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How To Distinguish An Independent Contractor From An Employee

Companies often retain independent contractors in the hopes of avoiding the expense and expectations associated with an employment relationship. This perceived cost-saving measure can backfire, and create significant financial risk. If an independent contractor is determined to be an employee, the following consequences could result:

1. State and federal employment taxes must be paid and income taxes withheld from the worker's pay; the government holds the company fully liable for both the usual employment taxes and the employee's personal income tax;
2. Federal and state overtime and minimum wage laws may apply, along with penalties for unpaid wages;
3. The worker may be construed an employee for workers' compensation purposes. Further, the worker may bring a claim for injuries that otherwise would be covered by workers compensation;
4. The worker may be governed by federal and state antidiscrimination laws, or other laws that govern the employment relationship;
5. The Company may be responsible for the worker's acts of misconduct.

Each government agency that analyzes the worker relationship in this context applies a different test, and we will not summarize each of them here. Enforcing agencies may include the Employment Development Department, the Workers Compensation Appeals Board, the California Labor Commissioner and Federal Department of Labor, the Equal Employment Opportunity Commission, the Department of Fair Employment and Housing, National Labor Relations Board, and the Internal Revenue Service.

Several bottom line factors are considered by each agency, and should be analyzed carefully and honestly by the company before it retains a worker as an independent contractor. Underlying each agency's determination of whether a worker is an employee or an independent contractor is the primary consideration: for a bona fide independent contractor relationship to exist, the company must give up its right to exercise control over the manner and means by which work is performed. In analyzing this question, the following factors typically are examined:

1. Is the worker engaged in a distinct occupation or business? For example, if an accounting firm hires a maintenance worker, this maintenance work is outside the accounting firm's core business. If it hired an individual to perform year-end financial audits, that worker would be engaged in the company's core business.

2. Is the kind of work is usually done by a specialist without supervision? Stated differently, does the worker have a unique skill set outside the company's core skill set, which the worker applies without supervision by the company? An example would be a manufacturing company that retained outside counsel to defend it in litigation. When a worker is required to follow instructions or procedure manuals, he is construed as an employee. Unskilled workers are generally employees.
3. Does the worker supply his own instrumentalities, tools and place of work? The agencies look to see if the independent contractor is acting like a business owner. Does the worker have skin in the game? Does the worker bear the risk of profit and loss for his own business?
4. For what length of time does the worker provides services for the company? If the work is not on a "project" basis, the relationship may resemble employment more than a contractor relationship. A continuing relationship often suggests an employment relationship.
5. Is the worker is paid by time or by the job? Payment on a job, fee or commission basis is customary for an independent contractor.
6. What do the parties understand to be the nature of the relationship? Although not dispositive, the presence of a consulting agreement may reflect the parties' expectations of their roles.
7. Is the worker free to work for others? If not, this suggests the company intends to control the worker, and suggests an employment relationship.
8. Does the worker set his own schedule, hours of work, etc.? Again, the agencies look to see how much control the company is exercising over execution of the tasks for which the contractor was hired.
9. Does the company have as employees individuals who are performing the same work as the worker? If so, it will be difficult to argue that his is a unique and distinct business and not the "core" business of the company.
10. Does the company record payments to the worker on its accounts payable ledger?
11. Does the worker have control over the hiring and firing of other workers, and subordinate workers?
12. Is the worker obligated to complete the contract or is he free to quit at any time? If he is free to quit without consequence, his relationship appears to be one of employment.

Other factors of relevance may include:

- Does the worker have his own business cards, stationary and invoices?
- Does he have a separate place of business?
- Who pays the worker's expenses, including travel and cell phone?
- Does the worker provide his own laptop, or does the company?
- Does the worker provide his own insurance?
- Does the worker make capital investment in his business?
- Does the worker obtain a business license, establish a fictitious name or form a corporation?
- Does the worker advertise his business or services?
- Does the company provide training, supervision, or uniforms to the worker?
- Is the worker required to attend meetings, submit reports or receive instructions?

No one of these factors is determinative. Each is important, and each agency weights the factors differently. If the answer supports a finding of independent contractor, each of these factors can help to demonstrate that the independent contractor retains control of the details of his work. The company can still exercise control as to the result, but must refrain from supervising the details.

Please let us know if we may be of assistance in determining whether a worker can be retained as an independent contractor, or in understanding the risks associated with doing so.