

Independent Contractor v. Employee

It's Not a Matter of Convenience - It's a Question of Fact

Why It's Important

Depending on the situation, there are inherent benefits to properly classifying a worker, and distinct dangers in incorrectly classifying an employee. The cost of labor is always an issue for small businesses. But the imagined cost savings of considering someone an independent contractor is far outweighed by the risks if the worker is misclassified.

Granted, by classifying a worker as an independent contractor, the business does not have to deal with withholding taxes, periodic payroll reports, or other administrative disadvantages. But if a worker is incorrectly classified, the company can be severely penalized for that failure.

In the legal world, the question of whether a worker is an employee or an independent contractor is a factual issue, and not simply a matter of convenience.

Factors Considered

The Internal Revenue Service has provided guidance to employers on what factors to consider in determining whether a person is an independent contractor or an employee. The weight given each factor varies depending on the circumstances. While state law may rely on different factors in making a determination, the IRS rules are a good start for analyzing an employer's situation. Some of the factors are:

- Training provided by employer
- Integration of services into business operations
- Services rendered personally
- Continuing relationship
- Set hours of work
- Working on employer's premises
- Oral or written reports
- Compensation structure
- Furnishing tools/materials
- Working for more than one firm at a time

Penalty For Getting It Wrong

The adverse consequences of incorrectly classifying an employee as an independent contractor could be enormous, potentially even devastating to a small business.

In the case of the IRS, an employer could be required to pay all back employment taxes on the worker, plus penalties and interest. Just having the IRS closely reviewing a business's books to determine if a worker is properly classified is an unneeded nuisance that is better avoided.

For state issues like Workers Compensation, the costs could be even higher. If an injured "independent contractor" is deemed to be an employee for Workers Compensation purposes, that person would be covered under Ohio's Workers Compensation Insurance. However, since the employer failed to report this person as an employee and hence did not pay insurance premiums, the employer would be liable for all medical bills and disability payments the employee was due under Workers Compensation law. In addition, the employer would have to pay the delinquent unpaid insurance premiums, plus penalties and interest.

But What If I Have A Contract?

Can a business use a contract to avoid the risks that may be present in classifying a worker as an independent contractor? Simply having a contract which clearly states that the relationship between two parties is that of an independent contractor as opposed to employer/employee will not protect the employer from certain liabilities if a government agency determines that the relationship is not that of an independent contractor.

While this may not be consistent with the theory of contracts, it is seen as good public policy, an effort to protect the worker who may be in a weak bargaining position when it comes to finding employment. A contract may help to clarify the relationship, but can not be used to override public policy.

If you have concerns about whether a worker is properly classified, consult an attorney.

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