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By Robert W. Wood

New Law Says Independent Contractors Are Employees: What It Means For Business

California's governor signed into law Assembly Bill 5, designed to required gig companies such as Uber, Lyft and others to treat their workers as employees. But Uber's top lawyer already announced that Uber would not put the brakes its independent contractor model for drivers. Tony West, Uber chief legal officer, pledged that its drivers will remain independent contractors, suggesting the true test of the new law will be in court. The new law takes effect Jan. 1, 2020, and could see a mixed bag of companies complying and some that refuse.

Under the new law, California workers could generally be considered independent contractors only if the work they do is *outside* the usual course of a company's business. Conversely, workers must be employees not contractors if *either* a company exerts control over how they perform their tasks, *or* if their work is part of a company's *regular business*. That latter rule is key. Other states could well follow California's lead, which could mean more tax money flowing.

For decades, who is a contractor v. an employee has been a battleground, with billions of dollars at stake. But with most of the focus on *how* you determine which is which, it is worth asking *why* it matters. From the individual's perspective, being an employee means that: Your employer must withhold income tax and your portion of Social Security and Medicare taxes.

Also, your employer is responsible for paying Social Security, Medicare, and unemployment (FUTA) taxes on your wages. Each year, your employer must give you a Form W-2 showing the amount of taxes withheld from your pay that year. You can deduct unreimbursed employee business expenses on Schedule A of your income tax return, IRS Form 1040. However, you can do so only if you itemize deductions and they total more than two percent of your adjusted gross income.

If instead you are an independent contractor: The business usually must give you an IRS Form 1099-MISC to report what it paid you. A copy goes to the IRS so they can match it against your return to ensure you paid tax on it. With no withholding, you are responsible for paying your own income and self-employment taxes. You may need to make estimated tax payments during the year. You can deduct business expenses on Schedule C of your own Form 1040.

From an employer's viewpoint, paying independent contractors offers the benefits of:

No income tax withholding;

No employment taxes;

No liability for acts of employees---like driving a car on company business;

No federal and state discrimination laws covering only employees; and

No fringe benefit, pension, retirement, or other plans.

Many worker status cases look primarily at:

The employer's degree of control over the worker;

The worker's opportunity for profit or loss;

The worker's investment in facilities;

How long-term the relationship is; and

The worker's skill set.

If workers are recharacterized from independent contractors to employees, the employer may face big liabilities for past failure to withhold taxes, plus penalties and interest. The taxes that must be withheld include income and employment taxes. And if the employer cannot prove the workers paid their own income taxes, the employer can be required to pay the taxes it should have withheld. The dollars can be huge.

The author of California's new law, Assemblywoman Lorena Gonzalez, said it was designed to stop businesses from misclassifying workers. The gig economy has changed the employment landscape in ways that would have been hard to predict. California wants to stop what it claims are "free-riding businesses" from passing their costs onto taxpayers and workers. Having employees triggers federal and state tax withholding, anti-discrimination, health care, pension, worker's compensation and unemployment insurance obligations.

Worker status issues can come up almost anywhere, and not just from the government. Third parties injured by an 'independent contractor' can sue saying he or she was really an employee, so the employer is liable. Workers who sign contracts as independent contractors can still sue claiming they are employees. There are numerous legal tests to determine who is an employee from the IRS, Department of Labor, state labor and unemployment laws, workers' compensation, and more. In that sense, it is no wonder that employers can't keep up.

Under the IRS test, to determine who is an independent contractor, you must evaluate 20 factors, and assess whether you are controlling the method, manner and means of

the work. The duration of your work relationship is important, as is whether it is full or part-time, professional credentials, flexible vs. rigid hours, who supplies tools and supplies, expense reimbursements and more. A written contract is key to independent contractor status, but that alone is clearly not enough.

Disputes are common, and many different agencies can second-guess your decision. The IRS, state tax authorities, labor departments, and insurance companies all scrutinize the status of workers. If an independent contractor classification doesn't hold up, taxes and penalties can be crushing. Given the huge stakes and the costs of having employees, it is understandable that some companies push the envelope. Uber has already taken a stand about the new law, doubling down that its drivers are independent contractors. Some companies will presumably fall into line. However, one wonders how many others may adopt Uber's mantra that it is just a tech platform.

Ironically, if Uber and other huge companies fare well in court, they might avoid the new California law. Meanwhile, many smaller companies seem more likely to comply, even if it means bigger worker costs. Some companies and their owners are probably dusting off their independent contractor agreements and assessing their risks. Be careful out there.

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