

Talking Yourself into Trouble: How Workforce Terminology Affects Co-employment Risk

James R. Ziegler, Ph.D.
President, Solo W-2, Inc.

EXECUTIVE SUMMARY

This white paper explains why HR managers, Procurement managers, executives and employees at every level of the organization must understand and appreciate the many fundamental differences that exist between workers who are employed by the company and workers who are employed as, or by, an outside vendor.

Because everyday speech, thoughts, attitudes and activities in the workplace contribute to co-employment risk, it is imperative that companies foster a corporate culture that rigorously and consistently reinforces the differences in worker status by promoting written and oral communications that unambiguously convey worker status.

A vocabulary table in this document lists commonly used terms that typically imply an employer-employee relationship. These terms are paired with functionally similar terms that imply a client-vendor relationship.

The discussion that follows illustrates how the misuse of employee terminology when discussing contingent workers can promote attitudes and behaviors that confuse worker status and increase the company's co-employment risk.

This document illustrates how inappropriate and misleading terminology—often deeply ingrained in the cultures of corporations and the staffing industry—results in common practices by HR departments and staffing vendors that can significantly increase the risk of worker reclassification by the IRS and the courts.

Finally, this white paper makes a number of specific recommendations for actions that companies can take to mitigate co-employment risk while promoting a strong affirmative defense against claims for reclassification of contingent workers by the IRS and the courts.

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INTRODUCING DUNGAREE DAN

Meet Dungaree Dan. Dan is a consultant, a contractor, a freelancer and a temp. Dan offers his professional services to others under the terms of a negotiated contract between Dan — or Dan's employer — and the party that pays for his professional services. When Dan provides his services according to the terms of his contract, he is doing so as an independent contractor, a business, a vendor.

For more than twenty years, Dungaree Dan has marketed his professional services all over the country to companies of every size and configuration. At no time has Dan felt that he was anything but an independent contractor. Whether self-employed or employed by a staffing agency, Dan has always conducted himself as a vendor. And, in the eyes of the IRS and other government agencies, that is exactly what he is — a business, or the representative of a business, selling professional services to others.

Dan is a knowledge worker — a skilled craftsman who works with information, knowledge, and knowledge management tools. A knowledge worker may be an accountant, a paralegal, a nurse practitioner, a budget analyst, a software programmer, a network integrator, a database architect or someone in any of a thousand different professions in which the worker applies advanced critical-thinking and problem-solving skills.

Dan is a craftsman. He is a craftsman who works with his mind; a craftsman who, perhaps, works more with his mind than with his hands, but a craftsman nonetheless. He labors over intellectual projects the way other craftsmen labor over manual projects. He is a laborer who works according to the terms of a contract to make, mend or maintain something of value for his client; not unlike a plumber, a carpenter, a landscape worker, or any one of a thousand different types of service provider, regardless of how skilled the required training, how routine the work or how rote the task. Dan is a craftsman and a laborer who is a vendor and a business just the same.

The story that follows recounts a pivotal encounter between Dungaree Dan and Mary, a project manager employed by Dan's client.

THE NEW HIRE

"So tell me," Dan inquired, "how is your current project going?"

"Oh, it's much better lately." Mary sighed. "We were short staffed for the first three months, and it was difficult to get any traction on the new project, but we finally recruited a superb new hire. His name is Jack, and he is turning out to be a very valuable member of my team."

Dan nodded, encouraging Mary to continue.

"We were really lucky. The job description for the position is pretty advanced, and most of the candidates we interviewed were under-qualified. Then, we interviewed Jack for the job and discovered that his skills were much stronger than his resume indicated. We negotiated a fair wage — actually, as much as our budget would allow — and hired him on the spot. I thought I still might have to pay for a lot of specialized on-the-job training in order to bring him up to speed, but he hit the boards running, and he has not faltered since starting the job. He's a good worker, a productive member of the team, and I hope I can keep him on my team indefinitely."

Dan agreed. "I've had lots of experience with tight budgets and short staffs. You were fortunate to hire such a good person."

"You can say that again. Jack is a project manager's dream. He works hard, he is flexible, he follows instructions to the letter and he readily accepts ad hoc assignments during lulls in the workload. He even completes our required status reports and time sheets on schedule." Mary leaned back and laughed, "It's a fact, Dan; I'm an incurable micromanager and a bit of a control freak. Still, I wish my own employees were as proactive and open to my close supervision as Jack is."

Dan's jaw dropped. Dan had been smiling, but his expression quickly changed to concern upon hearing Mary's last comment. "Did I hear you correctly; you wish your own employees were as open to supervision as Jack is? I thought Jack was your employee. Do you mean he's a contractor?"

Mary laughed and shrugged her shoulders. "Well, actually, he's employed by a temp agency, so, he might as well be one of our employees. I treat him the same as all the other employees on my team. Actually, Dan, I like working with contractors. If they do not work out or we have to cancel their project, we can fire them more easily than we could fire one of our own employees. All I have to do is pick up the phone and say I don't need their services any more."

"I see," Dan said, suppressing his disappointment at Mary's seemingly condescending attitude toward contract professionals. "From the way you were talking I just assumed you were describing one of your own employees."

Dan furrowed his forehead and leaned forward across the table. "Mary, I'm working on an open letter that I plan to distribute to all the project managers on my contact list. I believe it is an important document, and it specifically discusses this very subject. I would appreciate your feedback on what I have written so far. I will send you a draft copy by e-mail as soon as I get back to my desk. May I drop by your office later this afternoon to discuss it with you? Is four o'clock OK?"

"Well," said Mary. "I'm pretty busy, but if it's that important I can spare an hour."

"Great," Dan replied. "I'll be there at four o'clock sharp. I must get back to my own project now."

As Dan walked away, Mary wondered, what could be so urgent about bringing on this particular new hire that I should read Dan's article and discuss it with him this very afternoon?

DAN'S OPEN LETTER TO PROJECT MANAGERS

To: Project Managers, Staffing Professionals, Procurement Officers and others who work with Contract Professionals
From: Dungaree Dan, Independent Professional
Subject: How Workforce Terminology Affects Co-employment Risk

Dear Fellow Project Managers,

For several years now, I have had the opportunity as a contract professional to observe how companies interact with their contingent workers. My observations have led me to the conclusion that most frontline project managers and their team members are woefully unaware of the many ways that their everyday speech, thoughts, attitudes and activities can contribute to the risk of employee reclassification by the IRS and the courts.

I have drafted this open letter to address this matter and propose some simple, yet highly effective, measures that project managers can follow in the workplace to minimize co-employment risk.

Some Background

In October 1996, the IRS published a 160-page training manual for its field agents with the provocative title, Independent Contractor or Employee? IRS Training Course 3320-102(10-96). The training manual provides guidance to IRS field agents for determining the tax status of workers who provide products and services for others — specifically, whether a given worker should be classified as an independent contractor or an employee.

The IRS training manual explains,

"The status of a worker as either an independent contractor or employee must be determined accurately to ensure that workers and businesses can anticipate and meet their tax responsibilities timely and accurately."

To quote Hamlet in his famous soliloquy, "Ay, there's the rub." Who is better equipped to pay the

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taxes owed by a contingent worker than the worker's employer? Ultimately, it all comes down to this question: *Who is the worker's employer?*

Although the IRS training manual states that,

"Either worker classification – independent contractor or employee – can be a valid and appropriate business choice,"

...most observers would probably agree that the IRS has a strong inherent bias to classify workers as employees of the business that pays to have the work done. Even more so if the business already has established systems in place to withhold and pay the taxes owed on the worker's income.

A business that improperly classifies an employee as an independent contractor runs the risk of being assessed back taxes, penalties and interest on the entire amount that it has already paid for the contingent worker's services, an amount that is considerably greater than the mere wages that it would have paid to the worker as a regular employee.

The billing rate for an independent contractor is analogous to the fully loaded labor cost for an employee. It includes amounts above and beyond the independent contractor's net earnings – equivalent to an employee's wages – that the independent contractor has factored into the billing rate to cover payroll taxes, general liability and errors & omissions insurance, health and dental insurance, retirement savings, training, supplies, vacations and sick leave, owner's profit, and any other costs of doing business.

Any business involved in a reclassification claim faces the prospect of paying the worker's labor burden twice, once as a component of the billing rate, which it has already paid for the worker's services, and again as an assessment on top of the original billing rate, the entirety of which is now reclassified as employee wage. This amounts to an effective double assessment by the IRS for back taxes, penalties and interest.

Moreover, in civil employment cases, the courts may award retroactive compensation to reclassified employees for employee benefits and perks that

the workers would have received had they been properly classified as the company's employees in the first place.

It is interesting to note here that the \$97 million court judgment against Microsoft in the famous *Viscaino vs. Microsoft* class-action lawsuit happened because Microsoft had denied several thousand contingent workers, many of whom had worked at Microsoft for as long as five years, the opportunity to purchase Microsoft stock at the usual 15% employee discount.

Originally, the class-action lawsuit had sought compensation for the full range of Microsoft's employee benefits, including employer-paid health insurance and participation in the company's retirement savings plan. Fortunately, for Microsoft however, the courts ruled that the contingent workers remained employees of their agencies or their own consulting firms for the purpose of payroll and benefits, and that Microsoft was the employer solely for access to Microsoft's employee stock purchase plan.

Imagine the potential damage if the courts had ruled that Microsoft was also responsible for the withholding of taxes, employer-paid health insurance, and participation in Microsoft's retirement plan. Microsoft may have taken a \$97 million bullet in this case, but it dodged a billion-dollar howitzer shell.

But wait; there is more. Legal expenses incurred by the business to defend itself against a reclassification claim are staggering and unrecoverable, even if the business eventually prevails in court.

Speaking bluntly, notification of an impending IRS employment audit or a civil lawsuit filed on behalf of one or more disgruntled contractors is an invitation to reclassification hell.

Why "Independent Contractor or Employee?" is the wrong question

People reading the title of the IRS training manual may take it to mean that individual workers are intrinsically either an independent contractor or an employee, but that is not the case at all. Every

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worker is at once *both* an independent contractor *and* an employee. A better title for the IRS training manual might have been, “*Who is the worker’s employer?*”

When posed in this light, the confusing issues surrounding worker status and the consequences of misclassification fall neatly into place. Let me explain.

The default tax status of every citizen and resident alien in the United States is that of sole proprietor. A sole proprietorship is an unincorporated business owned by one individual, the sole proprietor. Sole proprietorship is the simplest form of business organization to start and maintain. A sole proprietorship has no existence apart from its owner. That is to say, the sole proprietor and the sole proprietorship are the same entity. A sole proprietorship’s liabilities are the owner’s personal liabilities. Its assets are the owner’s personal assets. The business reports income and expenses in the owner’s personal tax return and files the tax return under the owner’s Social Security number.

A sole proprietorship is a business. Another term for “business” is independent contractor. Accordingly, every citizen and resident alien in the United States is intrinsically and automatically an independent contractor.

Now that we have ascertained that every citizen and resident alien in the United States is an independent contractor — and is never NOT an independent contractor — let us turn our attention to the subject of who is an employee.

Well, guess what? Every citizen and resident alien in the United States, as well as every non-resident alien with a valid work visa, is someone’s employee.

Sole proprietors are self-employed, which means that each sole proprietor is an employee of his or her own sole proprietorship. Sole proprietors are responsible for paying both the employer’s and the employee’s share of FICA payroll taxes (Social Security and Medicare taxes) — what the IRS calls a self-employment tax — on their business earnings.

All other paid workers are employees of a separate business, such as a partnership, a corporation or a limited liability company. The worker’s employer may be an owner-only business — for example, a one-person corporation — or a business owned in part or entirely by others.

So, now we have also ascertained that every paid worker is an employee — and is never NOT an employee.

It is immaterial that some people may receive no income as a self-employed independent contractor, or even as someone else’s employee. The fact remains that virtually every citizen and resident alien of the United States is both an independent contractor and an employee.

Clearly, the issue at hand is not whether any particular paid worker is an independent contractor or an employee. At any given moment, every worker is *both* an independent contractor *and* an employee.

The issue at hand is this: given the particular context of the working relationship, *who is the worker’s employer?* Who is responsible for paying the employer’s share of payroll taxes on money paid to the worker, and who is responsible for providing employee benefits to the worker?

Is it the worker (sole proprietorship); is it the worker’s incorporated business (one-person corporation or one-person LLC) or is it a business owned by others (e.g., a staffing vendor or consulting firm)?

On the other hand, might the common-law employer be a business *other than the worker’s acknowledged employer* — a business that controls and directs the details of what the worker does and how that work is done?

Under common law, an *independent contractor* is a person or business who provides a product or service for others, where the party who pays for the product or service has the right to control and direct *only the result* of the work and not the means and methods of accomplishing the result.

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Under common law, also, an *employee* is a person who provides a service for others, where the party who pays for the service — the employer — *has the right to control and direct the details of what will be done and how it will be done.*

Put quite simply, the determination of whether a worker is an independent contractor or an employee *in any given context* depends on the degree of control by the employer over how the worker performs the services.

So it appears that the determination of worker status is all about who has the *right to control* the worker, which, in turn, determines *who is responsible for paying the worker's taxes and, possibly, their employee benefits as well.*

Certainly, there are circumstances that clearly indicate when a worker is an independent contractor and there are circumstances that clearly indicate when a worker is a common law employee and, yet, there is no bright line that distinguishes one from the other. Instead, there is a vast gray area of ambiguity where no company dare venture because the risk of getting it wrong is just too great.

The Control Standard

Over the years, the courts have identified over fifty common law factors, which in one way or another affect the determination of worker status. Nevertheless, the abundance of case law offers only an imperfect guide to the determination of worker status.

Courts of law must rely on the totality of evidence before them, factoring in many nuances of law and circumstance. So, it should not be surprising that some cases can move through several appeals, with each higher appellate court reversing and qualifying a previous court's findings. The result is a system for determining worker status that is arbitrary at best, if not utterly capricious.

Complicating the matter is the fact that various government agencies at both the State and Federal levels have compiled their own separate lists of common law factors. The best known of these lists is the so-called "twenty questions," devised by the

IRS in a 1987 revenue ruling to help companies and IRS agents determine the tax status of individual workers.

In 1996, the IRS revised the original list of twenty common law factors, narrowing the field to just eleven factors organized in three areas of control:

1. **Behavioral control:** The right to direct or control how the worker performs a specific task.

Common-law factors include:

- instructions
- training

2. **Financial control:** The right to direct or control how a worker conducts his or her business.

Common-law factors include:

- significant investment in business
- unreimbursed expenses
- services available to the relevant market
- method of payment
- opportunity for profit or loss

3. **Relationship of the parties:** How the parties perceive their relationship.

Common-law factors include:

- intent of parties/written contracts
- employee benefits
- discharge/termination
- regular business activity

The burden of proof is on every company to show unequivocally that any worker it pays as an independent contractor is a legitimate business — or the employee of a legitimate business — and not a common law employee of the company. It is not enough that both the worker and the client agree on the worker's status as an independent contractor.

Moreover, it is not enough that the worker is incorporated or is employed by a third party. Any company that presents the *appearance* of an employer-employee relationship between itself and its contingent workers is opening the door for the IRS and the courts to invite themselves in and

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reclassify those workers as the company's common law employees.

Loose Talk and the Slippery Slope to Reclassification Hell

One cannot deny that the words we use in our everyday speech shape the way we think and act. Positive speech projects a positive attitude. A positive attitude generates positive actions, and positive actions, in turn, attract good things into our lives. One can say the same for negative speech, negative attitudes and negative actions, which lead ultimately to unpleasant consequences.

So it is that when we talk about contingent workers – temps, contractors and consultants – the vocabulary we use can have far-reaching consequences, which may be good or bad depending on the vocabulary we use.

For example, when the employees of a company discuss a contingent worker using terminology usually reserved for employees, they blur the distinction between outside vendor and inside employee. Their inappropriate vocabulary creates the appearance of an employer-employee relationship, and reinforces the impression in the workplace that the contingent worker can be treated the same as an employee of the company. Using the wrong terminology is the first step down the slippery slope to reclassification hell.

Some companies require that contingent workers wear a different-colored ID badge, and most companies require that their contingent workers are employed by a third party or require that they meet rigorous standards of compliance as a legitimate business. Unfortunately, these measures do little to affect the actual working relationship between a company and its contingent workers and, consequently, these measures may do little to mitigate the risks of co-employment.

The courts and the IRS do not particularly care what color badge a worker wears. Nor are they particularly interested in who processes the worker's payroll. Rather, they look first at the fundamental nature of the working relationship between the company and its workers. If the working relationship looks like an employer-

employee relationship, then that is what it is – regardless of the color of the badge, regardless of who processes the worker's payroll, and regardless of what the two parties might believe about the nature of their relationship.

It comes down to *who has the right to control and direct the details of what will be done and how it will be done*. The regular employees of a company can turn any worker into a common-law employee of the company – regardless of whether the worker is a plumber, a gardener or a computer programmer – by supervising the worker too closely.

That is why it is so important always to use correct terminology in the workplace when working with outside vendors and their employees. Using appropriate terminology helps to reinforce the fact that the company's regular employees must follow a different protocol when dealing with contingent workers.

Co-employment Risks

Actually, the mere fact that a company uses contingent workers on its projects makes them *co-employees* of the company. That is to say, to a greater or lesser extent, all contingent workers, whether self-employed or employed by a staffing firm, are also employees of the company that is purchasing their services.

In the event of a legal claim or a government audit, the courts and the IRS will determine the degree of shared responsibility. That determination hangs on the amount of control that the company exerts over the nature of the work to be done by its contingent workers. This is why one must avoid even the slightest suggestion that an independent contractor might be a common-law employee of the company.

Every company walks a thin line whenever it engages the services of a contingent worker. On the one hand, company employees are obliged to treat their temps and contractors with the same respect that they treat their regular employees. Yet, they must take care to avoid any appearance that those contingent workers may qualify as common-law employees of the company.

Workforce Vocabulary for Employees and Independent Contractors

<i>Employee Vocabulary</i>	<i>Independent Contractor Vocabulary</i>
Employment	Contract, work for hire
Candidate, applicant	Bidder, vendor, seller
Employee, new hire	Independent contractor, vendor, provider, temp, contractor, contract professional, consultant, free agent, freelancer, etc.
Recruit, hire	Procure, purchase, buy, engage the services of, contract with
Fire employee	Terminate contract
Human resources, HR department	Purchasing, procurement department
HR manager	Procurement manager
90-day evaluation period	Contract-to-hire
Job, position	Project, contract assignment
Job description	Project specifications, specs, statement of work, requirements, scope, work order
Advertise a position	Request proposals, bids, quotes or information
Apply for a position	Bid on a contract, submit a proposal, submit an estimate
Resume	Marketing collateral, skills profile, brochure, proposal, bid, price list
Hiring authority, hiring manager	Procurement authority, buyer
Wage, salary, pay rate	Service fee, fixed fee, billing rate
Open-ended, indefinite	Fixed duration, contract extension
Employment agreement	Independent contractor agreement, contract for services, addendum, purchase order
Control details of how work is to be done	Specify end result, service level agreement, milestones, deliverables
Supervise	Manage, oversee, terms that do not imply close supervision
Ad hoc request	Work order, addendum to contract, purchase order
Employer-paid or mandatory skill-set training	Uncompensated or voluntary skill set training
Time sheet, signed approval	Preliminary invoice, statement of work, acceptance form, signoff form, final invoice, bill

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The HR Director knows all about co-employment and so does the company's legal counsel. But that information does not always filter down to the company's front-line managers and employees. And that is where companies typically get into big trouble.

How can companies disseminate this information? At the very least, they can instruct their managers at every level in the organization how to work with contingent workers. In this way, managers will have the tools to model in the workplace the correct way to discuss matters relating to the company's contingent workers.

When you consider the connection between what people say and ultimately how they act, it is only prudent that companies hold frequent in-service trainings to promote the etiquette of working with outside vendors.

A Simple Guide

The table on the previous page lists terminology that relates to worker status. The left-hand column lists vocabulary words, which typically imply an employer-employee relationship. The corresponding vocabulary words in the right-hand column typically imply a client-vendor relationship.

It is imperative that employees at every level of the organization understand and appreciate the fundamental differences that exist between workers who are employees of the company and workers who are employees of an outside vendor.

It is equally imperative that companies foster a corporate culture that rigorously and consistently reinforces those differences by promoting written and oral communications that appropriately convey worker status. This vocabulary table provides a simple guide to help employers and their employees in that effort.

Concluding Remarks

In this open letter, I have attempted to explain why companies must take positive steps to ensure that every employee understands and appreciates the fundamental differences that exist between

workers who are employees of the company and workers who are employed as, or by, an outside vendor.

I have explained why government agencies and the courts look to the issue of control when making a determination of worker status — specifically, *who has the right to control and direct the details of what will be done and how it will be done.*

I have shown that *who has the right to control the worker*, in turn, determines *who is responsible for paying the worker's taxes and, possibly, their employee benefits as well.*

The financial consequences for misclassifying a common-law employee as an independent contractor can be staggering.

Finally, I have prepared a simple vocabulary guide that I hope employers will discuss among themselves and with their employees in order to promote written and oral communications that appropriately convey worker status.

Sincerely,

Dungaree Dan

DUNGAREE DAN'S MEETING WITH MARY

Mary looked up at the sound of Dungaree Dan rapping on her cubical wall. "Hi Dan. I was just reviewing your vocabulary table." Mary stood to shake Dan's hand. "I can certainly appreciate how easy it is to confuse the separate vocabularies of employment and independent contracting. There are so many parallels."

Mary motioned for Dan to take a seat opposite her desk, as Dan began speaking. "That's right, Mary. And that's why I feel it's so important to train employees at every level of the organization on the proper application of the two vocabularies."

Mary paused for a moment. "That sure makes sense to me. All of us should use terminology that reinforces the fact that our contingent workers are outside vendors or the employees of outside

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vendors, and not the company's regular, full-time, fully benefited, salaried employees."

"That's right." Dan could tell that Mary was already absorbing this new way of thinking, and pleased that she was open to his mentoring. "You see, Mary, you know that contingent workers are outside vendors, and I know that contingent workers are outside vendors, but too often employees and front-line managers — even the contingent workers themselves — lose track of that distinction."

Dan turned to the vocabulary table in a copy of his open letter. "I'd like to review with you some of the terminology in this vocabulary table and discuss how using the wrong vocabulary can seriously contribute to your company's co-employment risk. Is that OK with you?"

"Sure. Let's get started." Mary was eager to begin. "That's why we're having this meeting."

Hire Employee or Procure Independent Contractor?

Dan suggested they begin at the top of the vocabulary table. "I recall that you referred to the new contractor as your **new hire**. Mary, companies **recruit** and **hire employees**, but they **procure**, **purchase**, **buy** or **engage the services of**, or **contract with**, outside **vendors**. And, by whatever name you give them — **temps**, **contractors**, **contract professionals**, **consultants**, **free agents** and **freelancers** — paid workers who are not your employees are outside **vendors** — what the IRS calls **independent contractors**."

"They are either legitimate businesses in and of themselves, or they are the employees of legitimate businesses, any one of which may be a specialized consulting company, a staffing firm, a generic payrolling service or a premium employer of record."

"For example, Mary, I'm currently employed by Solo W-2, Inc., a premium employer of record that negotiates my contracts, processes my payroll, and provides a superb, executive-level benefits infrastructure. In that regard, Solo W-2, Inc. is a vendor, and I am that vendor's employee. I find

work in any of three ways: (1) through an agency, (2) by marketing my consulting services to prospective clients directly or (3) by clients contacting me directly. Once the connection has been made, Solo W-2, Inc. takes over from there and handles all the details."

"That's right," said Mary, "but regardless of who actually processes your payroll, the relationship between you and the company that purchases your consulting services is that of an independent contractor and its client."

"And that," said Dan grinning broadly, "is the pivotal point on which any discussion of contract work must turn."

Fire Employee or Terminate Contract?

"OK," said Dan. "Now, let's look at the other side of the coin. As I recall, you said you liked working with contractors because it is much easier to fire a contractor than it is to fire an employee."

"It sure is," said Mary. "What's wrong with that?"

Dan waded right in. "Well, for starters, you can't fire a contractor. You can terminate the contract of a vendor for the services provided by the vendor or the vendor's employee, but you cannot fire a vendor, and you especially cannot fire a vendor's employee. Doing so, or even talking about doing so, creates the appearance of an employer-employee relationship between your company and the contract worker. You can **fire an employee**, but you must **terminate the contract** of a vendor.

"Oh, my gosh," said Mary, "every project manager I know talks about how easy it is to fire their contractors. Dan, I had no idea that the misuse of one small word like "fire" could have such serious implications. I have always operated with only the best of intentions for my employer."

"Yes," agreed Dan, "and, unfortunately, the road to reclassification hell is paved with good intentions."

Dan continued. "It's the small things that ultimately add up to a very big problem. Shall we move on?"

"By all means," said Mary.

Human Resources or Procurement

"In the general scheme of things, **HR departments** process employees, and **purchasing or procurement departments** process vendors. For this reason, many savvy companies process all of their contingent workers through purchasing or procurement in order to reinforce the fact that contingent workers are indeed outside vendors. Any organization that processes its contingent workers through HR, *especially in contract to hire situations*, sends a clear message to the IRS that its contingent workers are actually employees of that organization."

Dan leaned forward to emphasize that last point. "Mary, it is *absolutely imperative* that HR managers and Procurement managers, as well as the executives and employees at every level in the organization understand the entirely separate roles of HR and Procurement. Companies that allow HR to process outside vendors and the employees of outside vendors are begging the courts, the IRS and other government agencies to reclassify those independent contractors as employees of the company."

90-day Probation Period or Contract-to-hire?

Dan continued, "Consider, for example, the increasingly popular practice of **contract-to-hire**. This arrangement, which is promoted so heavily by recruiting firms as a benefit to the company — and which by some reports comprises 10% of recruiting firm revenues nationwide — serves no other useful purpose than to mitigate the risk that the recruiting firm will have to forfeit *the entirety of its placement fee* if for any reason the job candidate leaves the company before the end of the recruiting firm's 90-day guarantee.

Virtually all recruiting firms, and many staffing vendors, promote contract-to-hire arrangements as a convenient way to evaluate a job candidate's performance before the company is obligated to enroll that individual in the company's benefits program.

"Not only that," interrupted Mary, "but if the contract-to-hire arrangement extends beyond 90-days, the recruiting firm makes a bonus by continuing to collect the inflated markup beyond the full amortization of its placement fee."

Dan continued. "You got it, Mary. Companies have *always* had the ability under common law to terminate a new employee during an initial **90-day probation period**. The only possible benefit to the company of a contract-to-hire arrangement is the option of keeping a common-law employee on the job indefinitely as a permanent temp — or 'permatemp' — while denying the common-law employee access to the company's benefits infrastructure. And, I doubt seriously that many companies consciously choose contract-to-perm arrangements in order to disfranchise their employees from the company's benefits. As we are all very aware, permatemp status carries a huge risk for the company."

"Wow," exclaimed Mary. "If I understand correctly, you are saying that the only upside is to the recruiting firm because the contract-to-hire arrangement mitigates the risk of losing a placement fee — and may actually increase the firm's profits. Moreover, this upside to the recruiting firm has a huge downside for the recruiting firm's client because the contract-to-hire arrangement vastly increases the risk of worker reclassification. It looks to me like contract-to-hire is a totally bogus proposition."

"Well," added Dan, "I wouldn't necessarily agree that contract-to-hire is *totally* bogus, but the manner in which contract-to-hire is currently practiced in most companies is *mostly* bogus." There is, however, a safer alternative, and I think you can tell me what it is."

Mary pondered the question for a moment before responding. "Why, of course. The solution is obvious when you think about it. You said it yourself: '**HR departments** process employees, and **purchasing or procurement departments** process vendors.' A company can mitigate the risk of reclassification by having Procurement process the worker as an outside vendor during the 'contract' phase of the contract-to-hire arrangement and have HR process the worker as a new hire if and

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when the company decides to keep the worker on. It does this by negotiating a fixed-term, 90-day contract with the vendor. Procurement can then follow any of four options: (1) It can terminate the contract at any time during the 90-day term; (2) it can fail to extend the contract after 90 days; (3) it can extend the contract; or (4) it can refer the contractor to HR as a candidate for regular employment. That way, Procurement handles the 'contract' phase of the contract-to-hire arrangement, and HR handles the 'hire' phase."

"Yep," said Dan, "that would keep it all neat and clean, except for one minor complication. If the company advertises the 'position' as contract-to-hire, then there is no escaping the conclusion that the company is really soliciting applications for employment. A worker hired under a contract-to-hire arrangement is a common-law employee from day one of the relationship — regardless of whether HR or Procurement handles the contract phase of the arrangement."

Mary looked stunned. "I thought I had the perfect solution, but it has a fatal flaw, and that flaw is the *intent* of the parties. Any contingent worker in a contract-to-hire arrangement is a common law employee of the company because both the company and the worker intend from the very beginning to enter into an employer-employee relationship.

Dan continued. "And the situation gets even more serious if the company retains the common-law employee as a contractor beyond the time when its regular employees would normally become eligible for the company's employee benefits and retirement plan. For example, under ERISA — the set of federal rules governing employee benefits and retirement plans — the IRS could disqualify the company's retirement plan, in which case every employee in the company would owe immediately federal income taxes on all accumulated contributions and earnings in their retirement savings accounts. This, of course, would be disastrous for everyone in the company. I don't even want to think about the repercussions."

"But, Dan," interrupted Mary, "you said there is a safer alternative to contract-to-hire as it is currently practiced." Mary seemed a little

frustrated. "You must tell me what that safer alternative is."

"Well," said Dan, the answer is very simple and ridiculously obvious. *Companies should completely eliminate the practice of contract-to-hire and return to the former system of probationary employment.* It is easier, and it holds the recruiting firms' collective feet to the fire. Rather than hedging their bets by amortizing the placement fee over a three-month period as markup on the contractor's wage, recruiting firms will once again be held accountable for the quality of their candidates as well as the quality of their service."

"And, of course," Mary interjected, "the advantage to the company is that the elimination of contract-to-hire *completely eliminates co-employment risk.* But, wait a minute, Dan. Certainly, contract-to-hire arrangements mitigate the risk of wrongful termination claims during the probationary period?"

"Not at all," responded Dan. Haven't we already determined that contract workers in a contract-to-hire arrangement have the status of common-law employee from day one of their relationship with the company? Workers under contract-to-hire are covered by the same rules, regulations and covenants as the company's regular employees. Simply put, Mary, no company can offer a reasonable defense for replacing the usual 90-day probation period with a contract-to-hire arrangement.

"Now, shall we look at some more words and phrases on the list?"

"By all means," said Mary. "I'm anxious to learn more. This information is extremely important and also very useful."

Position or Project?

"When we were talking earlier about the new member of your team, I was convinced that you were describing a regular employee. You related that he **applied for the position** and you even referred to **advertising the position** and the position's **job description**. Mary, those terms

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describe employment and should never be used in the context of purchased professional services.”

Dan continued. “Companies seeking outsourced professional services typically publish a document variously called a **request for proposals (RFP)**, **bids (RFB)**, **quotes (RFQ)** or **information (RFI)**. The company posts these documents online or distributes them to vendors on their approved vendor list. An RFP, for example, details the **project specifications** – often called **the specs** or **statement of work** – and it describes **requirements** and **scope** of the work that the company wants done. For small projects and on-call work, the specs are often contained in a **work order**.

“Of course,” Mary responded. “It’s clear to me now. Employers publish job descriptions for the employment positions they want to fill, and they publish project specifications for projects they want done by outside vendors. **Employment contracts** and **project contracts** represent two very different forms of work.”

“That’s right,” replied Dan, “and we must never confuse the two.”

Resume or Marketing Collateral?

“But that’s only the half of it,” added Dan. “How job candidates and vendors respond to opportunities for work also differ in crucial and significant ways. Candidates for employment submit **resumes** when they **apply for a position**, whereas vendors submit **skills profiles**, **brochures**, **proposals**, **bids**, **estimates**, **price lists** and other types of **marketing collateral** when they **bid on a contract**, **submit a proposal** or **submit an estimate**.

Dan continued. “I can place this part of our discussion into perspective with a simple reality check. Your employer uses many types of vendors, including janitorial services, electrical contractors, landscape gardeners and painters. Let me ask you, Mary, does Procurement ask those vendors to submit resumes for the employees they send out to do the work? Of course, they do not. Procurement may ask those vendors to submit proposals containing brochures and price lists. And

Procurement may even ask for proof that a vendor’s employees have the requisite skills to do the work. But ask for resumes? Of course, they don’t ask for resumes. Those workers are vendors or at least they are the employees of vendors; they are not applicants for employment.”

“But Dan,” protested Mary, “those vendors aren’t supplying knowledge workers. We *only* run contract knowledge workers through HR, and HR *always* asks for resumes.”

Mary’s response flustered Dan. “But that is precisely my point, Mary. That is precisely why the practice of requesting resumes for contract knowledge workers is so dangerous. Companies all over the United States still make it a standard practice to require resumes for their temps and contract employees. Yet, incredibly, *contract knowledge workers are the very workers who are the most likely to be reclassified as an employee of the company during employment litigation or an IRS audit*. Talk about shooting yourself in the foot.”

Mary nodded. “I get your point. If companies run all vendors *except* contract knowledge workers through Procurement, and run contract knowledge workers through HR, it is as if the company is inviting the courts and the IRS to reclassify those knowledge workers as the company’s own employees. After all, that is what HR does. I mean, recruit, hire and provide orientation to the company’s regular employees.

“You got it,” said Dan. “Savvy companies run all vendors through Procurement regardless of the type of work they do.”

Mary sat in stunned silence, as Dan continued to speak. “Staffing vendors that submit employment resumes to their clients are leading their clients down a slippery slope to reclassification hell. And companies that, as a matter of policy, require resumes from their staffing vendors are greasing the skids.”

“Oh my,” gasped Mary. “I had no idea. Of course! Requiring our contractors and staffing vendors to submit resumes to HR naturally creates the appearance of an employer-employee relationship,

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if not the actual expectation that the contractor is in fact applying for a regular job. From this moment on I will drop the word *resume* from my contractor vocabulary.”

“That’s a good idea,” said Dan. “All vendors, whether they primarily work with their hands or their minds, should be processed through Procurement — and Procurement *never* works with resumes.”

Dan explained further. “Actually, a skills profile is very similar to a functional resume. It tells you who the Contract Professional is and who to contact to learn more about that individual. It lists relevant skills and past projects, and it includes evidence of the contractor’s proficiency. A skills profile omits information that is unrelated to the task at hand, such as dates of prior employment, names of past employers and educational background.

“Why is that, asked Mary?”

“Because requiring personal information about a contract knowledge worker, or any other third-party employee, for that matter, implies that you are primarily interested in that worker as an employee — not as a vendor of professional services.”

Almost as an afterthought, Dan added, “To be on the safe side, you should keep the skills profiles of your prospective contingent workers in a separate database from the resumes of your applicants for employment. This practice helps your company create a powerful affirmative defense against any claim that it is in fact recruiting employees instead of procuring vendors.”

“Even better,” suggested Mary, “we should keep resumes in a database maintained by HR and keep vendor data in a separate database maintained by Procurement.”

Hiring Authority or Procurement Authority?

Mary was beginning to draw some interesting conclusions from what she was learning. “You know, Dan, I am often called by staffing vendors who ask if I am the **hiring authority** or **hiring manager** for a particular contract assignment. I

now understand how misleading that question is. Those are employee terms; they are not independent contractor terms. I may be the hiring authority when I am seeking to hire a new employee, but I am the **procurement authority** or **buyer** when I am procuring the services of a contract professional.”

“That’s correct, Mary,” said Dan. “The staffing industry, which pitches contingent workers, has grown out of the recruiting industry, which pitches regular employees. I guess it is understandable that there should be considerable confusion about the worker status of the individuals that those agencies are pitching to client companies. In fact, there is a growing trend for so-called ‘full-service’ agencies to market both prospective employees and contract professionals to client companies, often to the same company and for the same job.”

“Wow,” exclaimed Mary, “I can see how the staffing industry can actually contribute to the co-employment risk of their clients by the way they systematically confuse contingent workers with candidates for employment.”

“And it’s not only the staffing industry and the recruiting industry that contribute to the problem. You can find examples of confusing worker status terminology in trade magazines and news articles. It is all around us. It’s no wonder that people are so confused.”

Wage or Billing Rate?

Dan directed Mary’s attention to the next row of his vocabulary table. “During our conversation over lunch you mentioned that you had negotiated a fair wage for the new member of your team. Mary, the new team member is a vendor, not an employee.”

Mary smiled sheepishly. “Oops. That *was* careless of me, wasn’t it?”

Dan nodded. “It is a common mistake, Mary.” We must keep in mind that employers pay their employees a taxable **wage** or **salary** — staffing vendors prefer to call it the **hourly pay rate** — from which the employer withholds payroll taxes and income taxes. Clients, on the other hand, pay

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their vendors a **service fee**, a **fixed fee** or a **billing rate**, from which no taxes are withheld.”

“Let’s revisit the example in our previous reality check,” said Dan. Do you think that this company’s Procurement department attempts to negotiate the wages that its janitorial service, electrical contractor, landscape gardener, or painting contractor pay to their employees. Case law and the IRS are quite clear on this matter. Specifying the wage of a vendor’s employee establishes an employer-employee relationship between the client company and the worker, leading the client down yet another slippery slope to reclassification hell. Staffing vendors that promote this practice set their clients up for an expensive fall, and companies that participate in this practice are courting disaster.”

Mary was flabbergasted. She had always negotiated a contractor’s pay rate and then applied the staffing vendor’s standard markup to arrive at a billing rate. It was clear to her now that she would have to adopt a safer approach for the sake of her company’s financial health. *From here on out, Mary declared to herself, I will only negotiate the billing rates for my contingent workers, as I would with any other type of vendor. It is simply too risky to negotiate the pay rates of agency employees.*

Open-ended or Fixed-duration Agreements?

Dan continued moving down the list of terms. “Remember, when you commented that you hoped you could keep the new team member busy indefinitely? Well, Mary, **employment agreements** are almost always **open-ended**, meaning that the relationship lasts **indefinitely** or until it is terminated by either the employer or the employee.

Independent contractor agreements, contracts for professional services, and purchase orders, on the other hand, are typically of **fixed duration**, meaning that there is a start date and a termination date specified in the terms of the contract. In fixed-bid contracts, the duration of the contract typically depends on the successful completion of a particular project milestone or work product. The courts and the IRS view the distinction between an open-ended employment

agreement and a fixed-duration client-vendor contract to be a key determinant of worker status.”

“I can see that now,” Mary interjected, “and any company that ignores the distinction is sliding down yet another slippery slope to reclassification hell.”

“You got it,” said Dan. “Nevertheless, a clearly stated termination date in the contract may not be enough to prevent the appearance of open-ended employment. You see, Mary, companies often sign multiple, successive **contract extensions** in order to keep a particular Contract Professional on the job indefinitely. The courts and the IRS do not appreciate this practice, and they are inclined to reclassify such a ‘permanent temp’ — or *permatemp* — as a common-law employee of the company.”

“But how does a company know when a contingent worker has been on the job too long,” Mary asked.

“Good question.” Dan shifted in his chair. “Case law and the IRS do not provide a specific answer, so companies have to wing it by creating their own policies. Many companies impose an arbitrary, yet rigorously consistent, upper limit to the time a contractor may work on a particular contract. The contractor must leave when the limit is reached, and may return under the terms of a new contract only after an equally arbitrary, yet rigorously consistent, period of absence.”

Dan winked. “You see, Mary, it’s the *consistency* with which the company applies its policy that matters — much more so than the actual limits themselves.”

Mary pulled at her memory. “Yes, as I recall our own contingent workers can’t work a day beyond eighteen months, and they must then stay away for six months before they can return under a new contract. And I also seem to recall that we can’t bring a terminated regular employee back as a contractor until after he or she has been off the job for at least six months.”

“That’s right,” said Dan. “There is no law that requires a six-month absence following termination of the employment agreement. For example, it

would be perfectly legal if a company were to terminate a regular employee on Friday and then bring that same individual back on Monday as a contractor. However, your company has adopted a six-month no-return policy in order to avoid any appearance that it terminates employees and then converts them to contractor status in order to avoid the expense of paying for government entitlements and employee benefits. Once again, it is the rigorous and consistent application of an arbitrary, yet reasonable, policy that mitigates the risk of reclassification by the courts or the IRS."

Mary interjected. "It looks like the road to reclassification hell is paved with the inconsistent application of company policies."

"And, I might add," said Dan, "that road is also paved with the inconsistent application of proper terminology."

Dan continued. "Oddly enough, I am not aware of any company that systematically trains its managers, supervisors and employees in the proper way to talk about contingent workers."

Mary added, "Just imagine the grief that organizations could avoid by implementing an in-service training program on this subject and by publishing formal guidelines in their employee handbooks."

Dan shook his head. "It boggles the mind, doesn't it?"

Control Details or Specify End Results?

Dan examined his notes. "The remaining terms in the vocabulary table relate specifically to the issue of behavioral control, which virtually everyone agrees is the primary characteristic of an employer-employee relationship. Simply put, companies control the work of their employees; and they do not control the work of their vendors."

"Quite right," said Mary. "From now on I will resist my natural compulsion to micromanage the contractors on my team. I may closely **supervise** my employees and **control the details** of how they do their work, but I may only **specify the end result** of any work carried out by contract

professionals when I **manage** a project and **oversee** its progress."

Dan nodded in agreement. "That's right, Mary, "and you do that by negotiating specific **milestones** and **deliverables** in your contract with the vendor, and by including carefully worded **service level agreements** that specify the performance parameters of the work to be done."

"I see," said Mary. "It is the project specifications in the contract itself that controls how the work is to be done, and not my personal supervision. But what if we have to change some aspect of the project? It happens all the time that we have to make ad hoc changes to the project specs."

"Of course it does," agreed Dan. "Projects are constantly evolving and, when a change is required, that is when you must issue a new **work order**, or you and the vendor must negotiate an **addendum to the contract**, or issue a new **purchase order** for the required changes. A savvy vendor will never respond to an **ad hoc request** outside the scope of the contract, especially when that request involves significant requirements creep or additional uncompensated work. Ad hoc requests without a work order or contract addendum have the appearance of an employer giving detailed instructions to a regular employee. Its one of the behavioral control factors that the IRS uses to determine worker status."

Paid Training or Uncompensated Training?

Dan segued to the subject of on-the-job training. "Another behavioral control factor is **mandatory or employer-paid skill-set training**. Do you remember telling me that you thought you might have to pay for specialized training in order to bring your new contractor up to speed? Mary, employer-paid specialized training, especially mandatory skill-set training, is a form of behavioral control indicative of an employer-employee relationship. That kind of paid training is never appropriate for contingent workers. On the other hand, **voluntary or uncompensated skill-set training** is perfectly OK."

"Oh boy, am I aware of that now," said Mary. "You know, Dan, project managers in this company commonly discuss how best to train their

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contingent workers — even during formal staff meetings. The next time I hear such a discussion I will sure set them straight. I now realize that employer-paid training creates a serious co-employment risk for this company. Companies train their employees; they do not train their vendors.”

“You are so right,” said Dan, nodding in agreement. “A company may require that its contingent workers have one or more specific certifications to assure that they have the necessary knowledge and skills to do the work. In addition, a company may provide *voluntary* skill-set training to its contingent workers as long as that training is *off the clock*. A company may even charge a fee to its contingent workers for any voluntary training it gives them. But the company may not pay for skill-set training or pay the contingent worker while he or she is receiving the training. Doing so would significantly increase the risk of co-employment.”

“OK,” said Mary, “but what about orientation and safety training? Statistics show that contingent workers are injured on the job ten times more often than a company’s regular employees. It is imperative that we provide orientation and safety training to every worker, regardless of their employment status. Surely, that kind of training must be allowed?”

“Whoa,” said Dan. “Hold your horses. Generic orientation and safety training is always permitted. Employers and clients alike are responsible for ensuring that every worker, regardless of worker status, is able to navigate the worksite and remain safe. It is the mandatory, paid, skill-set training that creates the co-employment risk for companies.”

Time Sheet or Invoice?

Now Mary began to look puzzled. “What’s the big deal about this last item in the vocabulary table? At every company I have ever worked for, contingent workers have had to submit time sheets to their onsite supervisor for approval and signature. It’s the way we have always accounted for the hours worked by our temps and contractors.”

“And who did you say signs the time sheet,” asked Dan?”

“It’s signed by the person who supervises their work,” Mary answered. The absurdity of what she had said hit her, and she groaned loudly. “Of course, Dan, requiring a temp or a contractor to submit a detailed time sheet for signed approval by a representative of the client is another example of behavioral control.”

“And control increases the co-employment risk,” said Dan. “Amazingly, some companies even make their light industrial temps punch a time clock just like their own non-exempt employees.”

“Wow,” exclaimed Mary, “that would be tempting fate, for sure!”

“Once again,” explained Dan, “it comes down to the realization that companies control the work of their employees; and they do not control the work of their vendors. You see, a non-exempt employee may be required to submit a detailed **time sheet** for approval or punch a time clock, but a vendor submits for the client’s records a **preliminary invoice, signoff form, acceptance form**, or similar document by whatever name, followed by a **final invoice** and a **bill**.”

Mary looked a little confused. “But isn’t that just a question of semantics, Dan.”

“Not at all, Mary. A time sheet is a way of accounting for every minute worked, which relates to controlling how the work is done. In contrast, a preliminary invoice is about results.”

“But Dan,” stammered Mary, “my tax accountant charges by the hour, and so does my lawyer. Lots of vendors charge for their time.”

“Yes they do, Mary,” agreed Dan. “Vendors of all types charge for their time. The difference is this: Vendors typically do not provide details about when and where they performed the work in a preliminary invoice — only that the work was performed, and that the vendor spent X number of hours doing it.”

“You see, Mary, a time sheet is an *internal* control that employers use to account for the *amount of wage* they must pay to their employees. It is wholly appropriate for a staffing vendor to require that its

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contract employees submit time sheets. But they should be submitted to the staffing vendor for approval, not to the client."

"When a client representative signs the very same time sheet that the contingent worker subsequently submits to his or her employer to support a claim for wages, that client representative is acting as an agent for the employer. Can you spell co-employment risk?"

Mary nodded in agreement. "Believe me; it's beginning to sink in. Please continue."

"The confusion surrounding the proper use of time sheets seems to be unique to contract knowledge workers. And you know what, Mary? Contract knowledge workers are the workers that most closely resemble this company's own employees."

Mary completed Dan's point. "And contract knowledge workers are also the workers most likely to be reclassified as employees of this company by the IRS and the courts."

Dan pushed the point further. "This company contracts with many types of vendors besides contract knowledge workers, including janitorial services, electrical contractors, landscape gardeners and painters who work on projects throughout this company. I assure you, Mary, the employees of those vendors do not submit time sheets to a representative of this company for signed approval."

"That's right, Dan," said Mary. "Also those vendors are processed through Procurement. And Procurement deals with preliminary invoices and signoff forms all the time. It's standard operating procedure."

"You got it," said Dan, "and HR deals with time sheets."

"Oh, yes," Mary agreed, "and that's yet another argument in favor of Procurement processing all the vendors, including those that supply contract knowledge workers."

Dan continued his line of reasoning. "But, you know, Mary, it's not just the preference of HR for

time sheets. I believe it is the staffing vendors, themselves, who are mostly responsible for creating this form of co-employment risk for their clients. Staffing vendors are notoriously distrustful and adversarial. They typically do not trust their temps and contract employees to report correctly the number of hours worked, and they do not trust their clients to pay against their invoices. Therefore, they have implemented a simple and convenient solution. Unfortunately, the solution they came up with turns the client into a surrogate employer for the staffing vendor's own employees."

Mary swept her hand through the air like a toboggan sliding down an icy hill. "And here we go again down the slippery slope to reclassification hell."

"But wait," interjected Mary. "What's a company to do if it can't sign a detailed time sheet for its contract knowledge workers? How does it know what it has to pay for?"

Dan shrugged his shoulders. "Well, Mary, I guess the company does what it does with every other type of vendor. All the other vendors submit preliminary invoices for approval and signoff by the project manager. The staffing vendor then uses that information to prepare and submit a final invoice, as it would in any event, followed by a bill for services rendered."

"And," said Mary, wrapping up the matter, "as far as any time sheets are concerned, that is strictly an internal matter between the staffing vendor and its own employees. The client should never have to see, let alone approve, a time sheet for a staffing vendor's employee."

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"Well, Mary, that's about it for the vocabulary table. I could have added more entries, but to my mind these are the most important for avoiding confusion when discussing contingent workers."

Mary stood and extended her hand to Dan. "I am so very grateful to you for taking the time to mentor me on the proper application of these vocabulary

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terms. I had no idea how important it is to be absolutely clear about worker status when we are referring to employees and contract professionals. I will make sure that I periodically review the terms in this vocabulary table during meetings with my project team, and I will make sure that employees and contractors alike rigorously and consistently use appropriate terminology.

Dan now turned to Mary. "I want to thank you too for being such a receptive student. But I see that we still have a little time left. Shall we give this guide a trial run?"

Mary gasped. "You mean right now, with my own team members?"

"Oh no," Dan reassured her, "What I mean is do you want to *practice* the independent contractor vocabulary right now, with me, *before* you meet with your team?"

"Well, OK." Mary seemed only slightly relieved by Dan's clarification.

Dan continued. "So let's begin. Do you remember our earlier conversation? I asked you, 'How is your current project going,' and you told me all about your new team member."

"Oh, yes. That is what prompted this little coaching session in the first place. I suppose you want me to tell you all over again about the new member of my project, but this time being careful to use a vocabulary that is appropriate to contracting."

"That's right." Dan was not going to let Mary off the hook. "Just imagine that you have done everything by the book, and you are now telling me about the new contractor on your team."

Dan prompted Mary. "You began by telling me you had just..."

"...procured the services of a superb new contractor, named Jack." Mary proudly completed the sentence, and continued. "He's a great complement to our team, and we were really lucky to sign him. The specifications for the contract assignment are pretty advanced, and most of the

contractors we evaluated were under-qualified. Then, we interviewed Jack for the project and discovered that his skills are much stronger than his skills profile and marketing collateral indicated."

"We negotiated a fair billing rate — actually, as much as our budget would allow. At first, I was concerned that Jack might not have the specialized training that the project requires, but he hit the boards running, and he has not faltered since starting the contract. Jack is a good worker, a productive member of the team, and I hope we will be able to extend his contract for as long as we can use him — provided it is not longer than company policy permits. I'll definitely keep his contact information in my separate vendor database so that we can procure his consulting services on future projects."

Mary stopped and looked up. "OK so far?"

Dan nodded. "You're doing great. Now let's do the rest of our conversation?"

Mary chuckled. "Oh, yes. It's etched indelibly on my mind." Then, Mary shook her head and lowered her eyes. "How could I have been so far off base?"

"Don't be too hard on yourself." Dan reassured her. "Using the wrong vocabulary when talking about contractors and contract work is so common that most people don't even notice, let alone appreciate the confusion it causes and the attendant risks."

"I guess you're right," Mary agreed, "and the correct terminology is so easy to learn and apply."

Dan urged Mary to continue. "I think you were about to say that the new team member is a project manager's dream."

"Right," said Mary. Jack is really pulling his weight. He is flexible, and he is willing to draw up contract addenda and sign separate purchase orders for ad hoc requests that come up during the project. He adheres closely to our project specifications and the service level agreement that we negotiated in the contract. He is conscientious about submitting his summary reports of work performed for my signoff, and he even keeps me abreast of his

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progress with weekly status reports. Of course, providing the status reports is a completely voluntary activity on his part, but I appreciate the effort nonetheless. Actually, I wish the employees on my team were as proactive and on the ball as Jack is."

Dan interrupted. "You said earlier that as an agency temp Jack might as well be one of your own employees, and that you could treat him the same as the regular employees on the project. Do you still feel that way?"

"Whoa," said Mary in disbelief. "I said that? That is so *wrong!* Whether a contractor is an independent contractor or the employee of an independent contractor, he or she is still a vendor, and I always treat the contractors on my projects as I would any other outside vendor working for the company."

Mary paused and laughed. "...At least from this moment on."

SOME FINAL THOUGHTS

At this point, Mary's mood turned more sober. "You know, Dan, after our meeting today I have a new appreciation for the power of words to shape a company's culture or, for that matter, to shape the culture of an entire industry."

"Yes, Mary, and it all comes down to a deceptively simple relationship." Dan approached Mary's whiteboard and wrote the following:

The vocabulary we use affects our thoughts and attitudes.

Our thoughts and attitudes affect how we act.

Our actions affect the nature of the working relationship.

Mary studied the words on her whiteboard. "The challenge, then, is to train our employees to use the appropriate vocabulary when talking about employees and contingent workers. Fortunately, I now have the tools to begin training my own project team. I would like to expand the training to the whole company. Gosh, why stop there? We

should spread this knowledge to every company in the United States, and we should not stop until the entire staffing industry understands and appreciates the critical factors that differentiate contingent workers from regular employees."

Dan applauded. "I'm really proud of you, Mary. You are a star student for sure. Let's keep in touch. I'd like to explore some other contractor-related issues with you."

"Yes, let's do," said Mary, "I value your perspective on contracting, and I look forward to learning more from you."

Dan stood up and warmly shook Mary's hand. "You know, I bet the people in HR and Procurement would benefit from a joint seminar on this subject. Hmmmm; that gives me an idea..."

Dan turned to leave. He was already deep in thought, planning how he might market this joint seminar idea to company CFOs.

It was now past five o'clock. Denizens of the cubicle farm were streaming toward the elevators. Mary logged off her computer, grabbed her briefcase and joined the flow.

SUMMARY RECOMMENDATIONS

The discussions in this white paper suggest a number of specific recommendations for actions that companies can take to mitigate co-employment risk while promoting a strong affirmative defense against claims for reclassification of contingent workers by the IRS and the courts. Some of these recommendations go against conventional wisdom and established practices and procedures in the staffing industry.

1. **Training of Employees:** Companies should conduct systematic and frequent in-service training for employees at every level of the organization in order to ensure that every employee understands and appreciates the fundamental differences that exist between workers who are employees of the company and workers who are employed as, or by, an outside vendor. The training should emphasize how everyday speech,

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thoughts, attitudes and activities in the workplace affect co-employment risk.

2. **Corporate Culture:** Companies should take positive steps to foster a corporate culture that rigorously and consistently reinforces the differences in worker status by promoting written and oral communication by employees that correctly and unambiguously conveys worker status.
3. **Human Resources:** Human Resources departments should get out of the contract staffing business and focus exclusively on recruiting, hiring and servicing regular employees of the company. Human Resources should have no role in the procurement of contingent workers.
4. **Procurement:** Procurement departments should procure all contingent workers, including temps, contractors and consultants. In this regard, Procurement should process contract knowledge workers and other types of contingent workers as it does all other vendors from which it purchases products and services.
5. **Contract-to-hire:** Companies should completely eliminate the practice of contract-to-hire and return to the former system of probationary employment.
6. **Resumes:** HR should accept resumes only from bona fide applicants for employment. Resumes should be maintained in a database managed exclusively by HR.
7. **Marketing Collateral:** Procurement must only accept skills profiles and other marketing collateral from vendors. Vendor information should be maintained in a database or file system that is managed exclusively by Procurement. Procurement should require that vendors of contract services omit personal information about individual workers in their marketing collateral unless it is specifically and directly relevant to the work to be done. Omitted personal information includes dates of prior employment, names of past employers and educational background. Procurement should never accept resumes for individual contingent workers.
8. **Wage and Markup:** Companies must eliminate the practice of specifying a wage and standard markup for its vendors' employees. Companies should negotiate only the rate that it will pay to the vendor for purchased services performed by the vendor or its employees.
9. **Time Sheets:** Companies should resist pressure from staffing vendors to have an employee of the company sign a detailed time sheet for a contingent worker that the worker subsequently submits to the vendor to support a claim for wages. However, company employees may sign a preliminary invoice or similar document submitted for approval by the vendor or the vendor's employee.

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:

1355 Willow Way, Suite 244
Concord, CA 94520