

WHO CARES ABOUT CONTRACTOR VS. EMPLOYEE STATUS? 10 ZONES OF DANGER

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Who is an independent contractor and who is an employee? We know it matters, and we know disputes over this fundamental divide occur. But do we know how, where and when they occur? Usually not. Most of us may know there are liabilities lurking in independent contractor versus employee controversies. But our awareness of the specific types of liabilities and the potential exposure varies widely, from ignorance to near paranoia.

Some of us naively assume things are always what you call them. Surely slapping an "independent contractor" label on a worker's name badge resolves the question! The more sophisticated among us know a nice moniker isn't enough. We seek to have an independent contractor treated as such in both word and deed. If we are very careful, that should bring a measure of certainty and protection from liability.

Yet almost nothing is risk free. Even the most cautious and carefully constructed working relationships and written agreements can go awry. Wherever you or your clients fit along this spectrum, you know almost instinctively that there is a risk of recharacterization. For tax and other purposes, the IRS or others may come along and say that you owe something that you do not think you should owe.

To be able to more carefully fix where you fit along the spectrum of awareness, you should have a better sense of the various battlegrounds where the worker status debate can be waged. Here are ten things about worker status disputes you should know.

1. **The IRS is Number One.**

Most classically, the independent contractor versus employee distinction is raised by the IRS. This is so both for income tax withholding and for employment taxes. The latter, it must be remembered do not fall exclusively on the worker and in fact are shared by the employer.

Yet in terms of overall dollar exposure, the biggest dollars at stake generally concern income tax. Independent contractors are paid the gross amount of their pay with no tax withholding. If the putative independent contractor turns out to be an employee, then all of that pay was "wages," and that means you should have withheld! If an employer fails to withhold income tax on wages, the penalties are severe. This potential liability can be enormous in a multi-year independent contractor versus employee controversy.

2. **State Income and Employment Tax.**

The same concerns that can arise for federal income and employment taxes can also arise under state law. Not every state has an income tax, but most do, and their withholding systems generally parallel the federal one. Thus, for both state income taxes (where applicable) and state employment taxes, the contractor versus employee distinction remains important.

Sometimes the state tax agencies are tougher than the IRS. In California, for example, it's generally accepted by tax lawyers and accountants that it is harder to win a California employment and income tax matter than to beat the IRS in a similar case. Given exchange of information agreements between the IRS and the states (and among the several states themselves), one battleground usually turns into another.

3. ERISA and the Department of Labor.

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. If you are an employer, its name should send you quaking. Jointly administered by the IRS and the US Department of Labor ("DOL"), it mandates and regulates a vast system of enforcement and compliance.

And guess who it excludes from its coverage and nondiscrimination rules? Independent contractors. As a result, in ways you may not have anticipated, the IRS or DOL or both may scrutinize who you cover and how you cover them.

4. Workers' Compensation Liability.

Workers' compensation systems are designed to provide no-fault coverage to employees injured on the job. Workers' compensation laws are creatures of state law, and while there is variation, they are pretty consistent. They cover only employees and not independent contractors. That leads to inevitable coverage disputes.

An injured "independent contractor" worker 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 that might involve only a few dollars can become the first domino in an expensive and protracted multi-disciplinary controversy.

5. Unemployment Insurance.

Like the workers' compensation system, most unemployment insurance is designed to provide a broad base of support where it is needed when workers lose their jobs. Unemployment benefits may not be much, but they help. That is why in the current economic doldrums, many state unemployment benefits systems are woefully under water.

Unemployment insurance applies only to employees who have been terminated or laid off, not to independent contractors. Even so, many putative independent contractors end up making claims for unemployment benefits. In doing so, they may actively be seeking reclassification as "employees."

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

6. State Labor and Employment Law.

Labor disputes represent another classic type of employment matter. One's workers may ask for more money or benefits, and this may occur whether the workers are employees or independent contractors. More often, one encounters investigations by state departments of labor or industrial relations.

Such agencies routinely receive complaints from workers which they are required to investigate. These investigations often lead to worker status disputes. In the absence of worker complaints, the agencies may target certain industries, looking for what they may consider to be rampant misclassification abuses in a particular industry or geographic area.

7. Union Organizers.

Understandably, union organizers want to expand their franchise and to gain a foothold in new organizations. After all, union members are the lifeblood of these organizations. To have power one must have strength, and in this context, strength requires numbers. More members pay more dues.

Yet when one thinks of labor law today, one increasingly thinks of employment and discrimination laws rather than of union organizations and traditional labor relations. Nevertheless, the independent contractor versus employee dichotomy is very much alive in the union context too. The vast system of laws governing organized labor covering strikes, walkouts, lockouts and more applies to employees, not to independent contractors. For that reason, disputes over worker status in this specific and traditional context can have high stakes.

8. Liability in Civil Suits.

Civil suits for tort liability might seem to be an unlikely place for worker status disputes to arise. In fact, however, such disputes are rampant, and for understandable reasons. If an independent contractor causes an auto accident, he may certainly be sued.

But if the driver is an employee on the job, the injured party may sue not only the driver but his employer too. The employee is an agent of his employer, and that makes the employer liable. But how does this drama play out given the vicissitudes of modern litigation?

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. Worker status disputes in this context are occurring with increasing frequency.

9. "Other Litigation."

Almost defying categorization, the status of a worker as either an independent contractor or an employee can arise in surprising ways. Under the rubric of "other litigation," one might lump the many legal contexts in which this legal issue occurs. The matter can arise in intellectual property disputes, in suits concerning the liability of officers and directors, in disputes between companies tangentially involving the acts of authorized persons, etc.

The independent contractor versus employee question may be a small or a large point in the overall case. It may even be the linchpin that imparts—or that avoids—significant liability.

10. Suits by Your Own "Contractors."

Suits may be brought by workers themselves for benefits, expense reimbursement, nondiscriminatory treatment, wage and hour protections and more. Such suits can come in many forms and in many forums. Some suits are brought as individual cases by one or several workers. Others are styled as class actions.

The object of such suits varies too. A suit may be primarily about benefits, about expense reimbursement, about working conditions, or something very targeted, such as valuable stock options. It may even be about applicable minimum wage. Usually it is only "employees" who are entitled to sue and to the legal protections many statutes provide.

Nevertheless, workers increasingly bring legal action for damages notwithstanding their explicit 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. Accordingly, the lawsuit will assert, they should be entitled to the financial and legal advantages employee status accords.

Perhaps more than any other type of worker status dispute, this type may generate the most ire of all on the part of the defendant companies. Some companies with very clear written independent contractor agreements find it outrageous that their workers may seek to contradict (and in effect to abrogate) a contract that the worker himself signed. However, this is not too different from the attacks mounted by government agencies that assert that a putative independent contractor is really an employee.

Whoever is pursuing the dispute, it is ultimately about the facts and the law. It might well seem to a defendant company that some kind of estoppel principle would protect them. Yet that argument fails in this context. The law is clear that even by written agreement, the parties cannot make someone an "independent contractor" who is truly an employee under the law.

Such worker suits are becoming more and more common. Across America, company liability for cases of this sort is exploding.

Conclusion

Most of us focus on the legal and factual distinctions between independent contractors and employees, on the specifics that are likely to make a worker one thing or another. Occasionally, though, it is worthwhile stepping back to look at the landscape of worker status controversies and to consider the particular contexts in which these disputes arise. When you do, you may find it is frighteningly vast and diverse.

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