

***Fox Rothschild Podcast***

**Legally EmpowHERed Podcast**

**Episode Three**

***Featuring Partner Sahara Pynes with Nancy Yaffe***

**Sahara Pynes:** Welcome to Legally EmpowHERed. I'm your host Sahara Pynes, and I'm really excited to bring this podcast to you. As an attorney and former business owner myself, I'm passionate about drawing on my own experience and insight to set my female clients up for success. I know my guest today feels the same.

It's such a privilege to welcome today's guest because she is someone I view as a true champion for women in the workplace. Nancy Yaffe serves as the co-chair of Fox Rothschild's Women's Initiative, a comprehensive firmwide program that is dedicated to promoting women attorneys within the firm as well as advancing Fox's women attorneys throughout the legal community. Like my own practice, Nancy focuses on labor and employment law counseling and litigation, with an emphasis on problem prevention. She defends all types of businesses against employee claims and lawsuits involving wage and hour violations, discrimination, harassment, and retaliation. She defends both single plaintiff and class or collective actions and is my go to mentor for all things labor and employment.

Her depth of experience will surely come in handy today as we dive into a conversation about independent contractors vs. employee classification. I'm so thrilled to have you here today, Nancy, and I really miss walking down to your office.

**Nancy Yaffe:** It's my pleasure, Sahara. Thank you for having me.

**Sahara Pynes:** Alright, so before we jump into the weeds here on this hot topic for entrepreneurs, let's get on the same page. Can you explain, Nancy, what is the difference between a contractor and an employee?

**Nancy Yaffe:** Absolutely. An employer will have two different types of workers, or team members. One type is an employee, and the other type is an independent contractor. An employee is someone who is paid by W2. An independent contractor is someone who usually has their own private business and is paid by 1099. Whether someone is a contractor, or an employee is a legal decision, it's not just the employer's choice or the worker's choice. Generally, under legal standards, if someone is doing work that is integral to your business and you're controlling what they do and how they do it, that person should be an employee even if they're not fulltime — so even if they are helping your business and they work either part time or temporarily or on-call. When a person is an employee, the employer pays payroll taxes and you

have to have workers comp insurance. When someone is a contractor, generally, an employer enters into a contract or agreement with the worker's business entity, and that worker or contractor pays their own taxes and you issue them a 1099.

**Sahara Pynes:** OK, and so the 1099 would be applicable to a contractor regardless of whether they have their own entity, right?

**Nancy Yaffe:** That is correct.

**Sahara Pynes:** OK, cool. So why is the contractor status so attractive to folks in the startup mode?

**Nancy Yaffe:** You know, I think it's because there is this thought in the startup mode that the entrepreneur is not really sure what kind of workers they will need, or for how long, so there is this constant of transforming work, or temporary work, and very often they don't want to make a commitment necessarily to the worker. Very often, too, a worker wants to be a contractor because they don't want those payroll taxes deducted.

**Sahara Pynes:** It's just less expensive, right?

**Nancy Yaffe:** It can be less expensive, but it's interesting, too, because there is this debate about whether it's better to be a contractor or an employee and there's two sides to the debate. A lot of our listeners might know of the debate that's been going on for platform drivers—Uber, Lyft. On the one hand there has been a big movement to make those drivers into employees, so they get covered by workers comp insurance, and covered by minimum wage laws, and compensated for all the hours they might spend driving—and the thought is that might be better for those workers. On the other hand, a lot of those workers really like the independence of being contractors. They like to set their own schedules. They like to decide when they're working and how they work and fit it into their own schedules. They feel like entrepreneurs with their own cars and their own business, right? So, there are really two sides to the story. I think that entrepreneurial spirit is why so many new businesses go directly to contractor status, and they don't really think about retaining people as employees.

**Sahara Pynes:** Well, and of course this debate is playing itself out in the courts right now—Uber, Lyft, as well as with food delivery service.

**Nancy Yaffe:** Right, all the on demand services are currently hashing out this issue in the courts. As I often say, what starts out on the coast will eventually move to the rest of the United States. California and New York have the bulk of that litigation right now, but other jurisdictions will likely have it in the coming years.

**Sahara Pynes:** Just a matter of time, right?

**Nancy Yaffe:** Yes.

**Sahara Pynes:** Yeah, and I know we've read articles about making a new classification of work for gig economy, rather than just have the old fashioned employee vs. contractor and potentially allowing some sort of hybrid model. We're just not there yet under the law, right?

**Nancy Yaffe:** Right. The law does not catch up to the way workforce has evolved. It's probably a decade or two behind, unfortunately. That's really hinderance to entrepreneurs and new businesses because there really should be a different classification. The laws were developed around the idea that people work 9-5 in an office, or some sort of manufacturing setting where an employer controls what they do and how they do it and they need protection and breaks, but that makes no sense in an on demand economy. Also you want to have an environment where businesses can thrive and the traditional employment rules make the quite hard for business, so that's another reason why I think entrepreneurs lean to retaining workers as contractors because they believe it give them more flexibility. Unfortunately, it also gives them a lot more risk.

**Sahara Pynes:** Absolutely, and I know costs are an issue for a lot of entrepreneurs when they're just starting out and they don't want to have the full cost of a salary plus payroll taxes. What are some of the other additional costs that entrepreneurs have to consider?

**Nancy Yaffe:** Sure. Well, in addition to payroll taxes, all employees have to be covered by workers compensation insurance.

**Sahara Pynes:** Only W2s, right?

**Nancy Yaffe:** Well, yeah. I'm going to correct semantics. Employees are W2s, contractors are 1099. So, when I say workers it's a general term that covers both of those, right? So your W2 employees do need to have workers comp insurance, you have to pay their payroll taxes, many jurisdictions require sick pay and the jurisdictions of sick pay expand probably every day it seems like—again, that is something that started on the coast and has moved throughout the country. Then there are other benefits that many employers provide to employees, quite often health insurance, 401 K or some sort of retirement plan. If an employee actually leaves employment for reasons generally unrelated to quitting, they would be open to get unemployment in most jurisdictions as well, which is an additional cost of having a W2 employee vs. a contractor.

**Sahara Pynes:** Right, and that could be how a company gets in trouble, right? The former contractor leaves employment, they don't realize that they're not subject to unemployment. We've had a number of situations where they go to file for unemployment, only to be told "hey you were a contractor, you're not eligible." Right?

**Nancy Yaffe:** Right, and that can initiate an audit by whatever state agency is paying the unemployment. In California that would be the Employment Development Department. You and I both know the EDD likes to audit companies that don't pay their payroll taxes.

**Sahara Pynes:** Sure, and the worker is pissed that they didn't get the unemployment, so they may seek plaintiffs counsel and come up with a whole host of other misclassification claims or wage and hour claims, which we both handle on a regular basis.

**Nancy Yaffe:** Right, and as long as you teed up that question, let's get into the risk of misclassification since we already kind of touched on it. You could get a claim from someone who believes they're entitled to unemployment; you could also get a claim from someone who was injured at work and is now not covered by workers compensation. We know that not everyone in the U.S. has private health insurance, so sometimes they need that workers comp insurance to take care of their injuries, whether they be physical or emotional.

Claims can also be triggered by state or federal taxing authorities, the IRS or, again, California has its own taxing authority, for back payroll taxes. For example, in a state like California, if you didn't pay payroll taxes and someone got audited by the EDD for unemployment, they could notify their agencies about payroll taxes and the employer could face other audits. Being audited is never fun, and there are all kinds of penalties that can flow from that.

There is the possibility of claims from former workers who were classified as contractors, even maybe willingly classified as contractors, but realized that they worked a lot of hours and haven't been paid as much as they would have been paid had they been employees. Perhaps they worked overtime, where in state like California, you get overtime after eight hours in a day, not just 40 hours in a week. Other states, again like California, have certain meal break requirements where their premium pay is triggered for failure to get a full break, or a break within a specific timeframe, so there are a lot of potential penalties for this misclassification that makes it quite risky.

**Sahara Pynes:** And as long as we're banging on California now, you've also got the Private Attorney General's Act, PAGA, for all the technical violations, right? That's a whole other episode we could have you back for.

**Nancy Yaffe:** We could have a whole PAGA episode that talks about the nuances of the problems with the paystub in California and how that can yield to penalties of other dollars for employee per pay period, but that's a topic for another day.

**Sahara Pynes:** Yeah, and the contractor issue truly is an issue across the entire country, not just a California issue. It's such a big thing in so many states. So, talking about states, how does state law factor into who can be a contractor? Does it matter where the company is based, or the worker him or herself?

**Nancy Yaffe:** What matters is where the worker is based. In very general terms, where the worker lives and resides is the place that the law will apply to that worker.

**Sahara Pynes:** OK, and so what is the law? I know that California and states like Illinois, I think Massachusetts, have this ABC test, which is more strict, and that there is generally a 21 factor IRS test that applies as far as control in many other states. Can you break the tests down a little bit for us so that we understand what we're looking at?

**Nancy Yaffe:** Sure. In all states, there is this concept of control. If the worker is controlled by the business, as far as when they have to work, how they have to work, the methods they need to use to get the work performed, then that worker is generally considered to be an employee, not a contractor. So, if the business is telling the worker what to do, when to do it, how to do it, to follow a particular script, to do it a particular way, the employer, or business, is controlling that work. That is known as the control test. On the other hand, if the workers decides the method, means, when and how the job is getting done, and all that is really being determined, being looked at by the business, is the end product, that is generally considered to be more like the work of a contractor. You're retaining the contractor for a particular skill set that contractor has that your employees don't have.

So that kind of control test is the general test that had been in effect pretty much everywhere in the U.S., with slight differences depending on what agencies was implementing it, until maybe five or so years ago. Then we got this new thing, the ABC test. The ABC test essentially has three factors. One factor is the control factor as I just discussed. The second factor is in order to be a contractor, the work has to be outside of the employer's usual course of business. So essentially you can't have a contractor doing the core functions of the business. The third prong of the ABC test is that the worker has to have an independently established business, trade, or occupation of the same nature as the work performed. So essentially the contractor has to have their own business setup that performs these services for all types of businesses, then you're retaining that contractor to essentially perform a service for your business that your employees don't do and that you don't control how they do it. That is what the ABC test is, so it's a lot more than just the normal control test that everyone was used to up until a few years ago.

**Sahara Pynes:** And the prong b, the work is outside of the employer's usual course of business, that sort of the Uber argument. Like Uber is a technology company, so the drivers are outside of our usual course of business creating a technology platform, so we shouldn't be covered by the ABC test.

**Nancy Yaffe:** Correct. Then the workers say, wait a minute, Uber and Lyft are all about drivers and we are the core function of the business. Therefore, under the ABC test we have to be employees – what is Uber without the drivers?

**Sahara Pynes:** Yeah, it certainly sets up a really difficult framework for companies, especially emerging companies. So, you talked about the prong c of the independently established trade or occupation that the worker should really be in business for themselves. I want to just talk about whether the worker is their own DBA or sole proprietorship, or whether or not they have an actual corporate entity setup. Does it make a difference? Can they just be paid through their company, and is that safer?

**Nancy Yaffe:** The answer is yes. If a business is going to retain a worker as a contractor, they should retain that worker through a business entity and not just pay that worker through the individual's social security number. The whole idea of hiring a contractor is you're hiring somebody who has a special skill set, so hopefully they have setup a business entity, hopefully it's more than just a registered DBA, although a registered DBA is better than nothing in certain states. It's certainly better to be a registered LLC or some other business entity that is actually setup and pays its own taxes rather than paying the individual just by 1099, in all states that is going to be a bit of a red flag.

In some states, it's less of a problem than it is in other states. This is part of the patchwork of this crazy system throughout the U.S. In what would traditionally be a blue state, just having an individual paid by 1099 would be highly suspect, whereas in a red state it might not cause as much concern. Just depends a lot on the regulatory scheme in a particular state.

**Sahara Pynes:** Right, and you still can't control what the worker is doing. It's not really a panacea to pay someone through an entity as far as classification goes.

**Nancy Yaffe:** Exactly, and that is the conundrum that many businesses continue to get confused about. "Well if I just pay them by 1099, why aren't they a contractor?" Because the law decides if they're a contractor. You and the worker don't get to decide. You have to do it in a way that is consistent with the regulatory scheme where the worker resides.

**Sahara Pynes:** Sure. It's not your choice and it's not the worker's choice. We often get the question, "can't they just sign an agreement saying that they want to be a contractor?" because

so many people actually want to have that flexibility and they want to be paid through their company for tax purposes. What's the story with that?

**Nancy Yaffe:** The story with that is, if you're going to have a contractor, you 100 percent should have a contractor agreement. It's going to be wonderful evidence that the person is actually a contractor and intended to be a contractor, but depending on where that person lives and resides, it is not guaranteed that the plaintiff's counsel or a regulatory agency or a taxing authority is going to agree with you and the worker that they are a contractor. The agreement is going to be exhibit number one, if that is ever challenged, and it's critical to have it, but it is no guarantee that people are going to agree with you.

**Sahara Pynes:** As long as we're talking about agreements, choice of law, right? You can't just put in a red state choice of law that would govern an employee sitting in New York?

**Nancy Yaffe:** Sahara, if I had \$100 for every time a business asked me that question, we would all be retired. Oh well Texas law applies, and then we can do whatever we want.

**Sahara Pynes:** Right. Good idea, no?

**Nancy Yaffe:** It obviously doesn't work that way otherwise everybody would just do it. So, no, that doesn't work.

**Sahara Pynes:** OK, fair enough. So, tell me about some situations where a contractor actually is going to be appropriate for a new business? What is safe? Is anything actually safe?

**Nancy Yaffe:** Well, yeah, although limited again depending on what state the person resides in. So, for example, you should be hiring a contractor to do something that is a skillset beyond the scope of what your employees traditionally do. So very often we see in our business, Sahara, in employment law, people hiring an HR consultant to help them setup the business, figure out how to hire employees correctly and to train somebody to do that part of the job and maybe work on a retainer or something like that. An established business that is an HR consultant might work out quite well. Any other type of consultant that a business might hire to do something where they don't have the employees to actually do that work, an IT consultant to setup their back of the house tech, or certainly any other type of vendors to do build outs or other type of work for sure.

Where it starts to get sticky is consultant like a lot of new business will hire, like a temporary CFO or sometimes even a CEO to run their business. If that person is exclusively working for the business, even on a temporary basis, that's when you start getting into a very sticky area. If that person lives and resides in one of these blue states, even a temporary or CEO if exclusive to the business should probably be an employee and not a contractor.

**Sahara Pynes:** So, what are some signs then that a worker should be an employee on a W2 basis, rather than a 1099 contractor?

**Nancy Yaffe:** Got it. Someone should be an employee when they're doing work that is integral to your business, that involves the core functions of what your business is setup to do. Someone should be an employee also if they're working for you exclusively and you don't want them working for any other business at the same time or competing with you. Someone should be an employee if they have been an employee for you in the past. I never like to see someone who has been an employee and then all of a sudden becomes a contractor. Some of the taxing authorities look at that very suspiciously. Someone should also be an employee if they have a long term consistent relationship with you. That is also a factor that is looked at very strongly by regulatory authorities.

**Sahara Pynes:** What about if that worker is coming to your office, although who is going to an office right now, or going to visit your customers and has a forward facing role?

**Nancy Yaffe:** If someone also is holding themselves out as a member of your business or affiliated with your business. If they're wearing your uniform or nametag, or on your business card, or, for new businesses, featured on your website as a key person in what your business is doing. All those people should be employees. By the way, no one should be on the website that is a contractor unless it specifically denotes them as a contractor. That is a sure sign that they will be considered an employee.

**Sahara Pynes:** Because this is such a fact-specific analysis, there is almost no slam dunk when you classify any worker as an independent contractor, so it's really always going to be safer to err on the side of a W2.

**Nancy Yaffe:** Absolutely. When in doubt, if you're questioning which classification the worker should be, the less risky option is always to classify the person as an employee. If they're on a temporary basis, that's fine, you can make them a temporary employee for a limited period of time, or for a particular project. That will help you defend against unemployment claims, if you're clear that hiring was temporary, but don't let the temporary or transitory nature of the relationship trick you into classifying them as a contractor if they really should be an employee.

**Sahara Pynes:** Well, and sometimes it's just a matter of risk/reward, right? We have entrepreneurs who might be OK with taking the risk on a shorter term engagement, knowing that damages would be limited even though the risk is technically still the same.

**Nancy Yaffe:** Absolutely. Everything us lawyers do, Sahara, is a matter of risk assessment. I tend to run toward the conservative and a lot of entrepreneurs are accepting of a higher level of risk,



which makes them entrepreneurs. I just want to say a word of caution though, I very often hear people tell me “oh that person will never sue, they’re very happy being a contractor, that’s what they want to be.” Then life happens, and certain things happen, or a Pandemic happens, or something else happens, and all of a sudden, the person who the business thought would never turn on them does. So, you’ve got to be careful out there, nothing is guaranteed.

**Sahara Pynes:** Thank you so much, Nancy, for joining me on this episode of Legally EmpowHERed. I’m so grateful you were able to provide our listeners with useful information on how to properly classify their workforce. Thanks for being here.

**Nancy Yaffe:** My absolute pleasure, Sahara, thank you for doing this podcast.