Review: Crafting Independent Contractor Agreements

By Chris Welsch • Legal Assistant, Wood & Porter • San Francisco

Increasingly, companies battling the recession are seeking new and unique business models. Some are running into labor law and tax problems over the classification of their workers. Worker status characterization disputes are fought over who is and is not an independent contractor. These disputes can be between companies and workers, between companies and government agencies, and sometimes in third-party disputes (for example, where the company faces *respondeat superior* liability over worker conduct).

Classifying workers as independent contractors grants tax and liability advantages to businesses, as well as a degree of flexibility in the business model. In fact, apart from reduced control over the workers, the primary downside is the propensity for the principal-contractor relationship to be overturned by courts or regulators. That can mean the business ends up with penalties, as well as new and unanticipated tax and regulatory burdens under an employer-employee relationship.

To help create genuine independent contractor relationships that can withstand scrutiny from courts and regulators, the National Constitution Center produced an hour-long telephone seminar *Employee vs. Independent Contractor: Drafting Agreements that Protect.* Ken Gauvey of Offit Kurman in Baltimore gave the presentation.

Choose Wisely

Gauvey stressed that worker status can be fraught with risks, danger and uncertainty.

Many different parties may scrutinize or challenge a classification. Not surprisingly, the IRS generally prefers workers be classified as employees. Employer withholding is a more reliable way to collect tax revenue many months before independent contractors would even receive their Form 1099s.

It's also far more efficient for the IRS to pursue employers for delinquent taxes than a much larger number of workers. Gauvey noted that even the Equal Employment Opportunity Commission is litigating cases of sexual harassment on behalf of independent contractors. Unions are increasingly attempting to litigate or circumvent independent contractor designations to aid unionization efforts.

State agencies may also be interested in reclassifying workers. This can separately impact workers compensation, unemployment insurance and other regulatory mandates. Then, there are the workers themselves.

In some situations, workers who are under contract as independent contractors are dissatisfied with the relationship. They may claim (in a stand-alone suit or a class action) that they are *really* employees. They may seek damages for vacation, minimum wages, expense reimbursements or other workplace privileges that would be required for employees but not for independent contractors.

Gauvey remarked on current signs that the field may become even more hostile towards independent contractor status. The Independent Contractor Proper Classification Act of 2007, proposed but (mercifully for employers) not passed, would have given the IRS larger decision-making authority over worker status classification. The act was co-sponsored by then-Senator Obama, though passage seems unlikely this year.

The act (if passed) would place the burden of proof for contractor status on the principal, rather than on the plaintiff or government agency. Moreover, it would generally assume that the putative employer is controlling the relationship and pursuing independent contractor status for cost savings at the expense of the workers. Given this perspective, it's only reasonable that the act seeks to remove the safe harbor provision that protects from penalties those principals who followed industry standards in classification.

The standards by which principal-contractor relationships are scrutinized are more rigorous and detailed than some companies may anticipate. Fortunately, this seminar stressed that the relevant standards generally derive from some common foundations and assumptions. This conference gave plenty of tips on how to properly approach the independent contractor relationship.

In Common

Generally, all the relevant independent contractor tests stem from the common law concept of a contractor as independent and an employee as dependent. The standards are phrased and grouped differently, and have different emphases, but much of it boils down to basics.

The underlying concepts are control of the worker over how, when and where worked is performed, and the financial and commercial independence of the worker. The agreement alone is not sufficient proof of the relationship.

In fact, even a stellar agreement cannot overcome actual facts that suggest a worker lacks control over the manner of his work or has no independent business. Labels and terminology that indicate independent contractor status will similarly not by themselves override the reality of an employer-employee relationship. Even having some very independent contractor-like aspects in a relationship—such as working remotely or lack of a supervisor—will not be determinative in the face of other controls.

A business may have a signed independent contractor agreement. It may have a consistent record of issuing Forms 1099 instead of Forms W-2. It may even have workers who prefer independent contractor status. All this may not necessarily serve as a shield to a reclassification fight. As there are many agencies and many different tests to satisfy in constructing a proper independent contractor classification, a hasty or superficial fix is seldom a viable option.

Be Authentic

As this National Constitution Center program stressed, the most important rule for a principal-contractor arrangement must be the authenticity of the relationship. Even a perfect independent contractor agreement, crafted and honed by the finest legal counsel, will not withstand

scrutiny if the actual relationship is riddled with conflicting facts and controls. The agreement itself is an important part of a proper principal-contractor relationship. Yet the reality of the relationship is more important still.

Flagrantly unreasonable attempts at independent contractor classification may result in greater penalties. If a company preemptively moves to change its business model, the change should be undertaken for a legitimate business purpose. Gauvey advised that it can be unwise for a company to reform its relationship with independent contractors solely for legal purposes.

The conference included a number of other tips. Aside from consistent treatment and an authentic principal-contractor relationship, a business helps its case by having some employees. After all, agencies and courts expect companies to have employees. An over-reliance on independent contractors—especially when those workers are performing the core business of a company—may raise suspicions.

Some workers will not easily sustain an independent contractor classification, because they are too integral to the business model. Regular audits, both internal and external, can be helpful. They may help to assure compliance with the independent contractor agreement, and can perhaps show a good faith effort to follow through on its promises.

Get Help

Gauvey also stressed that engaging outside counsel to review and analyze the relationship can be an important tool for companies utilizing independent contractors. Counsel can examine the facts for compatibility with the independent contractor tests, and for conformity with the agreement. In some cases, attorneys will issue an opinion letter attesting to the degree of their confidence level that independent contractor status will be upheld.

The National Constitution Center's program "Employee vs. Independent Contractor: Drafting Agreements that Protect" is a good overview of this thorny and pervasive subject area. Details are at *www.constitutionconferences.com.*

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