

# Information Database

## Ensuring That Your "Independent Contractors" Are Truly "Independent": A Key to Avoiding Governmental Investigations in 2010

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Employers who misclassify any of their employees as "independent contractors," whether done intentionally or not, have fallen into the crosshairs of our federal, state, and local governmental officials in 2010. Unlike employees, independent contractors are not subject to, among other things, withholdings for employment taxes (e.g., unemployment benefits, social security benefits, etc.) and, thus, any misclassification results in lost tax revenue for our governmental authorities. With the severe drop in tax revenue last year due to the most recent economic downturn, the Internal Revenue Service recently announced that, commencing in 2010, it will be randomly auditing over 6,000 companies nationwide regarding their classification of "independent contractors." The IRS hopes to recoup any unpaid employer taxes resulting from any such misclassifications in previous years, and to ensure full compliance with the law going forward. Of course, if the IRS finds that misclassifications are rampant in any given industry or geographic area, it may opt to expand the scope of its auditing initiative.

The IRS is not the only federal agency seeking to crackdown on employee misclassifications. President Obama's 2011 budget for the United States Department of Labor includes an additional \$25 million specifically earmarked for investigating claims of employee misclassifications. This is in addition to the many states which have implemented their own initiatives to combat the employee misclassification problem, including the creation of task forces to investigate such alleged misclassifications and the passing of new laws which provide for narrower definitions of "employees" and stricter penalties for noncompliance with the proper classification requirements.

The remedies for employee misclassifications can be quite severe and may include awards for unpaid back taxes, unpaid wages and benefit contributions, interest, and civil and/or criminal penalties. Thus, it behooves employers to take the time to reexamine the status of their independent contractors to confirm that they are properly classified as such. While the test for being deemed an independent contractor varies from jurisdiction to jurisdiction and from agency to agency within each jurisdiction, below are some of the most commonly reviewed factors in making this determination:

- **Whether the Employer Retains the Right to Control the Worker.** This is typically the primary factor reviewed in most jurisdictions. The more control the employer exerts over the means and methods in which the worker performs his/her functions, the more likely it is that the worker will be deemed an employee. This inquiry also involves examining whether the worker, among other things: (1) works unsupervised by the employer; (2) determines his/her own schedule; and (3) is free to work for other companies, including the competitors of the employer.
- **Whether the Worker Holds Himself/Herself Out as an Independent Company.** Governmental authorities are increasingly requiring proof that the worker owns, or is part of, a bona fide independent company which is in business for itself-as opposed to working strictly for the employer at issue. To establish independent contractor status, this must be more than a mere corporate formality. The government agencies will look to see whether the independent company actually operates like an independent company by, among other things: (1) obtaining a federal employment identification number; (2) having recurring business liabilities and obligations, (3) hiring its own employees; (4) maintaining its own employment records and payroll system; (5) maintaining its own office; (6) purchasing the necessary insurance coverage for its staff and operations; (7) issuing invoices to the employer and other customers; and/or (8) engaging in local advertising and/or maintaining its own business cards.

- **Whether the Worker Provides His/Her Own Uniform, Supplies, and Equipment.** The more the worker in question provides for his/her own uniforms, supplies, and equipment, the more likely it is that he/she will be deemed an independent contractor. Similarly, if the worker pays for all of his/her own work-related expenses (meals, travel, etc.), he/she is more likely to be properly classified as an independent contractor.
- **Whether the Worker Performs Work That Is Not the Primary Work Performed by the Employer.** If the worker is simply performing one of the employer's main business functions, he/she is less likely to be deemed an independent contractor, who generally serves a unique function unrelated to the employer's main business operations. For example, in a restaurant setting, a bartender is unlikely to be deemed an independent contractor because he/she is part of the restaurant's main business operations (i.e., serving food and beverages to the restaurant's customers). On the other hand, the electrician who is hired to install and maintain a new lighting system performs a completely separate function unrelated to the restaurant's primary function and is therefore more likely to be deemed a true independent contractor.
- **Whether the Employer and the Worker Have a Written Agreement Regarding the Worker's Independent Contractor Status.** It is always helpful if there is a written independent contractor agreement between the parties which specifically provides that the worker in question will be classified and treated as an independent contractor. However, too many employers operate under the mistaken assumption that a written agreement to this effect is sufficient to establish a worker's independent contractor status. It is not. An employer must generally satisfy most, if not all, of the other requirements listed above. The existence of such an agreement may support an employer's position that a worker is an independent contractor, but it will never be enough in and of itself.

Since, as noted above, the actual test for independent contractor status may vary depending on the actual governmental agencies involved, it is advisable that employers review their respective classification determinations with counsel to ensure their proper designations. The limited cost of undergoing these voluntary self-audits is extremely small when compared to the tremendous expense employers face-both in terms of time and money-after becoming the target of a governmental investigation.

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