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Urban Legends of Independent Contractor Relationships

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The urban legends surrounding independent contractors are more prevalent than those about alligators in the New York City sewer systems.

Among the more popular myths are the beliefs that you can establish a lawful independent contractor relationship by having a person sign an independent contractor agreement, or by issuing the individual a 1099, or just paying the person in cash. Employers who have followed such “advice” are likely to have misclassified employees as independent contractors and exposed their companies to serious liability. The unfortunate problem is that by the time these misinformed employers realize their mistake, they are either involved in a litigation or defending an audit from a government agency. I can recall several clients who received initial advice elsewhere, only to indicate that they wish they had planned more carefully.

Indeed, independent contractor relationships can be lawful, under the right circumstances, and the benefits of such an arrangement should incentivize employers to structure these relationships in the right way. So let’s start with the benefits.

Benefits of the Relationship

Entering agreements with an independent contractor to perform services for a business (without having to hire the contractor or any of its workers as employees) can help a company avoid many of the inherent liabilities in an employer-employee dynamic. For example, in an independent contractor relationship, employers are typically not required to withhold taxes on payments

to the contractor or provide unemployment insurance or workers' compensation coverage for the independent contractor or its employees. Also, an independent contractor relationship may shield a company from liability under various state and federal employment laws that only apply to employees.

Structuring the Relationship

While there are several different tests for determining whether a bona fide independent contractor arrangement has been formed, the degree of control that hiring company exerts over the contractor is usually the key factor. This means a reviewing court or agency will consider factors such as whether the contractor performs work for other companies, whether it has the freedom to establish its own schedule and hours of work, and the methods for how the work is completed, and whether the contractor is supervised by company personnel.

In order to receive the benefits of an independent contractor relationship, the employer is going to have to give up some of the control it would normally have in an employer-employee relationship. By putting the independent contractor relationship in writing, the contracting company will be able to ascertain whether it can operate under a bona fide arrangement and will be in a better position to argue that it is exempt from many employment liabilities. Keep in mind, I have read numerous cases where the company drafted the agreement properly, and then deviated from the structure in the agreement over time. Unfortunately, the company's failure to strictly adhere to the terms of the agreement resulted in severe economic penalties.

That said, while no contract can guarantee success in litigation, a properly drafted agreement can help better your chances. Contact your legal counsel to discuss whether the agreements are lawful, and useful, for your business.