

## Five Independent Contractor Myths That Can Hurt You

By: Gail Cecchetti Whaley, J.D.;  
CalChamber Employment Law Counsel/Content

Misclassification of employees as independent contractors is a serious problem. When workers don't actually meet the legal test for independent contractor status, the employer is exposed to significant legal liability.

A misclassification mistake can result in civil penalties; liability for unpaid wages, including potential overtime pay; liability for meal and rest breaks; liability for employment taxes; and more.

Class action lawsuits in this area continue to rise, and independent contractor arrangements are coming under increasing scrutiny from federal and state enforcement agencies.

California enforcement agencies, such as the Department of Industrial Relations (DIR) and the Employment Development Department (EDD), and federal enforcement

### Federal and state enforcement agencies pay close attention to independent contractor relationships ...

agencies, such as the Department of Labor (DOL) and the Internal Revenue Service (IRS), have made it a top priority to crack down on the misclassification of workers as independent contractors.

Falling for one of the many independent contractor "myths" out there can put you on these agencies' radar or land you in a lawsuit. Keep these five common myths in mind before your business decides to use independent contractors.

#### Myth #1: He Wanted to Be Classified That Way

Many employers mistakenly think that if the worker asked to be treated as an independent contractor, they are safe. The intent of the worker is just one factor that enforcement agencies and the courts will consider and certainly is not dispositive.

You can't base your classification decision on accommodating the workers' preference or your own preference. You must make sure that your hire is properly classified using the legal tests. California's DIR starts with the presumption that a worker is an employee.

With that in mind, it's a difficult hurdle to meet the independent contractor test. Simply labeling someone an independent contractor, even if that is his/her, or your, wish, does not make the person an independent contractor.

Courts and agencies generally look to the degree of control the employer exercises over the worker; the more control the employer has over the details of how and where the work is done, the more likely the worker is an employee and not an independent contractor. True independent contractors need to be able to exercise meaningful discretion to accomplish their work.

Are you exercising control over how the worker accomplishes the job? Is the work an integral part of your business? Is the worker economically dependent on you or truly in business for himself? These are just some of the factors that will be examined. Look at the reality of the situation, not the label applied.

## Myth #2: We Have a Written Agreement With Her

A written agreement is not enough by itself to make a worker an independent contractor and is not absolute protection from liability for misclassification. If the actual working arrangement doesn't meet the legal tests for independent contractor status, what you call the worker in a written document won't matter.

Courts and agencies often disregard written independent contractor agreements. Instead, courts and agencies look at what is actually going on in the day-to-day working relationship, regardless of what the document says.

## A written agreement does not always mean that the worker is an independent contractor ...

Does this mean you shouldn't have a written agreement? Absolutely not. If you have a worker who meets the independent contractor tests, then you will want to put an agreement in place. Just remember that an agreement alone will not turn an improperly classified worker into a properly classified one.

An independent contractor agreement can be a helpful factor if properly drafted and preferably reviewed by legal counsel. On the other hand, an improperly drafted agreement may end up being used against you in a misclassification audit or lawsuit.

The agreement needs to be customized to reflect the actual terms of the particular working relationship and should not be a boilerplate agreement used for all contractors. Put procedures in place to revisit a contractor's agreement if the job duties or expectations change over time.

## Myth #3: He Meets the IRS Test, so We're OK

This is a common myth. A determination by one government agency that a worker is an independent contractor for one purpose does not mean that a different federal or state government agency will reach the same conclusion.

Although the right to control the worker is a common factor, different agencies use different tests and may place greater emphasis on certain factors. Some agencies use broad definitions of who is a covered employee, while others use a stricter definition.

From California's Division of Labor Standards Enforcement:

Since different laws may be involved in a particular situation such as a termination of employment, *it is possible that the same individual may be considered an employee for purposes of one law and an independent contractor under another law.* Because the potential liabilities and penalties are significant if an individual is treated as an independent contractor and later found to be an employee, each working relationship should be thoroughly researched and analyzed before it is established (emphasis added).

## Myth #4: She Did a Great Job, so Let's Use Her Again

"Long-term" independent contractors are a mistake. If you keep using the same independent contractors on a long-term basis and are occupying the majority of their working time, it is likely that they have become employees. To be a true independent contractor, the worker should have his or her own business with a number of different clients.

When you repeatedly use the same worker over long periods of time or occupy that worker's schedule on a full-time basis, that worker is probably doing work that is integral to your regular business operations and also probably has become economically dependent on you.

## Take care to not create a working relationship that monopolizes an independent contractor's time ...

In other words, he/she more closely resembles a regular full-time employee. As the saying goes, "If it walks like a duck ..."

Moreover, just because someone was a properly classified independent contractor for one job does not mean the worker will always be an independent contractor. Working relationships can change, and you have to look at the present nature of the working relationship.

It is also a mistake to rehire former employees as independent contractors — especially when they are performing the same job functions they were performing before. This is a red flag for enforcement agencies.

## Myth #5: It's OK to Have My Independent Contractor Use a Timesheet

Don't pay independent contractors the same way you pay your employees — for instance, don't pay on an hourly or weekly basis or with a guaranteed payment, such as a salary, and don't put them on your payroll. Enforcement agencies often view this as proof of employee status.

You should require your independent contractor to submit an invoice to you for work done, ideally on a per-project basis. The contractor also should have an employer identification number (EIN) and not just use a personal Social Security number. Independent contractors should receive the Form 1099 for amounts paid to them and be responsible for their own employment and income taxes. You should not be reimbursing independent contractors for any expenses they incur.

Submitting invoices, having an EIN and receiving a *Form 1099* instead of a *Form W-2* will not guarantee that the person is truly an independent contractor, but these items can help.

Keep in mind, however, that enforcement agencies will look beyond these formalities to examine the underlying substance of the worker relationship and whether it really is an employer-employee relationship. Again, what matters is the reality of the situation and factors such as:

- Whether the employer has the right to control how the worker does the work (an employee) or whether the worker controls how the work is done (an independent contractor).
- Whether the worker is economically dependent on the employer (an employee) or is truly in business for him or herself (an independent contractor).

## Avoid Classification Mistakes

Companies that use independent contractors should analyze carefully how the contractors actually perform their work and how that work fits in to your overall business model. Ask yourself whether an in-house employee is better suited to perform the job. Consult legal counsel with any questions about the nature of the working relationship, as mistakes are costly.

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