The Law Offices of Douglas F. Walters, APC

The Employment Law Newsletter

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Cases To Watch

- Kizer v. Tristar Risk Management
- Goonewardene v. ADP, LLC
- Voris v. Lampert

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Are you an Employee or an Independent Contractor? Knowing the Difference Matters!

By Ryan J. Carlson

If you have a job of any kind in any field, the significance of knowing the difference between the rights of an employee and the rights of an independent contractor, and which rights apply to you, cannot be understated. These two distinct "relationships" or "classifications" are governed by two very different standards, and may be the most misunderstood, misapplied, and misconstrued concepts in the realm of labor and employment law. This volume of the Employment Law Newsletter aims to correct those misconceptions and help workers to understand their rights and obligations based on their respective classification. (The words "relationship" and "classification" will appear frequently, and they are meant to be used interchangeably. You will also see the word "principal" pop up a lot. For purposes of this newsletter, the principal is the person in charge of the worker, regardless of the worker's classification.)

Perhaps the most important thing to know about this area of the law is that **YOUR RELATIONSHIP IS NOT DETERMINED SIMPLY BY THE WAY IN WHICH YOU ARE CLASSIFIED IN YOUR CONTRACT OR BY THE PRINCIPAL.** As several courts have said, the parties' label on their relationship is not dispositive and will be ignored if their actual conduct establishes a different relationship. In other words, you are not an employee simply because your boss says you are his/her employee. Similarly, you are not an independent contractor simply because the contract between you and the principal says you are. If you take nothing else away from this newsletter, take away the understanding that *you can be viewed as an independent contractor by those you work for and with, but really be an employee in the eyes of the law, and vice versa!*

While your label is one small factor to be considered, determining the true legal relationship between you and your principal requires much more analysis. After running through the factors considered in making such a

Employment Law

Insurance Law

Personal Injury

determination, we will give you some examples of how tricky this analysis can be, then explain why it is important to know where you truly stand, both for you and the person for whom you work.

THE "TIEBERG" FACTORS

In determining whether you are an employee or an independent contractor, the most important element to be considered is the right to control the manner and means of accomplishing the desired result. However, it is control over the *manner and means* that is important, not control over the result. If the principal has the authority to exercise complete control over every aspect of the project or task, an employer-employee relationship likely exists. If the principal leaves the completion of certain duties, jobs or tasks up to the worker, the worker is most likely an independent contractor. As you might expect, it is not always easy to determine who actually controls the manner and means of accomplishing the desired result. Accordingly, there are several factors we must weigh in order to decide.

It is important to note that there is no set formula or approach for how, when or to what extent these factors should be applied or decided. *The statements below are very generalized and should not be read as absolute in every context.* Each individual case involves different circumstances, and each factor can be argued differently based on the way the facts are presented.

Factor #1 – Is the worker engaged in a distinct business or occupation? If the answer to this question is yes, that is more indicative of an independent contractor relationship. If the answer is no, however, that lends more to an employer-employee relationship. Answering this question requires us to take a look at the nature of the business operated by the principal, compared to the nature of work being performed by the worker. It may also be helpful to determine whether the principal is working or contracting directly with the worker, or a business *owned* by the worker.

Factor #2 – Is the worker performing work that is typically done under the direction of the principal, or by a specialist without supervision? If, based on local practices, the work is typically done at the direction of the principal, this factor would weigh in favor of an employer-employee relationship. If the work is typically done by a specialist without supervision, the worker is likely acting as an independent contractor.

One question that is often asked in evaluating this factor is whether the worker is required to hold a special professional license in order to perform the work. This is so because holding a license in many contexts suggests a lack of supervision in the workplace. However, not every professional license holder is an independent contractor, and not every non-licensed professional is an employee. For example, an attorney – who is required to be licensed by the State Bar – could easily be an employee of the law firm for which she works. Similarly, an electrician – who is required to be licensed by the Contractors State License Board – could be an independent contractor for his local electric company.

Another question that is sometimes asked when resolving this factor, is whether the worker can determine his or her own hours, work days, breaks and/or time off. The more freedom the worker has to determine her work schedule, the more likely it is that the she is an independent contractor.

Factor #3 – Is there a particularized skill set required of the worker? Where no special skill is required to complete the work, the worker is most likely an employee rather than an independent contractor. On the other hand, if the worker is brought in specifically because of his or her specialized knowledge, training or experience, this factor may weigh in favor of the worker being an independent contractor.

Factor #4 – Who supplies the tools of the trade? First of all, what are the "tools of the trade?" These are the items, or instrumentalities, necessary for the worker to complete the job. For the trucker, it may be the truck she drives. For the receptionist, it may be the phone and/or computer she uses. For a salesperson, it may be the merchandise or the point of sale system. For a landscaper, it might be a lawnmower or hedge clippers. Tools of the trade in many contexts can also include the office or facilities where the work is to be performed.

If the principal supplies the instrumentalities necessary for a worker to complete the work, then this factor would weigh in favor of a finding that an employer-employee relationship exists. If the worker is on his own to furnish the tools of her trade, however, that lends more towards the worker being classified as an independent contractor.

Factor #5 – Is the worker providing services over a short or lengthy period of time? The lengthier the period of time for which the worker is hired to work, the likelier it is that the worker is an employee. Moreover, if there is no contemplated end to the working relationship, that weighs in favor of an employer-employee relationship. Conversely, where the worker is hired only for the duration of a single project, this factor would weigh in favor of an independent contractor relationship.

Factor #6 – Is the worker being paid by the time or by the job? If the worker is paid by the time rather than by the job, this factor would lend more towards an employer-employee relationship. Receiving a salary and/or a benefits package also might support this conclusion. If the worker is being paid by the job, that is more indicative of an independent contractor relationship.

Factor #7 – Is the worker performing work that is an integral part of the principal's regular business? If the answer to this question is yes, this factor would weigh in favor of an employer-employee relationship. When the work performed by the worker is not vital to the operation or success of the principal's business, the worker may likely be an independent contractor. Much like factor #1, resolving this question requires us to look at the nature of the principal's business. It may very well be that two workers performing the same exact type of work for two separate principals could be classified differently based on the nature of the principal's business.

Factor #8 – What sort of relationship do the parties think they are creating? While labels placed on the worker are ignored if the parties' interactions establish a different working relationship, the intent of the parties is actually given a little consideration. While this intent can sometimes be established by looking at the contract between the parties, sometimes there is no contract, or, if there is, it is silent as to the nature of the parties' relationship. In such cases, the trier of fact might look to the parties' interactions with each other, or even the worker's individual conduct, to decipher their intent.

For example, the fact that the worker deducts costs for business expenses on her personal tax returns, or identifies herself as self-employed in those returns, might indicate the parties' understanding that they entered into an independent contractor relationship. On the flip side, the trier of fact may view as important the fact that the principal deducted tax withholdings from the worker's paycheck, or that the principal purchased business cards for the worker, or that the worker was given an identification badge with the word "employee" on it. These individual facts might all be indicative of the parties' intent to create an employer-employee relationship.

So those are the factors. We cannot stress enough how fluid this analysis is, and how it must be applied on a case-by-case basis. Even the smallest differences in the worker's relationship with his or her principal can have a tremendous impact on how the worker is classified, and that classification has a tremendous impact on the rights, responsibilities and obligations of each party. Before discussing the legal effects of one's classification, here are two quick examples to help illustrate how the analysis works, and how the results may surprise you. *Please note that these examples are not meant to serve as blanket statements regarding the proper classification of each worker covered. They are instead being provided to demonstrate how determining one's proper classification is never as easy as black or white.*

Example #1: Marie is a licensed attorney who performs legal work for a large law firm (factors 1 and 2). She has been brought on by this firm because a case it just took involves a specialized area of law with which she has a lot of experience, but she will also be offering guidance to other attorneys working on other cases (factor 3). The firm could not have taken the case without Marie's help, but the success of the business is not dependent upon the outcome of that case (factors 3 and 7). She is required to be reachable during normal business hours, (factor 2) but she has the choice of working at her office provided by the firm, or remotely from her home-office on a laptop provided by the firm (factor 4). The firm assigns all her work and sets deadlines by which the work must be completed, but the firm does not tell her how to do her work. Marie understands that her engagement with the firm will end upon the completion of the specialized case, but that will likely take years (factor 5). She is paid on an hourly basis for all work she performs (factor 6). There is no contract between the parties and the firm does not withhold taxes from Marie's gross wages, but Marie feels as though she is the firm's employee (factor 8). If you guessed that Marie is an employee, you are probably wrong - but it is close.

Example #2: Steve is an IT technician who owns his own business called "FixIT PC." Through his business, he performs IT services for a local gas utility whose success

depends entirely upon the availability and operation of their computer network and server (factor 7). Steve is highly skilled with computers in ways that others at the company are not (factor 3) and he uses his specialized skills to perform his work under the supervision of the IT manager, during hours set by the gas company (factor 2). He performs all of his work on site at the utility company's offices, as assigned by the company's IT Director, using tools provided by the principal (factor 4). The contract between him and the principal is for a fixed term of one year (factor 5), provides that Steve will be paid on salary (factor 6), and clearly states that Steve is being hired and paid as an independent contractor – i.e. with no deductions for taxes withheld from his paychecks (factor 8). However, that contract is the third such contract entered into between them in as many years (factor 5). Like Marie, Steve also feels as though he is an employee (factor 8). If you guessed that Steve is an independent contractor, you are probably wrong again.

In Marie's case, though a lot of factors weighed in favor of her being an employee (not engaged in a distinct business/occupation; long period of engagement; paid on hourly basis; supplied with tools of trade), the overarching control element is not present because she controls the manner and means by which the work is done. She is also specialized in her field and not working under anyone's supervision. In contrast, while a lot of factors weigh in favor of Steve being an independent contractor (engaged in his own business; uses a specialized skill; was hired for a fixed term, albeit three+ consecutive fixed terms; no taxes withheld; and is classified as an independent contractor within his contracts), a substantial number of factors indicative of overarching control are present (tools of the trade were provided; worked under supervision; services rendered are an integral part of principal's business; work assignments and hours set by principal; paid on salary; multiple renewed one-year contracts).

Full disclosure: these two examples were purposely crafted to be tricky in order to demonstrate the complex nature of the analysis involved. They also demonstrate how similar facts can result in different findings. And again, though both hypotheticals are based roughly on real life cases, *they are meant to serve only as examples to help educate the reader and should not be read as statements that apply categorically to every attorney or IT technician across the board.* The outcomes of each case and the findings of each court – or trier of fact – depend entirely upon the individual circumstances and how the facts are framed by the attorney handling the case.

THE LEGAL EFFECTS OF BEING MISCLASSIFIED

To provide a comparative breakdown of the rights, responsibilities and obligations of an employee compared to those of an independent contractor would bore the reader to death, and would probably require an unnecessary amount of trees. Rather than providing a full dissertation on all of those differences, here are just a few of the more important ones to show you how much your classification matters.

Difference #1 – Tax Obligations: Perhaps the most important and financially significant difference between being hired as an employee versus being hired as an independent contractor, is the tax obligations that accompany each working relationship. Just to give you an idea, the total cost to California in lost tax revenue, as a result of

principals misclassifying their workers, has been estimated at $7 billion. And that number was as of 2015!

The obligation to pay taxes, however, affects both principals and workers alike. Anyone who has been hired as an employee knows that their employer is legally obligated to deduct and withhold federal and state income taxes, and other deductions like Medicare or social security, from their employees' paychecks. Depending on his or her earnings, an employee can typically expect to pay between 15-40% of their annual gross income to the state and federal governments, and the employer generally matches that amount. This is not the case for a principal who hires an independent contractor.

Instead, the independent contractor is responsible for satisfying his or her tax obligations from the income he or she earns from the principal, and the principal incurs no additional tax consequences. To the contrary, the principal can, in many cases, deduct as a business expense the amount it pays to the independent contractor for the work performed. Obviously this lets the principal off the hook for a substantial amount of money, but it also burdens the independent contractor with the dreaded "self-employment" tax.

While the self-employment tax rate varies by state, independent contractors who are obligated to pay it are typically hit with about 7-7.5% in additional taxes, compared to what they would have paid if the principal properly classified them as an employee. So, instead of paying taxes of roughly 15-40% of your gross income, you can expect to pay about 22-47% instead, based on your classification as an independent contractor. This difference could cost an independent contractor literally thousands and thousands of dollars that the principal should have paid.

Difference #2 – Workers' Compensation Protection: Another key and costly distinction between the rights of an employee and an independent contractor is the principal's obligation to pay for injuries sustained by the worker in the course and scope of his or her employment (i.e. injuries suffered while performing the work they were hired to perform).

As you may have guessed by the terminology we used above, only employees are entitled to workers' compensation benefits if they are injured at work. These benefits often involve the employer paying the employee's medical expenses and lost wages which result from the employee's injury and inability to work. The workers' compensation system is built around the premise that an employee should not bear the financial burden associated with injuries he or she sustained while laboring for his or her employer. Such is not the case for independent contractors, partly because independent contractors labor for themselves in the eyes of the law. Generally speaking, a principal who hires an independent contractor has no duty to compensate the independent contractor should he or she be injured in the course of performing work for the principal.

In many states, including California, employers are required to maintain a policy of workers' compensation insurance, and their failure to do so exposes them to substantial criminal and civil liability. Not surprisingly, maintaining this policy of insurance

constitutes a tremendous business expense which only gets bigger as the business grows. Also not surprisingly, many business try to avoid this expense, or the risk of being on the hook for workers' compensation benefits, by purposely misclassifying their employees as independent contractors. This results in a huge savings for the business but leaves employees to fend for themselves with respect to medical bills and alternate sources of income if they get hurt.

Difference #3 – Overtime Compensation: While, generally speaking, every person performing services for another is entitled to be compensated at a rate not less than the minimum wage, not every person providing services is entitled to overtime compensation. To state it simply, employees are and independent contractors are not. This means that independent contractors get paid at the agreed-upon rate regardless of the time it takes them to complete the work. It is much different for employees.

Subject to a few exceptions (which will be covered by a future installment of the Employment Law Newsletter), an employee is required to be paid at a rate 1.5x his or her regular hourly rate for all time worked in excess of eight (8) hours in one day, or forty (40) hours in one work week. In addition, if an employee works seven days in one work week, he or she is entitled to 1.5x the hourly rate the first eight (8) hours worked on that seventh day. Furthermore, for all time worked in excess of twelve (12) hours in one day, and/or for all time worked in excess of eight (8) hours on the seventh consecutive work day, an employee is required to be paid at a rate 2x his or her regular hourly rate.

The principal is able to avoid paying these increased wages by misclassifying its workers as independent contractors. When you consider all of the other ways the principal can save money by such misclassification, as discussed above, you can see how that number can really add up to a substantial amount.

Difference #4 – Family Leave and Other Leave Laws: When an employee is forced to miss work because he or she is receiving treatment for a serious health condition, expecting a baby, or needs to care for a sick or injured loved one (usually a child or spouse), there are certain laws that enable the employee to take a leave of absence without the threat of losing his or her job. When the employee returns from this leave of absence, these laws require the employer to reinstate the employee into the same, or a substantially similar, position as the one he or she had prior to the leave of absence. If you are a working mother reading this, it probably comes as no surprise to you that the most common example of this practice is pregnancy leave.

These leave laws, such as the Family & Medical Leave Act (FMLA) or California Family Rights Act (CFRA), only extend to employees. Thus, when independent contractors are pregnant, sick, need to care for a loved one, or would otherwise qualify for leave, there is nothing protecting their job when they are ready and able to return to work. Moreover, if an independent contractor is forced to miss work without any leave protection, that could result in a breach of the contract between the independent contractor and the principal, which may expose the independent contractor to additional civil liability.

Difference #5 – Other Affected Rights Under California Law: California has an entire section of law devoted to labor and employment. This source of law was creatively named the California Labor Code. While it does apply to independent contractors in some areas, it also has several sections devoted to rights applicable only to employees. Here are just a few examples of some rights created for employees, but not independent contractors, within the Labor Code:

- The right to sue your employer for retaliatory termination (§1102.5)
- The right to receive an accurate paystub reflecting your paid wages (§226)
- The right to take a 30-minute meal break for every 5 hours worked (§226.7)
- The right to take a 10-minute rest break for every 4 hours worked (§226.7);
- The right to immediate payment of all earned wages upon termination (§203);

Another key right for employees that is not created by the Labor Code, is the employees' right to sue their employer for wrongful termination. A claim for wrongful termination requires that the person be terminated from *employment.* This necessarily presupposes that there exists between the parties an employer-employee relationship. An independent contractor cannot sue a principal for wrongful termination. While an independent contractor may be able to instead sue for breach of contract, its rights and damages are limited to what the contract provides. The amount of damages available to an employee suing for wrongful termination could be significantly more than those available to an independent contractor suing based on a theory of breach of contract.

There is, however, one very important section of the Labor Code that does pertain to independent contractors: Labor Code §226.8. This is the code section that makes it unlawful for any person or employer to willfully misclassify a worker as an independent contractor. A violation of this section exposes the individual or employer to pretty hefty civil penalties for doing so. While the misclassified employee cannot personally sue their employer for a violation of Labor Code §226.8, there are several avenues of legal recourse created by the Labor Code which enable a misclassified employee to seek reimbursement for wages or benefits they would have been owed and/or entitled to but for the employer's misclassification. A classic example of this is a misclassified independent contractor suing the principal for the overtime wages that he or she would have earned had the principal properly classified him or her as an employee.

As you now know, the classification of your working status is not a matter to be taken lightly. Ensuring that you are labeled correctly in the eyes of the law is incredibly important regardless of your job, income or area of expertise. If you feel you have been intentionally and improperly misclassified, do not wait until tax season rolls around before you do something about it; do not wait until you are stuck with ridiculous medical bills from injuries you suffered at work before you do something about it. Act now!

Here at the Law Offices of Douglas F. Walters, we have extensive experience evaluating working relationships based on the criteria above, and we would be happy to discuss yours if you feel you have been, or may be, misclassified.