WORDS ON WISE MANAGEMENT

The risks of 'independent contractors'

by Joseph Godwin

Many employers classify workers as "independent contractors," believing the relationship is mutually beneficial. In fact, if a worker agrees to an independent contractor relationship with an organization, there is no risk to him. However, that isn't the case for employers. Strengthened enforcement by both the U.S. Department of Labor (DOL) and the IRS poses numerous risks for employers involved in this type of arrangement.

Why would an employer think the independent contractor relationship is advantageous?

- An employer doesn't have to deduct income or Social Security taxes or pay workers' compensation or unemployment taxes for independent contractors.
- Many federal antidiscrimination laws exclude independent contractors because they cover only "employees," thereby shielding companies from other types of liability to which they would be subject if workers were employees.

But no matter how appealing the independent contractor approach may seem, *do not* be tempted to go that route—all is not as it seems.

When employers misclassify employees as independent contractors, the result can be litigation and potentially significant legal liability. In addition to back taxes, penalties, possible retroactive inclusion in benefits plans, and other penalties, independent contractors may have legal claims against the employer that aren't available to employees. An independent contractor, in some cases, has a written contract—which isn't typically the case for employees, who generally operate under an "employment-at-will" agreement in which either party can immediately terminate the relationship at any time with or without warning. That isn't the case if an independent contractor has a written agreement from his "client."

In one example, a nightclub employed dancers as independent contractors. The entertainers filed suit, claiming they should have been considered employees and were owed back pay for overtime. The nightclub management, in a self-destructive effort to make matters worse, fired the entertainers. The federal trial court agreed with the entertainers, found the nightclub had retaliated unlawfully against them by terminating their employment, and ordered the dancers reinstated. Moving forward, management had much difficulty attempting to terminate any of the entertainers, no matter what the circumstances were. "Employment at will" ceased to exist in the real life of that employer.

Most independent contractor disputes don't actually get to trial; however, rulings from the disputes that do go to trial significantly affect enforcement efforts. Before classifying workers as independent contractors, carefully review a variety of factors considered by the courts and the DOL in determining worker status, including:

- The nature and degree of the contractor's control over the manner in which the work is to be performed;
- The contractor's opportunity for profit or loss;
- The contractor's investment in equipment or materials required for his task or his employment of workers;
- Whether the service rendered requires a special skill;
- The degree of permanency and duration of the working relationship; and
- The extent to which the service rendered is an integral part of the alleged employer's business.

As a general rule, employers should ask the following questions: Does the worker have some type of occupational license? Multiple clients or customers? An investment in tools, equipment, intellectual property, and workspace? If the answer is no, she probably won't meet the requirements to be considered an independent contractor.

The courts, the IRS, and the DOL will examine a worker's status closely when a claim of misclassification is raised. Frequently, they will expand their investigation to other areas to create more expensive problems for the employer. So remember this adage when it comes to determining whether to enter into an independent contractor agreement with someone: If it appears to be too good to be true, then it probably is.

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