



Is Your Independent Contractor Really an Employee?

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If you obtain services from an “independent contractor,” you need to be prepared for this question – is that independent contractor really an employee? The probability that you will be accused of misclassifying an employee continues to increase as governmental agencies remain under pressure to recover revenue. The IRS, Department of Labor and Michigan’s Unemployment Agency coordinate enforcement efforts and share information. Michigan’s Department of Treasury is aggressive in its pursuit of revenue from employers that misclassify employees. If any one of these agencies questions your classification of a worker as an independent contractor, you will need to be prepared to convince all of them that your workers are independent contractors or suffer significant financial consequence.

Classification questions often arise when an ex-worker files a claim for unemployment or an injured worker seeks worker’s compensation. Random audits may also lead to an inquiry. In any event, the financial risk of misclassification is too high to ignore. While not an exhaustive list, the risks include: unpaid federal income tax plus a penalty for failure to withhold; your share of FICA plus a substantial percentage for failure to withhold; state and federal unemployment tax, plus interest and penalties; worker’s compensation liabilities to include a percentage of the worker’s wages plus fines; Department of Labor penalties, fees and back wages, including overtime. Additionally, where you have misclassified a worker, you are effectively penalized under the Worker’s Compensation Act by losing your immunity from tort claims.

Determining whether your classification reflects the current state of the law and the reality of your relationship with the worker is worth the cost of what may be a fairly complex analysis. While a discussion of all of the factors that need to be examined is beyond the scope of this article, start by considering:

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1. Is the worker engaged in an “independent occupation,” meaning that they provide self-directed services to you and to others with the worker’s own resources? If you tell the worker how to perform tasks, they do not offer their services to others, and the worker uses your resources (i.e. equipment, tools, telephone), they are not an independent contractor.
2. Does the worker have other sources of income? If you are the only source of the worker’s income, be forewarned of what appears to be a trend to find that the worker is an employee even if all other aspects of the relationship support classification as an independent contractor.

If you question whether you have accurately classified a worker as an independent contractor, promptly call an attorney with experience in this area or your accountant. If they question your classification, you need to know what can be done to change and document the relationship to increase the likelihood that your worker will be determined to be an independent contractor. If you cannot make necessary changes to convert what you have to a true independent contractor relationship, your attorney or accountant will likely soften the financial blow by finding an appropriate “amnesty” program and guiding you through other voluntary corrections.

If you are advised that you have properly classified the worker as an independent contractor, you need to examine whether the documents and information within your control will convince an agency or court that the worker is in fact an independent contractor. While you need to have signed independent contractor agreements in your file, this alone, even if perfectly worded, will not protect you from an adverse determination. An annual audit, which we can tailor to your business, is a means of requiring the worker to provide to you the information and documents that will allow you to defend an independent contractor classification.

For more information on misclassifying an employee contact Deanna Swisher at dswisher@fosterswift.com or 517.371.8136.