

Will Your Independent Contractors Be Relabeled, And By Whom?

By Robert W. Wood

Who is an independent contractor and who is an employee? We know it matters, and we know disputes occur. But do we know how and why? There are many liabilities lurking in controversies over independent contractor versus employee characterization.

Slapping an "independent contractor" label on a worker's name badge does not resolve the question.

Recharacterization is always possible, by different agencies and for different purposes. You may have a good handle on the issues that may mitigate in favor of one classification or another for a particular worker. But there is always more to learn. Let's start with who can dig into this issue.

Traditionally, the independent contractor or employee distinction is raised by the IRS. That's true for both income tax withholding and employment taxes. The latter do not fall exclusively on the worker and are shared by the employer. Independent contractors are paid the gross amount of their pay with no tax withholding.

If a so-called independent contractor turns out to be an employee, then all of that pay was "wages," and that means the employer should have withheld! If an employer fails to withhold income tax on wages, the penalties are severe. It may be several years later when the worker's status is recharacterized, so the tax numbers can be big and ugly, plus penalties and interest.

The same concerns that can arise for federal income and employment taxes can also arise under California law. It's generally accepted by tax lawyers and accountants that it is harder to win a California employment and income tax case than it is to win a similar case against the IRS. Plus, there is usually less room to settle a California tax case. The IRS is more flexible than the California authorities.

In any event, you can usually expect to deal with both. These days, given exchange of information agreements between the IRS and California, one battleground usually turns into another.

Then there are the pension people. The Employee Retirement and Income Security Act of 1974 has been amended many times and is among the more complex of federal laws. It governs pensions and employment benefits. Jointly administered by the IRS and the U.S. Department of Labor, it mandates and regulates a vast system of enforcement and compliance. It excludes independent contractor from its coverage and nondiscrimination rules so the IRS, DOL or both may scrutinize who you cover.

How about workers' compensation? That system is designed to provide no-fault coverage to employees injured on the job. The key word is "employees," as workers' compensation covers employees, not independent contractors. That leads to inevitable coverage disputes.

An injured "independent contractor" who makes a workers' compensation claim may (or may not) realize that only *employees* are covered. But even claims that start out innocently can end up being time consuming and expensive. A claim

involving only a few dollars can become the first domino in an expensive and protracted controversy with several different agencies.

Unemployment insurance provides a base of support when workers lose their jobs. Axiomatically, unemployment insurance applies only to employees, not to independent contractors. Many putative independent contractors make claims for unemployment benefits.

As occurs with workers' compensation claims, they may (or may not) appreciate the distinction between the two classifications of workers. In either case, disputes often arise. A seemingly small claim may turn out to be the proverbial straw that broke the camel's back.

Don't forget the EDD either. The Employment Development Department or California Department of Industrial Relations may come calling too. Such agencies routinely receive complaints from workers which they are required to investigate. In the absence of worker complaints, the agencies may target certain industries, looking for misclassification in a particular industry or geographic area.

Unions can have a stake too. Union organizers may want to expand, since union members are the lifeblood of unions. The vast system of laws governing organized labor covering strikes, walkouts, lockouts and more applies to employees, not to independent contractors. Thus, the independent contractor versus employee dichotomy is alive in the union context too.

How about plain old civil lawsuits? If an independent contractor causes an auto accident, he can be sued. But if the driver is an employee on the job, the employee is an agent of his employer. That makes the employer liable too.

What happens if there is a written "independent contractor" agreement for the driver? Even if on paper and in fact it appears that the driver was an independent contractor, the injured party may sue the putative employer. The injured party may expect the employer to settle rather than to risk a large fight over the worker's status that may turn out badly. There are many other contexts in which the legal status of workers can arise.

The issue comes up in intellectual property disputes, suits concerning the liability of officers and directors, contract disputes between companies involving the acts of authorized persons, etc. The contexts can be wide-ranging, and the legal positioning can be creative. The independent contractor versus employee question may be a small point in the overall case. Yet the contractor versus employee issue may be the linchpin that imparts or avoids significant liability.

Finally, suits can be brought by workers themselves for benefits, expense reimbursement, nondiscriminatory treatment, wage and hour protections and more. Some suits are brought by one or several workers. Others are class actions. A suit may be primarily about benefits, expense reimbursement, working conditions, or something targeted, such as stock options.

Usually it is only "employees" who would be entitled to sue for these benefits. But workers can sue despite their status

within the company as "independent contractors." In effect, they are saying that, whatever their contracts and agreements may *call* them, they are being *treated* as employees. They may claim they are entitled to the financial and legal advantages of employees.

Companies with clear written independent contractor agreements may find such suits outrageous. However, the law is clear that the parties cannot make someone an "independent contractor" who is truly an employee under the law.

There are many factors that go into making a worker an independent contractor or an employee. It is worthwhile stepping back to see the vast landscape of worker status controversies. There are plenty of gotchas out there, and they can sometimes be surprisingly connected.

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