

Independent Contractors

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Introduction

The “independent contractor” is a person or entity hired to provide a specific service or product, but not hired to work as an employee. Contracts to hire design firms typically declare that the firm will work as an independent contractor. Similarly, design professionals usually retain their professional subconsultants as independent contractors, as distinguished from the prime consultant’s employees. But design firms can also hire individuals as independent contractors to work within the firm, performing specific services or tasks. These relationships, unless handled carefully, can result in unexpected “employer liability” if the independent contractor’s relationship is not sufficiently independent.

Definition of an “Independent Contractor”

According to Black’s Law Dictionary, an “independent contractor” is:

Generally, one who, in exercise of an independent employment, contracts to do a piece of work according to his own methods and is subject to his employer’s control only as to end product or final result of his work. One who renders service in course of self-employment or occupation, and who follows employer’s desires only as to results of work, and not as to means whereby it is to be accomplished.

An independent contractor is a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other’s right to control with respect to his physical conduct in the performance of the undertaking.¹

¹ Henry Black, Joseph Nolan & Jacqueline Nolan-Haley, BLACK’S LAW DICTIONARY, Abridged 6th Ed., page 530 (West Publishing, St. Paul, MN, 1991).

Retaining Independent Contractors

SUBCONSULTANTS When one business hires another to provide a specific service, the first business often hires the second as an independent contractor. A clear declaration of independent contractor status emphasizes that the businesses intend to remain distinct from each other, that one is not the other's subsidiary, and that the firms are not a joint venture or other form of association. Failure to maintain these distinctions could lead third parties to interpret the acts of either business as binding on the other, and cause creditors to believe that they might recover from both businesses for the debts of either one. Thus, both businesses have an interest in maintaining the independent contractor relationship between them.

INDIVIDUALS In addition to the relationship between a prime and its subconsultants, design professionals sometime retain individuals to work on projects as independent contractors, rather than as employees of the designer. Some individuals prefer this work relationship because it allows them to retain their separate professional identity. Such individuals' interest may extend to only specific project types or roles, and they may have no interest in becoming part of the prime design firm's business or other projects.

Such independent contractors do not receive pay for vacations, sick days, or holidays, and firm insurance and other benefits do not extend to them. They retain individual control over their own compensation, benefits, and work schedules. Business employers may prefer to hire independent contractors to avoid many costs and liabilities associated with hiring employees, while giving the business flexibility to precisely match individuals to particular tasks.

Significance of Independent Contractor Status

The distinction between employees and independent contractors has significance for the employer's liability exposure arising from the actions of the person or entity employed, as well as liability for a range of employment benefits and expenses.

VICARIOUS LIABILITY An employer is "vicariously liable" to third parties for its employees' acts, since the actions of employees are imputed to their employer while the employee is acting within the scope of his or her employment. Thus, if an employee injures a third party, the injured party may sue the employer under the legal doctrine known as respondeat superior and hold the employer liable to the same extent as the employee is liable.

*Example:
Work by
Employee*

For example, if a company uses its own engineer/employees to design and build a building, the company is responsible for the building's structural design. If the company sells the finished building, and it subsequently collapses and injures someone, the company will be liable for any negligence in its engineer's design. The company is liable even if negligence by the engineer was the sole cause of the collapse. This applies without regard to whether the engineer is still with the company at the time the injury occurs.

*Example:
Work by
Independent
Contractor*

In this same example, if the company hired an independent contractor to provide the structural engineering design, the company would not face the same liability for the engineer's negligence. Since an engineer working as an independent contractor has the sole responsibility for his or her own work, the company would not be held liable for negligence committed by the independent

contractor that it hired.² Thus, the company can control its liability exposure by using independent contractors for professional services, rather than using its own employees, although it may have employees who possess the requisite professional skills for the work.

Similarly, a consultant can reduce its liability exposure if it uses independent contractors as subconsultants. An architect requiring structural engineering services can reduce its exposure for the structural design if an independent contractor performs the engineering, rather than an engineer on the architect's own staff. The independent contractor subconsultant should carry its own liability insurance, and the architect can seek indemnity from the engineer for any claims regarding the engineer's negligence. In contrast, if the architect's own employee provides the engineering, the architect's liability insurance would cover the engineering work, and the architect will have no one else to turn to for indemnity regarding any engineering negligence.³

**EMPLOYER'S
LIABILITY FOR
BENEFITS,
INSURANCE &
EXPENSES**

In addition to vicarious liability, the other significant distinction between employees and independent contractors concerns responsibility for employment liabilities: benefits, insurance, and taxes. This constitutes less of an issue between two business entities, where the entity retained is not an individual. State and federal laws prescribe benefits, insurance and taxes that employers must provide to or pay on behalf of their employees. Generally, these requirements do not apply to independent contractors, since independent contractors provide all of their own benefits, insurance and tax payments themselves and on behalf of their own employees.

Independent Contractors and Design Control

**CONTROL OF
WORK**

Typical contracts for designer's services or those of its subconsultants will provide that the design professional is an independent contractor to the client or prime consultant. Responsibility for determining how to perform the particular design work rests with the independent contractor; the client or prime consultant does not control how the independent contractor performs the work. Contracts with an independent contractor focus on the relationship between the entities and the products that each must deliver to the other, not on how each will do its work.

An Example

For example, an owner may hire an architect as an independent contractor, who hires an independent contractor for the structural engineering, who in turn retains a wind tunnel consultant, again as an independent contractor. The contracts for each of these relationships defines the scope of work for each professional, their duties and obligations, compensation, information, and products. The owner does not tell the architect which consultant to retain for each specific purpose. The architect requires the structural engineer to provide the structural design, but does not control how she does her calculations or performs her analysis. And the structural engineer does not tell the wind tunnel consultant how he will do his analysis. At each stage, the contracting parties make agreements regarding the information, services and compensation each will provide, but each party remains responsible for determining for itself how to fulfill its respective obligations.

As long as the contracting firms clearly maintain their separate identities and fulfill their obligations as businesses—both as established in their agreement and as defined by law – the independent contractor arrangement generally poses no unusual concern.

² This assumes, of course, that the company's choice of the independent contractor for the engineering work was reasonable, and that the company neither knew of the engineer's negligent design, or had any reason to know of it.

³ In this example, the architect could seek indemnity from its own employee for the employee's own negligence if the claim exceeds the firm's insurance. But professional firms rarely pursue their own employees, except for fraud, gross negligence, deliberate misconduct, or criminal acts.

EMPLOYEE LIABILITY

When a business retains an employee, the business incurs various legal obligations, and the employee acquires certain rights, which other laws define. In particular, for each employee, an employer has obligations to pay the following:

- Social Security retirement and Medicare taxes;
- Federal and State Income Tax withholding;
- State Workers' Compensation and unemployment insurance premiums and training program taxes;
- The Firm's Health insurance, to the extent applicable;
- Contributions and benefits to the Firm's retirement program, if any; and
- Federal, state, or local minimum wage, overtime, and holiday pay, as applicable, to the particular category of employee.

The employer also has obligations to its employees regarding state and federal fair employment law, non-discrimination law, Americans with Disabilities Act compliance, and benefits under ERISA. And, as already noted, under the respondeat superior doctrine, employers are liable to third parties regarding the actions of their employees.

Retaining Individuals as Independent Contractors

ADVANTAGES

In terms of overall cost, a designer may realize an immediate saving in personnel costs by hiring an independent contractor rather than another employee. When a business hires a true independent contractor, the business does not – indeed, must not – pay for the independent contractor's taxes, insurance, and other benefits, as previously listed. Those costs are the independent contractor's responsibility, and their payment by the business could negate the business claim that the person is an independent contractor and not an employee. In addition, the business has no obligation regarding minimum wage or overtime regulations, fair employment laws, or ERISA concerning any independent contractors working for the business. And the doctrine of respondeat superior does not apply to the independent contractor's actions.

DISADVANTAGES

The significantly increased flexibility and reduced direct employment costs provide strong reasons for firms to retain individuals as independent contractors. But several important considerations explain why this practice is not more widespread.

Control or Independence

First, the concept of a truly "independent contractor" precludes the employer from exercising control over how the contractor works. The employer's control over the independent contractor exists only by accepting or rejecting the work product. An independent contractor retains that status only as long as it is in fact independent – meaning independent of the direct control by the business that has retained him or her. If the employer exercises significant control or direction over the work, its actions deny the "independent contractor" nature of the relationship, and convert it into one of employer/employee in the eyes of the law. Indeed, the business cannot terminate the independent contractor "at will," but only for breaching its contract or providing an unacceptable work product.

Effect on Employees & Office Culture

Another factor limiting use of independent contractors is that more extensive use can undermine an organization. A business cannot promote the independent contractor's professional development or firm loyalty while claiming that the individual is not an employee. Thus, extensive use of independent contractors within a firm works against development of ongoing relationships, internal cohesiveness, and continuity.

*Liability for
Injuries to
Workers*

Another risk of employing independent contractors is the firm's exposure to damage claims if the independent contractor is injured while working on a project. Workers' Compensation insurance limits recovery for job place injuries. But it only covers employees, not independent contractors. Thus, an injured independent contractor is free to sue the employer for the full extent of injuries, including all actual and compensatory damages, lost earnings and even punitive damages (if applicable). Thus, by hiring an independent contractor, a business surrenders the significant protections offered by the laws that limit employees' rights to recover for workplace injury.

Handling Uncertain Relationships

CHALLENGES TO CLASSIFICATION

Whether an individual is an independent contractor or an employee is, in the end, a legal determination with significant consequences for any misclassification.

*Challenges by
Agencies*

The Internal Revenue Service (IRS) and various state employment agencies can audit a business's records at any time. Both federal and state agencies have the power to impose fines and collect back taxes if they determine that a claimed independent contractor was actually an employee.

*"Change of Heart"
Challenges*

And individuals that a firm retained as independent contractors may later sue the businesses that hired them if the individuals decide to later argue that they were actually employees and thus entitled to all the benefits enjoyed by regular employees of the business.⁴

*Challenges by
Third Parties*

Also, hiring an independent contractor does not necessarily avoid respondeat superior liability. An injured third party can always claim that the purported independent contractor is actually an employee, and try to hold the business liable for the independent contractor's actions. In our ever-more litigious world, if the independent contractor lacks sufficient assets to cover an injured person's claims, that person has every incentive to establish employer/employee liability.

RISKS OF MIS- CLASSIFICATION

Thus, the designer or firm who retains an independent contractor can find himself/herself in court or before an agency having to defend the independent contractor classification. Unfortunately, proving the relationship's true nature is difficult and not consistent among the potential adversaries who may challenge the independent contractor's status.

*Conflicting
Standards*

Unfortunately, federal and state agencies use different standards to determine if an individual is an employee or an independent contractor. Each examines different factors to reach its conclusion, and no one factor resolves the matter for any agency. But one baseline consideration common to all is a focus on the employer's right to control the independent contractor's work and workers, with significant (but varying) weight given to the following:

- What is the degree of independence in how the individual performs the work;
- Does the individual have his or her own business entity, with its own profit or loss;
- Is payment by the task/project or by the hour;
- Who supplies tools, equipment and additional labor;
- Who controls the right to delegate the work; and
- Is the relationship continuing or limited to the task/project?

⁴ In a recent, high-profile example, thousands of former "independent contractors" at Microsoft sued the company and obtained a multi-million dollar settlement for back-payment of benefits.

IRS “Safe Harbor” The IRS has provisions that allow an employer to avoid back taxes and fines for misclassifying an employee, but those provisions do not apply to professional engineers, architects or draftpersons. Furthermore, to the extent the provisions cover non-technical individuals, they apply only to mistakes made based on a good faith belief that the individual actually was an independent contractor and the employer satisfies other technical requirements. And while these limited “safe harbor” provisions may help avoid added federal tax liability, they offer no assistance regarding state unemployment, Workers’ Compensation, disability insurance, any state income tax withholding, or legal liability matters.

CHANGE IN CLASSIFICATION

A business has two basic options if it believes that an independent contractor relationship might fail the legal test of an agency with authority to impose sanctions: restructure the relationship to more accurately fit the definition of independent contractor; or reclassify the individual as an employee.

No Change in Classification

If a business chooses to keep the workers classified as independent contractors, it can restructure the relationship along lines that better match the regulatory agencies’ criteria. But such measures will not protect the business from liability regarding past relationships in the event of an audit or lawsuit. Indeed, the very fact of having made changes might serve as evidence against the employer, tending to show that the prior relationship was not that of an independent contractor and employer.

Change in Classification

Similarly, a decision to reclassify the individual might not avoid penalties. If any governing authority audits the business, having reclassified a former independent contractor as an employee might constitute an admission that the employer had previously misclassified the individual. And the fact of a change would disqualify the employer from the IRS’s “safe harbor” provisions. Therefore, when reclassifying individuals to employee status, a business should also take steps to treat them differently than it had previously as a way of emphasizing the change in status and minimizing exposure to possible fines and back taxes.

Working With Independent Contractors

WHAT TO DO

When seeking to use an independent contractor, consult a specialist who knows employment law and the factors most applicable to the type of relationship contemplated. Structure the relationship to satisfy as many factors as possible, and when hiring the independent contractor, require that it provide copies of all relevant documentation, such as its business license, fictitious name statement, insurance certificate, and evidence of compliance with tax and reporting regulations.

WHAT TO AVOID

In working with the independent contractor, a business should scrupulously require the independent contractor to submit invoices for payment, and not make its payments to the independent contractor from the business’s payroll account. Both employer and independent contractor should carefully follow the terms of their contract and properly amend it if changes become necessary. In describing the scope of services and tasks involved in the relationship between the parties, avoid words of employment, such as “supervise” and “report to,” and avoid providing any “employee benefits” to the independent contractor, including such seemingly innocuous perks as an invitation to staff-only events. And, finally, in the day-to-day work of the independent contractor, the employer must resist any urge to assert control over how the independent contractor performs its work.