Keeping Your Independent Contractors Truly *Independent*

By Justin K. Markel

Many businesses rely on outside help to function. But what risks do they take on by hiring outside help? This article discusses the differences between employees and independent contractors, and why those differences matter. Specifically, it discusses the legal risks associated with misclassifying workers as independent contractors, and how to limit those risks in the future. The article also explores the main factors courts (and governmental agencies) look to in determining whether a worker is an employee or an independent contractor. Finally, this article provides some guidance for employers so that they can keep their independent contractors truly independent, and avoid the legal risks associated with misclassifying workers.

Why should employers care about how their workers are classified?

Even to a small "mom and pop" business, the difference between an employee and an independent contractor could mean thousands of dollars. Employers that misclassify employees as independent contractors open themselves up to legal liability in many different areas.

To start, employers that employ misclassified employees may run afoul of federal wage-and-hour laws. Those laws generally require employers to pay employees the federal minimum wage, and overtime compensation (i.e., one and half times the regular rate of pay) for hours worked over 40 in a regular work week. If a court or the Department of Labor considers the worker to be an employee rather than an independent contractor, the employer generally must pay any unpaid minimum and overtime wages for the previous two years.

If the employer is found to have *willfully* violated these laws, the consequences could be disastrous. In this case, the employer is liable for three years of unpaid minimum and overtime wages, as well as "liquidated damages" in the amount of the unpaid wages. The employer may also be required to pay civil money penalties of up to $1,100 per violation, and may be criminally prosecuted, resulting in fines of up to $10,000. And if the employee sues the employer, the employer may be on the hook for the employee's attorney's fees.

For example, let's say a small business employs an on-site maintenance worker for five years. The employer pays the worker $30 per hour, no matter how many hours she works in a week, but the worker typically works 43 hours per work week. The worker believes she should've been paid time-and-a-half for the three extra hours she worked every week, and so she sues the employer. After a trial, the court agrees that the worker is an employee, and not an independent contractor, and finds that the employer acted willfully. The court renders judgment in favor of the worker, and orders the employer to pay $7,020

in unpaid overtime wages, $7,020 in liquidated damages, and the worker's attorney's fees in the amount of $42,000. And on top of this, the employer had to pay its own attorney $40,000 to defend the lawsuit, because the wage-and-hour claim wasn't covered by its employment-practices liability insurance policy. This one misclassification has cost the business nearly $100,000.

But the story doesn't end there. In addition unpaid wages, employers that misclassify their employees are required to pay various employment taxes, including FICA (i.e., the employers' half of income taxes), unemployment taxes, and amounts for social security and Medicare. The nonpayment of these taxes could result in federal tax liens on employer's property. Removing those liens and squaring up back taxes could cost thousands in legal fees alone.

In addition to liability related to wages and taxes, employers open themselves up to personal-injury liability by mistakenly employing employees. Under Texas law, employers often owe a duty to protect the public from their employees' negligence, but not for their independent contractors' negligence. So if an employer's security guard is considered an employee and he negligently hits someone with his car, the employer may be liable for the resulting property and medical damages.

Finally, businesses that misclassify employees subject themselves to Texas unemployment laws, workers' compensation laws, and whistleblower laws. Companies that employ 15 or more employees subject themselves to Texas and federal anti-discrimination and anti-retaliation laws. The administrative costs of complying with these laws can rack up fast. And enforcement lawsuits brought by disgruntled former employees can cost a business thousands more in legal fees.

In short, a company that mistakenly thinks it only employs independent contractors may be subject to legal liability from the misclassified employees, the government, and the public, potentially costing thousands of dollars in legal fees.

Which workers are considered independent contractors, as opposed to employees?

As you might imagine from the multitude of laws mentioned above, there is no all-purpose standard for determining who is an employee and who is an independent contractor. Nevertheless, courts and administrative agencies often look to the same factors to make this determination, including:

(1) whether the employer has the right to control the details of the work;

(2) whether the employer supplies the worker with tools, supplies, and materials;

(3) whether the worker's line of work is different from the employer's business;

(4) how long the worker is employed for; and

(5) whether the worker is paid for time worked (e.g., hourly, weekly, etc.) or by the job.

The first factor—control over the details of the work—is the most important. Under this factor, courts and administrative agencies are more likely to consider a worker an employee if the employer has the right to control the progress, details, and methods of operation of the work. If, on the other hand, the employer only has the right to control the final product, and not how the worker gets there, it's more likely that the worker will considered an independent contractor.

The remaining factors also help to determine whether a worker is considered an employee or an independent contractor. A worker is more likely to be considered an independent contractor if he furnishes his own tools, performs work that is distinct from the employer's operations, and is paid by the job. In contrast, an on-site worker who is employed for an indefinite period of time at an hourly wage is more likely to be considered an employee.

How do employers keep their independent contractors independent?

A good first step is to enter into a written contract with the worker to define the contours of the relationship. The employer and the worker might even call their contract an "Independent Contractor Agreement," specifically acknowledging their intent to have an independent contractor–employer relationship. The agreement may also specifically provide for the factors described above, setting forth the amount of control (if any) the company has over the details of the workers' job, the method of payment, and whether the worker must furnish his own tools. As with any agreement, the contract should accurately state the parties' intentions. Courts have no qualms looking "behind" the title "Independent Contractor Agreement" if the true nature of the relationship is that of an employer and employee.

Even with a written agreement, employers should be careful not to exercise control over the details of their independent contractors' work. Employers may be able to set deadlines and the requirements for the finished product, but they should avoid asserting control over the process the worker takes to get there.

Employers should also require their independent contractors to furnish their own tools and materials for projects. And to keep the other factors on their side, employers should also be aware that the longer they employ their independent contractors, the more likely they will be considered employees. Employers should also pay their independent contractors by the job, rather than on an hourly or weekly basis.

Conclusion

Thousands of dollars in legal fees rest on whether workers are properly classified as independent contractors, as opposed to employees. In light of the factors discussed above, employers would be wise to consult their attorneys to ensure that they are keeping their independent contractors independent, so that they avoid the legal risks of misclassification.