

Tempted To Use An Independent Contactor To Fill A Vacancy?

Provided By QTS Payroll Services, Inc. and the Pros at HRAnswerLink

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Watch out. These workers can actually end up costing you more in headaches, back taxes, and penalties if you improperly classify them as independent contractors. The fact that the individual wanted to be classified as an IC will NOT protect you – it is YOUR responsibility to classify all workers within your company properly.

The government agencies that enforce employment laws are aggressively pursuing claims in this area for overtime wages, discrimination, and benefits pay-outs. In particular, the Internal Revenue Service (IRS) has collected millions this way in back taxes and penalties for violations. Therefore, you should make sure your independent contractor classifications are proper and not a shortcut to an expensive nightmare.

There can be advantages to using contractors. Two good ones are:

- If you have a project that requires a special or not readily available level of expertise, hiring a consultant or qualified contractor to do the work can jump-start the process.
- The use of independent contractors can give you more flexibility to "staff up" and cut back, without incurring many of the normal costs of hiring or layoffs.

If you are using Independent Contactors because one of these reasons, you are playing with fire:

- You do not have to pay taxes on their behalf.
- They don't participate in your benefit plans.
- These workers usually are not covered under state workers' compensation or unemployment compensation laws.
- They are not entitled to overtime under wage and hour laws.
- ICs cannot sue under discrimination statutes.
- They are not eligible to take leave under the Family and Medical Leave Act.

The Focus is on Control

So, how do you avoid misclassification? The answer is tricky since the courts and agencies generally use three different standards to determine contractor status. The first standard is the IRS 20-factor analysis for coverage under federal withholding requirements.

The IRS Twenty-Factor Test

The IRS considers the existence of an employer-employee relationship to depend on whether the worker is subject to the will and control of the employer, based on an analysis of the following factors:

1. Instructions. Employees typically must follow instructions as to when, where, and how to perform the job.
2. Training. A requirement for training tends to support employee status.
3. Integration. Integration of the worker's services into the business operations suggests that the hirer directs and controls the worker.
4. Services rendered personally. If a designated worker must provide services personally, then the hirer controls the methods used to complete the work.
5. Control of assistants. Control by the hirer over the hiring, supervision, and pay of assistants implies employee status.
6. Ongoing relationship. A continuing or long-term relationship suggests that an employer-employee relationship exists.
7. Set hours of work. The establishment of set hours by the hirer implies control over the worker.
8. Full-time work. A worker who must devote full working time to the hirer is being controlled.
9. Work on hirer's premises. Regular on-premises work indicates employer control, especially when the work could be done elsewhere.
10. Order or sequence. Work that must be performed in an order or sequence established by the hirer suggests control.
11. Reports to hirer. A requirement that the worker submit regular oral or written reports to the hirer implies control.
12. Payment method. Payment by the hour, week, or month generally indicates an employer-employee relationship, while payment by the job or commission supports independent contractor status.
13. Payment of expenses. Payment of the worker's business or travel expenses suggests an employer-employee relationship, since the hirer is regulating and directing the worker's activities.
14. Furnishing tools and materials. Provision of tools, materials, and other equipment by the hirer shows an employer-employee relationship.
15. Significant investment. Independent contractor status is implied if the worker invests in the facilities used for the work, while an absence of investment indicates an employer-employee relationship.
16. Realization of profit or loss. A worker who can realize a profit or suffer a loss as a result of providing services is usually an independent contractor.
17. Serving more than one firm. A worker who provides services to several unrelated firms generally is an independent contractor.
18. Serving the public. A worker whose services are regularly available to the general public is an independent contractor.

19. Right to discharge. The right of the hirer to discharge the worker at any time is a factor indicating an employer-employee relationship, but contractor status is supported when the hirer's right to terminate the worker is limited to failure to perform under a contract's specifications.
20. Right to quit. A worker with the right to terminate the relationship with the hirer at any time, without liability or contractual obligations, is generally an employee.

The presence or absence of any one of these 20 factors will not be determinative, or conclusive, by itself in supporting a proper contractor designation. Instead, the IRS usually considers how all the factors affect the relationship.

The second is the "economic reality" test used to determine compliance with requirements of the Fair Labor Standards Act (FLSA). And, the third is the common law "right to control" test used by many courts in discrimination and benefit cases. These three tests share several common features, the most important of which is the amount of control the employer exercises over the work relationship.