INDEPENDENT COTNRACTORS

Many business owners, both small and large, prefer to treat their workers as independent contractors rather than as employees. Quite simply, the reason is money. When they hire independent contractors, employers do not have to pay the social security and unemployment taxes they must pay for their employees. These taxes can be substantial for employers who operate on thin profit margins, engage a large number of workers, or have a large payroll.

Unfortunately, the government is aware that most employers would like to avoid paying these taxes. Moreover, because these taxes are imposed to promote the welfare of employees, the government tries to protect workers with a set of stringent rules. Thus, the rules strictly limit an employer's ability to treat workers as independent contractors. Instead, they require employers to treat most workers as employees and, in turn, pay payroll taxes on their behalf.

Why Do Employers Need to Be Careful in Treating Workers as Independent Contractors? The short answer, again, is money. If the government determines that an employer has been erroneously treating workers as independent contractors rather than as employees, the government can require the employer to pay back payroll taxes plus penalties and interest. The government can also void the employer's fringe-benefit plan by claiming that, by not covering all employees, the plan violates the nondiscrimination rules. This article examines these matters from the employer's point of view and discusses the principal factors that the government considers when determining whether workers are employees or independent contractors.

The Principal Factors Of course, employers should never call workers employees if they want to treat workers as independent contractors. However, simply calling a worker an independent contractor will not necessarily convince the government of a worker's status. Instead, the government will examine the substance of the relationship between the employer and the worker.

Essentially, independent contractors are persons who operate their own businesses, while employees do not operate their own businesses. If you keep this distinction in mind, you may be better able to understand the myriad factors discussed below.

In 1987, the Internal Revenue Service (IRS) issued a ruling listing 20 factors that the IRS considers when determining whether a worker is an independent contractor or an employee. However, that list is not exhaustive

because the courts consider many additional factors. No one factor is conclusive. Instead, in reaching a decision, the IRS and the courts weigh all the pertinent factors in each particular case. It is as if all the factors are placed upon the "scales of justice." The factors supporting a determination that a worker is an independent contractor go on one side, while the factors supporting a determination that a worker is an employee go on the other side. Here are some of the most important factors.

Controlling the Manner and Details One key factor is whether the worker or the employer controls the manner and details by which the end result of a job is to be achieved. If the employer controls the manner and details, then the worker may be an employee. If the worker controls the manner and details, then the worker may be an independent contractor.

The employer's right to control the end result is not indicative. Let's distinguish the manner and details of a job from the end result. For example, blueprints containing plans and specifications are very detailed, but they constitute the end result, not the means to achieve that result. Conversely, the right to require workers to use particular tools in implementing the result shown on the blueprint indicates a right to control the manner and details by which the end result should be reached.

Generally, employers control the end result. But employers who want to treat workers as independent contractors should give the workers as much control as possible over the manner and details by which the workers may attain the end result.

At-Will Relationship An employment relationship with no fixed duration and with an employer's right to terminate workers at will (that is, without prior notice, at any time, and for any or no reason) is a strong indication that the workers may be employees. Conversely, a relationship with a fixed term (for example, a six-month period) coupled with a right to terminate workers before the term expires only for cause or upon significant notice (such as 30 days or more) indicates that the workers may be independent contractors.

Employers who want to treat workers as independent contractors should hire them for fixed terms, such as six months, and should retain the right to terminate them only for cause or after significant notice. If the employers want the relationship to continue after the term expires, they may do so. However, employers should not agree to renew the term automatically and perpetually, as such an arrangement too closely resembles one with no fixed duration. Instead, each time the term expires, the employer should enter into a new agreement for another fixed term.

Operating Their Own Business Remember, the essential feature of independent contractors is that they operate their own businesses, while employees do not. Several factors, in addition to those discussed above, especially indicate this fact. Independent contractors often do the following: (1) do business as a corporation or under a trade name (i.e., a name other than their own); (2) hire others to assist in the work; (3) perform or seek to perform services for more than one employer; (4) provide their own tools and transportation and pay their own expenses; and (5) are paid by the job rather than through wages or a salary.

Employers who want to treat their workers as independent contractors should suggest (but not require) that the workers incorporate or at least use a trade name. Moreover, whenever possible, employers should do the following: pay workers by the job (rather than wages or a salary); allow them to hire others to assist them; require them to furnish their own tools and transportation and pay their own expenses; and encourage them to advertise and render their services to others. The government is far more likely to consider a worker an independent contractor if the worker performs or at least attempts to perform services for multiple employers.

Conclusion Structuring a relationship with workers so that the IRS will view them as independent contractors is not cut and dried. Employers will often be faced with competing choices. On the one hand, they may want to retain as much control over workers as possible along with the greatest flexibility to change or terminate the relationship. On the other hand, retaining too much control may cause workers to become employees.

It is usually impossible to have all of the most advantageous factors in a particular situation. To best assure a favorable outcome, employers should have an attorney assist them in structuring arrangements with their workers. The attorney should then prepare a contract memorializing that arrangement. Finally (and, of course) in dealings with workers, employers should always abide by the terms of the contract.