

The Five Most Dangerous Assumptions Businesses Make About Independent Contractors...

...and How You Can Avoid Them!



Presented by Collabrus Inc.
Contingent Workforce Management & Compliance Solutions

Introduction

The IRS reports finding wrongly classified Independent Contractors in more than 90% of the firms they audit.

Mitigating the risks involved with using Independent Contractors while gaining all the benefits.

Using Independent Contractors has become a vital component of workforce planning. However, this contingent workforce can expose your company to significant risk.

The IRS, EDD and numerous other government agencies have made tracking down misclassified Independent Contractors a top priority. Their motivation is to close what they call the "Tax Gap" – the estimated *\$35 billion per year* in income taxes and unpaid employment taxes that are not collected due to the misclassification of workers.

The IRS reports finding wrongly classified Independent Contractors in more than 90% of the firms they audit. The combined back taxes, penalties and interest a company may face for violations can reach into the millions of dollars.

To help you navigate through this potential legal minefield the following whitepaper reviews the five most dangerous assumptions businesses make about Independent Contractors, and how you can avoid them.

Dangerous Assumption #1

It's the work and how it is performed, not the length of time, that will determine if someone is an employee or an Independent Contractor.

The duration of the job is less than six months, therefore the consultant can safely be classified as an Independent Contractor and we don't have to worry about tax risk.

Reality: There are numerous court decisions stating that the length of time personal services are provided does not alone determine if an individual is an employee or an independent contractor.

It is possible to work less than a day and still be classified as an employee. Conversely, it is possible to work for a year and still be a valid independent contractor. For the IRS or EDD the length of time is not the sole determining factor.

Also, be aware that a temporary worker performing the duties of an employee who is on leave of absence is often viewed as an employee by government agencies. It's the work and how it is performed, not the length of time, that will determine if someone is an employee or an Independent Contractor.

Dangerous Assumption #2

A contract by itself will not determine the true status of the relationship.

There is a contract, signed by both parties, stating that the consultant is an Independent Contractor responsible for his/her own taxes and benefits; therefore, neither the IRS nor the EDD will dispute the contractor's status.

Reality: Courts have consistently held that a written contract only shows the intention of the two parties. A contract by itself will not determine the true status of the relationship. The reality is that a contract cannot supersede the law.

Furthermore, courts have concluded that a "contract cannot affect the true relationship of the parties to it. Nor can it place an employee in a different position from that which he actually held." In fact, during training both EDD and IRS auditors are taught that since the government did not sign the contract, it is not bound by it. These government agencies have full authority to scrutinize all contracts.

Dangerous Assumption #3

The elements of direction and control between the individual and the client company determine the status of the relationship.

My consultant is incorporated; therefore, the usual common law employee versus Independent Contractor factors can be bypassed because consultants with their own corporations are automatically Independent Contractors.

Reality: Courts have ruled that the individual who forms a corporation technically becomes an employee of that company. However, it is possible for an individual to form a corporation and still perform work that makes them an employee of their client.

For the client company to be protected the agreement should specify that the corporation does the work, not an individual. It should not matter who the vendor corporation sends to do the work, so long as it is completed as agreed.

In addition, the elements of direction and control between the individual and the client company still apply to determine the tax status of the relationship.

Dangerous Assumption #4

A business license alone will not determine the actual relationship between the two parties.

My consultant has a business license and professional liability insurance, therefore he/she is an Independent Contractor and my company has no risk in using their services.

Reality: The short answer is "it depends!"

A business license and professional liability insurance are generally viewed as "indicators" of an independent business. However, they alone will not determine the actual relationship between the two parties. The total picture must be considered.

There have been numerous cases where the individual contractor had both a business license and professional liability insurance yet was still found to be an employee of the company. This finding can result in back pay and benefits, and in the case of a tax audit, in an assessment for additional taxes, penalties and interest for the company that incorrectly classified the employee as an Independent Contractor.

A number of other factors, such as the right to direct and control the details of the work, are more important than a business license or insurance when determining the status of a consultant.

**Dangerous
Assumption #5**

*You can safely use
consultants as
Independent
Contractors, so long
as you classify them
correctly.*

The IRS and the EDD hold everyone to be an employee because they want to capture the tax revenue and therefore believe there is no such thing as an Independent Contractor.

Reality: This is an untrue statement. Both the IRS and the EDD have publicly stated that using Independent Contractors is a proper and legitimate business strategy. Audit findings confirm that position everyday. You can safely use consultants as Independent Contractors, so long as you classify them correctly.

You must do it right. All of the factors must be considered and documented for each Independent Contractor classification. In the unfortunate (but increasingly common) event that you are audited your best protection is a properly documented decision that will allow you to prove to the IRS or EDD that you have correctly followed the rules.

It is dangerous to guess incorrectly, just as it is dangerous to ignore the issue and hope that you won't get caught. Prudent businesses seek to mitigate risks.

About Collabrus

Collabrus provides:

Contingent Workforce optimization, risk mitigation and cost control.

Collabrus provides clients with a comprehensive suite of contingent workforce management services designed to optimize your workforce spend and mitigate risk. Services include professional-level pay and benefits for contract employees, worker qualification and contract administration for Independent Contractors, and end-to-end outsourced managed solutions. Our tailored programs enable you to make the contingent workforce a key asset in your overall talent strategy.

Collabrus solutions include:

- **Compliance and Risk Mitigation** – The unique Collabrus evaluation process is a combination of Web-based tools and expert review to ensure 1099 compliance. Since not all individuals or vendors qualify to be legally called “Independent Contractors,” Collabrus helps clients implement procedures to eliminate the risk associated with utilizing contractors. This often involves working with the IC’s to achieve compliance, or moving them to our payroll solution whereby Collabrus becomes the employer-of-record.
- **Professional-Level Payroll** –Collabrus pay services and benefits packages are tailored to meet the needs of your highly skilled contract workers and consultants, on a nationwide basis.
- **Contingent Workforce Managed Services** – Collabrus builds personalized programs that enable clients to manage all aspects of their contractor workforce – Independent contractors (1099), staffing suppliers, and W2 workers – using a combination of web-based technology and high touch services.

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