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White House On Contractor Vs. Employee: There Will Be Blood

Employers have big incentives to treat workers as independent contractors: avoid income tax withholding, Social Security taxes, workers compensation, unemployment insurance, even liabilities to third-parties. Plus, you can steer clear of liability for tax-favored pension and fringe benefit plans and a whole pile of federal and state labor and employment laws. Many companies go out of their way to classify workers as independent contractors, but such arrangements can be scrutinized and lines often blur. Classically, employees go to work at set hours while independent contractors determine their own.

Employees follow orders, while independent contractors work in the manner they prefer. Employees receive regular paychecks while independent contractors are paid by the job. Employees work year-round, while independent contractors are temporary. Employers have control over the actions of employees, while the method, manner, and means of production are left to independent contractors.

Of course, these are archetypes. Real-life fact patterns are rarely so clear and therefore require analysis. The IRS and a variety of state and federal agencies make these determinations. In fact, a worker can be an employee for one purpose and an independent contractor for another.

Apart from tax and labor law, there's workers compensation, providing no-fault coverage to employees injured on the job. Unemployment

provides benefits when employees are out of work. Both cover only employees, so there are inevitably coverage disputes. Many putative independent contractors claim unemployment or workers compensation benefits.

The stakes may *seem* small, but a \$1,000 workers compensation dispute can lead to a \$10 million tax dispute. Civil suits for tort liability involve employee status too. An independent contractor in an auto accident can be sued, but if he is employed while driving, his employer will be sued too. Workers themselves can sue for benefits notwithstanding their explicit independent contractor status.

President Obama has keen interest in worker misclassification, having pushed for [corrective legislation](#) even before he entered the White House. The stakes are now huge, and policy and revenue goals (for once) seem to coincide. The White House has already endorsed the latest bill introduced September 15, 2010, the Fair Playing Field Act of 2010 ([H.R. 6128](#), [S. 3786](#)) introduced by Sen. Kerry (D-Mass) and Rep. Jim McDermott (D-Wash). This bill would end a moratorium barring the IRS from issuing misclassification guidance, and would affirmatively require the Treasury Department to issue guidance. Plus, the bill would increase penalties on employer failures to withhold.

Controversially, the bill would require companies using independent contractors to disclose to each such person in writing their federal tax obligations plus information about labor and employment issues. This type of Miranda warning for independent contractors could really smart for companies making widespread use of independent contractors. Such warnings inevitably may invite some workers themselves to start questioning just why they are at such a disadvantage.

Whether this particular bill passes, something will eventually. The White House included misclassification reform in its 2011 budget, and supported two prior bills, the Taxpayer Responsibility, Accountability and Consistency Act of 2009 ([H.R. 3408](#)) and the Employee Misclassification Prevention Act of 2010 ([S. 3254](#)). Republicans worry about costs on business, but to borrow the Oscar-winning movie title, [There Will Be Blood](#).

Workers must be either employees or independent contractors, disputes are common, and the stakes are huge. There is now much interaction between agencies, so be careful.

For more on employee vs. independent contractor issues, see:

[All Lawyers Need to Know: Independent Contractor Basics](#), Issue 1, Business Law News (2010), p. 15.

[Ten Things GAO Has to Say About Employee Contractor Misclassification](#), Vol. 9, No. 195, Daily Tax Report (Oct. 13, 2009), p. J-1.

[IRS Gives 10 Tips on Employees Versus Independent Contractors](#), Vol. 9, No. 172, Daily Tax Report (Sept. 9, 2009), p. J-1.

[Ten Things IRS Wants Workers to Consider When Contractors Become Employees](#), Vol. 9, No. 156, Daily Tax Report (Aug. 17, 2009), p. J-1.

[Ten More Consequences of Reclassifying Independent Contractors as Employees](#), Vol. 9, No. 140, Daily Tax Report (July 24, 2009), p. J-1.

[Ten Consequences of Reclassifying Independent Contractors as Employees](#), Vol. 9, No. 123, Daily Tax Report (June 30, 2009), p. J-1.

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