

Are Your Independent Contractors Really Employees? For Some Purposes, They Are Treated As Such

By Karen Sutherland

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Legal Background

Many people believe that an agreement between an entity and a worker that clearly states that the worker is an independent contractor is sufficient to create an independent contractor relationship. However, the agreement between the parties is only one of many criteria for establishing independent contractor status. As a result, many workers are improperly classified as independent contractors when they are really employees. If misclassification comes to light during an IRS audit of either the employer or the worker, or if the worker fails to pay taxes, the employer can be subject to penalties. Also, if it turns out that the misclassified worker should have been treated as a nonexempt employee under the wage and hour laws, the employer could end up paying double damages and attorney's fees for unpaid overtime.

Additionally, many people are not aware that there are different tests for whether a worker is an independent contractor or an employee, depending on the type of law applied. For example, independent contractors have many of the same rights as employees under state and local anti-discrimination laws. The reverse is also true - discrimination or sexual harassment initiated by an independent contractor could result in liability to the entity for whom the independent contractor is working. Also, concept of agency may result in the principal being bound by the words or acts of the independent contractor, such as erroneous verbal or written commitments to buy or sell goods or services at a certain price, defamation, or tortious interference with a contract or business expectancy.

Practical Guidelines

From the IRS' perspective, there is no "bright line" test for determining whether a worker is an independent contractor or an employee. Instead, the IRS weighs three categories of evidence -- *behavioral control*, *financial control* and the *type of the relationship*.

According to IRS Tax Topic 762, "behavioral control" covers facts that show whether the business has a right to direct and control how the work is done, through:

- Instructions,
- Training, or
- Other means

"Financial control" covers facts that show whether the employer or business has a right to control the business aspect of the worker's job. This includes:

- The extent to which the worker has unreimbursed business expenses,
- The extent of the worker's investment in the business,
- The extent to which the worker makes services available to the relevant market,
- How the business pays the worker; and
- The extent to which the worker can realize a profit or incur a loss.

Facts that establish the type of relationship include:

- Written contracts describing the relationship the parties intended to create,
- The extent to which the worker is available to perform services for other, similar businesses,
- Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay, and
- The permanency of the relationship.

Sexual Harassment and Discrimination Liability

Even if a worker meets the independent contractor test set forth by the IRS, businesses and municipalities should keep in mind that under most circumstances, they will be liable for any sexual harassment or discrimination of their employees or customers by the independent contractor.

To address possible liability for the conduct of an independent contractor, you may wish to insure against this risk and/or require independent contractors to provide certification that they have been trained in sexual harassment and discrimination. Requiring the independent contractor to go through the on-site training that you provide for your employees, however, could negatively affect the "behavioral control" part of the independent contractor test. Thus, requiring that a person have this kind of training already as one of the qualifications for being an independent contractor may be more prudent. Additionally, an agreement requiring the independent contractor (and his or her employer, if any) to indemnify, defend and hold you harmless from any such claims will also provide some protection, provided that the independent contractor is solvent.

Principal-Agency Liability

As for being bound by the words and acts of an independent contractor under an agency theory, be sure that anyone who comes under contract with the independent contractor knows the scope of the independent contractor's authority to speak and act on your behalf. If it appears that you have given the independent contractor *carte blanche* to act and speak for you, you may have inadvertently increased the apparent scope of the independent contractor's authority beyond what you intended.

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