

## **An Employer's Liability when using 1099 Contractors or "Independent Contractors"**

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A 1099 contractor, or an "independent contractor", is a legal and tax-related term used in the U.S. to refer to the type of worker that contracts their services out to a business or businesses.

Employers face complicated tax issues, claims of misclassification, employee vs. contractor scenarios that create penalties, liabilities and various types of insurance issues arise for a company if they use any worker as an independent contractor and pay them directly using the 1099 form method vs using a structured Consulting/Projects Company that is a true Corporation or a Staffing Agency.

### **Risk Scenarios:**

- 1) If the 1099 independent contractor does not pay their State or Federal taxes, payroll taxes or otherwise, the IRS can force the hiring company to pay all withholding taxes, plus interest. The IRS State/Federal can go back up to seven years and request all funds for a company's 1099 workers.
- 2) In an article published on the front page of the N.Y. Times on February 18, 2010, entitled "A Crack Down on 'Contractors' as a Tax Dodge", (<http://www.nytimes.com/2010/02/18/business/18workers.html>) it was stated that the Obama Administration, along with State officials, plans to crack down on companies that are misclassifying workers as "independent contractors" that according to their guidelines, should actually be classified as employees.

Part of the government's issue regarding this, tax dollars that are lost because the "independent contractors" not reporting all or a portion of their revenue as taxable income. The N.Y. Times article claims the federal government will be cracking down and reclaiming at least \$7 Billion over the next 10 years.

This can expose Employers to fees, back taxes, insurance fees, and stiff penalties from multiple agencies: the Internal Revenue Service, Employment Development Department, Workers Compensation Appeals board, Immigration and Naturalization Service, the U. S. Department of Labor, and the State Labor Commissioner.

The N.Y. Times article also states that 1099 independent contractors are not all paying into, or receiving unemployment insurance, workers compensation if injured, health insurance, overtime pay if applicable, sick pay, vacation pay, retirement benefits, and more. Some companies have pressed workers into situations where they must incorporate into separate business entities or forcing them to work through an agency that does not provide benefits.

### 3) Insurance Issues

- a) Health care coverage: If the 1099 independent contractor does not have health coverage and is injured while on company premises, (and typically independent contractors will not have their own Workers Compensation insurance, as mentioned in the N.Y. Times article) they will most likely sue the Employer to pay for their medical expenses. And if it gets into the court system, it is unlikely that a jury will deny an injured person from being paid by a company. **Risk:** How many 1099 persons do you have working on your property who do not have basic insurance coverage?

If the 1099 independent contractor contracts an infectious or debilitating disease, they could sue for medical costs. There has been precedence set by the Hewlett Packard Aids case several years ago. A 1099 contractor contacted HIV and sued HP for health coverage, stating that they are really an HP employee. HP settled the case. **Risk:** Although rare, when cases like this occur, handling the situation can be quite costly.

- b) Providing Workers Compensation insurance is a California state law. The employer must carry this coverage on all of its employees. The California Labor Board would not like to find that an independent contractor was injured on the company premises without Workers Compensation insurance. **Risk:** If a person working at your premises gets hurt and does not have Workers Compensation (or perhaps Health Insurance), then this worker may take the Employer to court to cover all the costs of that injury. Those costs can become high very quickly.
- c) Business Liability insurance would be needed if the independent contractor injures a fellow person at the worksite or someone gets injured near the independent contractor's work area and places the blame on the independent contractor. This also applies to property damage. The legal issues surrounding these events are time-consuming and expensive. **Risk:** If someone gets hurt, or property is damaged, and if the independent contractor does not have the proper insurance, all parties involved may turn to the Employer to cover all damages and costs.
- d) Errors and Omissions insurance (sometimes called E&O) is required in the event that the 1099 independent contractor's work causes some issue that hurts someone else at work or damages something. It too would be time demanding and expensive. Also, any of the other injured parties are likely

to sue the company because of the perception of “deep pockets”. **Risk:** This type of insurance is expensive and usually never carried by independent contractors.

- e) Auto Insurance coverage is another issue. Owned & non-owned vehicles can potentially be an issue if the 1099 independent contractor is driving to or from work or while driving somewhere for the company incurs an injury or causes an injury to others or damages property. **Risk:** Workers are driving every day. It is not a question of "if...", it's a question of "when..." a traffic accident will occur.
- f) Dishonesty in the workplace is an issue if the 1099 independent contractor is involved in stealing or lying. The Employer will incur any and all costs and ramifications from all the worker's illicit actions. **Risk:** With no insurance coverage, the company will have to bare the entire cost of the transgression.

4) Company benefits:

- a) 1099 independent contractors can claim that they are an employee of the company and that they have rights to some of those company benefits after working for the company as a 1099 independent contractor for several months.

This occurred in the landmark case involving Microsoft in 1999, where contractors claimed rights to stock options and health coverage because they performed the identical tasks as the direct employees of Microsoft. The areas at issue were health care coverage, 401k plans, Stock plans, and profit sharing. Microsoft's benefits did not specifically spell out who the plans covered. There were no definitions of who an “employee” really was, therefore the "independent contractors" exploited Microsoft in this particular situation. Since this incident, Microsoft and other knowledgeable companies have had their benefit plan documents revised with clear employee definitions, and explicit language added that makes it clear who is eligible for benefits and who it not.

5) Assignment of Intellectual Property (technology, patents and inventions):

- a) Without the right protective language, the 1099 independent contractor can claim rights and force the client company to pay royalties on Intellectual Property or designs that they have created. They may also claim rights and royalties to items or technology that is patentable.

**Risk:** How safe is your company's Intellectual Property?

**In summary:** In today's economic climate, many Employers are "doing more with less" and this translates to their workforce. Many Employers bring on people as needed, or outsource work from time to time.

If your company hires 1099 independent contractors or outsources work, and something goes wrong, it can be costly and time consuming to settle these situations. Could an issue like this cripple your company or project? Can you take that risk?

Any independent contractor can go to the California Labor Board, at no cost to them, and file a claim against the Company. The Labor Board generally exerts a great amount of pressure to the Company in terms of documentation, verification and depositions. The Company could incur significant costs and ramifications from the actions of the independent contractor's actions.

## How to Avoid the Risks

Using a knowledgeable and experienced organization, like Albin Engineering Services, Inc. (a California Corporation), the risks are eliminated.

Here's why:

- a) Since day-one, Albin Engineering has obtained all the state and federal required insurances, prescribed above at the required limits.
- b) Albin Engineering pays all the required taxes, and required workers comp insurance for all its workers/employees.
- c) The N.Y. Times article on February 18, 2010, entitled "A Crack Down on 'Contractors' as a Tax Dodge", (<http://www.nytimes.com/2010/02/18/business/18workers.html>) goes on to state that workers classified as "independent contractors" are being taken advantage of and it can be dangerous and open you up to costly lawsuits, by not giving benefits of any kind. This is a very true assessment, and can be completely avoided by using Albin Engineering.
- d) Every Albin Engineering contractor is a W-2 employee of our company. We provide all of our contractors/employees benefits (including medical, dental, vision, life insurance, paid time off (PTO), Section 125 Cafeteria Plan, and 401k) that they would normally receive at a company. And as W-2 employees, they are covered by our extensive insurance programs so it is a mutually beneficial relationship for the employee, your company and Albin Engineering.
- e) Albin Engineering is very experienced in working with our clients to classify workers correctly as overtime exempt or non-exempt. Albin Engineering is very knowledgeable about the CA (and federal) overtime laws AB60 and SB88. As a matter of fact, Albin Engineering's CEO, Marc Albin, helped write the language in SB88.
- f) The Obama Administration and many state governments have made it clear that they are "cracking down" on companies paying workers as "independent contractors" (most of time on a 1099). If you are doing this or thinking of doing it, please call Marc at Albin Engineering immediately to help you through this contractual minefield. It is now going to become a political minefield as well.

- g) With the "crack down" coming, they are going after penalties to generate more tax revenue, which is what is behind this in the first place, your exposure can be very high on this matter.
- h) Prevent law suits from injuries or other medical claims. Albin Engineering provides health, dental, vision and workers compensation insurance to all its employees, and has since day one of its inception.
- i) Prevent law suits from business insurance claims. Albin Engineering provides all types of Business Insurance, including Errors and Omissions insurance, Owned and non-Owned Vehicle insurance, Employee Dishonesty insurance that covers all its employees, and has since day-one of its inception.
- j) Albin Engineering is very knowledgeable about the subject of protecting Intellectual Property and has very up-to-date language in its Employment Agreement (EA) that all of our employees (engineering contractors to you) are required to sign. We make it very clear that all rights are owned by your company starting day one.

And Albin Engineering takes this one step further, this EA also states that the employee shall waive any and all rights to the client's benefits packages, nor are they eligible for client's benefits of any kind. All of our agreements between clients and our employees cover issues created by the Microsoft case mentioned earlier.

Albin Engineering has proven reputation for performing with integrity and we are committed to bring our clients the right people who are essential to their success. Albin Engineering scores high in the performance factors that mean the most to you – High Quality, Meeting Schedules, Affordability, and Customer Service.