The Independent Contractor: When is a Worker Truly Independent?

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It is a commonly held belief that there is no downside to using an independent contractor. Or is there? If you run a company, little could be more appealing than to issue IRS Form 1099s to those performing work for you, and thereby identifying these individuals or groups of individuals as "independent contractors." Suddenly, with a brief word to your accountant (and possibly a consultant agreement) many costs, liabilities and hassles of an employer would appear to vanish into thin air.

No doubt, the use of an independent contractor to perform services for your company brings with it many benefits, including:

1. Independent contractors generally are not subject to withholdings for federal and state taxes or unemployment;
2. Independent contractors are not entitled to overtime and, in California, meal and rest periods;
3. Identifying individuals as an independent contractor could, in limited circumstances, shield your company from liability for accidents caused by the independent contractor; and
4. Independent contractors have fewer rights to bring wrongful termination or equal opportunity lawsuits than do employees.

In addition to potential benefits, however, attaching the "independent contractor" label to those that perform services for you has significant downsides and risks. First, as a practical matter, the company must give up considerable control over how the work is performed by an independent contractor as compared to an employee. As discussed herein below, the key component of such a contractor is that a worker be truly independent.

Second, the misclassification of an individual as an independent contractor could subject you to significant and expensive litigation, fines and possibly criminal sanctions should a court or regulatory agency determine that the worker was misclassified as an independent contractor. Specifically, a misclassification of an employee as an independent contractor could make your company and you personally responsible for restitution and penalties related to unpaid wages (including violations of laws requiring minimum wages, overtime, and payment for meals and rest periods), violations of tax withholding laws, violation of overtime and minimum wage laws (which can go back up to four years), violations of the duty to provide workers' compensation coverage, and violations of equal opportunity laws such as Title VII, the Americans with Disabilities Act and the Fair Employment and Housing Act.

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special feature

The difference between an "independent contractor" and an "employee"

Given the importance of classifying your workers correctly, companies must know how to tell the difference between an "independent contractor" and an "employee." Though there is no clearly defined line that draws that distinction, below are a few helpful tips to assist a business owner through this complex analysis and to minimize the risk that your workers will be deemed misclassified.

We begin by noting that there is a legal presumption that a person performing services for a company is an employee. It is generally considered the business' burden to prove the worker was really an independent contractor. How does it do this?

First, the company should ask itself the following questions:

1. Are the services being performed by the worker an integral part of the company's business?
2. Does the worker lack the common characteristics of running his/her own business? (e.g., the worker does not have a business license? He or she does not carry their own workers' compensation insurance? He or she does not have their own workers?)
3. Are the workers performing low skill-level work (e.g., the work requires no specialized training, or the worker is not required to have a contractor's license or other type of license)?
4. Is the work they are performing customarily performed by employees in the industry?

A "no" to some or all of these questions is helpful to prove that the worker is not an employee. But again, this is not the final analysis. How does a business further protect against a misclassification?

One of the most powerful tools to protect a worker's classification as an independent contractor is to have a contract with the worker that clearly defines the worker as an independent contractor. That contract classification, however, is not a silver bullet to

prevent misclassification. Instead, the contract must also meet the other requirements that are looked at to determine classification.

The basic rule, found in the Restatement of Agency (Second) § 220, defines an independent contractor as someone having the "right to control means and manner of accomplishing results." Thus, the contract should clearly give the worker the right to control the means and manner in which the work is performed. Other factors that should be addressed in the contract include:

- Under what conditions can the company terminate the services of the worker (e.g., is the worker "at will");
- Whether the company will exercise direct supervision over the worker;
- Whether the company will provide all of the equipment, tools and supplies to the worker;
- Whether the worker is required to have a contractors license or other license; and
- Defining the method of compensation – if the worker is paid like an employee (hourly basis, salary, or piece rate);

To conclude, the decision about whether to classify workers as independent contractors is one of the more important decisions a company makes about its business, and should not be made without consideration of the benefits and potential liabilities. Such decisions must be made with careful planning to be sure that your business has the tools to defend itself should a court or regulatory agency disagree with the company's classification. ◆

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— Rob Doud, McGuire and Hester