

Virginia Business Lawyers

Contract or Cat License?

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The perils of DIY drafting.

Remember the [classic Monty Python skit](#)? Eric Praline (John Cleese) walks into the Post Office to get a fish license for his pet halibut (also named Eric) and gets into an argument with the man behind the counter (Eric Idle). Here is an excerpt*:

Praline (pulling out his “cat license” to prove such things exist):

What’s that then?

Man: This is a dog license with the word ‘dog’ crossed out and the word ‘cat’ written in crayon.

Praline: The man didn’t have the proper form.

Man : What man?

Praline: The man from the cat detector van.

It gets sillier from there, but I digress...

Of what possible relevance is this you ask? Simple, this happens all the time in small business. Understandably, business owners want to control costs. Legal fees in particular. In light of the huge volume of legal documents accessible from the web, who can blame a business owner for finding what looks like a perfectly good form, marking it up and using it for a critical contract. This is commonplace, but very risky. I spend a significant portion of my practice time trying to extricate clients from unfortunate situations caused by this casual approach to contracts.

Here’s an example. Suppose business is tight, and you need some additional help, but you’re not prepared to hire a full-time employee. That’s when many businesses turn to “independent contractors” or “1099s” (in reference to the tax form the company sends to the contractor at tax time). This can be an excellent solution to the business problem, but a casual approach to the contract can have consequences far more expensive than the withholding tax that might be saved. In these situations, I have seen numerous examples where the business owner simply takes their standard “employment at will” agreement, does a search and replace substituting “contractor” for “employee” and “contract” for “employment.” What could be simpler?

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But here's the rub. Many of the pro-employer terms in a good employment agreement can have disastrous tax consequences if they remain in an independent contractor agreement. The IRS is not bound by your contract, but it can certainly give them lots of ammunition to use against you. The IRS has a list of 20 characteristics that determine whether the relationship is truly an independent contractor relationship, or merely a disguised employment. One of those key points is whether the relationship is terminable at will by the "employer." If it is, then the IRS will likely take the position that this is an employment relationship.

So the standard "at will" clause in an employment agreement is the last thing you want to see in an independent contractor agreement. That's just one of many examples. If the IRS decides your independent contractor arrangement is really just employment in disguise, they will not only assess the employer for unpaid withholding taxes, they can also impose a heavy 100% penalty on the "control persons" who write the checks or authorize the payments. That would generally be the owner. And what's worse, if the IRS recharacterizes the independent contractor relationship as one of employment, then the contractor/employee may even have a claim against the employer for unpaid overtime, which would include significant damages and legal fees.

Take the same situation, but reversed. If the company dusts off what is really an independent contractor agreement, and tries to use it as an employment agreement, they have probably tossed away their right to terminate the employee "at-will" because the contractor agreement was for a specified task at a set price. As long as the contractor performs the specified task, they have a right to finish the job and get paid. Is this what you want in an employment agreement? Probably not. Keep that in mind if you are considering the DIY approach. Sure, you will probably save some legal fees, but from our experience, they will be dwarfed by what it will cost to untangle the "hairball" you may create.

For more merriment from Monty Python's Flying Circus, go [here](#).

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