

How Companies Can “ACE” the Independent Contractor Conundrum

Overview

Some experts estimate that up to 50% of the workforce in the United States will consist of non-employees within 10 years. This is attributable on one hand to businesses’ desire to retain flexibility and control staffing-related expenses and, on the other hand, the worker’s desire to do personally fulfilling work on their terms – flexible schedule, location, etc. – so-called “life balance” issues.

The challenge, of course, is determining appropriate employer status by answering what should be a very straight-forward question – is a worker an employee or an independent contractor? The answer, according to many employment law experts is: “It depends.”

The answer depends, in part, on for what purposes the question is being asked. For example, are you trying to determine if someone is an employee for purposes of minimum wage coverage? Tax reporting? Unemployment benefits? Union issues? Workers’ compensation? Yes, it is possible for someone to be an employee for one purpose and an independent contractor for another.

And why does it matter? Employers are required to calculate and remit employment-related taxes to the federal and state governments, including income and unemployment taxes, as well as Social Security and Medicare/Medicaid taxes. In addition, employers must provide workers’ compensation coverage for their employees (not independent contractors). Employees are also afforded protections under state and federal antidiscrimination and wage payment laws – protections which are not enjoyed by independent contractors.

The purpose of this article is to help sort issues in the employee vs. independent contractor determination. It is not meant to take the place of legal advice from a qualified attorney. This is an important point; misclassifying an employee as an independent contractor can expose a business to fines and penalties under state and federal laws. Cash-strapped governments are looking for revenue and the independent contractor area is widely perceived as rife with underreporting and paying of tax liabilities.

States are suing big businesses over the classification issue – New York, for example, joined by other states, has sued FedEx for alleged misclassification of employees as independent contractors under state law. At the federal level, the IRS has made proper classification of employees an enforcement priority. The Supreme Judicial Court of Massachusetts held that employers who misclassify employees as independent contractors may be held strictly liable for their classification mistake, clearing the way for misclassified employees to sue their errant employers for damages. The measure of these damages can be significant, amounting to the difference between what the worker would

have made as an employee – including overtime and other benefits – and what they were actually paid as independent contractors. Pending bills in Congress could substantially increase penalties for misclassification and do away with “safe harbor” provisions which currently protect employers who misclassify employees as independent contractors, if they had a reasonable basis for so doing. Welcome to the latest example of mismatch in governmental policy and workforce reality.

An “Independent” Framework

The determination of employee vs. independent contractor status is a fact-intensive undertaking and should be guided by a qualified legal professional. Applicable laws include, but are not limited to state fair employment, unemployment, safety and workers’ compensation laws; federal laws, including the Fair Labor Standards Act, OSHA, Title VII, ADA, ADEA, EPA, ERISA, NLRA and, importantly, the Internal Revenue Code.

Although differing tests of who qualifies as an “employee” apply under each of these laws, there are some basic considerations for independent contractors and businesses contemplating engaging their services. These basic considerations fall into three broad categories - *Analysis, Contracting and Engagement management* – or “ACE.” By being aware of the risks and issues, and applying the ACE approach, the reader should be in a better position to avoid these risks and successfully engage independent contractors.

Analysis – Answers the basic question of what type of worker should perform the task. This can run the gamut from a short-term agency employee assignment, to outsourcing the function or part of the function to a separate company, to utilizing an independent contractor. Projects better-suited for independent contractors are those which are for *a defined period of time* or for *a particular project* (which ends upon completion of the project), *require little or no instruction or training* by the company, and which can be performed at a location and in a manner determined by the independent contractor, *utilizing his or her own staff and tools*, as may be necessary. Put more simply, this is true project-based work, where the deploying company is interested only in the quality of the outcome and the timeliness of its delivery. An assignment may not be suitable for engaging an independent contractor to perform if it is ongoing in nature, requires the work to be done at a particular time, place or in a particular order, requires training or instruction on how to do the job, or is subject to ongoing supervision and evaluation. If your

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business currently employs individuals who are performing the same tasks as called for in the project you are considering assigning to an independent contractor, it likely is not going to withstand scrutiny by federal or state labor officials.

Contracting – Assuming you have determined that a particular project is suitable for engaging an independent contractor, the next step is to select the appropriate professional for the position and enter into a written agreement. Start with a description of the project that includes key deliverables, timelines, budget and any major milestones. Once the project description is complete and approved by key stakeholders, develop a list of knowledge, skills, abilities, training and licenses (as may be needed) the successful independent contractor will need to possess in order to achieve the project deliverables. Use these tools to drive a request for proposal (RFP) process. The RFP process, which culminates in the selection of the independent contractor, should be appropriate to the size and complexity of the project at hand.

For example, an RFP process should be more involved if the contract is for \$3M than for \$3K. Solicit proposals from at least two independent contractors for a baseline in the selection process. Sometimes overlooked in this process is to ensure that the independent contractor is thoroughly screened, including multiple business references, educational and licensure verifications (including state and local business licenses), civil records, and professional and general liability insurance (ask for evidence of current insurance coverage). In addition, you may want to consider providing the independent contractor with a copy of the form agreement you intend to use for the engagement, which will cover several key areas, including:

- Define the “independent” nature of the engagement, ensuring there is no confusion between the parties that the independent contractor is not an employee;

- Project deliverables, timelines and financial issues (e.g., how the independent contractor will be compensated, billing arrangements, payment terms, expenses, etc.)

- Term and termination conditions;

- Insurance coverage, which must be in force (and kept in force) by the independent contractor for the length of the engagement, which may include general liability, professional liability and workers’ compensation insurance;

- Confidentiality provisions, including requiring the independent contractor to keep information confidential even after the assignment ends;

- Intellectual property ownership by the company of “works made for hire” by the independent contractor during the engagement and a catch all assignment of intellectual property rights by the independent contractor to your company;

Other “legal” provisions, covering how disputes will be resolved, what happens in case of breach, any limitations of liability, indemnification and choice of law.

It is vital to have a well-crafted independent contractor agreement in place, and the services of an attorney are extremely helpful in this regard. While the existence of an agreement calling someone an independent contractor is not in and of itself the determining factor if the classification is ever called into question, it is an important factor.

Engagement Management – It is important that the engagement of an independent contractor be appropriately managed throughout the course of the engagement. Too often, a manager who is used to supervising regular employees can unintentionally blur the line between contractors and employees. The key is to ensure that managers do not start treating a contractor like an employee. For example, exercising too much control over the contractor’s work, dictating working hours, requiring work to be performed in a particular location (especially if that location is one of the company’s offices) or specifying where the independent contractor is to buy supplies and services – these are all potential threats to the classification of a worker as an independent contractor. Importantly, the company should not extend regular employee benefits – e.g., health and welfare benefits, 401(k) participation, paid time off, etc. - to an independent contractor. Keep in mind that treating an independent contractor like an employee can make them into one, exposing your business to taxes, penalties and other employment-related liabilities.

Conclusion

The determination of employee vs. independent contractor can be quite confusing. However, if you keep the *ACE* principles in mind – *Analyze* the task to see if it is suitable to be performed by an independent contractor; *Contract* for services with a written agreement and only after the independent contractor has passed background screening; *Engagement* management – do not turn an independent contractor into an employee by treating them like one - you should be able to “ace” the successful engagement of independent contractors.

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