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Even Lawyers Face Independent Contractor - Employee Disputes

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There is considerable talk about tech workers and worker status. There are also big lawsuits over who is truly an independent contractor and who is *actually* an employee, whatever you may call them. The stakes are big for governments, for workers, and for companies whose practices are scrutinized. Independent contractor v. employee distinctions can apply just about anywhere. With workers in almost any setting, there are tax, employment law, pension, and fringe benefit reasons that the government, third parties, and workers often argue about worker status. Even lawyers can be independent contractors or employees.

If you hire a lawyer for a few hours of consulting, a flat fee assignment, or contingent fee case, you may not think twice. In those situations, your lawyer is presumably an independent contractor, just like a doctor who treats you. But in other cases, it may not be so clear. A traditional grey area in law firms involves of counsel lawyers, where lines can blur.

Independent contractor treatment offers the benefits of:

- No income tax withholding;
- No employment taxes;
- No agency liability for the acts of your employees (whether driving a car on company business or legal malpractice liability);

- No federal and state discrimination laws covering only employees; and
- No fringe benefit, pension, retirement, or other plans.

Considering the disadvantages, you may wonder why anyone is hired as an employee. Yet much is not a matter of choice. Our system generally presumes workers are employees unless you can prove otherwise. There can be some special considerations for lawyers. The IRS, a state labor commissioner, insurance company, employment development department or unemployment insurance authority, will generally assume workers are employees unless you can prove otherwise.

Formulations vary for determining who is an employee, but most tests center on the degree of control over the worker. The IRS has enhanced its enforcement and is actively cooperating with other federal agencies and the states. Lawyers can be prime targets, and in some cases, they get caught. Take *Donald G. Cave A Professional Law Corp. v. Commissioner*, where the U.S. Tax Court held an incorporated law firm's sole shareholder, his associate attorneys and law clerk were all employees. If you read the case you may wonder how the lawyer ever thought he could treat himself and his associates as independent contractors. The lawyers were really employees of the law firm, and the main question was whether the firm could rely on Section 530 relief. It is a kind of get-out-of-jail-free card for employment tax liabilities available if you:

1. Consistently treat the worker and similar workers as independent contractors;
2. File all Forms 1099 for these workers treating them as independent contractors; and
3. Have a reasonable basis for not treating them as employees. The reasonable basis is usually judicial precedent or IRS rulings, a past IRS audit, or a long-standing practice of a significant segment of the relevant industry.

Donald Cave's law firm collected all fees but split a portion (generally one-half or one-third) with the attorney who handled the case. The firm treated everyone as independent contractors, claiming it didn't control how they did their jobs. When the IRS said this was wrong, Cave said he relied on Section 530 relief. Cave himself was an employee, all his associates were, as was his law clerk. Plus, Cave and his law firm failed to issue the requisite Forms 1099 and didn't have a reasonable basis for the contractor treatment. Although worker status determinations can be difficult for of counsel lawyers, one thing is clear: drafting a good independent contractor agreements is essential.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.