



Ask the Lawyer

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EMPLOYEES OR INDEPENDENT CONTRACTORS? A SLIPPERY SLOPE

Most business owners would jump at the chance if they can easily save money by not having to pay the wage-related taxes and employee benefits and still have a strong workforce. The choice to use independent contractors is often promoted as just that: all of the benefits of hiring an employee with few of the costs. However, the employment-status decision is never as simple as merely choosing an independent contractor label. Misclassification exposes the business owner to potential liability on many levels. The first step in understanding your workforce is distinguishing between these two classifications.

Independent contractors are generally characterized as being in control of the work they provide. This means that an independent contractor, and not the employer, determines the manner and means of the work performed, the hours worked, and often the materials and equipment used. An employee's services are dictated and managed by the employer. Put another way, independent contractors contract with a business to perform a specific project or an end result on an independent basis, while employees provide work on an ongoing and structured basis.

This general distinction is not ironclad. The Internal Revenue Service (IRS) and New York courts have developed similar common law tests to determine a worker's employment status. The IRS has published 20 specific questions which they rely upon when making determinations.

Determining Categories

The IRS has summarized these tests into three categories:

- **Behavioral Control** – considers whether the worker receives instruction or training as to how and when the work is to be done.
- **Financial Control** – considers whether the worker has significant financial investment and risk in the work performed. Employer reimbursement of expenses or efforts to minimize the worker's independent profits and losses will be taken into account.
- **Relationship of the Parties** – considers both the availability of employee benefits and existing contracts between the parties when examining the parties' relationship.

No one or combination of these factors are conclusive. The judgment often is based on the totality of the

circumstances, and sometimes one seemingly insignificant factor can be the deciding one.

While control over work and hours generally weighs heavily toward independent contractor status, it's not always the case. For example, a college athletic coach was considered an "employee" despite his autonomous control over how and when practices would be held. Even computer consultants who signed independent contractor agreements were categorized as "employees" if they tailored their work schedules to the company's workplace guidelines, filled out time sheets or received compensation directly from the company. A photographer who used his own equipment and was free to accept or reject assignments and clients was still an "employee" if his business carried no independent financial risk.

Misclassification Consequences

While there are substantial potential cost savings for a small business to hire independent contractors, there are severe consequences for misclassifying workers. Business owners are subject to liability under several New York laws that grant employees certain protections and rights while independent contractors are not. Should a worker be improperly treated as an independent contractor, the employer may be sued. Federal liability may also arise. In the event of a misclassification, an employer may not only be held liable financially in connection with unpaid employee benefits or wages, but may also be responsible civilly or criminally in connection with these statutes.

To further complicate the issue, different states have different ways of classifying



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independent contractors. A business that correctly classifies a worker as an independent contractor under New York law cannot necessarily rely on the accuracy of that classification for workers operating in the exact same manner in other states. The same holds true between federal agencies. A classification of "independent contractor" for IRS purposes is not automatically the same classification for the purposes of the FUTA (Federal Unemployment Tax Act), FICA and Medicare taxes.

There are additional legal concerns which often receive less attention, like vicarious liability. While an employer is vicariously liable under New York law for acts of its employees within the scope of employment, a business owner may not be vicariously liable for the acts of independent contractors. If the court determines that the worker is an employee, the employer may be liable for that employee's acts. Furthermore, the employer's insurance coverage may not protect the employer if it was purchased based on the misclassification.

Businesses with copyrightable property should know that while material produced by an employee is generally the property of the employer, that produced by an independent contractor doesn't automatically belong to the business and remains property of the independent contractor unless specific contracts are executed.

The decision to classify workers as independent contractors can be potentially disastrous to the small-business owner. Before entering into independent contractor agreements with workers or service providers, the employer should seek legal and tax advice to ensure an accurate classification. □



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