



Employee v. Independent Contractor

Who, What, Why . . .

Who does it apply to: Any employer who characterizes someone who works for them as an independent contractor.

Why does it matter: While you may not think it matters much whether the individual pays their taxes or you withhold them, the IRS, Texas Workforce Commission (TWC), and Texas Attorney General (for child support) care a lot. It could become an issue for your business in many different kinds of lawsuit.

How does it affect me: Mischaracterizing an independent contractor as an employee has nominal consequences, but the consequences of mischaracterizing an employee as an independent contractor can be significant. You may be audited by the TWC or IRS and subject to penalties and interest.

What is the rule: The TWC and IRS will start with a presumption that the person is an employee so owners really start off with one strike against them. The tests used by the TWC, IRS, and in commercial litigation are all different, but the factors considered are similar. What follows is an amalgamation of the tests that should give you a good idea of what category the person falls into:

- **Instruction and Control** – This is the KEY factor! If you say where to go and leave it up to the individual to get the work done, they may be an independent contractor. If you tell the individual how to do it, they start to look more like an employee. Each additional instruction slides the scale closer to employee status.
- **Training** – If you are training them, they are probably employees
- **Equipment and Expenses** – If you provide equipment and pay expenses, they are probably an employee
- **Benefits** – If you provide benefits, like healthcare and 401(k), they are almost definitely an employee

- **Other Work** – If the person works solely for you, perhaps has set hours of work, and would not have time for another “customer” or employer, they are probably an employee. Independent contractors regularly work for numerous customers or clients.
- **How Paid** – If you pay a weekly salary or draw that is not dependent on performance, they are probably an employee. Independent contractors are usually paid by the job and don’t get paid if a job is done unsatisfactorily.
- **Terminating the Relationship** – If you can unilaterally let the person go in the middle of a project or they can walk away from work in progress, they are probably an employee. Independent contractors cannot usually be terminated in the middle of a project without someone having a right to damages.

Common Situations:

Outside Sales Rep: Often the most difficult to characterize, the outside sales representative is a bit of a chameleon. The factors that really matter here are: (1) whether you provide training or a particular sales pitch; (2) whether they act as a sales representative for other companies or whether you would allow the person to sell for another company; (3) how they are paid – straight commission or commission and salary; and (4) whether you reimburse expenses. NOTE: If there is ever a covenant not to compete – you best characterize them as an employee.

Terminated “Contractor”: In a down economy, you cut back your workforce, including several “contractor” construction workmen. One decides to file for unemployment. When the TWC investigates, it will determine whether you have properly characterized the workman. If you lose, the TWC will make you responsible for back taxes, and interest (which you will have a great time getting back from the workman). Then . . . the TWC will tell the IRS

and Attorney General. After their audits you can find out how much back child support you should have withheld that you are now responsible for!

Contract Employee v. Independent Contractor: Don't mistake a contract employee for an independent contractor. Contract employees are still "employees" who are paid like any other employee and for whom you must deduct appropriate state and federal taxes.

Accident: One of the few advantages to a business owner in characterizing people as independent contractors arises in the event of an accident. If you have a true independent contractor and they injure someone while working for you, there is less potential liability for you! Conversely, employees involved in accidents are the direct responsibility of the employer (unless they were working outside the "scope of employment").

What should I do:

Good: Conduct a quick review of those who work for you. In most cases you will quickly be able to rule out concern except in a few cases. For the exceptions, examine the above factors and make sure to maintain appropriate separation. Too often, an independent contractor will grow into an employee over time as they become a more integral part of your business.

Better: Create written job classifications for each position in your company including restrictions on the position. Make a written contract with all independent contractors that clearly lays out their status (but do not include a covenant not to compete – which is a clear sign of an employee).

Best: In this case, best is really "safest." If you characterize everyone who works for you in any capacity as an employee, except with the most obvious exceptions, there will rarely be any cause for concern. That said, it can result in an administrative headache.



Michael Kelsheimer focuses his practice on the employment law needs of Texas businesses and executive employees. He recognizes that the cost and expense of litigation make resolving employment disputes challenging. To help avoid these concerns, he utilizes his experience in and out of the courtroom to prevent or quickly resolve employment disputes through proactive employer planning and timely advice. When a dispute cannot be avoided, Michael relies upon his prior experience as a briefing attorney for the United States District Court and his extensive experience in employment and commercial lawsuits to secure favorable resolutions for his clients.

This guide is one in a series. For more information, or to receive the entire collection contact Michael Kelsheimer by email at mkelsheimer@grayreed.com or by phone at **469.320.6063**