

Business Law Notes

Employee or Independent Contractor?

AN EMPLOYEE BY ANY OTHER NAME IS . . .

F. Stephen Glass

. . . an independent contractor? Important tax consequences are at stake in making the correct designation. An employer must generally withhold income taxes, withhold and pay social security and Medicare taxes, and pay unemployment tax on wages paid to an employee. However, an employer does not generally have to withhold or pay any taxes on payments to independent contractors.

To determine whether a person is an employee or an independent contractor, the relationship of the worker and the business must be examined and all information that provides evidence of the **degree of control** and the **degree of independence** must be considered. Facts that provide evidence of the degree of *control* and *independence* fall into three categories:

1. Behavioral control.

☐ *Instructions the business gives the worker.* An employee is generally subject to the business' instructions about when, where, and how to work. 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.

☐ *Training the business gives the worker.* An employee may be trained to perform services in a particular manner. In contrast, independent contractors ordinarily use their own methods.

2. Financial control.

☐ *The extent to which the worker has unreimbursed business expenses.* Independent contractors are more likely to have unreimbursed expenses than employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important.

☐ *The extent of the worker's investment.* An independent contractor often has a significant investment in the facilities used in performing services for someone else.

☐ *How the business pays the worker.* An employee is generally paid by the hour, week, or month. An independent contractor is usually paid by the job.

☐ *The extent to which the worker can realize a profit or incur a loss.* An independent contractor can make a direct profit or loss from the work performed, whereas, an employee is paid a fixed rate.

3. Type of relationship.

☐ *Written contracts* describing the relationship the parties intended to create.

☐ *Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.*

☐ *The permanency of the relationship.* If a worker is engaged 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.

☐ *The extent to which the worker's services are a key aspect of the regular business of the company.* If a worker provides services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control the worker's activities.

If there is any question as to whether someone who works for you should be treated as an employee or an independent contractor, contact your legal counsel before making this important determination.

PAST DUE RECEIVABLES POSE SERIOUS BANKRUPTCY RISK

M. Blen Gee, Jr.

Imagine that your best customer has just filed bankruptcy. It looks like the \$25,000 invoice that you just sent to this customer is not going to get paid. It is a blow that staggers your small business. Imagine again that a few weeks later you receive some correspondence related to the bankruptcy demanding that you repay three months worth of collections that you received from your bankrupt customer. Your customer had been way behind on payments and you bent over backwards to keep him afloat; you worked hard to collect all that past due money.

Next, you go to your lawyer who says something about “*preferential transfers*” and tells you that if you don’t immediately pay all this money into the bankruptcy court, you’re going to be sued for it and you are going to lose.

This nightmare is repeated on a regular basis throughout the country and especially during times of economic downturn.

The federal Bankruptcy Code is designed to prevent a company on the verge of bankruptcy to prevent a company on the verge of bankruptcy from paying its friends and favored customers while other creditors are left empty handed. Basically, if a company pays a past due debt (an “antecedent debt” in bankruptcy terminology) within 90 days prior to its filing a petition for bankruptcy, the bankruptcy trustee can set aside that payment and require the person receiving the payment to pay it back to the bankruptcy court. If you are an “insider,” for example an officer (even an assistant secretary), director or family member, the 90-day preference period is extended to one year.

The best defense to a preference claim is to ensure that customers pay on time and to put slow paying customers on a COD basis. Other things can be done on a case by case basis to reduce the risk of a “preference” claim. For example, past due debts can usually be restructured so that they fall under the “new value” exception. Also, “earmarking” payments may sometimes work. Competent legal advice is essential to maximize the availability of defenses to a claim by the bankruptcy trustee of a preferential transfer.

UNEMPLOYMENT INSURANCE, THE ESC AND YOUR BUSINESS

F. Stephen Glass

Employers must make unemployment contributions on wages paid to employees. Employers are required by North Carolina law to keep and submit records of wages on quarterly reports to the Employment Security Commission (“ESC”). These reports are confidential.

The unemployment tax rate for your business can go up or down based upon the charges made by the ESC to your account. North Carolina public policy has long been that employees who are discharged through no fault of their own should receive unemployment benefits which are chargeable to the employer’s account. However, employees are disqualified from receiving unemployment benefits -- and the employer’s account is not charged -- in the following circumstances, among others:

- employee leaves work without good cause attributable to the employer;
- employee is discharged from work for misconduct connected with the work;
- employee is discharged for substantial fault connected with work.

Documentation is important. Keeping thorough records of an employee’s misconduct, absences, etc. and all warnings, counseling sessions and notices will be valuable evidence in the event a discharged employee files a claim with the ESC.

If your business receives a notice of a claim filed against it, you should act promptly and within the time specified in the notice. It is important that the your business respond whenever any ESC form is received . Always keep copies of all documents, including the notices from the ESC and your responses.

OVERTIME ISSUES UNDER NORTH CAROLINA WAGE AND HOUR LAW

F. Stephen Glass

Both the federal Fair Labor Standards Act and state Wage and Hour Act (“the Act”) address the issue of employee overtime. The federal law

provides that when both the Act and a state law apply to the employment subject of the Act, the law setting the higher standards must be observed. The federal Act and our state statute are not in conflict. The Act requires that covered employees, *unless otherwise exempt*, be paid not less than one and one-half times their regular rates of pay for all hours worked in excess of 40 in a workweek. For overtime purposes, each workweek stands alone; employers cannot average the hours worked during two or more workweeks. The workweek may begin on any day of the week and any hour set by an employer, but may not be retroactively manipulated by an employer to avoid paying overtime.

Every employer is required to pay each employee who works longer than 40 hours in any workweek at a rate of not less than time and one-half of the regular rate of pay of the employee for those hours in excess of 40 per week.

"*Workweek*" is defined as "any period of 168 consecutive hours." This calculates to be a seven-consecutive-day workweek.

The key to whether and when overtime is due during this pay period is the proper determination of when the workweek began. Assuming, for example, that your business' regular workweek for employees begins on Monday and runs through the following Sunday: seven-consecutive-days. You may apply this standard workweek test to the days worked by an employee, and determine whether at the end of those seven consecutive days he or she worked in excess of 40 hours, entitling the employee to overtime pay for those extra hours.

The employer, however, not the employee, determines when the workweek begins and ends.

Executives, administrators, professionals and outside sales persons are exempt from the federal wages and hours laws. Special requirements apply to some computer professionals.

Practical Pointer: *Check your company's policy manual to be sure that it reflects clearly when the work-week begins for purposes of overtime pay.*

Johnson, Hearn, Vinegar & Gee, PLLC
Two Hannover Square, Suite 2200
Post Office Box 1776
Raleigh, N.C. 27602-1776
919-743-2200 ~~ Fax: 919-743-2201
jhvg@jhvglaw.com

NEW LIMITS ON DISABILITY PROTECTION UNDER THE ADA

F. Stephen Glass

In three recent decisions, the U.S. Supreme Court took a restrictive view of the type of disabilities protected by the *Americans with Disabilities Act* (the "ADA"). Each of the plaintiffs in those three cases had a disability that could be corrected or effectively treated with medication. The ADA defines a disability as an impairment that "substantially limits one or more of the major life activities." The Court interpreted this as "*requiring that a person be presently – not potentially or hypothetically – substantially limited in order to demonstrate a disability.*"

The Court found that while a person with a corrected impairment still has the impairment, "*if the impairment is corrected it does not 'substantially limit' a major life activity.*" Thus, in one of the cases, the plaintiff whose vision was corrected with glasses was not protected by the ADA. Likewise, in another, a person with hypertension that was controlled by medication was not disabled under the ADA.

ABOUT THAT ARBITRATION CLAUSE IN YOUR CONTRACT

M. Blen Gee, Jr.

Businesses regularly enter into contracts containing a clause requiring arbitration through the American Arbitration Association (AAA). Few people, however, have a clear understanding of the risks and benefits of arbitration. Supporters feel that arbitration is cheaper and faster than the court process. Others find it to be a surprisingly expensive and risky alternative. Here are some of the pros and cons of AAA arbitration and a few basic facts:

Positives.

▲ Arbitration provides an opportunity to choose the decision maker. Under AAA's rules, the AAA administrator provides each party with a list of proposed arbitrators who are generally familiar with the subject matter involved in the dispute. Each side has 10 days to strike any names that are unacceptable and number the remaining names in order of preference. The AAA then picks the arbitrators from the names remaining on the list.

▲ A panel of three arbitrators is much less likely to "run wild" than a jury. Arbitration affords

an opportunity to choose intelligent, experienced professionals who will see past the red herrings and smoke screens thrown up by the opposition. This is probably the best reason for choosing arbitration. Example: It may be possible for a party to choose a CPA as an arbitrator, especially if there is a panel of three arbitrators. This can be extremely useful if the case involves valuation issues or complicated financial or business issues.

▲ Arbitration is definitely quicker than the court process. Preliminary issues can typically be decided by a phone conference with the arbitrator. This avoids the sometimes long wait to have preliminary motions set on the court calendar. Time consuming discovery is more limited in arbitration than in court.

▲ Court rules of evidence do not apply in arbitrations. The arbitrator will generally listen to whatever evidence is presented and will give it whatever weight he thinks appropriate.

▲ Arbitration is more private than the court process. Unless one side appeals, there will be no public record of the hearing. The parties can agree to have the whole hearing process made confidential if they wish.

Negatives.

▼ AAA arbitration is not cheap. Filing fees are non-refundable and range from \$500 for disputes involving \$10,000 or less up to \$13,000 for disputes involving \$7 to \$10 million dollars plus a case service fee of \$3,000. A party filing a counterclaim in the same arbitration must also pay

a filing fee. There are also hearing fees, postponement fees, processing fees and charges for hearing room rental. The fees for individual arbitrators are comparable to other professionals and are set by the arbitrators themselves. If the arbitrator must travel to the hearing location, the parties must pay for his lodging, travel and related expenses. These costs are generally split equally by both sides of the dispute.

Additional Points to Note.

Early in the arbitration process, a decision must be made as to whether to use a single arbitrator or a panel of three arbitrators. Expenses for a panel of three arbitrators can mount up quickly, especially if there are preliminary hearings in addition to the final hearing. A single arbitrator will be less expensive. However, there will be a substantially greater risk of getting stuck with an unreasonable result.

It is extremely difficult to overturn an arbitrator's decision. Unless the parties agree otherwise, the typical arbitrator's award simply states its decision without any explanation. When no explanation is given, the arbitrator's award is rarely overturned by an appeal.

The opportunity to request documents, ask written questions or conduct depositions of the other side's witnesses is much more limited in arbitration than in court. This keeps costs down, but it may also make it impossible to get important information from the other side.

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**BUSINESS LAW NOTES**

P.O. Box 1776  
Raleigh, North Carolina 27602-1776  
Telephone: 919-743-2200  
Fax: 919-743-2201  
jhvg@jhvglaw.com