



# Employee vs. Independent Contractor: Classifying Your Workforce Correctly

June 4, 2026

# Agenda

**1** Importance of  
Proper Classification

**2** Federal Tests

**3** State Tests

# Employee vs. Contractor: General differences

## Employee

- Work set hours determined by the employer
- Use the employer's tools and equipment
- Are economically dependent on one employer
- Have taxes withheld (FICA, income tax)
- Are eligible for benefits, workers' comp, and unemployment
- Can be supervised on how they do their work, not just the end result

## Independent Contractor

- Set their own hours and work methods
- Use their own tools and equipment
- Work for multiple clients or customers
- Are responsible for their own taxes (self-employment tax)
- Receive a 1099, not a W-2
- Are hired for a specific project or outcome — the hiring party controls what gets done, not how

# Scenario: The pizza shop bathroom painter

- Imagine a small neighborhood pizza shop with regular customers and a tight team. The owner realizes the customer bathroom needs a refresh: New paint, maybe a more modern color, and some touch-ups.
- Instead of hiring a full-time maintenance person, the owner hires a local painter who runs their own painting business.
- This is a classic example of a legitimate independent contractor relationship—but only if structured correctly.
- Now let's break down why...



# Practical matter: Why would a company want an independent contractor?

- Access to Specialized Expertise
- Project based Needs
- Flexibility
- Faster Access to Talent
- Reduced Administrative Burden
- Outside Perspective

# Employee vs. Contractor: Why it matters

There can be significant ramifications for employers who miscategorize an employee as an independent contractor, including:

**1**

**Back Taxes**

**3**

**Wage and Hour Liability**

**2**

**Unpaid Benefits Claims**

**4**

**Civil Penalties**

Misclassification claims are often enforced by state Departments of Labor and Attorneys General.

# Misclassification penalties

Penalty Type	Unintentional Misclassification	Intentional/Willful Misclassification
<b>Income Tax Withholding</b>	1.5% of wages	20% of wages
<b>FICA (Employee Share)</b>	40% of required withholding	100% of required withholding
<b>FICA (Employer Share)</b>	100% of matching share	100% of matching share
<b>W-2 Filing Failure</b>	\$50 per unfiled form	\$50 per unfiled form
<b>Criminal Penalties</b>	None	Up to \$1,000 per worker + up to 1 year imprisonment
<b>Additional</b>	0.5% monthly failure-to-pay penalty (max 25%)	Personal liability for company officers under IRC Section 6672

# Examples of recent enforcement actions

## **New Jersey recovers \$19 million from Lyft for misclassifying its drivers as contractors**

In 2025, the New Jersey DOL and AG's Office announced that they'd recovered more than \$19 million from Lyft for misclassifying more than 100,000 of its drivers as independent contractors instead of employees.

## **D.C. recovers \$3.75 million from company that misclassified construction workers**

In 2024, the D.C. Office of the AG announced that it had secured a \$3.75 million recovery from Power Design, Inc., which misclassified hundreds of construction workers as independent contractors to avoid paying sick leave and payroll taxes.

## **Massachusetts reaches \$865,000 settlement with grocery store that misclassified delivery drivers**

In 2025, the Massachusetts AG's Office announced a \$865,000 settlement with with an online supermarket that had misclassified approximately 160 delivery drivers as independent contractors instead of employees.

# There is no “one test” to rule them all

There are different tests for determining whether a worker is an employee or a contractor, and the test that is used often depends upon the purpose of the determination.

## Federal Tests:

- Fair Labor Standards Act (FLSA)
- Internal Revenue Service (IRS)
- The Employee Retirement Income Security Act (ERISA)

## State Tests:

- Wage and Hour
- State Tax
- Unemployment Insurance
- Workers Compensation



# Federal tests

## 1. **Economic Realities** Test

Used by the Fair Labor Standards Act (FLSA)

## 2. **Common Law** Test

Used by the Employee Retirement Income Security Act (ERISA)

## 3. **Right to Control** Test

Used by the Internal Revenue Service (IRS)

# Economic realities test

**Considers the following factors to decide if the worker is economically dependent on the employer for work, or is instead in business for themselves:**

- Opportunity for profit or loss depending on managerial skill
- Investments by the worker and the employer
- Permanence of the work relationship
- Nature and degree of control
- Whether the work performed is integral to the employer's business, and
- Skill and initiative

Some additional factors can be considered but some facts are irrelevant—like employee titles.

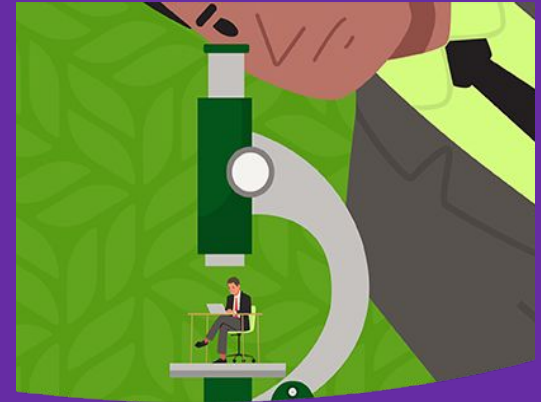
# Opportunity for profit or loss

- Examines whether a worker can **earn profits or suffer losses** through their own independent effort and decision making.
- Some **relevant facts** include whether the worker:
  - ◆ Negotiates their pay
  - ◆ Decides to accept or decline work
  - ◆ Hires their own workers
  - ◆ Purchases material and equipment, or
  - ◆ Take other efforts to expand a business or secure more work, like marketing or advertising



# Nature and degree of control

- Examines the **level of control** the employer has over the performance of the work and the economic decisions in the relationship.
- Some relevant facts include whether the employer:
  - ◆ Controls hiring, firing, scheduling, prices, or pay rates
  - ◆ Supervises the performance of the work
  - ◆ Has the right to supervise or discipline workers, and
  - ◆ Takes actions that limit the worker's ability to work for others



# Investments

- Examines whether the worker makes investments that are capital or entrepreneurial in nature.
- Investments that support business growth, like reducing costs or expanding market reach, indicate contractor status.
- Costs to a worker of tools for a specific job and costs that the employer imposes on the worker are not capital or entrepreneurial investments.



# Permanence of work relationship

- Examines the nature and length of the work relationship.
- Inconsistent, sporadic, or project-based work tends to indicate contractor status.
- Continuous work with no end date, or work that is the worker's only business relationship tends toward employee status.



# Integral nature of work

- Examines whether the work is critical, necessary, or central to the employer's *principal* business.
- Important distinction between an integral worker and integral work.
- A pizza parlor can't survive without someone to manage payroll, but it wouldn't exist at all without someone to make pizza.



# Skill and Initiative

- Examines whether the worker uses their own specialized skills in connection with business initiative.
- Workers relying purely on employer- provided training for the job are not using specialized skills.
- The presence of skill alone is not determinative—it must be used to support or grow the business.



# Two major state-level classification frameworks

## The ABC Test

*Used by many states for state wage & labor law*

- Starts with a presumption of employment
- Hiring entity must satisfy all three prongs (A, B, C) to classify as a contractor
- Conjunctive—fail one prong and the worker is an employee
- Typically created by statute

## The Right to Control Test

*Used at the federal level and by many states*

- No built-in presumption of employment
- Common law test that weighs multiple factors
- Totality of the relationship governs—no single factor is decisive
- Understanding the goal of the test is more helpful than memorizing factors

# The ABC Test: Overview

A worker is presumed to be an employee unless the hiring entity satisfies ALL THREE prongs:



## Prong A: Free from control

The worker is free from the control and direction of the hiring entity in performing the work—both under the contract and in actual practice.



## Prong B: Outside usual course

The worker performs work that is outside the usual course of the hiring entity's business.



## Prong C: Independent trade

The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

*All three prongs must be satisfied—failing even one means the worker is an employee.*

# The ABC Test: Common variants

1

## The “ABBC” Test

Some states allow the second prong to be satisfied if all of the work is performed outside of the employer’s place(s) of business even if it’s part of the employer’s regular business

2

## The “AC” Test

Some states omit the second prong entirely and allow contractor status for workers that satisfy A and C.

3

## The “ABC+” Test

Some states keep the standard prongs but require workers to satisfy additional elements in order to be classified as contractors (e.g., WA workers’ comp.).

*By the numbers, these variants are more common than the standard ABC Test.*

# The ABC Test: Key pitfalls for HR teams

1

## It's a conjunctive test.

Contractor status requires all three prongs to be satisfied, just satisfying two isn't enough, even if those two prongs weigh heavily in favor of contractor classification.

2

## Labels aren't enough.

Referring to a worker as a "contractor" is not enough, even if that label is written into their contract. The worker must still satisfy all three prongs to be a contractor.

3

## They should work for multiple employers.

If a worker depends entirely on your organization to make money, they likely don't have an "independent business" related to the work. It's possible to satisfy prong C with just one employer, but it's uncommon.

4

## Certain industries can have different tests.

Even in states with statutory ABC tests, certain occupations (licensed professionals, construction workers, etc.) use different tests written into other areas of the law. Knowing whether your state has these is crucial to ensure you use the right test.

# The Right to Control Test: Overview

The central question: Does the employer have the right to control not just the *result* of the work, but the *manner and means* by which it is performed? Specific factors vary across states, so understanding what the test is trying to determine is essential.

The IRS organizes the relevant factors into three categories, which are helpful across all jurisdictions:

1

## Behavioral control

Does the employer control **how** the worker does the job? Instructions, training, supervision, set work hours, and restrictions on using assistants are all relevant examples.

2

## Financial control

Does the company control the worker financially? Method of pay, expense reimbursement, paying for tools/equipment, and restrictions on taking other work are relevant here.

3

## Type of relationship

Does the relationship look like that between an employer and employee? Written contracts, employee benefits, how long the worker is retained, and whether the work is integral to the business are all relevant.

# Right to Control: Common Factors

Factor	Employee Indicators	Independent Contractor Indicators	IRS Category
Detailed Instructions/Training	Follows detailed instructions on how to complete work	Decides which methods to use based on their own experience	Behavioral Control
Hours and Location of Work	Works hours set by the employer at a location determined by the employer	Sets own schedule and is free to complete the work anywhere, as long as it gets done	Behavioral Control
Tools & Equipment	Uses equipment and tools provided by the employer	Supplies their own tools and equipment at their own expense	Behavioral Control Financial Control
Payment	Paid by time (e.g., hourly or via annual salary)	Paid by the job, regardless of time spent	Financial Control
Delegation	Must perform work themselves, or must get permission to delegate	Is free to send assistants to complete the work in their place	Behavioral Control Financial Control
Termination	Can quit or be fired at will	Can't quit or be fired before work is done without breaking a contract	Type of Relationship
Discipline	Subject to discipline (e.g., suspension, PIPs) for breaking policy or subpar work	Only subject to contract termination or lawsuit for breaking policy or subpar work	Type of Relationship Behavioral Control
Other Work	Typically works full time for one employer	Works for multiple clients; holds themselves out to the public as for hire	Type of Relationship Financial Control
Duration of Relationship	Open-ended, will continue in employment as long as both parties are satisfied	Subject to a defined endpoint, typically after the completion of the work	Type of Relationship

# Right to Control: Key pitfalls for HR teams

## The "right" problem

Having the right to control the worker can make them an employee, even if the employer doesn't exercise that control. Be wary of contractor agreements that give your organization the power to dictate how the work is performed.

## Don't forget remote workers

Remote workers can still be employees if the company has the right to control how services are performed, even if they never come in to the office—especially if the employer has limits on where remote employees can work from.

## Look at the totality of the circumstances

If the right to control exists, courts can find employee status, even if most or all of the other enumerated factors indicate contractor. With balancing tests, courts look to the totality of the circumstances to decide which classification is appropriate.

## Avoid mixing signals

Paying per project (contractor) while setting hours, providing equipment, and requiring regular reporting (employee) creates an ambiguous, risky picture. Try to be as consistent as possible with how you treat contractors.

# Best practices for HR teams

1

## Identify applicable test(s)

Determine which test(s) apply based on jurisdiction, industry, and legal context—tax, wage/hour, benefits.

2

## Audit the actual relationship

Review how work is really performed, not just what the agreement says.

3

## Document everything

Keep written records of the factors supporting the classification at the time it's made.

4

## Don't rely on job title

"Consultant," "freelancer," and "1099 worker" are not legal classifications.

5

## Seek counsel for close calls

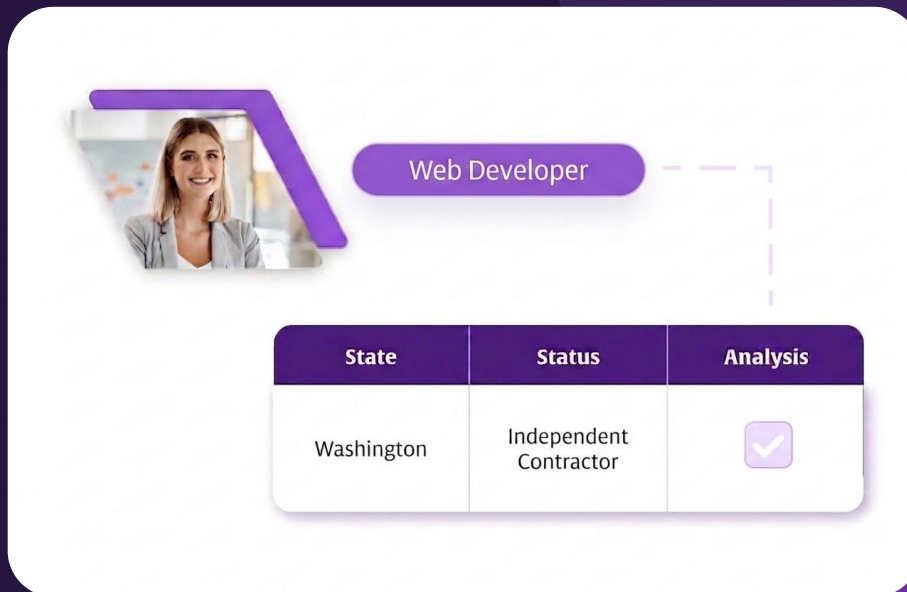
When factors point in different directions, consult employment counsel before finalizing.

6

## Reassess regularly

Relationships evolve—periodic audits catch classification drift.

# Explore SixFifty's Updated Employee Contractor Analyzer



State	Status	Analysis
Washington	Independent Contractor	<input checked="" type="checkbox"/>

Join our popular  
**Mid-Year Employment Law Update**  
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**We'll be covering:**

- Dozens of updates going into effect starting July 1st for minimum wage, pay transparency, and more
- A look ahead to other deadlines hitting late summer and fall of 2026
- A review of key employment law changes from the first half of the year

# Q&A time!

## Ready to streamline employee classification?

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