

Contract Lawyers: Independent Contractors or Employees?

Law firms working with contract lawyers should be aware that law firms, just like any other businesses, may be audited by federal and state agencies to ensure they are correctly classifying their contract lawyers as either employees or independent contractors. A firm may assume a contract lawyer is an independent contractor without carefully analyzing the factors distinguishing independent contractors from employees.

So, why does it matter whether you correctly classify contract lawyers as independent contractors? If the contract lawyer is really an employee and not an independent contractor, the law firm could be exposed to significant damages, including responsibility for federal and state income and employment taxes; pension, health, Medicare, and other benefits; unpaid retirement and disability coverage; workers' compensation benefits; and unemployment insurance benefit payments. Liability could arise from failure to provide protected leave, violation of discrimination or wage and hour laws, failure to comply with I-9 requirements, and a host of other employment-related claims.

In the case of *Donald G. Cave a Professional Law Corp. v. Commissioner*, T.C.M. 2011-48, the U.S. Tax Court ruled that the law firm incorrectly classified its attorneys as independent contractors when they were actually employees. The Tax Court awarded the Commissioner damages of \$150,000 for unpaid employment taxes and a \$10,000 penalty against the law firm. The Fifth Circuit Court of Appeals affirmed the Tax Court's decision, finding that the law firm failed to meet its burden of proving that the lawyers were true independent contractors.

Administrative Agency Review

Several state and federal agencies review whether a worker is correctly classified as an independent contractor or an employee. In Oregon, the state agencies that evaluate whether a worker is correctly classified as an independent contractor include the Department of Revenue, the Employment Department, the Bureau of Labor Wage and Hour Division, and the Workers' Compensation Division. At the federal level, the IRS and the Department of Labor both independently audit employers to ensure that the workers are correctly classified as independent contractors.

The various state and federal agencies that audit these relationships apply different tests. For example, the IRS has a 20-factor test; the Department of Labor and the Bureau of Labor Wage and Hour Division apply an "economic reality" test; the Oregon Department of Revenue applies the factors listed in ORS 670.600; the Oregon Civil Rights Division and the Workers' Compensation Division apply the "right-to-control" test.

The Contract

One way a law firm can protect itself from potential liability is to have a written agreement in place clarifying that the parties understand and agree that this is an independent contractor relationship and not an employer-employee relationship. The parties should consider including in the contract the following provisions:

- The contract lawyer is responsible for his or her own income tax withholding and Social Security self-employment taxes, professional liability insurance, and excess coverage.

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- The firm will issue a Form 1099 for the services performed by the contract lawyer.
- An acknowledgement that this is not a joint venture and the parties do not have any shared business interests.
- The contract lawyer is currently licensed and in good standing with the Oregon State Bar, has current professional liability coverage, and has no pending malpractice claims or ethics complaints.
- The contract lawyer does not have a conflict with any of the parties involved in the assigned project.
- The contract lawyer agrees to at all times fulfill his or her professional duties to protect the client's privileged and confidential information.
- The contract lawyer will at all times comply with his or her ethical and legal responsibilities as a lawyer licensed to practice law in the state of Oregon.
- The contract lawyer will return all client documents, including all copies of the documents, when the project is complete.
- The contract lawyer will not receive any employee benefits or workers' compensation coverage.

The Working Relationship

From a practical standpoint, to be an independent contractor, a contract lawyer should have his or her own office, business cards, e-mail account (separate from the firm's e-mail system), online research tools, computer and copying capability, and tax ID number. The contract lawyer should not be integrated into the law firm or expected to regularly work at the firm or attend firm meetings. An independent contract lawyer should determine how much he or she will be paid for a specific project and invoice the firm for the work performed. The firm should allow the contract lawyer to set his or her own work hours. The firm should avoid excessively monitoring the work of the independent contractor or exercising control over how the work is performed. The independent contractor and the firm must agree on the specifics of the assigned project and the due date for that project, but the firm should not ask for regular status reports.

The parties should clarify that the independent contractor works for various law firms and business entities and is not economically dependent on any one firm as a source of business. While the independent contractor may work regularly with one firm, he or she must also work with other firms; the working relationship can be frequent but not constant, allowing some intervals when the contract lawyer is not doing work for the firm. The firm's financial success should not be dependent on the work of the independent contractor; for example, lawyers working in a firm cannot all be independent contractors. The contract lawyer cannot be "fired at will." Instead, the

contract lawyer must satisfactorily complete the work he or she contracted to perform according to the contract specifications or be subject to the terms of the contract relating to breach of contract.

Law Firm Internal Controls

Independent contract lawyers should not be former employees who are performing the same job they had as associates in the firm, nor should they be performing the same job as other employees of the firm. If a problem arises with the contract lawyer, the problem should not be resolved as an employee issue through the human resources department, but by enforcing or modifying the terms of the contract. Contract lawyers should not typically be invited to employee functions or instructed on firm policies and procedures. They should not be asked to read or sign the employee handbook. The contract and any other information relating to the independent contractor should be maintained with the firm's vendor files, not with other employee files. The firm must bill for the work of the contractor as a vendor, not as an employee. Moreover, the contract cannot include a non-compete agreement.

Summary

A law firm wanting to use an independent contractor should consider taking the following steps to establish and maintain the independent contractor relationship:

- **Right to Control** – The firm should provide information necessary for the contract lawyer to perform the work assignment, including the date when the work needs to be completed, but should not micromanage the "means and manner of providing the services."
- **Scheduling** – The contract lawyer should be allowed to set his or her own work hours.
- **Location** – To the extent possible, the contract lawyer should work outside the firm.
- **Compensation** – Payment should be made on a project basis; the contract lawyer should invoice the firm for the work performed.
- **No Employee-Type Benefits** – The firm should not pay for or provide benefits such as insurance for the contract lawyer.
- **1099 Tax Form** – The firm must issue a Form 1099 at the end of the year and should never use a Form W-2.

For the contract lawyer, the overall goal is to maintain an "independently established business," which is the test codified in ORS 670.600 and utilized by the Oregon Department of Revenue. While no single factor is conclusive, contract lawyers should consider the following steps

to maintain their independent contractor status:

- **Independent Office** – Use his or her own home or business office.

- **Assignments** – Perform work on a project or assignment basis and invoice firms for the work performed.

- **Diversify** – Work for more than one firm, seeking work through appropriate legal and business publications, speaking engagements, and professional networking opportunities.

- **Business Expenses** – Pay for office expenses, staffing and copying assistance, online research tools, business cards, stationery, and other office supplies.

- **Bar and Licensing Requirements** – Pay for bar memberships and fees, CLE requirements, and business licenses.

- **Insurance** – Maintain legal malpractice insurance as required by the PLF.

- **Taxes** – Pay for income tax withholding and Social Security self-employment taxes and agree that a Form 1099 will be issued by the firm for work performed.

While there is not a bright-line test for determining whether a lawyer is an independent contractor or an employee, carefully defining the terms of the relationship between the firm and the contract lawyer will be helpful in avoiding an obvious misclassification and limiting the potential risks associated with this type of business relationship. Although this article describes the basic issues to consider, you should consult qualified employment counsel with respect to specific situations.

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