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10 Reasons to Worry About Worker Status Disputes

ROBERT W. WOOD

San Francisco, California

Who is an independent contractor and who is an employee? We know it matters, and we know disputes occur. But do we know how and why? There are many liabilities lurking in controversies over independent contractor versus employee characterization.

Some of us may naively assume that slapping an "independent contractor" label on a worker's name badge resolves the question. But recharacterization is always possible, and by different agencies and for different purposes. Even if you have a good handle on the issues that may mitigate in favor of one classification or another for a particular worker, there's more to learn.

Here are 10 things about worker status disputes you should know.

The IRS Is Number One: Most classically, the independent contractor versus employee distinction is raised by the Internal Revenue Service, and that's true for both income tax withholding and employment taxes. The latter do not fall exclusively on the worker and are shared by the employer. Independent contractors are paid the gross amount of their pay with no tax withholding.

If the putative independent contractor turns out to be an employee, then all of that pay was "wages," and that means you should have withheld! If an employer fails to withhold income tax on wages, the penalties are severe. Often it is several years later when the worker's status is recharacterized, so the numbers can be significant.

State Income and Employment Tax: The same concerns that can arise for federal income and employment taxes can also arise under California law. It's generally accepted by tax lawyers and accountants that it is harder to win a California employment and income tax case than it is to win a similar case against the IRS. Plus, there is usually less room to

settle a California tax case. The IRS is more flexible than the California authorities.

In any event, you can usually expect to deal with both. These days, given exchange of information agreements between the IRS and California, one battleground usually turns into another.

ERISA and the Department of Labor: The Employee

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10 Reasons to Worry

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Retirement and Income Security Act of 1974 (ERISA) has been amended many times and is among the more complex of federal laws. It governs pensions and employment benefits. Jointly administered by the IRS and the U.S. Department of Labor, it mandates and regulates a vast system of enforcement and compliance. It excludes independent contractors from its coverage and nondiscrimination rules so the IRS, Department of Justice or both may scrutinize who you cover.

Workers' Compensation Liability: The workers' compensation system is designed to provide no-fault coverage to employees injured on the job. The key word is "employees," as workers' compensation covers employees, not independent contractors. That leads to inevitable coverage disputes.

An injured "independent contractor" who makes a workers' compensation claim may (or may not) realize only employees are covered. But even claims that start out innocently can end up being time consuming and expensive. A claim involving only a few dollars can become the first domino in an expensive and protracted controversy with several different agencies.

Unemployment Insurance: Unemployment insurance provides a base of support when workers lose their jobs. Axiomatically, unemployment insurance applies only to employees, not to independent contractors. Many putative independent contractors make claims for unemployment benefits.

As occurs with workers' compensation claims, they may (or may not) appreciate the distinction between the two classifications of workers. In either case, disputes often arise. A seemingly small claim may turn out to be the proverbial straw that broke the camel's back.

State Labor and Employment Law: The Employment Development Department or California Department of Industrial Relations may come calling. Such agencies routinely receive complaints from workers that they are required to investigate. In the absence of worker complaints, the agencies may target certain industries, looking for misclassification in a particular industry or geographic area.

Union Organizers: Union organizers may want to expand, since union members are the lifeblood of unions. The vast system of laws governing organized labor, covering strikes, walkouts, lockouts and more applies to employees, not to independent contractors. Thus, the independent contractor versus employee dichotomy is very much alive in the union context too.

Liability in Civil Suits: If an independent contractor causes an auto accident, he can be sued. But if the driver is an employee on the job, the employee is an agent of his employer. Under the doctrine of *respondent superior*, that makes the employer liable too.

What happens if there is a written "independent contractor" agreement for the driver? Even if on paper and in fact it appears that the driver was an independent contractor, the injured party

may sue the putative employer. The injured party may expect the employer to settle rather than to risk a large fight over the worker's status that may turn out badly.

"Other Litigation": There are many other contexts in which the legal status of one or more workers can arise. The issue comes up in intellectual property disputes, in suits concerning the liability of officers and directors, in contract disputes between companies involving the acts of authorized persons, etc. The contexts can be wide-ranging and the legal positioning can be creative. The independent contractor versus employee question may be a small point in the overall case. Alternatively, the contractor versus employee issue may be the linchpin that imparts or that avoids significant liability.

Suits by Your Own "Contractors": Workers themselves may bring suits for benefits, expense reimbursement, nondiscriminatory treatment, wage and hour protections and more. One or several workers may be behind one suit. Others are class actions. A suit may be primarily about benefits, about expense reimbursement, about working conditions, or something very targeted, such as valuable stock options.

Usually it is only "employees" who would be entitled to sue for these types of benefits. However, workers may sue notwithstanding their explicit status within the company as "independent contractors." In effect, they are saying that whatever their contracts and agreements may call them, they are being *treated* as employees. As a result, they may feel that they are entitled to the financial and legal advantages employee status accords.

Companies with clear written independent contractor agreements may find it outrageous for their workers to seek to contradict (and in effect to abrogate) a contract the workers have signed. However, the law is clear that the parties cannot make someone an "independent contractor" who is truly an employee under the law.

Most of us focus on the specifics that are likely to make a worker either an independent contractor or an employee. It is worthwhile stepping back to see the vast landscape of worker status controversies. If your practice is very focused (for example, perhaps you only handle workers' compensation cases), you should be aware that independent contractor controversies can end up spreading fast, not unlike a forest fire jumping a fire break.

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Robert W. Wood is a tax lawyer at Wood & Porter in San Francisco (www.woodporter.com) with a nationwide practice. The author of over 30 tax books, including *Taxation of Damage Awards & Settlement Payments, 4th ed.* (www.taxinstitute.com, 2009), he can be reached at wood@woodporter.com.