

Lawyers share their practice tips

The *Montana Lawyer* continues a series of law-practice tips, many of them excerpted from “How to . . .” articles presented in the July/August 2010 edition of the ABA’s *GPSOLO* magazine. Other tips, like the ones below, will be provided by members of the State Bar of Montana. You can find the entire *GPSOLO* “How-to” issue with the full-length articles at www.americanbar.org/publications/gp_solo_magazine_home.html, click on “Browse Past Issues” and find the July/August 2010 edition. More article excerpts will appear in the August *Montana Lawyer*.

10 mistakes to avoid over independent contractors

By Robert W. Wood

As a full-time tax lawyer for over 30 years, I sometimes forget what it is like to be a client and to face the complexity of the law from a business person’s viewpoint. Yet certain areas have enormous tax and legal implications.

I can’t think of a better example of this phenomenon than the decision whether to hire someone as an employee or an independent contractor. This is not only a tax decision, but involves elements of labor and employment law, ERISA and employee benefit laws, worker’s compensation, and unemployment insurance law. And the list goes on.

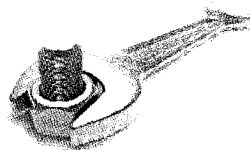
In fact, it is hard to think of a more consequential business decision. Yet paradoxically, the question whether to hire someone in one capacity or the other often gets virtually no attention from advisers.

Here are the top ten mistakes I see committed by companies – and even by advisers – in using workers you believe are safely “independent contractors” but who may actually turn out to be reclassified as employees.

1. Not Having a Written Contract. This one is inexcusable yet I see it frequently – simply failing to have any kind of written agreement for independent contractors. It is a recipe for disaster. Sure, if you hire a plumber for a one-time toilet fix one afternoon and pay him \$200, I would not worry that he is an employee. But you would be surprised at how many businesses have regular and long-term workers – on their premises or off – paid month after month and year after year as independent contractors without a written contract. Don’t do it! You are almost doomed to fail in any dispute over the status of that worker, no matter how strong your independent contractor facts.

The taxing, labor and employment and insurance authorities expect you to have a written contract that states that the worker is an independent contractor and will be paid as such with no tax withholding, no benefits, etc.

2. Treating Similar Workers Differently. It is perfectly OK for a business to have some employees and some inde-



pendent contractors. But it is not OK to have one worker selling shoes on an independent contractor basis and another similarly situated worker doing the same thing as an employee. The risk of treating peo-

ple differently is that the people you are trying to treat as independent contractors may be reclassified as employees. In effect, you set yourself up for that by having the two differently classified workers for ready comparison by the IRS, state tax authorities, labor or employment agency, or other authority. They all look for this tell-tale sign.

3. Providing Tools and Supplies. One of the hallmarks of independent contractors is that they are required to supply their own tools, equipment and supplies. After all, independent contractors are classically independent business people or professionals. It makes sense that they would bring their own ladder, shovel or paint brush. If you purport to have independent contractors but supply a desk, chair, computer, software and telephone – everything they need – how convincing is it? As this example suggests, this problem may be biggest with office work.

4. Reimbursing Expenses. Another red flag is the extent to which you reimburse workers for their business expenses. If they work late, do you pay for their dinner or a taxi? If they need special paper for the report they are producing, do you provide it or reimburse them? There is no bright line saying you can’t cover the expenses of an independent contractor, but doing so can suggest the worker is an employee. Classically, all such items are supposed to be factored into the price you are paying the independent contractor for a finished product.

5. Paying By the Hour. How you pay someone can be one of the most fundamental indicators of whether a worker is an employee or an independent contractor. Classically, you pay a contractor for a job, like repairing your computer system. In contrast, you classically pay employees by the hour or by the week. There is no rule saying that you can’t pay an independent contractor by the hour. After all, that is how most lawyers bill time to their numerous clients. But when you have alternatives, paying by the hour can be unwise. Consider whether you can come up with a payment regimen that fairly covers all

the elements going into the work and yet that is independent contractor-like in scope. Ideally, a project fee or success fee is more consistent with independent contractor status than an hourly rate. Furthermore, you may be able to address any tool, equipment, and supply issues, and even expense reimbursements, as part of the payment formula you devise. The answer may be to charge back the worker for the item provided, the charge subtracted from his invoice at the end of the week.

6. Failing to Have Consistent Forms and Documents.

The fact that you call someone an independent contractor does not make it so. An “employee lounge” sign in your office does not mean only employees can go there. The fact that you pay a worker based on a time card and then issue a check and paystub does not make him an employee. But all these things add up. So consider if you should have an “Employee File” for each employee and use a different name for independent contractors. Consider if independent contractors should turn in an “invoice” not a time card. Consider whether independent contractor discipline should be handled in exactly the same way as employee discipline. Usually changes in terminology or substance can be made that may not impact your business but that may help bolster independent contractor treatment.

7. Over Supervising. With an independent contractor you are paying for a product or result. With an employee you are paying for him to do what you ask, whatever that might be. With employees you control not only the nature of the work, but the method, manner, and means by which they do it. This control factor is the most over-arching way in which you can end up in trouble. How much do you check in with workers, monitor what they are doing, or make suggestions? How frequently must they check in with you and report how and what they are doing?

Be very careful with supervision and control. The mere fact that an independent contractor must provide a weekly progress report on how the installation of the new laundry room in your house is going does not mean the builder is an employee. But if the report involves constant tweaking and redirecting of the effort, it might be otherwise. Be careful what your contract and other documents say about reports, supervision, and the like.

8. Requiring Set Hours. One of the classic signs of

employee status is a time clock or 9-to-5 office hours. In contrast, with independent contractors you should normally pay for the result, not exactly when or how they do it. That does not mean you can’t have some control over the hours an independent contractor works. For example, the fact that you tell your building contractor he can’t work on your kitchen remodel past 7 p.m. does not make him an employee. Consider whether you can allow workers to complete work on their own schedule as long as they meet applicable deadlines. That can help show they are independent contractors.

9. Prohibiting Competition. Many businesses using independent contractors require full-time work, prohibit competition, or do both. Both of these points are inconsistent with independent contractor treatment. For that reason, it pays to consider whether you need such rules and why. Optimally, if you are paying for a particular result – such as selling a minimum dollar volume of goods each month – you should stick to that target. Don’t focus on how long the worker may take to do it or where else they may work during the same period. Those details are arguably irrelevant. Always bear in mind the paradigm case: an independent contractor like a lawyer or plumber serving many customers. If you are worried about the worker giving away your business methods or intellectual property to a competitor, make those concerns explicit.

10. Attempting the Impossible. If you cannot possibly keep your influence and direction over workers to a minimum, cannot possibly let them come and go as they please, can’t allow them to work part time and for other companies and can’t abide the thought that they may make some of their own decisions, is it realistic to even try to treat them as independent contractors? Probably not. That may mean simply treating the workers as employees. Sometimes cutting corners ends up costing you way more money in the long run than if you had done it right in the first place. I have seen that occur over and over with independent contractor issues.

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