

What you don't know about independent contractor compliance can hurt your company.

SETTING THE CONTEXT

Contingent Workers and Co-employment

A contingent worker is a temporary or part-time worker, usually one working under contract for a fixed period on a specific project.

Co-employment occurs when a court of law or a government agency rules that a contingent worker, who is self-employed or employed by another employer, is also your employee, to a greater or lesser extent, with respect to one or more of the following:

- ✓ Payroll and Income taxes
- ✓ Government mandated entitlements: E.g., Workers Compensation, Unemployment Insurance, Social Security, Medicare, etc.
- ✓ Employment protections: EEOC, ADA, FLSA, etc.
- ✓ Employee benefits
- ✓ Retirement contributions
- ✓ Stock options and stock purchase plans
- ✓ Liability for negligence, criminal activity, etc., etc., ...

Your company can avoid co-employment risk by employing directly every contingent worker who works for your company – albeit not a very practical idea.

Your company can lessen co-employment risk by engaging outside vendors that clearly qualify as legitimate businesses to work on your projects.

The greatest risk of co-employment arises when a company augments its staff by engaging the services of an independent contractor or agency temp who works on company projects, side-by-side with the company's own employees, often for extended periods and under the close supervision of a company employee.

The flexible nature of staff augmentation is highly attractive to businesses seeking to optimize their competitive advantage. Staff augmentation is also highly risky.

At issue is this: Does the contingent worker look like an employee who your company is paying "under the table" in order to:

- ✓ Avoid its obligations as an employer,
- ✓ Avoid paying for government entitlements,
- ✓ Avoid paying for employee benefits?

In other words, are you creating a condition of co-employment?

If It Looks Like a Duck...

It's like the saying: *If it looks like a duck, walks like a duck, swims like a duck and quacks like a duck, it's probably a duck.* If your company's relationship with a contingent worker looks like an employer-employee relationship, then that is probably what a court of law or a government agency will rule as they reclassify the contingent worker as an employee of your company.

The financial consequences of reclassification in terms of legal costs, retroactive compensation for employee benefits, and the payment of back taxes, penalties and interest can be staggering, often in the neighborhood of \$100,000 per reclassified employee.

It is critical that all company employees who have anything at all to do with contingent workers understand the risk factors that contribute to the appearance of co-employment.

The following discussion presents several common scenarios involving contingent workers. Evaluate each scenario. Does the situation aggravate (create or increase) co-employment risk? Or does it mitigate (eliminate or lessen) co-employment risk?

TEST YOUR KNOWLEDGE

1. The IRS 20 Common-Law Factors Test

Scenario: Your HR manager has distributed the Twenty Common-Law Factors Test developed by the IRS to help companies determine whether a contingent worker is a common-law employee of

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your company or a legitimate independent contractor.

You follow the guidelines carefully and you only engage the services of consultants who satisfy all twenty common-law factors to qualify them as independent contractors.

Does strict reliance on the IRS Twenty Common-Law Factors Test **aggravate** or **mitigate** the risk of co-employment?

2. A Valid Independent Contractor Agreement

Scenario: Every worker that your company engages as an independent contractor must sign a work-for-hire contract with the Procurement Department that states clearly that the worker is a valid independent contractor and, specifically, that the worker is not an employee of your company.

Does relying on a contract that states specifically that the worker is an independent contractor **aggravate** or **mitigate** co-employment risk?

3. Transfer the Risk of Co-employment to a Staffing Vendor

Scenario: You only engage the services of contingent workers who are employed by a third-party staffing vendor, such as a consulting firm, recruiting firm, temporary help agency or contractor employment agency.

Does transferring the risk of co-employment to a staffing vendor **aggravate** or **mitigate** the risk of co-employment?

How Did You Do?

1. The IRS 20 Common-Law Factors Test

Strict reliance on the IRS Twenty Common-Law Factors Test **aggravates** co-employment risk.

The so-called 20-questions test is outdated. The IRS devised the list of twenty common-law factors following the 1987 Revenue Ruling [87-41, 1987-1 CB 296]. A lot has happened to the nature of work in the United States since 1987 and, while the 20 common-law factor test is a helpful tool, strict reliance on the test is at best misleading and at worst incomplete.

In 1996 the IRS published *Independent Contractor or Employee? IRS Training Course 3320-102(10-96)*.

The 160-page training manual trimmed the list of common-law factors to eleven factors organized in three areas of control.

- ✓ **Behavioral control:** The right to direct or control how the work is done.
- ✓ **Financial control:** The right to direct or control how the business aspects of the worker's activities are conducted.
- ✓ **Relationship of the parties:** How the parties perceive their relationship.

However, even the 1996 control standard published by the IRS is inadequate because it applies only to the determination of worker status for employment tax purposes. Every state and federal department that has anything to do with employees has a separate set of criteria to determine worker status.

Examples of government agencies with their own common-law tests include:

- ✓ The Employee Retirement Income Security Act (ERISA) uses a twelve-factor list to determine if a worker qualifies for employee benefits.
- ✓ The Immigration Reform and Control Act (IRCA) applies a seven-factor test to determine the employment status of foreign workers.
- ✓ The Equal Employment Opportunity Commission (EEOC) applies a standard based on the right to control the means and manner of a worker's performance in federal employment discrimination cases.
- ✓ The Fair Labor Standards Act (FLSA) applies a six-factor "economic realities" test in settling wage and hour disputes based on the extent to which a worker is economically dependent on the business.
- ✓ Other government agencies with common law criteria, including the Social Security Administration (SSA), the US Department of Labor (DOL), state and federal safety boards (OSHA), state departments of employment, state workers compensation boards, and countless local agencies.

Government agencies make it their business to ensure that workers are properly registered for public entitlements and that they are protected by rules and regulations governing the workplace. These criteria apply to regular employees. For the most part, they do not apply to independent contractors.

Government agencies are not the only ones to apply common-law factors to worker status. The courts also invoke common law to distinguish between independent contractors and employees. In his book, *The IRS, Independent Contractors and You!*, tax attorney James R. Urquhart III, lists 51 common-law factors that have figured in court cases and appeals.

Clearly, relying on only a narrow subset of all the factors affecting worker status ignores the totality of the evidence and may significantly aggravate the risk of co-employment.

2. A Valid Independent Contractor Agreement

It is always important that client and vendor lay out the terms of their working agreement in a written contract. Indeed, the absence of a written client-vendor contract can imply an employer-employee relationship.

Nevertheless, you cannot make a worker an independent contractor – and not an employee of your company – simply by stating as much in a written contract.

It is not enough that your company and the worker agree in writing that the worker is an independent contractor. The specifics of the relationship between your company and the worker must comply with the relevant common-law criteria.

When determining worker status, courts of law generally ignore or reject as irrelevant the existence of a client-vendor contract. They look, instead, to the nature of the working relationship between the employer and the worker.

Clearly, a client-vendor contract stating that the worker is an independent contractor will do little to mitigate your risk of co-employment. Indeed, relying exclusively on contract language to protect your company may significantly aggravate the risk of co-employment.

3. Transfer the Risk of Co-employment to a Staffing Vendor

Many companies routinely refer non-compliant, direct-sourced, independent contractors to a third-party employer of record for W-2 employment status. This approach has several advantages. For one, the company signs a service contract with a legitimate business and not with an individual who may look more like an employee of the company than a legitimate business.

A third-party employer has the trappings of a legitimate business, including a registered business name, valid business license, separate tax ID number and separate tax return for the business.

In addition, a third-party employer is more likely than an independent contractor to carry general liability insurance, thus protecting your company from the financial consequences of injury or damage caused by the contingent worker.

A third-party employer further protects your company by covering your contingent workers for state and federally mandated unemployment insurance and workers compensation.

Finally, and perhaps most importantly, a third-party employer processes payroll for your company's contingent workers, ensuring that Social Security, Medicare and income taxes are paid on money earned by the contingent worker.

All of these factors mitigate the risks of co-employment. However, transferring the risk of co-employment to a staffing vendor does not guarantee that your company will escape the threat of reclassification. In fact, some of the largest cases of reclassification have involved employees of staffing vendors.

The courts, government agencies and the IRS do not particularly care who processes payroll for your contingent workers. Rather, they look first at the fundamental nature of the working relationship between your company and the contingent worker. If the working relationship looks like an employer-employee relationship, then that is what it is – regardless of who processes the worker's payroll, and regardless of what your company and the worker might believe about the nature of the relationship.

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It always comes down to who has the right to control and direct the details of how the work will be done. Your company's regular employees can turn any contingent worker — whether self-employed or employed by a third party — into a common-law employee of your company simply by supervising the worker too closely. Accordingly, relying on third-party employment, without due consideration to the fundamental nature of the working relationship, may significantly aggravate the risk of co-employment.

WHAT CAN A COMPANY DO?

Your company's legal counsel knows how to mitigate the risks of co-employment. Your company's C-level executives know. Your HR manager knows. Your procurement director knows. It is their job to know these things.

Unfortunately, it is your company's project managers, team leaders and supervisors — those employees working most closely with your contingent workers — who are most likely to get your company into trouble by inadvertently treating your contingent workers in a way that makes them common-law employees of your company.

The key to effective mitigation of co-employment risks is training your front-line managers and supervisors in the principles and practice of everyday risk mitigation.

Few companies, today, make the effort to teach their project managers, team leaders and supervisors about contingent workforce management and co-employment risk mitigation.

A small investment in time and resources for training in co-employment risk mitigation can pay huge dividends by reducing the real financial consequences of employee reclassification.

ABOUT SOLO W-2, INC.

Solo W-2, Inc. began in 1998 as an economical and benefits-rich alternative to the traditional staffing vendor business model.

Solo W-2, Inc. provides back-office logistics support, executive-level employee benefits and contracts administration for independent professionals, including self-employed persons, small business owners, freelancers and consultants.

Solo W-2, Inc. also provides contingent workforce compliance, co-employment risk mitigation and contractor payment services for corporate employers, progressive staffing vendors and government agencies.

Solo W-2, Inc. serves independent professionals and client companies throughout the United States from its corporate offices located at:

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