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Q: Employee vs. Independent Contractor? A: Employee, Almost Every Time

If it looks like a duck, swims like a duck and quacks like a duck, it is a duck." A California Court of Appeal recently quoted this old adage in concluding that the individuals in question were employees and not independent contractors. As trite as this guidance is, employers are well-served by keeping it in mind when examining whether a particular individual is an employee or not.

The ramifications of misclassifying someone as an independent contractor are varied and significant. California and Federal payroll-related taxes, Social Security and related contributions, penalties and interest are assessed for the period of time the individual was misclassified. The Workers' Compensation Appeals Board has the authority to issue penalties, liens, stop orders and to authorize claims by the injured worker. The individual may claim that he or she performed work that is overtime-eligible and for which no overtime premium pay was made. A claim for failure to pay wages brings with it various potential penalties, as well as prejudgment interest at the astounding rate of 10 percent. The misclassified individual would also be potentially entitled to any benefits provided to employees, such as participation in profit-sharing, vacation time and the like. Moreover, the Internal Revenue Service (IRS) and the Employment Development Department (EDD) share information and resources such that an audit by one agency will likely lead to an audit by the other.

Small businesses tend to rely on professional and other services provided by individuals to survive. After all, most small busi-

nesses have no need to have on staff a computer professional to keep their systems running or an attorney to advise them on specific compliance or regulatory issues, or a private investigator. Consider the difference between a company hiring an investigator to perform forensics on an employee's computer and a company that performs forensics work who hires an individual to perform these tasks. The former is most likely hiring an independent contractor, whereas the latter is probably hiring an employee.

The legal definition of an employee is, generally, an individual who is hired by an individual or entity (the principal) to perform services and the principal has the right to exercise control over the manner and means by which the individual performs his or her services. The EDD advises employers in its myriad publications and forms (provided on its website, at www.edd.ca.gov) that the right of control by the principal over the individual is the most important factor in determining whether an employment relationship exists. The essence of the test is the control of details regarding the manner and means by which the worker accomplishes the work.

Additional factors applied by the EDD and recognized by the California Supreme Court, in a 1989 case involving whether an individual was an employee for purposes of workers' compensation coverage¹, are:

1. Whether the worker is engaged in a distinct occupation or business – which would be demonstrated by the person

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- having an office, having a website, having a business license, carrying liability insurance, advertising his or her services, etc.
2. Whether, considering the kind of occupation and locality, the work is usually done under the principal's direction or by a specialist without supervision – as with the general “right of control” factor, if the principal needs to oversee the work to ensure its proper completion, then it is indicative of an employment relationship.
 3. The skill required – the less skilled the position, the more indicative it is of an employee.
 4. Whether the principal or worker supplies the instrumentalities, tools and place of work – if the principal is providing these items, then the worker is usually an employee.
 5. The length of time for which the services are to be performed – an ongoing period of work that bears no relationship to a particular project is an employment relationship.
 6. The method of payment, whether by time or by job – although some occupations are typically paid by the hour, payment by the project is more indicative of a contractor relationship.
 7. Whether the work is part of the principal's regular business – if the worker is performing the same duties as anyone who is an employee or if the worker is providing the services of the business, then it is indicative of an employment relationship.

8. Whether the parties believe they are creating an employer-employee relationship – even though there may be a written independent contractor agreement, the worker may be treated like an employee and have the belief that he or she is an employee.

Applying these factors, the court in *Estrada v. FedEx Ground Package System, Inc.*², held that FedEx drivers, who sued as part of a class action to obtain reimbursement for business expenses, were employees. FedEx required its drivers to sign contractor operating agreements in which the drivers purchased or leased their trucks according to FedEx specifications (paid through payroll deductions), wore FedEx-approved uniforms, drove routes assigned to them, worked according to specified schedules and were required to work full-time only for FedEx. The only skill required was driving. The court noted that, despite the agreement's clever portrayal of the arrangement as an arm's length business contract, virtually all of the factors indicated an employment relationship, thus the conclusion that a duck is a duck even if you call it a swan. ♦

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1. S.G. Borell & Sons, Inc. v. Dep't. of Industrial Relations (1989) 48 Cal.3d 341, 350-51
2. 154 Cal.App.4th 1

Practical Tips

Most payroll tax audits by the EDD are triggered by claims for unemployment insurance benefits filed by individuals who allege that they were misclassified as independent contractors. It is crucial that individuals do not have misconceptions that they are employees which can easily occur if they complete timesheets, are paid on a regular schedule without submitting invoices, do the same work as others who are employees, and the like.

Prior to engaging the services of an independent contractor, review all of the factors described above and, if in doubt, obtain legal advice. Regularly review and evaluate all individuals utilized as independent contractors to ensure compliance and to guard against a short-term project having turned into an extended, open-ended arrangement. At the least, have a file for each contractor that contains a written agreement and documents reflecting the individual's independent business (such as business card, business license, liability insurance, etc.). ♦