

Employee? Independent Contractor?

Sometime around 1884, poet James Whitcomb Riley used humor to explain inductive reasoning with the observation, “When I see a bird that walks like a duck and swims like a duck, and quacks like a duck, then it probably is a duck.”

His duck test is a good place to begin if your organization is trying to decide whether a worker should be classified as an independent contractor or as an employee. In most cases, the distinction is clear — employees look like employees.

Supplementing your regular workforce with independent contractors often makes sense. It’s efficient and offers significant financial advantages. But misclassifying workers as an independent contractor can be a costly mistake. It also deprives them of the rights and protections they deserve.

Both the IRS and state agencies are stepping up efforts to uncover longterm “temps.” President Obama’s 2011 budget calls for 100 new investigators to pursue misclassification cases. In Congress, the House recently adopted the Employee Misclassification Prevention Act. The legislation is awaiting Senate action.

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In addition to stiffer penalties, the new law would require employers to keep records reflecting the accurate status of each worker, notify workers of their classification and prohibit retaliation against those who speak out about misclassification practices.

This issue of *Arts Law Memo* outlines the benefits and risks of hiring independent contractors and offers suggestions for structuring working arrangements that will help preserve an independent contractor’s status. It also includes the IRS Independent Contractor Test.

EMPLOYEE RELATIONSHIP

Some workers are clearly employees. A museum’s staff photographer, for example, receives daily assignments from her supervisor, memory cards from the supply cabinet and weekly checks from the payroll department. Federal, state, local and the employee’s share (7.65 percent) of Social Security and Medicare taxes (FICA) are deducted from those checks. The museum also is required to pay an additional 7.65 percent in FICA.

Unless your organization is very small, employees must be covered by workers’ compensation and unemployment insurance. In addition, many organizations voluntarily offer their employees fringe benefits such as vacation pay, health insurance and retirement plans.

How about copyright? This important subject is often misunderstood. When the photographer is an employee, the art museum automatically owns the copyright in the work that she creates while on the job. So, if the staff photographer wants to independently publish a book of her best work, the museum must grant her reproduction rights.

CONTRACTOR RELATIONSHIP

Independent contractors — also known as freelancers, consultants and the self-employed — perform services but don’t have the legal status of employees.

They are paid to perform a discrete assignment during a set period of time with a specific starting and ending date. Independent contractors control how they perform their services, and they usually have more than one client.

A freelance photographer who shoots a cover photo for an art museum’s annual report is a good example of an independent contractor. He uses his own equipment, and is paid a fee for his work. The photographer is responsible for paying quarterly taxes on his self-employment income and what amounts to both the employee’s and employer’s share of Social Security taxes (15.3 percent). He is not

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- Sponsoring seminars and public forums;
- Arranging for guest speakers;
- Maintaining a reference library and website;
- Operating an arts space clearinghouse;
- Supplying model contracts and other arts law and business materials;
- Conducting and disseminating research;
- Contributing articles to publications;
- Collaborating on arts advocacy and nonprofit initiatives; and
- Providing access to the national volunteer lawyers for the arts network.

This issue was written by VLAA Executive Director Sue Greenberg.

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Tips for Arts Organizations

1. Use written agreements. A written agreement does not automatically make a worker an independent contractor, but it helps. A written agreement also can avoid misunderstandings about the scope of work, payment schedule, deadlines, insurance and copyright ownership.

2. Obtain taxpayer ID numbers. Make sure you obtain the independent contractor's taxpayer ID number and address. Simply ask the contractor to complete IRS Form W-9, Request for Taxpayer Information Number, before the job starts. You don't have to file this form with the IRS.

3. File all required 1099-MISC forms. Your organization is required to file IRS Form 1099-MISC for any unincorporated independent contractor who is paid \$600 or more in any year. The forms, along with the cover sheet, Form 1096 Annual Summary and Transmittal of U.S. Information Returns, must be filed with the IRS by February 28. Independent contractors must receive their copies by January 31.

4. Be consistent in the way your organization uses independent contractors. When possible, keep the jobs done by your employees and independent contractors separate. For example, using both employees and independent contractors as set designers could confuse government regulators.

5. Let the independent contractor determine when, where and how to accomplish the job. Remember, independent contractors are in business for themselves and are not your employees. Don't supervise their every move.

6. Don't give independent contractors free equipment or space. Generally, independent contractors should use their own equipment and work space. If you must provide equipment or space, consider charging rent.

7. Require invoices for payment. Don't pay independent contractors on a weekly, bi-monthly or monthly basis like you pay employees. Pay them when you cut checks for other outside vendors.

8. Hire incorporated independent contractors. Most independent contractors are sole proprietors, running unincorporated, one-person operations. However, some independent contractors form their own corporations. Try to hire incorporated independent contractors wherever possible, since there is less chance the IRS or other government agencies will view them as employees.

9. Keep good records. Establish a file system containing the independent contractor's contract, invoices and copies of 1099-MISC forms. Don't keep independent contractor records with your employee personnel files.

10. Understand copyright ownership. Ask for a written agreement transferring copyright ownership to your organization. Without an agreement, the independent contractor usually is presumed to be the copyright owner.

entitled to fringe benefits or unemployment compensation.

Unless ownership is transferred by a written assignment agreement, the copyright in the image belongs to the photographer. In this case, he simply grants the museum one-time rights to use the photograph on the cover of the annual report. Although the museum commissioned the work and has the jpg file, it should get permission to reproduce the image elsewhere, and should be prepared to pay a licensing fee.

A contract outlining the scope of the assignment and the copyright ownership can help avoid ugly misunderstandings.

ADVANTAGES

Hiring independent contractors provides expertise for short-term or specialized projects.

It also saves money. In addition to not withholding taxes, making Social Security and Medicare contributions or providing employee benefits, organizations can sidestep wage and hours laws, lower insurance premiums, avoid the obligation to bargain with a union and be shielded from liability arising from certain employment discrimination violations.

RISKY BUSINESS

Be careful. When government agencies or courts determine that workers are, in fact, employees and not independent contractors, their employers can incur large liabilities. Organizations may face back taxes, state and federal penalties, unpaid overtime and overdue contributions to the unemployment compensation system.

Although the IRS provides "duck test" guidelines (see page 3), some workers fall within the "gray area." If you are unsure of someone's correct status, please consult a qualified attorney.



Employee or independent contractor: What does the IRS say?

To determine whether an individual is an employee or an independent contractor, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

BEHAVIORAL CONTROL

Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of:

Instructions the business gives the worker An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work:

- When and where to do the work
- What tools or equipment to use
- What workers to hire or to assist with the work
- Where to purchase supplies and services
- What work must be performed by a specified individual
- What order or sequence to follow

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training the business gives the worker An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

FINANCIAL CONTROL

Facts that show whether the business has a right to control the business aspects of the worker's job include:

The extent to which the worker has unreimbursed business expenses Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.

The extent of the worker's investment An employee usually has no investment in the work other than his or her own time. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.

The extent to which the worker makes services

available to the relevant market An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

How the business pays the worker An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

The extent to which the worker can realize a profit or loss Since an employer usually provides employees a workplace, tools, materials, equipment, and supplies needed for the work, and generally pays the costs of doing business, employees do not have an opportunity to make a profit or loss. An independent contractor can make a profit or loss.

TYPE OF RELATIONSHIP

Facts that show the parties' type of relationship include:

Written contracts describing the relationship the parties intended to create This is probably the least important of the criteria, since what really matters is the nature of the underlying work relationship, not what the parties choose to call it. However, in close cases, the written contract can make a difference.

Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay The power to grant benefits carries with it the power to take them away, which is a power generally exercised by employers over employees. A true independent contractor will finance his or her own benefits out of the overall profits of the enterprise.

The permanency of the relationship If the company engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.

The extent to which services performed by the worker are a key aspect of the regular business of the company If a worker provides services that are a key aspect of the company's regular business activity, it is more likely that the company will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

Source: IRS Publication 15-A Employer's Supplemental Tax Guide