Are They Really Independent Contractors?

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Your company was in a layoff mode and a hiring freeze was in effect over the last year. Two critical employees in the accounting department were out on extended medical leave. To get around the hiring freeze you contracted with two workers to complete accounting tasks and classified them as "independent contractors." The replacements were allowed to come and go as they pleased and were paid a premium rate for each hour they worked. Once the workers out on medical leave returned, your company immediately severed its relationship with the independent contractors. What are your potential liabilities?

Under both the state and federal law the replacements you hired as "independent contractors" almost certainly would be considered employees rather than independent contractors. Therefore, your company would have been required to withhold the appropriate federal and state taxes, comply with the immigration laws (e.g., completion of I-9 forms), comply with state and federal wage and hour laws (e.g. minimum wage, overtime, meal and break periods), pay social security and unemployment insurance taxes, and carry workers' compensation insurance coverage for them.

Claims for unemployment benefits brought by persons misclassified as independent contractors are common, and they are oftentimes the triggering event for the IRS or the California Employment Development Department ("EDD") to commence an audit into all of the workers classified as independent contractors. The information collected during such an audit is often shared among the government agencies. These audits may result in enormous tax assessments or other financial liabilities. Due to the current budget crisis that faces California, the EDD has stepped up its efforts to conduct audits in the hope of generating more revenue for the state.

How can an employer safeguard itself to ensure that it will not incur liability for misclassifying a worker as an independent contractor? Unfortunately, there is no simple answer. Many different legal tests are used to determine if a worker is properly classified as an independent contractor. As a general rule, however, the more control the company has over the independent contractor the less likely the worker is properly classified as an independent contractor.

While not foolproof, a written agreement is an excellent means to establish the scope of the independent contractor relationship. If possible, the agreement should cover the following: (1) the scope of the work performed; (2) the ability of the independent contractor to complete the task without much, if any, supervision from the company; (3) the independent contractor has and is encouraged to provide similar services to others; (4) the independent contractor has the right to hire

encouraged to provide similar services to others; (4) the independent contractor has the right to hire his or her own employees to help complete the desired task; (5) the independent contractor has a taxpayer identification number separate from his or her own social security number and possesses a business license; (6) the independent contractor provides all tools necessary to complete the desired task and incurs non-reimbursable business related expenses; (7) the independent contractor is paid on the completion of the task and payment for services occurs only after an invoice (not a timesheet) is submitted; and (8) the agreement to perform services is ended upon completion of the task or upon written notification by either party.

Liability for misclassification of a worker cannot be avoided just because an independent contractor agreement exists, however. Periodic internal audits should be conducted to confirm that the independent contractors are following the terms of the agreements. Finally, competent legal counsel should be consulted to assist in drafting the independent contractor agreement and help to evaluate the possible risks of classifying a particular worker as an independent contractor.

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