (concluding doctor was an independent contractor where he treated his own patients, engaged with other hospitals, and did not have to accept patients referred to him from the hospital); and
6. The contracts between the physician and the hospital described him as an independent contractor (“The parties expressly set out from the beginning to create an independent contractor relationship.”)

In summary, the physician's duties do not exhibit the level of control present in employment relationships, but rather evidence the physician's professional independence from the hospital in treating his patients (concluding anesthesiologist was an independent contractor “because the details concerning performance of the work remained essentially within the [doctor's] control”).