

Employment Status: Independent Contractor—Yes or No?

Contributed by Ava J. Abramowitz, Esq., Hon. AIA

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COMMON MISTAKEN ASSUMPTIONS

As bona fide professionals, some architects may find themselves associated with firms as independent contractors rather than as employees. Many independent contractors, and the firms who contract for their services, assume that the status of the independent contractor can be established by negotiated agreement, and that as long as the parties mutually agree that the terms are logical and fair, the arrangement is lawful.

To understand this issue clearly, it is better to discard these assumptions. Employment status is a matter of law at both state and federal levels, as it determines who is responsible for paying (or withholding) taxes for income, Social Security and Medicare, and for unemployment and workers' compensation insurance. Employment status is also a matter of considerable concern to governments, as independent contractors are among the people most likely not to pay their taxes. For these reasons, government agencies use very specific criteria to determine whether an individual is an employee or an independent contractor—the fact that the two parties agree on a contracting arrangement is largely irrelevant.

A firm also needs to be concerned with respect to its professional liability insurance coverage. Not all policies provide coverage for independent contractors.

FROM EMPLOYEE TO CONTRACTOR: SPECIAL CONSIDERATIONS

Situations in which employees become independent contractors require particular attention. Employees may legitimately go into business for themselves, and enter into a contract with their former employer—it happens often. But it is likely to draw the attention of the IRS and other government agencies, for obvious reasons.

TRULY INDEPENDENT?

Independent contractors, whether or not they are former employees, must be able to demonstrate that they are in business for themselves and are truly independent. Typical evidence of a truly independent business includes:

- a separate place of business
- a particular or distinct skill set that the contractor's clients do not possess in-house
- independent control over the work being performed, including where it is performed and on what schedule
- bona-fide office stationery, including letterhead, business cards, invoices, etc.
- consulting agreements with multiple clients
- evidence of business status as required by state or local governments, such as papers of incorporation or registration, and/or a business license
- typical business insurance, such as bonding, professional liability insurance, and/or general business insurance
- regular payment of taxes, including property taxes, income taxes, corporate taxes, and employment-related taxes such as Social Security, unemployment, and workers' compensation
- direct payment of business-related expenses such as travel and lodging (though these expenses may be reimbursable expenses billed to a client).

These are the obvious business characteristics of an architectural firm's engineering or other technical consultants. If you do not business with your independent contractors in the same way, it will probably be difficult to persuade government agencies that they are truly independent.

A CHECKLIST FOR THE FIRM

Firms that wish to retain independent contractors can and should use additional criteria to determine whether the worker is truly independent, including:

- Profit or loss: can the worker make a profit or loss?
- Investment: does the worker have an investment in the equipment and facilities used to perform the work?
- Multiple clients: does the worker work for more than one company at a time?
- Offer of service: does the worker offer services to other firms or the general public?
- Independence: does the worker decide when, where, and how to work?
- Training: do you train the worker to do the job in a particular way?
- Integration: are the worker's services so important to your business that they have become a necessary and integral part of the business?
- Services rendered personally: must the worker provide the services personally, as opposed to being free to delegate tasks to the worker's employee(s)?
- Worker's assistants: do you hire, supervise, and pay the worker's assistants?
- Continuing relationship: is there an ongoing relationship between the worker and your firm?
- Work hours: do you set the worker's hours?
- Full-time work: must the worker spend all of his or her time on your job?
- Work done on premises: must the individual work on your premises, or do you control the route or location where the work must be performed?
- Sequence: do you have the right to determine the order in which services are performed?
- Reports: must the worker give you reports accounting for his or her actions?
- Pay schedules: do you pay the worker by the hour, week, or month, as opposed to being invoiced by the worker in accordance with a contracting agreement?
- Expenses: do you pay the worker's business or travel costs?

- Benefits: do you provide the worker with benefits normally provided to employees?
- Tools and materials: do you provide the worker with equipment, tools, or materials, such as a computer?
- Right to fire: can you fire the worker?
- Worker's right to quit: can the worker quit at any time without incurring liability?

RISKS FOR EMPLOYERS

Government agencies such as the IRS or the National Labor Relations Board examine the entire employment situation in determining the employment status of an individual. The relative importance of individual factors may vary according to individual circumstances and the market or industry in which the services are provided.

Every employer should seek competent legal counsel to determine whether the firm's employment policies and procedures are within the law. Firms that are unable or unwilling to manage this issue carefully are advised to refrain from hiring independent contractors.

Penalties for failure to comply with the law can be severe. If an independent contractor is found to be delinquent in the payment of federal taxes, and the IRS subsequently determines that the person has been improperly classified as an independent contractor, then the firm that retained the independent contractor may be found to be the employer of that person for tax purposes. This could result in fines, penalties, and interest both for the firm as well as the reclassified independent contractor. The newly identified "employer" may also be held responsible for retroactively providing the newly classified "employee" with all of the benefits that a regular employee would have received during the same period of employment.