



## Independent Contractors/Freelancers

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### Background

The terms *independent contractor* and *free-lancer* are often used interchangeably. While every freelancer is an [INDEPENDENT CONTRACTOR](#), not every independent contractor can be considered a free-lancer. The term "free lance" actually first appeared in Sir Walter Scott's novel *Ivanhoe* in 1819, to denote a mercenary knight (in medieval times they were called "free companions"). Freelancers of today are not mercenaries in the soldier-of-fortune sense; they may be writers, artists, computer experts, or business consultants. Independent contractors are people who are not considered employees. That definition includes freelancers, but it also includes anyone in private or sole business practice such as lawyers, plumbers, electricians, and shopkeepers.

From a legal standpoint, whether an individual is an independent contractor or an employee has tax ramifications. The Internal Revenue Service has guidelines that are intended to clarify the difference, partly to avoid confusion and partly to guard against illegal practices such as listing employees as independents.

### Who Are Independent Contractors and Freelancers?

There are a number of reasons why people choose to work as freelancers or independent contractors. Most sole proprietors will say that they prefer the freedom of working for themselves; they dis-like the burdens of office politics, of attending meetings, of fighting for raises or promotions. In some fields, such as the publishing and computer industries, people become freelancers after they are laid off from their jobs. People who have a special professional skill may choose to work independently and sign on with many clients rather than one company because it provides more diverse (and often, more lucrative) opportunities.

Companies, likewise, have many reasons for working with independent contractors. Independents can be brought in for short-term specialized projects. Doing so eliminates the need to train employees to do work they may never need to do again, and it also eliminates the need to add staffers whose skills and talents will be underused. Almost always it will cost less to bring in an independent contractor because employees receive benefits as well as salary. Human resource professionals estimate that benefits (health insurance, [PENSION](#), paid vacation, etc.) can add as much as 30 percent on top of an employee's base salary. In a small office, space considerations may be an issue; there may not be enough office space to accommodate extra employees.

## Encyclopedia of Everyday Law: Independent Contractors/Freelancers

The advent of electronic communication has made independent contracting much easier for both clients and contractors. Given access to email, a publisher who employs freelance writers, editors, and designers can work with people who live anywhere in the world. The freelancers do the work and send files via email to the client. It is not uncommon for companies to work with freelancers without ever meeting them or even speaking over the telephone.

For contractors such as lawyers or electricians, of course, this level of freedom is impossible. Still, such contractors can be brought on-site on an as-needed basis. A large company may have on-site maintenance staff or legal [COUNSEL](#), but for a smaller company there is no reason to do so if independent contractors are readily available and able to provide good service.

While there are clearly many benefits to both companies and contractors, hiring independents requires responsible behavior on both sides. Clients have an obligation to pay for the work contracted in a timely fashion and to provide input to make sure the contractor understands what is needed. Contractors have an obligation to do the work as agreed upon, also in a timely fashion, and to take responsibility for work done improperly.

### Types of Workers

In general, according to the **IRS**, if a company has the right to control the *result* of an individual's efforts but not the *means* by which he or she achieves those efforts, the individual is an independent contractor.

Under the rules of [COMMON LAW](#), the individual who controls not only the results but the means by which a person completes a project is the employee. The IRS recognizes the *substance* of the working relationship when it makes its determination. For example, a part-time worker can be considered an employee if other "employee" conditions are met. Temporary workers are usually considered employees of the agency that assigns them; many temp agencies consequently withhold employee taxes. Some temp agencies even offer their workers benefits such as pension plans and paid vacations and holidays.

So-called *statutory nonemployees* are also considered independent contractors by the IRS. **STATUTORY** nonemployees include *direct sellers*, who sell from their homes or door-to-door (Fuller Brush or Tupperware products, for example), as well as licensed real estate agents. The services of statutory nonemployees have to be spelled out in a contract that states plainly that they will not be treated as employees for tax purposes.

### How to Classify Workers

A company that misclassifies an employee as an independent contractor can face stiff fines and penalties from the IRS. A typical way in which companies are found to have misclassified an employee occurs when a contractor is laid off and subsequently tries to file for unemployment. If circumstances show that the person was an employee and not an independent contractor, the company will have to pay the money it should have been contributing on his or her behalf, as well as the IRS penalties and fines.

To be sure, some companies may misclassify employees through an honest misunderstanding. Not all companies, however, are quite that blameless. In the past, some companies have tried to get around making the required Social Security, **MEDICARE**, and unemployment contributions by laying off employees and hiring them back as independent contractors. Sometimes an employee will be laid off from a company, or quit of his or her own volition, and agree to do freelance projects for the company. If that arrangement falls within the independent contractor guidelines as outlined by the IRS, there is no problem. But in the case of a

company that hires back several people and has them working on-site for regular 40-hour work weeks, it is clear that the rules are being broken.

Unfortunately, even a company that inadvertently misclassifies an employee is liable for fines and penalties. Thus, it is crucial that both companies and contractors must be clear on the rules and requirements.

### **Avoiding Mistakes**

The IRS offers examples in its literature as a means of clarifying who is an employee and who is an independent contractor. In one example, a man hired to supervise the remodeling of a house is considered an employee. The homeowner pays for liability and [WORKERS' COMPENSATION](#) insurance for the man, who is not free to work on other projects while working in this particular house. Moreover, he is paid an hourly wage and will assume no contractual liability if he fails to complete the job. In another example, a woman who works as an electrician is an independent contractor. She is under contract to complete a project for a flat fee rather than an hourly wage, and she is free to work on other projects with other clients while working on her current job, as time permits.

In another case, a computer programmer is laid off when his company downsizes, but the company takes him on as an independent contractor. The company provides a contract that specifies clearly the work relationship, and the programmer does most of his work from his home. He is neither expected nor allowed to attend company meetings, and the company provides him only with product specifications, not instructions on how to do his work. The IRS does consider this worker an independent contractor. If he were required to attend meetings and be on-site during regular business hours, the IRS would likely view him as an employee.

### ***Establishing Criteria***

The IRS lists three factors that can provide [EVIDENCE](#) that a worker is either an employee or an independent contractor:

- *Behavioral control* refers to the level of control that the company has over the worker's production. Employees are usually required to follow the company's instructions about where, when, and how to do the work in question, including what supplies to use, where to get those supplies, and with whom to work. Employees often receive specialized training to do their work; independent contractors usually use their own methods.
- *Financial control* covers the company's financial contribution to the worker, including salary and expenses. For example, employees are generally guaranteed a regular wage usually based on an hourly or weekly rate. While some independents are paid hourly rates, often they are paid flat fees for their work. Employees are usually given the supplies and equipment they need to do their work; independent contractors supply their own equipment, which can be anything from a word processor to a fully equipped office. Independent contractors also tend to have unreimbursed expenses related to their business (such as rental of an office or a [LEASE](#) on equipment).
- *Type of relationship* is often spelled out in a written contract, but there are other factors. If a company pays for a worker's health insurance or provides vacation or sick pay, the worker is an employee. Employees also work under the expectation that the relationship with the employer will be indefinite; independent contractors usually work on a per-project basis or may work on a particular ongoing project. If that project involves services that represent a key aspect of the company's regular business (a lawyer hired to do work for a law firm, for example), that usually indicates an employer-employee relationship.

## **IRS Guidelines**

The IRS has developed a set of 20 factors to help companies determine whether a worker is an independent contractor or an employee. Some of these factors are covered above. Among the others are the following:

- If the worker works on-site (or at a site designated by the employer), then the worker is likely an employee.
- If the worker hires his or her own assistants, then the worker is likely an independent contractor.
- If the worker can make a profit or loss, then the worker is an independent contractor.
- If the worker is required to do the job in a set order or sequence, then he or she is likely an employee. Independents usually have more leeway.
- If the worker can be fired at will, then the worker is an employee. Independents cannot be fired if they produce work according to the contract specifications.

The factors are intended to serve only as a guideline. Different professions may have different requirements. A computer consultant, for example, may have to work on-site rather than from a home office. But if the consultant has several clients and works on a per-project basis for a flat fee, he or she is an independent contractor. Many freelance writers and editors are paid hourly rates for the work they do. This is common in the publishing industry, even though in many others it might signal that the workers are employees. An employer generally provides guidance and instruction for employees. That does not mean that all independent contractors are expected to approach each new project blindly. They can receive guidance and instruction, too. The difference is that employee instructions are usually more comprehensive and encompass a long-term relationship.

## **Where To Get Help**

For people who are independent contractors or freelancers, or for those who wish to become self-employed, there are a variety of resources available. The IRS provides a number of publications about self-employment regulations, many of which can be downloaded from its website (<http://www.irs.gov>). Likewise, the U. S. Small Business Administration (SBA) offers a number of resources, including information on how to obtain small business loans. The SBA has a website (<http://www.sba.gov>) as well as regional offices in all 50 states.

Organizations such as the National Association for the Self-Employed (NASE) act as advocates for their members and offer such benefits as health insurance at group rates. These groups can answer many questions self-employed professionals have about how to run, grow, and maintain a business. Individual professions almost always have some sort of professional association that caters to the needs of their self-employed members. Professions in which self-employment is the rule rather than the exception often have their own organizations. Freelance writers and editors, for example, can join groups such as the National Writers Union (NWU) and the Editorial Freelancers Association (EFA). Groups like these address the issues of self-employment as they relate directly to members' professions, and they provide a forum for networking with others in the same field.

Companies that wish to hire independent contractors can make use of many of the same resources. The IRS, for example, can help a business owner determine whether a freelancer is really a freelancer or might be classified as an employee. Professional associations for the self-employed often have job referral or listing services that companies can use when they need to hire.

## Additional Resources

*Crossing the Bridge to Self-Employment: A Federal Microenterprise Resource Guide.* U. S. Department of Labor, 2001.

*Successful Freelancing: How to Enjoy Being Your Own Boss.* Smith, Carolyn D., Aletheia Publications, 2000.

*Working Solo Sourcebook: Essential Resources for Independent Entrepreneurs.* Lonier, Terri, Wiley, 1998.

## Organizations

### ***Internal Revenue Service, Small Business/Self-Employed Operations Division***

5000 Ellin Road

New Carrollton, MD 20706 USA

Phone: (202) 622-0600

Fax: (202) 927-1399

URL: <http://www.irs.org/smallbiz>

Primary Contact: Joseph Kehoe, Commissioner

### ***Small Business Administration (SBA)***

409 Third Street SW

Washington, DC 20416 USA

Phone: (800) U-ASK-SBA

URL: <http://www.sba.gov>

Primary Contact: Hector V. Barreto, Administrator

### ***U. S. Department of Labor, Office of Small Business Programs***

200 Constitution Avenue NW

Washington, DC 20210 USA

Phone: (202) 693-6460

Fax: (202) 693-6485

URL: <http://www.dol.gov/dol/osbp>

Primary Contact: June M. Robinson, Director

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