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The Importance of Properly Characterizing the Individual Who Works for Your Business

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It is quite common for a business to be conducted by someone other than the principal who owns the business. This is particularly true when the business is an entity such as a corporation or a limited liability company, since business entities are hypothetical legal people and not actual people. Hypothetical legal people can conduct activities only through human beings.

For a host of reasons, when business activity is performed by delegates, it is important to determine the characterization of the person performing the business activity.

To begin with, it is well known that an employer will be liable for the wrongful acts or omissions of an employee and that the employer will generally not be liable for the acts or omissions of an independent contractor, unless the act in question is characterized as a nondelegable duty.

This characterization as a nondelegable duty is generally imposed on those duties that are deemed to be of such an important public interest that there is absolute liability for the performance. A classic example is the duty imposed on those who are in control of public sidewalks to keep those walks safe and clear of obstacles. Even if the responsible party commissions an independent contractor to clear the walk of ice or debris and the task is either not done or done negligently, the party responsible will remain liable for any injury sustained as a result of the task having not been properly performed.

Other exceptions for the liability of independent contractors include carelessness in hiring or retaining an independent contractor after learning of a problem. This liability is imposed because one cannot cavalierly retain an incompetent person and then claim that the delegate alone is responsible. In this type of situation, the one who hires or retains the wrong person for a task will
be liable for injuries sustained as a result of a wrongful act because of the hiring party’s own carelessness in hiring or retaining that independent contractor.

Employers will also be responsible for the wrongful acts or omissions of independent contractors when those acts or omissions are characterized by the law as “inherently dangerous”. The characterization of inherently dangerous activities is fact specific and varies from state to state, but some things are clearly within that category, such as working with dynamite.

The tax laws also distinguish between employees and independent contractors. Under the federal tax laws and the laws of most states, employers are responsible for retaining and paying employees’ income tax withholding, Social Security and unemployment payments. When the person is characterized as an independent contractor, however, that person will be responsible for his/her own income tax, Social Security and the like. Employers who fail to withhold required payments from employees’ incomes will remain responsible for those payments and thus may wind up in the untenable situation of having paid an employee 100 percent of the employee’s salary without making proper withholding and later learn that required payments were not made. In this situation, the employer will be required to make those payments to the appropriate authorities and will thus have to pay those amounts a second time.

Determining who is an employee as distinguished from an independent contractor is therefore important and, as a result, many statutes provide guidelines. The Internal Revenue Code and the related regulations interpreting it provide some guidance for making this determination for federal income tax purposes, and most states have comparable provisions. It is important to know the applicable law for your state.

The characterization of employee/independent contractor is also essential in determining whether a person who is injured on the job must be covered by Worker’s Compensation Insurance or whether that person will have a viable civil claim against the employer. There is a host of cases interpreting the characterization of a worker in order to make this determination since employees injured on job-related activities, regardless of fault, are absolutely covered by Worker’s Compensation Insurance, whereas independent contractors may not be. In addition, if Worker’s Compensation Insurance should have been available for an employee and a policy was not purchased, then the employer will be absolutely liable for the injury, and the defenses which might otherwise be available in such a lawsuit will not be.

The importance of characterizing an individual’s status as either that of an employee or of an independent contractor has arisen in other contexts as well. For instance, many employment laws dealing with discrimination apply to protect the employee and may not be available for an independent contractor.

It is extremely helpful to have a written agreement specifying the relationship between an employer and the person hired, though this will by no means be definitive, and other relevant facts will be reviewed when making the determination. For this reason, it is important to work
with a knowledgeable and experienced employment lawyer in order to determine whether a worker is likely to be characterized as an employee or an independent contractor. Unfortunately, there are no hard and fast rules, and a person may even be considered an independent contractor for some purposes while being considered an employee for other purposes. Experienced attorneys can, however, assist in making meaningful evaluations of the job situation.

Because the consequences of an improper characterization of a worker’s status as an independent contractor rather than that of an employee can have catastrophic effects on a business, it is essential to be diligent in making the determination. It is only by taking appropriate precautions and making the best assessment possible that a business can avoid some of the extraordinary consequences that may flow from a wrong decision.

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