

Robert W. Wood's *Legal Guide to Independent Contractor Status*

Reviewed by David K. Colapinto

Robert W. Wood, *Legal Guide to Independent Contractor Status*, 4th Ed. Published by Tax Institute (2007). Approx. 906 pages. Price: \$344.74. To order, contact the Tax Institute at accounting@taxinstitute.com.

Robert W. Wood's *Legal Guide to Independent Contractor Status* (Tax Institute, 4th Ed.) is the most thorough legal compendium on the classification of workers as independent contractors. This is the 32nd book published by Wood, a recognized expert on the taxation of damages and settlements and a partner at the San Francisco law firm Wood & Porter. Wood admirably tackles the complex subject of disputes arising out of worker classification, producing a highly readable handbook about this often misunderstood and increasingly contentious field of law, the difficulty of which is compounded by the labyrinthine character of many of the issues.

Wood's comprehensive and thoroughly researched work covers virtually every aspect and potential pitfall concerning the independent contractor status of today's workers. The chapters are well organized and discuss the controlling authorities and regulations governing the multifaceted law of independent contractor status. Wood analyzes numerous examples of different kinds of workers who may be classified as independent contractors, ranging from appraisers, child care providers, construction workers, consultants, nurses, truck drivers, and many more. He even analyzes and provides examples of cases involving workers or consultants for nonprofit charitable and religious organizations.

Due to the ever-changing nature of the modern American workplace and the high costs and related legal liabilities of employee benefits, more workers are being classified as independent contractors by their employers. However, rather than solving an employer's problems and limiting their legal liabilities, in some ways worker classification has actually increased an employer's exposure to legal troubles. The modernization of the workplace and employer-employee relations has been accompanied by a rise in owner-worker conflicts rooted in the classification of workers' employment status.

This is not a one-time characterization problem. As Wood aptly points out, in the area of human resource management, employers must understand that the status of both independent contractors and employees is not just an issue when the employment contract is signed. Rather, worker status must be constantly monitored and reevaluated in light of the constant changes in regulatory

requirements, or the employer might inadvertently run afoul of the law and incur civil liabilities.

Disputes over employment status primarily arise when the IRS or a state or local tax authority attempts to collect employment taxes from the employer. However, employers are also vulnerable on other fronts. The Department of Labor and state employment and manpower departments also have vested interests in the classification of workers as either independent contractors or employees. Classification affects the treatment of workers not only in the area of federal unemployment insurance, but also under state-run programs such as workers' compensation.

Moreover, federal- and state-regulated health insurance and employee benefits programs are clearly implicated. Even more importantly, the employment status of a worker creates potential vulnerabilities in the area of civil litigation (contract, torts, and employment discrimination law). After all, employers typically are vicariously responsible for the acts of their employees, but not for the acts of independent contractors.

Classification of 'Permatemps'

The Duchess: And the moral of that is: Be what you would seem to be — or if you'd like it put more simply — Never imagine yourself not to be otherwise than what it might appear to others that what you were or might have been was not otherwise than what you had been would have appeared to them to be otherwise.

— Lewis Carroll, *Alice in Wonderland*

Wood's work is an important resource for those confronted by the changes resulting from the information age and the rise of the high-technology industry. Those important cogs of the national economy gave rise to a new kind of employee during the 1980s and 1990s, the "permatemp." As workers became more highly skilled, with a concomitant rise in the demand for highly skilled workers in a postindustrial economy, more flexible work and compensation arrangements came into vogue.

Adapting to the novel demands of nontraditional, postindustrial production, employers increasingly began to use independent contractors in their workforce. This was facilitated by the exigencies of high-tech work, which loosened the direct bonds of supervisory control exercised by employers over their workers. In addition, to limit the expenses of employee benefits in an age of rising healthcare and other benefit costs, employees attempted to cap the costs of their employed human capital by hiring temporary employees on a long-term basis.

This gave rise to the permatemp, an employee who — like Mary Shelley's Frankenstein (which neither belonged to human society nor was the demigod envisioned by Victor Frankenstein) — was neither completely

an employee nor completely an independent contractor. Permatemps were hired on a seasonal or other long-term basis but were not accorded the same benefits as permanent employees, even though they did the same kind of work. Indeed, they often worked on the employer's premises, with the scope of work defined by, directed by, and under the control of the employer

Although permatemps are typically hired and paid through third-party entities and are considered freelancers or independent contractors by their employers, as Wood points out, this gave rise to a plethora of litigation, as workers began to sue their employers to obtain the right to benefits that accrue to employees but not to independent contractors. Most famously came *Vizcaino v. Microsoft*, 120 F.3d 1006, *Doc 97-22026*, 97 TNT 145-14 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998). This 1996 class action filed by Microsoft's permatemps is the most noted lawsuit involving the classification of employees.

In *Vizcaino*, a class of workers designated as independent contractors sought benefits, specifically valuable Microsoft stock options, from the software behemoth. Notably, these were benefits that they were not entitled to under their employment contracts. Even though Microsoft's contract specifically and explicitly denied the plaintiffs the benefits they sought, the Ninth Court of Appeals upheld the plaintiffs' right to them as employees. Plainly, this blurs the line between owners-designated independent contractors and employees. Plus, losing the case cost Microsoft \$100 million, arguably a much greater amount than the dollar worth of employee benefits it thought it had avoided via the use of permatemps.

Thus courts increasingly are ignoring the wording of an employment contract that designates a worker as an independent contractor. Understandably, they are investigating the underlying ties that bind owner to worker to determine the true nature of the relationship. The crux of the matter is the degree of control that the company and its supervisors exercise over their workers, whether designated independent contractors or freelancers. The developments in case law as well as federal and state regulatory regimes over the past decade have made the shift to independent contractor from employee more than a simple designation, and more than simply using third-party human resource providers.

Wood's work underscores the fact that the designation of employees has become a difficult process that gives rise to exposure to vicarious liabilities for owners that frequently hinge on subtleties. Employers must be aware that all determinations of worker status are intensely factual. Thus, a company and its supervisors must be aware of the law and must be realistic about what is required of their workers before they designate them as either an independent contractor or an employee. To avoid adverse legal consequences, employers must stay abreast of developments in the law and regulatory environments. Add to that the constantly changing patterns of work their contractors do and its effect on the supervision of their workers, and you have a tall order.

The Queen: Now, here, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!

— Lewis Carroll, *Through the Looking Glass*

It is vital for employers, employees, and practitioners to have the fourth edition of Wood's *Legal Guide to Independent Contractor Status*, because the tax and employment laws governing determinations of independent contractor status are in a state of constant flux. In addition to elucidating current IRS audit procedures, the new edition reflects up-to-date changes in the law governing worker status determinations.

Notably, in May 2007 the Joint Committee on Taxation addressed the federal determinations of worker status, aiming to eliminate the complexity and contradictions of extant laws and practices. The JCT determined that the failure to adequately classify workers may be resulting in the loss of significant tax revenues for the federal government. While the JCT failed to produce a definitive proposal to tighten restrictions on the classification of workers as independent contractors, it unanimously endorsed the idea that there needs to be an overhaul of the current tax and regulatory system governing worker classifications. Not only does Wood discuss this important JCT report but he includes it as one of the appendices.

While the rules may be changed, those in place typically are tough and unyielding. The fact is that even employers who have not deliberately misclassified their workers are exposed to liability because they may inadvertently have classified workers doing similar jobs as both employees and independent contractors. In addition to employers incurring civil or criminal liabilities for the deliberate or accidental mischaracterization of workers, Wood points out, recent developments have created a minefield of other issues that employers must address, including their liability for employee benefit plans.

Factors Used to Classify Workers

Wood elucidates the problems inherent in the recharacterization of workers to avoid penalties. Worker reclassification may potentially backfire and create adverse consequences for the employer. Many companies have sought to avoid the characterization problem by encouraging workers to incorporate and then hiring the corporation. Employers may be dismayed to find that this does not entirely exempt them from the characterization issue.

Most tests to determine worker status rely on factual determinations of the relationship between employer and worker, based in the common-law right-to-control standard. However, one reason Wood's book is so vital to employers, employees, and practitioners is that as one attempts to ascertain factors the IRS and the states use to determine whether workers are independent contractors, there is no one test. There is a lack of consistency among public agencies in determining the validity of an independent contractor designation because of the multiplicity of federal and state agencies and their purposes.

While the IRS's 20-factor test is one generally accepted benchmark, other federal and state agencies' determinations of worker status differ because their criteria are geared for different purposes. The labyrinthine nature of

worker classification is grounded in the fact that federal and state tax and labor laws are overlapping. A worker may be considered an employee under one test for one purpose by one agency and an independent contractor for another purpose by the very same agency. In this through-the-looking-glass world, we see a field of practice in which multiple layers add opacity rather than translucence. The fourth edition of the *Legal Guide to Independent Contractor Status* serves as an essential compass in that topsy-turvy world.

Beyond the field of employee taxes, the proper classification of workers is critical. Under federal law, a worker's status as either an independent contractor or an employee will affect cases brought under the Age Discrimination in Employment Act, Title VII of the Civil Rights Act of 1964, the Fair Labor Standards Act, the National Labor Relations Act, and the Older Workers Benefit Protection Act. In addition, human resources management areas affected by worker classification include unemployment taxes, workers' compensation, and qualification for tax-favored employee benefit plans.

For determining the status of workers for tax purposes, Wood provides helpful forms and checklists to guide the reader through the complex maze of tax laws and regulations applicable to independent contractor status. Also included are sample independent contractor contracts or agreements for different types of employment.

One of the most useful sections of this treatise is the appendix, containing copies of the applicable, updated IRS and Treasury regulations, as well as other guidance. This and other primary-source material should be useful

to any person interested in determining the tax status of an employee or independent contractor. Any practitioner in this area of the law will find the appendices both useful and time-saving. Particularly helpful is Wood's inclusion of the IRS training materials to determine whether a worker is an employee or independent contractor.

In summary, Wood's book is an excellent guide on to how to deal with worker classification. The book examines the use of independent contractors, the differences and distinctions between independent contractors and employees, and the legal and tax liabilities that accrue from classifying a worker in one status or the other. Perhaps more importantly, it provides invaluable guidance on how to deal with a worker status audit by the IRS and by state tax authorities.

Wood also skillfully analyzes contract and tort liability issues linked to the use of independent contractors. He ably answers such questions as what is the business owner's personal liability for employment taxes and how to write a contract designating a worker as an independent contractor in such a way that it can stand up to a challenge. In short, Wood's work brings sanity and sense to what at times may seem like an *Alice in Wonderland*-type world of independent contractor law.

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