

Uber's Dilemma: Obstacles to Converting Freelancers to Employees

Why is Uber fighting tooth-and-nail to avoid converting its freelancers/independent contractors into full-time employees? The driving service company has around one million independent contractors driving customers in 300 cities, according to [Business Insider](#). Some of these drivers have called Uber to court, demanding employee benefits like health insurance and 401(k) plans. But Uber resists. The company's reasons for resisting the conversion are impacts that every large company should consider when converting freelancers into employees.

Uber is only the most recent and most well-covered company to struggle with converting freelancers to full-time. In the 1980's, Microsoft had a large number of independent contractors, working side by side with employees. As [Berkeley Technology Law](#) explains, in 1989 and 1990, the IRS decided that these freelancers actually functioned as employees, according to the IRS 20 factor test. The criteria is a bit abstruse, but the basic idea is that if contractors follow the same rules as employees, they are employees. At Microsoft, "the independent contractors were required to work on-site, worked on teams with regular employees, performed identical functions to regular maintained the same hours as regular employees." Microsoft ended up paying millions of dollars worth of back taxes to these independent contractors because of the court ruling. To avoid situations like this, the IRS now has a form that will classify a worker as an employee or independent contractor, based upon his situation. Companies that incorrectly classify independent contractors, when they are really employees, often pay the price, as millions in back taxes for filed suits.

Based on the experience of Microsoft, it seems that a company like Uber could avoid the misery of financial suits simply by converting the freelance drivers to employees. There is little risk that a company will be sued by employees, who receive benefits, for being mistakenly classified as an employee. Mistakenly classifying an independent contractor as an employee has few legal ramifications. So, why doesn't Uber want to convert its drivers to employees and end the legal battle? There are many costs, in both time and money, that a big company like Uber has to reconcile before converting freelancers to employees.

[Business Insider](#) estimates that converting Uber drivers from freelancers to full-time employees will increase the cost of each person by 20-30%. An increase this large, multiplied by hundreds of thousands of drivers, is enough to make Uber wary of converting its drivers to employees.

Employee Benefits Costs

Taxes

One reason that some Uber drivers want the company to convert them to employees is for the benefits. While some benefits are not mandatory, like 401(k) plans, Uber would be legally obligated to provide a minimum number of benefits. As [required by federal law](#), Uber would have to pay the Social Security taxes at the same

rate as their employees. The current rate is 6.2% for each party. The same would likely apply for Medicare taxes. A certain portion would need to be matched by the company. Additionally, Uber would likely have to pay worker's compensation and federal unemployment tax. None of these taxes are necessary for their current freelance workforce.

Health Insurance

As an employer with more than 50 employees, Uber would also be required to offer “affordable” health insurance, due to the [Affordable Care Act](#). The cost is not trivial. Start-up errand running company, Alfred, said that adding health benefits cost the company between \$200 and \$600 per person converted from freelancer to W-2 employee. This cost would vary between companies and employees, but it is a sizable cost. Even if Uber didn't convert all one million freelancers, each driver converted would impact the bottom line.

Minimum Wage

Converting drivers to employees would also force Uber to meet minimum wage requirements. There are both federal and local minimum wage requirements. Seattle, for example, has a \$15 minimum wage within the city limits. Uber would have to comply with this wage. More importantly, the minimum wage must be met after the costs incurred by the drivers (fuel and maintenance). If a driver makes \$100 for working for 5 hours, his wage is \$20 an hour. Uber complies. But, if maintenance and gas costs exceed \$40 for that period, his wage drops below \$15 an hour. His wage is no longer compliant with Seattle's local minimum wage. Upon converting drivers to employees, Uber would have to verify that the driver wages are compliant in every one of the 300 cities in which they operate.

Work-related Expenses

Uber may also be responsible for covering work-related expenses, in some cases. These costs could include fuel for the drivers and the maintenance of the car. Independent contractors cover this cost, but employees might not have to pay, depending on the regulations in the local area.

Additional Local Costs

On top of the federal costs, many states have additional requirements for benefits that employers must provide to employees. For example, in California, employers are [required to reimburse](#) employees for a cell phone that is used for work purposes. All Uber drivers use a cell phone and a data plan. To convert its drivers to employees, Uber would have to pay for the cell phone plans for California drivers. As of 2015, there are 45,000 Californian Uber drivers. Yet California is just one of the many states that Uber operates in. Each state would have to be individually evaluated for additional benefits that employees receive.

Logistical Costs

Onboarding Employees

Onboarding Uber employees is already an intensive process. The company conducts a background check, inspects cars and submits regulatory paperwork on behalf of the drivers. To hire drivers as an employee, it is

likely that this process would dramatically change. At the least, Uber will have to include the following [required documents](#) as part of its process: an I-9 form (to verify U.S. Citizenship or legal resident status), and a W-4 (for tax purposes). These documents are federal documents and there may be more requirements in local areas. The additional time and paperwork required becomes costly when multiplied by thousands of newly converted employees.

Scheduling & Overtime

With the conversion of drivers to employees, Uber would also face a logistical challenge, scheduling. Currently, Uber drivers are contractors. They have no schedule and decide to “go online” and drive as they please. This schedule is typical for an independent contractor. However, employees usually have regulated hours. An employee is expected to work at a certain time of the day and for a specific amount of time. To convert drivers to employees, Uber would have to determine how to meet demand in each city they serve, using the drivers available.

In determining this schedule, Uber would also have to take overtime rules into account. Federally, employees covered by the [Fair Labor Standards Act](#) would have to be paid for hours worked in excess of 40 hours per week. Drivers working these excess hours could be entitled to 150% of their regular pay for this work. Uber would have to account for these increased costs in determining the appropriate schedule for the drivers.

Converted employees would also likely be entitled to a certain amount of leave. Labor regulations differ from state to state. At the very least, Uber would have to comply with the [Family and Medical Leave Act](#). While the law only stipulates that certain employees are allowed 12 weeks of unpaid leave for specific reasons, it does say that health insurance coverage must be maintained. Uber would have to comply with leave policies in each city in which it operates, which adds another layer of complexity to the scheduling logistics,

Potential Payroll Changes

Complying with employee standards rather than freelancer standards also may force Uber to re-think its payroll system. Payroll requirements are highly dependent on local regulations. When errand-running company, Alfred, changed its contractors to employees, they had to change payroll providers as well. Legally, the start-up had two different types of employees. Though both employee types were W-2, they had to be paid differently. Uber would have to evaluate these changes too. However, Alfred only operated in Massachusetts at the time. Uber, which operates in 300 cities, would have to look at 300 different local labor law regulations. Adjusting the payroll system could be an expensive nightmare.

Integration into Current Employee Standards

Many large companies, like Uber, require employees to undergo specialized training. Independent contractors are exempt from this training because they are not employees. Once converted, however, some internal company policies may apply. If all employees are expected to undergo process improvement training, the newly converted employees will need to take the class. There are benefits to this additional training, like increased efficiency and better collaboration. But there is a cost associated with sending more people through the training. Uber, and other companies, would need to assess how to work the newly converted employees into the current structures.

Are Employees Worth the Cost?

While it is a complicated process to convert freelancers to employees, many start-up companies are taking the leap. As [Business Insider](#) reveals, Instacart began converting freelance shoppers into W-2 employees in order to “improve customer service and efficiency.” Shyp converted its couriers to increase the company's quality control. Start-ups are discovering many reasons to convert freelancers to employees, despite the cost.

For large companies, there are similar reasons to convert, but the hurdles may be larger. Many companies operate across local, state or international borders. Converting freelancers to employees requires an understanding of the legal requirements in each area. It is an undertaking, but large companies can reap the same benefits as the start-ups. Operational improvements like increased efficiency and better quality control can have a huge positive effect on the bottom line even after the cost of converting freelancers.