

INDEPENDENT CONTRACTORS ARE GREAT FOR YOUR BUSINESS

Unless they are Technically Employees

BY Beverley Adams

Many industries in the Fargo area, such as health care, technology and agriculture, hire independent contractors.

In Western North Dakota, the oil industry frequently hires welders, large equipment operators and geology consultants as independent contractors to perform specific specialized tasks. Companies can avoid significant wage, tax and other obligations by engaging independent contractors instead of employees. And using independent contractors can result in considerable cost savings and increased workforce flexibility. However, if employees are mistakenly categorized as contractors, penalties can be punitive.



Beverley Adams works with employers on a wide variety of employment law issues at Fredrikson & Byron. Prior to joining Fredrikson, she prosecuted in Clay County, worked as a litigator in private practice and was general counsel overseeing litigation in a local healthcare company. You can reach her at badams@fredlaw.com.

Some recent examples of settlements in cases where employees were misclassified as independent contractors include:

- Maple Bear Inc. dba Instacard, where delivery workers were misclassified, resulting in a \$4.6 million dollar settlement;
- AT&T corporate training managers were misclassified, resulting in a \$2.75 million dollar settlement; and
- Prudential Financial, Inc., where financial advisors were misclassified, resulting in a \$12.5 million dollar settlement.

Individuals often choose to become independent contractors because they desire greater control over their work environment and schedules and are interested in operating their own business and using their entrepreneurial skills to more directly impact their earning capacity.

While it can be advantageous for both parties, independent contractor classification involves careful consideration of several factors, application of multiple standards and exposure to liability in several areas, including potential liability for unpaid overtime compensation, taxes and employee benefits.

Simply referring to a worker as an independent contractor, even in a written agreement, does not prevent legal

challenges to that classification by workers, the Department of Labor (DOL), the Internal Revenue Service (IRS), Workforce Safety & Insurance, Job Service North Dakota or state and local authorities. Misclassification audits, investigations and lawsuits are increasingly common and can result in steep costs and penalties.

What is an Independent Contractor?

An independent contractor does not work regularly for any single company and is not an employee. An independent contractor typically:

- Is engaged only for the term required to perform an identified service or task
- Retains control over the method and manner of work
- Charges fees for service
- Retains economic independence
- Is responsible for paying their income, Social Security and Medicare taxes
- Is not protected by most federal, state or local laws intended to protect employees

A business or person contracting with an independent contractor generally has the right to control only the end result of the project and not how the independent contractor accomplishes it. The best examples of independent contractors are plumbers, electricians, attorneys and accountants. Independent contractors are generally free to offer their services to the public and to perform work for other clients. Independent contractors often own their own business and provide services according to their own terms.

An employee, by comparison, is subject to significant oversight by a company. The company has the right to control the method and the manner of the employee's work. In addition, an employee:

- Is economically dependent on the employer
- Is paid wages (which may include overtime compensation) and company-sponsored benefits
- Is employed for a continuous period of time and performs whatever tasks the company requires
- Pays the full amount of their income taxes and a portion of their Social Security and Medicare taxes, generally, through the amounts their employer is obligated to withhold from their wages.
- Is protected by applicable federal, state and local employment laws.

Companies cannot rely on generalizations to determine employee or independent contractor status. Nor should you look to your industry to see how they are classifying these employees since your situation may be different or they could be misclassified. Classification depends on the facts of each case, application of the appropriate independent contractor tests and the differences in the judicial and administrative interpretation of those tests.

Independent Contractor Tests

Unfortunately, there is no single test to evaluate independent contractor status for all purposes, and compliance is complicated by the fact that different tests may apply. A worker may be an independent contractor for some purposes and an employee for others. The tests vary between different federal laws such as the wage and hours laws, federal benefits laws and the IRS. There are also different standards between state and federal laws.

In addition, some states require advance application for certification for independent contractor status, regardless of whether the position meets the legal standard for an independent contractor. Failure to obtain advance certification results in fines and penalties. Some states, including North Dakota, offer companies and employees the ability to verify independent contractor status through the State Department of Labor office, for current or future work relationships for work performed in North Dakota.

A certificate issued verifying independent contractor status is effective as long as the work remains unchanged. The IRS also issues determinations on the classification if requested. A Form SS-8 is used by the IRS to gather relevant information after which the IRS issues a Determination Ruling Letter. This process can take up to six months.

The tests often do share some common characteristics. For example:

- They typically involve an analysis of the same or similar factors
- Are a balancing test and no single factor is determinative
- Analyze the degree of control the company has over the manner and means by which the worker accomplishes the work
- Afford little weight to the parties' characterization of the relationship, including any terms of a written agreement

What happens when an independent contractor really is an employee?

A company that misclassifies employees as independent contractors may lead to litigation or administrative decisions resulting in:

- Civil money penalties
- Employee benefits, including retirement benefits, health plan coverage or stock options
- Back pay, including overtime compensation
- Reimbursement of work-related expenses
- Failure to complete an I-9 form for a worker who should be an employee results in fines and penalties under the Immigration Reform and Control Act of 1986
- Disability payments and worker's compensation premiums
- Tax and insurance obligations
- Liquidated damages

Because independent contractors are not employees, entities contracting with them can avoid many of the financial and other obligations of using employees to perform work. However, penalties for misclassification are significant and often involve litigation. Damages are always dependent on the number of employees who are misclassified, which may be costly. Avoid litigation by properly classifying employees.

How to avoid treating someone like they are an Independent Contractor when they really are an employee?

Companies should implement these practices:

- Conduct an audit with the review of legal counsel
- Train personnel on classification issues
- Obtain a ruling from the State of North Dakota or the IRS
- Draft agreements that specifically detail the responsibilities of each party that accurately reflect the arrangement and address each element of the applicable independent contractor test

Independent contractors are a great resource. However, there are very specific standards that apply in setting up these types of arrangements. Having individuals classified as both employees and independent contractors within the same job classification in your business is always a warning signal to seek legal advice to avoid litigation. It is always wiser when making a decision to hire an independent contractor to ask permission in advance, rather than ask for forgiveness later. ■

solving
customer
imaging
technology
needs with
experienced
quality
service

LANIER



Experienced
Solutions
Provider

Copiers | Printers | Wide Format Printers
DOCuivity - Managed Print Services
Scanners | Projectors | White Boards
Mailing Equipment | Managed IT Services
Document Management | Solutions

LIBERTY
BUSINESS SYSTEMS, INC.



libertybusiness.com/savenow



701-241-8504

Looking For More Space?

6 Fargo Locations | Temperature Controlled | Video Recording | Access Gates



Free high security disc lock when you mention this ad!

Rental Office: 3255 43rd St S. Fargo, ND | 701.365.5000 | www.fivestorstorage.biz

VALUABLE INSIGHT SOUND **ADVICE**

Beverley L. Adams
Kristy L. Albrecht
Aubrey J. Zuger
Employment & Labor Attorneys

Fredrikson
& BYRON, P.A.

WHERE LAW AND BUSINESS MEET®
fredlaw.com/fargo

FINC050619

