



# DAILY TAX REPORT



VOL. 8, NO. 246

DECEMBER 23, 2008

## Employee Versus Independent Contractor Determinations Can Be Difficult in Cases Involving 'Of Counsel' Lawyers

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**T**he meaning of the "of counsel" designation in law firms can mean just about anything these days. Among its more common connotations are any one or more of the following:

- a senior lawyer in a firm who is partially (or fully) retired but who is occasionally still called upon to render legal advice;
- an attorney who is too senior to be called an associate but is too junior (or too untested) to be a partner;
- a midlevel or senior lawyer brought into a firm laterally on a trial period, after which the lawyer will either become a partner or be sent packing;
- a part-time lawyer;
- a specialist in an area of law not normally practiced by the law firm; or
- an outside lawyer who is available to give advice when called upon.

In fact, one could add many other potential descriptions to this list. Custom and practice varies concerning physical proximity, and concerning the number and scope of firm affiliations. It is possible in many states for a single lawyer to be of counsel to multiple firms at the same time. It is also possible for one law firm to be of counsel to another law firm.

Apart from the various meanings the of counsel label can have, there are infinite factual variations. For example, even if one were to focus solely on of counsel attorneys who are too senior to be called "associates" and who are making lateral transfers into law firms, there is enormous variety. The of counsel lawyer might be in

another city or office, and might be working primarily from home or from that lawyer's independent office. Conversely, the lawyer might be housed within the firm, right next door to associates and partners. The of counsel lawyer might be working a few hours a week for the firm and its clients, keeping a separate practice on the side, or might be working full-time for the firm and be flatly prohibited from taking outside engagements.

### The \$64,000 Question

Are of counsel lawyers independent contractors or employees? How should they be treated, and what are the risks and benefits? With all these factual and legal variations, it is no wonder there is no standard treatment for of counsel lawyers. That means no standard treatment for purposes of income and employment tax withholding, as well as the many labor and employment law, insurance, contract, and liability considerations that factor into the employee versus independent contractor dichotomy.

**Some of counsel lawyers will be treated as independent contractors for all purposes.**

**Conversely, some will be treated as employees for all purposes. Still others will be a hybrid—employees for some purposes and independent contractors for others.**

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*This discussion is not intended as legal advice and cannot be relied upon for any purpose without the services of a qualified professional.*

Some of counsel lawyers will be treated as independent contractors for all purposes. Conversely, some will be treated as employees for all purposes. Still others will be a hybrid—employees for some purposes and independent contractors for others. If that sounds dizzying, let us first dispense with the hybrid category, since it can be confusing no matter what the context.

By “hybrid” I simply mean workers (in this case of counsel lawyers) who are treated as independent contractors for some legal purposes and employees for others. This is not common with lawyers but is common in certain industries. For example, workers might be treated as employees for workers’ compensation and unemployment insurance purposes but as independent contractors for all other purposes.

Putting such hybrid possibilities aside, should of counsel lawyers be independent contractors or employees?

## Characterization Matters

It is worth noting the pervasiveness—and the almost metaphysical character—of an independent contractor versus employee characterization debate.

There are at least two (and usually additional) perspectives from which to view the age-old question whether independent contractor or employee status is appropriate. The question is not merely one to address at the inception of a relationship. One should reconsider these issues periodically. And if you decide on independent contractor status, be aware that either the government or private parties can seek to abrogate that status.

One way to view the employee versus independent contractor characterization point is that you simply do not get to decide this point, whatever you put in a contract.

It may be easy to see the reason for this policy when considering the perspective of third parties, including the Internal Revenue Service, an insurance company, a labor or employment development department, etc. Consider the fate of a third party injured by the “contractor” who wants to assert liability to the employer under the doctrine of respondeat superior. Only if the injured party can prove the worker was really an employee does he get to recover against the employer.

Some characterization battles do not involve third parties or the government, and are strictly between the worker and the company. Despite a written contract, a putative independent contractor may claim to be an employee. One could argue that he should be estopped from claiming employee status based on a written contract that makes clear he is not an employee. Nevertheless, the law imports its own standards on who is and is not an employee.

This is not hard to understand when one considers that, from an employer’s perspective, “independent contractor” treatment offers the outsize benefits of:

- no income tax withholding (saving the company enormous administrative costs as well as liability exposure for withholding and reporting);
- no employment taxes (saving significant dollars because the employer bears liability for employment taxes on wages paid to employees);
- avoiding wage and hour laws that impose breaks, rest periods, overtime, and working condition rules;
- avoiding respondeat superior liability for the tortious acts of employees;
- avoiding federal and state discrimination and many other legal protections available only to employees;
- avoiding union organization of employees; and
- avoiding liability for participation in fringe benefit, pension, retirement, and other plans—under federal

and state pension and labor and employment laws, there are many obligations, including nondiscrimination rules, so the dollars at stake can be huge.

With of counsel lawyers, there are additional issues, such as liability for malpractice. In fact, this issue should be considered even with of counsel attorneys who are indisputably independent contractors.

Considering the disadvantages of having employees, one may well wonder why anyone is hired as an employee. Yet most of this is not a matter of choice but a matter of the law. Our system generally presumes that a worker is an employee unless you can prove otherwise.

In some cases, the presumption of employee status is expressly stated in the law, and in other cases, it is merely implicit. Whether you face IRS recharacterization or an inquiry from a state labor commissioner, insurance company, a state employment development department, unemployment insurance authorities, etc., they are all likely to assume that workers under your purview are employees unless you can persuade them otherwise.

## Just the Facts

How does one analyze whether an of counsel lawyer should be treated as an independent contractor or an employee? It is difficult to attempt to define the relationship between law firm and of counsel lawyer without talking about the fundamental issues of control, and how the legal world views it.

If the law firm and lawyer are both willing to opt for employee treatment, you will not have any trouble. No one will try to assert independent contractor status.

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On the other hand, if law firm and lawyer desire independent contractor treatment, there are many niceties to observe. Different legal tests are used for federal tax purposes, workers’ compensation laws, unemployment insurance, and federal and state labor and employment laws. To say that is confusing is a vast understatement. Still, without getting into the nuances of the various tests, it is possible to give some guidance that applies more or less across the board.

## Whose Definition?

While generalizations are dangerous, it is relatively safe to say that the overarching consideration in these worker characterization disputes is whether the employer has the right to control the worker.

The relevant right to control is not only the right to control the end result or product but also the method, manner, and means of doing the work. That usually signals employee status, since a true independent contractor should be able to pick when and how to do the work, and the order or sequence in which to do it, as long as the end result is achieved.

Interpreting this common law right to control standard, IRS tries to put considerable shading into this analysis. IRS enumerates 20 of the most important factors in worker classification:

**1. Instructions.** The more instructions that are given, the more likely is employee status.

**2. Training.** The more training provided, the more likely is employee status.

**3. Integration.** The more closely integrated the work is with the employer's business, the more likely is employee status.

**4. Services Rendered Personally.** If the worker must personally do the work, employee status is likely.

**5. Hiring, Supervising, and Paying Assistants.** A worker who does these things will often be an independent contractor.

**6. Continuing Relationship.** The longer the arrangement's term, the more likely is employee status.

**7. Set Hours of Work.** Set hours are more consistent with employee status.

**8. Full Time Required.** Working full time suggests employee status.

**9. Doing Work on Employer's Premises.** Working on the employer's premises may suggest employee status.

**10. Order or Sequence Set.** Performing services in a particular order or sequence set suggests employee status.

**11. Oral or Written Reports.** Regular reports to an employer tend to suggest employee status.

**12. Payments by Hour, Week, or Month.** Payment by the hour, week, or month suggests employee status.

**13. Payments of Business and Traveling Expenses.** Payment of business and traveling expenses suggests employment status.

**14. Furnishing of Tools and Materials.** Furnishing significant tools, materials, and other equipment suggests employment status.

**15. Significant Investment.** A worker's significant investment tends to indicate independent contractor status.

**16. Realization of Profit or Loss.** A worker's significant investment tends to indicate independent contractor status.

**17. Working for More Than One Firm at a Time.** Working for more than one firm at the same time suggests independent contractor status.

**18. Making Service Available to the General Public.** Making services available to the general public on a regular and consistent basis suggests independent contractor status.

**19. Right to Discharge.** The right to discharge a worker suggests employment status.

**20. Right to Terminate.** A worker's right to terminate the relationship without incurring a liability suggests employment status.

Despite this 20-factor test, there is no litmus test. There is no numerical threshold of how many factors you need going one direction or the other. There is also no pecking order of which factors are more important

than others. It is an overall facts-and-circumstances test.

## Of Counsel Lawyers

How does the typical of counsel arrangement fit into this legal standard? Lawyers are professionals, licensed and generally holding themselves out to the public to provide legal services. They are highly skilled. In fact, it could be argued that they are the paradigm of a true independent contractor.

However, one should ask questions such as:

- Will the lawyer be working exclusively for the law firm for which he or she is of counsel? (The more exclusive the lawyer is, the more likely the lawyer is an employee.)

- Will the of counsel lawyer have any supervision from partners or others within the firm in the conduct of legal work? (More supervision can equate to employment.)

- Is the of counsel lawyer paid a salary and bonus, or a strict percentage of what the lawyer brings in? (The more the lawyer's pay looks like a regular paycheck, the closer it resembles employee status.)

- Will the of counsel lawyer be housed in the same offices, provided a secretary or assistant, office supplies, an office, etc.? (Tools, instrumentalities, and assistance are traditional badges of employee status.)

- Will the of counsel lawyer be on committees within the firm and otherwise be integrated within the firm's practice, or be operating more as a lone wolf? (Integration helps push the arrangement toward employee status.)

- Will the of counsel lawyer receive fringe benefits, and participate in firm employee benefit or pension plans? (Benefits are usually provided only to employees.)

- Will the of counsel lawyer have the ability to make decisions on behalf of the firm, such as taking on new clients, compromising bills, etc.? (Authority is usually only for employees.)

- Will the of counsel lawyer receive training from the firm, or will the firm pay for outside training? (Training provided by the employer is another traditional badge of employment.)

- Must the of counsel lawyer render services personally, or can he delegate his duties to other lawyers or associates? If so, are these persons within the firm or outside it? (Independent contractors usually have a greater ability to delegate than employees.)

- What is the tenure of the relationship, and how continuous is it (full time, part time, and for how long)? (The more regular, continuous, and long term the relationship, the more it suggests employee status.)

- Must the of counsel lawyer adhere to established office hours or other hours of work? (The paradigm independent contractor works when he or she wants to.)

- Are there particular sequences or procedures the of counsel lawyer must follow that are set by the firm? (The more structured and ordered the tasks are, the more it looks like the firm is paying for the process, not merely for the end result.)

- Must the of counsel lawyer submit regular reports or other progress reports? (Progress reports are more typical with employees.)

■ In addition to how the lawyer is paid, how frequently is the lawyer paid? (Again, the reference here is to regular paychecks.)

■ Does the lawyer receive everything needed in the way of tools and materials from the firm, or supply his or her own? How much investment in facilities (computer, dictating equipment, furnishings, etc.) does the lawyer provide himself or herself? (The more the of counsel lawyer provides, the more likely independent contractor treatment will be available.)

■ Is it possible for the lawyer to actually realize a loss or a profit? (An independent business person may have a loss, meaning expenses exceed income; employees are usually compensated for their expenses.)

■ Can the lawyer be fired at will or is there a waiting period? Conversely, what kind of termination rights and liabilities are there on the part of the lawyer? (Termination at will is most classically associated with employee status.)

As daunting as the above list may seem, it is not even exclusive. One should inquire into virtually every facet of the relationship between the of counsel lawyer and the firm to try to discern whether the lawyer is (or should be treated as) an employee or as an independent contractor.

Of course, there should be a written agreement between the of counsel lawyer and the firm. It should set out what each party expects of the relationship and the requirements of same.

Significantly, though, such an agreement will not bind third parties. A mere written agreement (even one that covers all of the points above) is not the be-all and end-all of the relationship. The taxing, labor, and other authorities can go behind agreements to ascertain the truth of the relationship, whatever the document says.<sup>1</sup> Plus, even the parties themselves may not be bound on something as fundamental as worker status.

There have been relatively few legal disputes over whether of counsel lawyers are independent contractors or employees. For that matter, the whole question of whether lawyers are employees or independent contractors rarely seems to arise. A lawyer independently representing many different clients is likely to be an independent contractor. On the other hand, a “captive” lawyer working only for one client, such as an in-house position, is almost classically an employee.

<sup>1</sup> See *S.G. Borrello & Sons v. Department of Industrial Relations*, 48 Cal. 3d 341, 349 (Cal. 1989).

In one case, IRS expressly considered whether an of counsel attorney at a firm was a contractor or employee.<sup>2</sup> Reviewing the facts and background, IRS concluded that the of counsel lawyer did not qualify as an independent contractor and was an employee. The basic reason was that the law firm retained the right to control the lawyer.

Among the more significant points noted by IRS were that:

■ there was a written contract calling for the firm to pay for legal malpractice coverage, which it did;

■ staying with the firm was conditioned upon “satisfactory” performance (which sounded discretionary and employee-like);

■ the lawyer’s role commenced only when the lawyer moved into the firm;

■ the lawyer had to complete firm time sheets and submit monthly reports about client work;

■ the firm paid business expenses;

■ the of counsel lawyer did not have to make an investment in the firm;

■ the lawyer lacked a risk of loss (or profit);

■ the firm provided support staff; and

■ the arrangement was intended to be long term.

Given the number of points suggesting firm supervision, firm support, and subjective criteria governing what would be “satisfactory” work performance, this case was not even close. Considering the facts, it seemed inevitable that IRS would rule the lawyer was an employee.

## Conclusion

Given the paucity of cases, law firms and lawyers must generally rely on authority involving non-lawyer workers to gauge whether it is realistic to treat of counsel lawyers as independent contractors.

Despite the independence traditionally associated with a professional practice, exercise caution. If the of counsel lawyer is housed in the law firm, works only with the law firm’s clients, is provided support staff, equipment, and services by the firm, is covered by the firm’s malpractice insurance, etc., the firm should seriously consider whether independent contractor status is realistic.

<sup>2</sup> See IRS Field Service Advice, 1995 FSA Lexis 300 (Sept. 15, 1995).