

# LAW MEMO

## Independent Contractors: Pros & Cons

Whether a worker should be classified as an independent contractor or an employee has long been a frustrating issue for arts organizations. Using independent contractors offers organizations significant financial advantages; but misclassifying someone as an independent contractor can be a costly mistake.

This issue of *Arts Law Memo* summarizes the new training materials being used by the Internal Revenue Service examiners who handle worker classification issues. It also 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.

### EMPLOYEE RELATIONSHIP

Some workers are clearly employees. A museum's staff photographer, for example, receives daily assignments from her supervisor, film 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 taxes (FICA) are deducted from those checks. The museum also is required to pay an additional 7.65 percent in FICA.

Unless the organization is very small, it must purchase 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, even by arts organizations.

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 free lancers, consultants, and the self-employed — perform services but don't have the legal status of employees. They run their own businesses and have more than one client. They set their own hours and methods for doing the job.

A free lance photographer hired to shoot a special cover for an art museum's annual report would be considered an independent contractor if he uses his own camera, studio, and darkroom, maintains control of his own schedule, and is paid a flat 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 entitled to fringe benefits or unemployment compensation.

Unless ownership is transferred by a written assignment agreement, the copyright in the picture belongs to the photographer.

Copyright ownership, which is separate from the physical possession of the work, allows the photographer (and his heirs) to benefit economically from his artistic endeavors. It gives him the exclusive right (for life plus an additional 70 years after his death) to reproduce, adapt, distribute, and display his picture.

In this case, he simply grants the museum one-time rights to use the photo on the cover of its annual report. Although the museum commissioned the work and owns a print, it should seek permission to reproduce the image elsewhere, and it should be prepared to pay a royalty fee.

Independent contractors are generally paid more per hour than employees. But, in the end, they often save their clients money. When they hire independent contractors, arts organizations do not have to withhold taxes or pay FICA.

Published by the St. Louis Volunteer Lawyers and Accountants for the Arts (VLAA), *Arts Law Memo* is mailed, free of charge, to more than 650 Missouri and Southwestern Illinois arts organizations, VLAA volunteers, and corporate sponsors.

VLAA helps artists and arts organizations solve and avoid legal and accounting problems by:

- Making referrals to lawyers and accountants;
- Mediating arts-related disputes;
- Publishing *Arts Law Memo* and concise how-to guides;
- Sponsoring seminars and public forums;
- Arranging for guest speakers;
- Maintaining a reference library;
- Operating an arts space clearinghouse;
- Supplying model contracts and other arts law and business materials;
- Facilitating meetings;
- Conducting and disseminating research on issues affecting the arts;
- Contributing articles to publications;
- Collaborating on arts advocacy initiatives;
- Matching volunteers with arts organizations seeking board members; and
- Providing access to the national VLA network.



This issue was written by Sue Greenberg, VLAA's executive director.

*This publication is distributed with the understanding that VLAA is not engaged in rendering legal or accounting counsel. We urge you to seek professional services to address your specific needs.*

### St. Louis Volunteer Lawyers and Accountants for the Arts

3540 Washington  
St. Louis, MO 63103  
314/652-2410  
vlaa@stlrac.org  
www.vlaa.org

## TEN TIPS FOR WORKING WITH INDEPENDENT CONTRACTORS

- 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, 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 is started. 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. 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, charge 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, like the printer.
- 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 is usually presumed to be the copyright owner.

They need only file a Form 1099-MISC with the IRS if they pay an independent contractor \$600 or more during a calendar year.

Organizations may also lower their premiums for general liability insurance, avoid the obligations to bargain with a union, be shielded from tort liability arising from the worker's actions and from back pay and punitive damages liability for certain civil rights violations.

Finally, hiring independent contractors can provide flexibility by providing expertise for short-term or specialized projects.

### RISKY BUSINESS

There are risks for organizations that use independent contractors, particularly when the contractors are sole proprietors, as distinct from corporations or partnerships. Sole proprietors sometimes "forget" to report self-employment income on their tax returns, so the government would like to see them receive W-2 wages.

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 state unemployment compensation funds.

### REPLACING THE 20 FACTORS

Some workers are clearly independent contractors. A composer commissioned to write one work, at home, using his own synthesizer, is an example. Many workers, however, fall into a gray area. Equally frustrating is the fact that various state and federal agencies use different tests for determining worker status.

For many years, the Internal Revenue Service relied on a common law 'facts and circumstances test' with an unwieldy list of 20 factors, which addressed degree of control. Small business owners complained; the IRS listened. Its new training materials instruct the agency's field auditors to use a more reasonable approach based on the three categories outlined on the next page.

## Employee or independent contractor: What does the IRS say?

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

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties as shown below.

### 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 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.** 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.**
- **Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.**
- **The permanency of the relationship.** If you engage 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 your 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 your regular business activity, it is more likely that you 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.

Publication of *Arts Law Memo* is made possible by grants from the Regional Arts Commission; the Illinois Arts Council, a state agency; and the Missouri Arts Council, a state agency.



NONPROFIT ORG.  
U.S. POSTAGE  
PAID  
ST. LOUIS, MO  
PERMIT NO. 3363

3540 WASHINGTON  
ST. LOUIS, MO 63103



## Additional Resources

### **IN THE NEWS: FREE LANCERS AUTOMATICALLY RETAIN ELECTRONIC RIGHTS**

In September, a dispute between free lance writers and powerhouses like the New York Times was resolved by the U.S. Second Circuit Court of Appeals when the court ruled that publishers could not place their work on electronic databases like Lexis/Nexis without their permission and — by extension — without additional compensation. The case, *Tasini v. New York Times*, reversed a lower court decision dating back to 1993. The court based its decision on two factors: First, that the databases were not “revisions” but were, instead, re-uses of copyrighted material. Second, that there were no written agreements between the authors and the publishers authorizing the electronic versions of the articles. Although transfer agreements are now common practice in the publishing industry, their use is rare among nonprofits. Arts organizations should seek approval from free lance writers, designers, and photographers before their work is reproduced on the Internet.

### **MODEL CONTRACTS**

VLAA maintains an extensive file of arts-related contracts, which should be modified to address your specific needs. They are free on request.

### **VLAA LIBRARY**

Many books on arts law and business practices are available at the **St. Louis Volunteer Lawyers and Accountants for the Arts library** located within the Regional Arts Commission office, 3540 Washington, in Grand Center. The expansion of VLAA's library (which now includes the **Foundation Center's database on CD ROM**) and promotion of its use is made possible by a generous grant from the Gateway Foundation.