

SMALL-BUSINESS GUIDE

Hiring Contractors Without Getting Into Trouble

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Jeff Ready, chief executive of [Scale Computing](#), would like nothing more than to double his sales staff to meet projected demand for the information technology infrastructure that his Indianapolis-based company develops and manufactures. But in an uncertain economy, Mr. Ready is reluctant to commit to significant hiring.

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Jeff Ready, owner of Scale Computing, supplements his in-house talent with contractors

Instead, he uses independent contractors to supplement Scale Computing's presence at trade shows, as well as to help with legal, public relations, finance, accounting, editing and other functions.

"It's been difficult to predict the future in terms of the strength of the economy," Mr. Ready said. "You have to be very prudent in how you hire. What I'm doing is trying to keep a smaller in-house contingent and supplement it with contractors based on the ebbs and flows of how much business we have."



Quick Tips:

- Be sure to get legal advice.
- Follow hiring protocols even though the jobs are not permanent.
- Independent really does mean independent.

Suggested Resources:

- An F.A.Q. from Nolo.
- A primer from the S.B.A.
- A guide from the I.R.S.

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For both legal and practical reasons, Scale Computing does not use contractors in areas like sales that require significant oversight and training, and Mr. Ready also worries about the ever-present risk of a contractor being unavailable or quitting. And there is a larger concern: the government has been cracking down on companies that treat workers as contractors for wage, tax and benefit purposes but as employees when it comes to their work duties.

An audit conducted by either the Internal Revenue Service or the Department of Labor can overwhelm a small business — even if the issues raised turn out to be unfounded.

Business owners interviewed for this small-business guide say that independent contractors can be helpful when companies try to increase operations while retaining the flexibility to cut back if necessary. But if not used effectively, they can increase costs without producing the desired results.

KNOW THE LAW The first consideration is the legal risk. "It has become a much bigger issue in the last three to five years because the federal government is taking a much harder enforcement approach," said

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Kevin B. McCoy, partner with [Kruchko & Fries](#), a labor and employment law firm based in McLean, Va. Under federal tax and labor law, contractors must have greater independence than employees, which effectively limits their use. Employers must also comply with state labor requirements.

There is widespread misunderstanding about when an individual meets the legal requirements to be treated as a contractor, rather than as an employee, Mr. McCoy said. Employers most often slip up, he said, when they try to fill a part-time or short-term need with an independent contractor, thinking that because the position is less than full time or of limited duration, it can be filled by a nonemployee.

In fact, the law speaks to the independence of the individual and the employer's control over the work — not to the number of hours worked. Simply put, if you tell someone when, where and how to work, you do not have a contractor relationship.

An employer that violates the I.R.S. rules on independent contractors can be forced to pay back employment taxes as well as penalties. Labor laws for independent contractors generally relate to the minimum wage and overtime rules, and violations can lead to the payment of back wages and triple damages.

Kelly Strowd found this out when a contractor for the pet-sitting franchises she operates in North Carolina filed for unemployment after her contract was terminated. In the end, the individual did not pursue the claim, and the state employment security commission found the business in compliance. But the audit required Ms. Strowd and her accountant to spend a tremendous amount of time pulling together hundreds of pages of documentation and explaining them to the auditor.

"It was really nerve-racking," she said. "I could have owed years of back taxes. I probably would have gone bankrupt."

Since then, she has changed her orientation process for new contractors, who walk and care for the pets. She emphasizes that they are independent contractors, with control over their own client relationships and how they perform the work. Instead of giving them a branded T-shirt that might appear to be a uniform, she provides such clothing for purchase as an option. She also encourages them to develop their pet-sitting businesses with other clients.

Bottom line: Do not use an independent contractor just because you cannot afford an employee. Use contractors when the task to be performed can truly be done independently.

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