

EMPLOYEE OR INDEPENDENT CONTRACTOR?

By Paul A. Rianda, Esq.

Almost all of my clients have sales people working for them. I am often asked questions about whether or not these sales people should be classified as independent contractors or employees. Below I will discuss when it is appropriate to categorize these sales agents as independent contractors and when they must be treated as employees.

Why the Categorization is Important?

My clients usually want to treat all their salespersons as independent contractors. The main advantage in doing so is that if a sales person is an independent contractor, the ISO does not have to pay the sales person minimum wage, there are no overtime issues and generally all the laws that protect employees from being exploited will not apply. The ISO is free to let the independent contractor sink or swim as a sales person without having to incur the extra expenses associated with having employees.

The issue of whether or not a sales person is an independent contractor or an employee is usually raised in regard to sales persons that work for an ISO at the ISO's physical location. As will be explained in more detail below, if you have sales agents that work outside of your location and you have no control over their actions, it is generally safe to assume those types of sales agents may be legally classified as independent contractors. But, when you have the sales persons working at your office and you try to classify them as independent contractors, the law may determine that they are employees regardless of what you call them.

Your in-house sales agents can be legally classified as employees even if you take steps to make them "look" like independent contractors. Many ISOs make their in-house sales persons sign an "Independent Contractor Agreement" and think that just because the sales person signs that agreement that automatically makes them an independent contractor. Nothing could be further from the truth. Other ISOs will make their sales persons sign such an agreement, rent their desk, pay for their phone and other expenses in order to try to have their sales persons classified as independent contractors. However, none of these efforts will necessarily enable you to successfully have your sales agents classified as independent contractors. As will be explained below, there are a number of different criteria that the law uses that will determine if sales persons are independent contractors or employees in spite of whatever you may call them.

Test for Employee or Independent Contractor:

In order to determine if a sales person is an employee or independent contractor, one must review the state and federal laws on the subject. One good place to start is the Internal Revenue Service's (I.R.S.) standard for determining such status. As the I.R.S. states, the critical inquiry is into the "degree of control and independence" of the employee in question. The I.R.S. goes on to identify three main areas of inquiry in making the determination namely, the following:

- “1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. Financial: Are the business aspects of the worker’s job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?”

The key thing to remember is that no one of these factors is determinative. That is why people often think their sales persons can be categorized as independent contractors when that is not true. For example, many people believe that if they meet the test for financial independence by making the sales person pay for expenses like a desk and phone and then also have the sales person enter into an independent contractor agreement, that the sales person will be classified as an independent contractor. But, that ignores the behavioral aspect of the test which can override the rest of the factors. In my experience, it is the behavioral aspect of the inquiry that is paramount.

According to the IRS website, “the behavioral control factors fall into the categories of: (i) type of instructions given; (ii) degree of instruction; (iii) evaluation systems; and (iv) training. Of these, I find that the type of instructions given is usually the most important aspect of this part of the analysis. The IRS goes on to state that “an employee is generally subject to the business’s instructions about when, where, and how to work. All of the following are examples of **types of instructions** about how to do work:

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow when performing the work.”

I don’t mean to stereotype people, but most of the persons running the ISOs and small sales offices that I know in our industry are take charge individuals. That usually extends to wanting to control many of the aspects of their in-house sales persons activities. To that end, invariably they want to tell the sales agents when they can come and go, how they should be selling (sales pitches and the like) and they want to discipline them if they do not sell well. So, if you as an ISO are telling your sales persons things like that, no matter what else you do they almost certainly are employees not independent contractors.

That is not to say that you cannot have inside sales persons that are independent contractors. However, I find that it is extremely difficult to do so. In essence you have to let the sales persons in your office come and go as they please, not show up for work if they do not feel like it, provide them virtually no guidance and training on sales techniques and generally leave the sales agents totally alone. In my experience, none of the ISOs I have dealt with wanted to give up that much control to have such a sales force work under their roof.

The ramifications of having mischaracterized your sales persons as independent contractors when they should have been employees can be severe. The sales persons can sue you for wage and hour violations. If they were not paid any wages, they can sue for at least minimum wage as compensation for all the hours they worked and can also get overtime. In many states you would also have to pay penalties and fines for mischaracterizing sales agents. In addition, you could have to pay all the employment taxes that you should have been taking from the sales agents pay checks. In California recently for example, Federal Express just paid \$26.8 million to settle a lawsuit related to misclassifying workers as independent contractors. As you can imagine, misclassifying sales persons could potentially be financially crippling.

In my opinion the best thing to do is if you want to have real independent contractors, don't have them work under your roof. Have them work from home or from their own office so that you can show you really have no control over their actions. Any time you have sales persons in your offices and you try to classify them as independent contractors, you are looking for trouble.

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