Avoid the Dangers of Misclassifying Employees as Independent Contractors

Labor & Employment Law Update

on March 13, 2018

A dangerous misunderstanding persists in the business community that an employer can choose to "1099" its workers, or classify them as independent contractors, so long as there is an agreement between the employer and employee and both are satisfied with the arrangement. This misguided belief can have dire consequences if blindly followed.

When a worker is classified as an independent contractor, the employer is not liable for federal tax withholding, payment of state unemployment tax, maintaining workers compensation insurance or compliance with state and federal wage and hour law. It is only logical that an employer would see this as an attractive option. The problem, however, is that the government may view this as opting to evade taxes and other statutory obligations. Neither the employer nor the worker has the authority to choose to avoid legal duties, and an agreement between the employee and employer is not determinative of status.

Instead, state and federal government will use one of several "tests" to determine whether the worker is an employee or independent contractor. For example, the "ABC" test is frequently used under Illinois law. Under this test, a company defending its classifications is required to show that an individual providing services: A) is free from control and direction; B) performs services outside the usual course of business for the enterprise for which such service was performed; and C) is engaged in an independently established trade, occupation, profession, or business.

Other states, utilize the "IRS" test. Under this test, twenty factors are weighed to determine whether a worker is an employee or independent contractor. To make it more confusing, the federal Department of Labor uses a six-factor "economic realities" test to determine liability under the federal wage and hour law, the Fair Labor Standards Act. Other tests also are used, like California's multi-factor "Borello" test, named for the lawsuit in which it was created. Generally speaking, the tests all turn on whether the employer has the right to control the worker. If the employer controls what work will be done, and how it will be done, then the worker is an employee notwithstanding any agreement, label or waiver to the contrary.

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An employer who has misclassified its employees is subject to payment of back taxes and insurance premiums, unpaid wages and overtime, late fees and hefty penalties, not to mention civil lawsuits filed by misclassified employees, including class actions. Government agencies often share information, resulting in a snowball effect that can have severe adverse effects on a business, and each has the power to audit an employer to ensure compliance. The burden is on the employer to defend its classification. Be advised, if an inquiry or audit is triggered by an "independent contractor" applying for unemployment, filing a workers compensation claim, or simply reporting non-compliance, strict anti-retaliation or whistleblower protections can result in significant liability if any adverse action is taken against the worker.

Employers should be aware that employment laws are passed for the protection of *employees*, and will be construed broadly in favor of finding employee status. However, courts are willing to uphold an independent contractor designation, where appropriate. Recently, a California federal court judge ruled that a Grubhub driver was correctly classified as an independent contractor because Grubhub exercised little control over the "manner and means" used by the worker to complete his job. The court also considered a variety of secondary factors under the Borello test, but the scales tipped in favor of independent contractor status.

It is imperative for employers to consult with an experienced labor and employment counsel to determine if its workers are truly independent contractors to avoid the implications of misclassification. This begins with understanding what test will be used, and evaluating each worker against the relevant factors. Counsel should also be utilized to craft independent contractor agreements that do more than simply label the relationship as independent contractor, but also incorporate the language necessary to demonstrate that the contractor truly meets the applicable standards.