Read This Before You Hire an Independent Contractor

Trick question: Do you employ independent contractors (also known as freelancers), or have you thought about employing independent contractors? Before you answer, read these important tips.

Published August 31, 2018

Trick question: Do you employ independent contractors (also known as freelancers), or have you thought about employing independent contractors?

The Ecstasy of Hiring Independent Contractors

Before we explain why that's a trick question, it's worth pointing out that 1 in 10 workers in the United States are full-time independent contractors. That number likely doubles when you factor in individuals who augment their income with side gigs. There are numerous reasons why many companies like to hire independent contractors:

1. **Cost Savings:** There's no need to spend money on supplies, office space, or medical insurance. You also save on payroll expenses related to workers' compensation insurance and Social Security.
2. **Staffing Flexibility:** Independent contractors come on demand, when and where you need them.
3. **Training Expenses:** What training expenses? Much of the appeal of independent contractors is that they already have the necessary skills and expertise.
4. **Ease of Regulations:** Unlike employees, who are covered by a maze of employment laws, independent contractors are easier to pay. Rules related to minimum wage, overtime, unionization, sick leave – even most anti-discrimination statutes – don't apply to them.

And the Agony ...

If all of the above benefits sound too great to be true, it's because they are. Working with independent contractors also comes with potential drawbacks:

1. **Loyalty:** What loyalty? Sure, independent contractors will hopefully do a great job for you, but they will always have one eye on the next job or client.
2. **Limited Influence:** Your ability to determine a host of variables around how, when, and where independent contractors work is restricted, which can result in misalignment around expectations and results.

3. **Contractual Obligations:** In most of the country, people work under the doctrine of at-will employment, whereby you can fire someone for any reason – or no reason – without warning, as long as you don't violate certain civil rights related to traits like race, religion, etc. Not so with independent contractors. A written or verbal agreement (we don't need to tell you which is better!) determines the nature of the working relationship with freelancers.
4. **Misclassification:** If you hire an independent contractor but treat the individual as an employee, then it can really hit the fan with the IRS.

Don't Mess With the IRS

It's that last point that's most important to keep in mind when hiring and paying people. It also goes back to the opening question about employing independent contractors. It's a trick question because you technically cannot employ a freelancer. You can only employ – an employee. Except here's the problem: Distinguishing between the two is not always easy. Generally speaking, all workers are either employees or independent contractors. The majority of employees are covered by the Fair Labor Standards Act (FLSA), which establishes minimum wage, overtime, and a wide variety of record-keeping and employment rules. However, the law does not apply to independent contractors. That's why it's so important to clearly understand whether the people you hire are, in fact, employees or independent contractors. You don't want to mess with the IRS.

Employee or Independent Contractor?

Before you pay someone for work, you first have to figure out the nature of your business relationship with the individual. According to IRS rules, "anyone who performs services for you is generally your employee if you have the right to control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed." Meanwhile, someone is an independent contractor if you "have the right to control or direct only the result of the work and not the means and methods of accomplishing the result." In other words, it comes down to control. Specifically, you need to pay attention to three factors to make sure you don't treat an independent contractor like an employee:

1. **Behavioral Control:** Avoid telling freelancers how to do their jobs. Don't give them instructions on when to work, supplies to use (or where to purchase those supplies), or how to sequence their tasks. What's more, despite good intentions to provide training, you should let freelancers manage their own professional development.
2. **Financial Control:** Likewise, you shouldn't try to influence how independent contractors conduct the business aspects of their work. For instance, those noncompete clauses you may use with employees? Steer clear of them with independent contractors.

3. **Type of Relationship:** You want to establish clear contrasts between the benefits you offer your employees vs. independent contractors. The IRS is more likely to charge you with misclassification if you offer vacation pay, health insurance, or sick pay to both groups. Likewise, someone may be considered an employee unless your contract stipulates that the relationship is for a specific project or time period.

These Are Not Trick Questions

To help you avoid misclassifying workers, below is a list of questions adapted from the IRS. Although they are no longer used by the agency as official measures of worker status, they can nonetheless help you make informed determinations:

- Is the worker required to follow specific instructions as to the means and manner of performing the work?
- Is there a set amount of hours and days that the person must work each week?
- Does the employer supply the office, equipment, and tools needed to accomplish the work?
- Must the work be performed on the employer's premises? (Typically, a "yes" answer would indicate the person is an employee; however, there are instances where an independent contractor would be required to perform on the premises. You would need to consider your answer to this question in relation to everything else.)
- Is the worker trained by the employer to perform the assignments?
- Is the assigned work a part of the regular business of the employer?
- How long does the relationship continue? (In general, the longer the relationship continues, the more the worker looks like an employee.)
- Is the person paid in the same manner as employees, e.g., biweekly? (Again, typically a "yes" indicates the person is an employee, but there may be instances where the independent contractor is paid in the same or similar manner. Here again, you will need to consider this factor in relation to all other factors.)
- Is the worker prohibited or limited from hiring assistants?
- Does the worker provide services only to your business?
- Is there a written contract between the parties delineating their rights and responsibilities?
- Can either the worker or the employer terminate the relationship at will?
- Are you making any investment in the worker's facilities or equipment?

The more "yes" answers, the more likely that the government would consider the worker an employee, in which case you should rethink how you hire and pay people. Independent contractors can still be a valuable part of your staffing plan. Just be sure that they aren't really employees in disguise.

Learn more about the differences between employees and independent contractors in our upcoming

webinar Independent Contractors: Avoiding Misclassification. *Click the button below to register now!*

This information is for educational purposes only, and not to provide specific legal advice. This may not reflect the most recent developments in the law and may not be applicable to a particular situation or jurisdiction.