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## Independent Contractor Or Employee?

### Making The Right Choice For Your Small Business

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One of the critical issues facing small and large companies alike is the proper classification of those individuals who perform services for the company. Classifying someone as an employee or independent contractor is a decision that must not be taken lightly and involves serious consequences in the event the decision made is the wrong one.

The primary benefits a company receives from utilizing an independent contractor rather than hiring an employee is the ability to engage the person only as needed and without some of the tax ramifications noted below or the obligation to pay health benefits.

Among the risks employers face when treating an individual as an independent contractor is liability under the Fair Labor Standards Act, which, in some circumstances, can result in individual liability for officers of the corporation. FLSA liability can arise from the failure to pay the minimum wage and/or overtime to an employee and can create liability going back two, or in some instances, three years. A successful plaintiff can recover back pay and liquidated damages, as well as attorneys' fees.

Employers face liability under other statutes as well. For example, under the Internal Revenue Code, the employer is responsible for the employee's tax withholdings. The employer can also be liable for the failure to pay unemployment compensation taxes, as well as workers' compensation premiums, in which case the employer will not enjoy the immunity from suit from an injured worker that normally arises by virtue of the workers' compensation system.

One prominent example of the risks of misclassifying individuals involves one of America's largest companies, Microsoft Corporation. In the case of Microsoft, it engaged independent contractors or so-called "temporary" workers who had worked for Microsoft for many years. However, these individuals, who later became known as "permatemps", performed the same work as regular Microsoft employees and often worked side-by-side with traditional employees. Importantly, however, these permatemps were not afforded the benefits of employment at Microsoft, including such things as health insurance, pension benefits and stock options. The subsequent suit by the independent contractors and ultimate recovery of the benefits they missed highlights the importance of the proper classification of employees and independent contractors.

However, treating someone as an independent contractor without fully analyzing whether the individual should properly be treated as an employee could result in significant liability for the company. So, what does a company need to make certain that it is engaging true independent

contractors and not an employee?

Although there are many different definitions of an independent contractor, including a 20 question inquiry formulated by the IRS, the key elements to look for are the degree of control exercised over the individual. The more the company is concerned only with the results, and not the method for how the work is done, such as scheduling and directing the work, the greater chance that there is an independent contractor relationship. In addition to this so-called "behavioral control" relating to who directs and controls how the work is done, there are also financial and relationship issues. In particular, a company should make certain any independent contractor it engages has their own business with separate clients whom they also service, have their own workers' compensation insurance and their own payroll and employees, if applicable. Companies should also document the relationship so it is clear that the person is being engaged as an independent contractor, who, among other things, acknowledges they control and direct the performance of their work and that the company is concerned only with the end results of such work.

By carefully structuring and documenting relationships with independent contractors, a company can enjoy the benefits of such a relationship, while avoiding the significant financial risks associated with using independent contractors who are truly regular employees.