

INDEPENDENT CONTRACTOR OR EMPLOYEE?

Issues regarding the status of a rep agency or the status of its employees as an "Independent Contractor" is crucial to most independent sales rep organizations. The question arises in a number of situations involving the operation of a rep agency. The first situation has to do with the rep agency and the manufacturer. Almost all written contracts between principals/manufacturers and the rep agency include a statement to the effect that the representative is engaged in his/its capacity as an independent contractor and is not an employee or agent of the manufacturer.

Rep agencies often express concern that various (often excessive) obligations and demands, such as extensive reporting, imposed on the agency by the manufacturer/principal will convert the relationship to that of employer-employee, notwithstanding the provisions of the rep agreement. As you will note from the guidelines discussed below, it is very unlikely that a multi-line rep agency will be characterized as an employee of the principal rather than as an independent contractor. The conclusion may be different if the rep agency has only a single principal who has a great deal of influence over the rep and provides iron-hand direction and "guidance" to the agency. Furthermore, as will be noted below, it would not be advantageous to the principal for the rep organization to be characterized as an employee?

The second situation where the issue of independent contractor or employee is important is when characterizing or defining the status of individuals who work for rep organizations.

High unemployment makes it possible to obtain the services of capable sales personnel and office personnel on less than a full time basis. Often these individuals are engaged as independent contractors, thus negating the requirements to pay benefits and employment taxes, and to withhold income taxes. The line separating employees from independent contractors is often fuzzy. If your organization classifies some workers as independent contractors and the IRS reclassifies them as your employees, what are the consequences?

First, the IRS will assess heavy penalties against you for failure to properly withhold and report income and employment taxes. You risk being held personally liable for unpaid payroll taxes. Second, reclassified employees may sue you for fringe benefits and back overtime, vacation and sick pay. They may also be entitled to benefits under some or all of your employee benefit plans.

Independent contractors are workers engaged in an independent trade, business or profession who offer their services to the public. They are not employees. But simply calling workers "independent contractors" doesn't make them so in the eyes of the IRS and the courts. Nor does just paying them through your accounts payable department rather than your payroll division. To avoid misclassifying workers, familiarize yourself with the complex governing rules. The IRS's 20-factor test will assist you on how to classify workers. Not all of the factors have to be present and some are given greater weight than others, but your best bet may be to focus on the extent to which you control workers' activities.

One of the most important criteria is to determine whether the worker (or rep organization) is his or its own "profit center." In other words, can the worker or rep agency realize a profit or sustain a loss from the services provided to you.

Here are some guidelines intended to make the rules easier to understand and apply. Your workers are probably employees if you:

- Have the right to tell them when, where and how to perform work and have a continuing relationship with them;
- Provide them with training;
- Generally integrate their services into your operations;
- Require them to provide their services personally;
- Hire, supervise and pay assistants and generally control all workers on a job;
- Establish set work hours and expect them to usually do the work on your premises in the order you set;
- Require them to devote full time to your operations (and implicitly or explicitly restrict them from doing other gainful work);
- Require them to submit regular oral or written reports;
- Pay them by the hour, week or month;

- Guarantee them a minimum salary or grant a draw account at stated intervals and don't require them to repay any excess over the amount earned;
- Pay their business or traveling expenses;
- Furnish tools, materials and all necessary facilities; and
- Have the right to discharge them, and they have the right to end the relationship at any time without incurring liability.

Who are independent contractors?

Your workers are probably bona fide independent contractors if they:

- Hire, supervise and pay other workers to perform a service for you;
- Contract to furnish the labor and materials needed to attain a result and are responsible only for the attainment of a result;
- May choose for whom and when to work;
- Are customarily paid on a commission or job basis;
- Invest significantly in equipment they use to perform services;
- Can realize a profit or suffer a loss from providing their services;
- May work for more than one employer or firm at the same time;
- Make their services available to the general public; and
- Usually agree to complete a specific job, are responsible for its satisfactory completion or are legally obligated to make good for failure to complete a job.

In addition, the IRS in determining worker status may consider the procedure you follow in engaging workers, including advertisements and any contracts. Be aware that you'll attract IRS scrutiny if you hire temporary workers or independent contractors to perform work similar to work performed by your regular employees.

With respect to sales rep organizations and their workers, for various reasons a worker may form his/her own corporation, and enter into a contract with the sales rep agency as a "Sub-Rep," but will only rep those lines of the sales rep agency. Since a rep agency would presumably have substantial control over the worker's corporation, this is an extremely dangerous situation because the worker could easily be characterized by the IRS as an employee rather than an independent contractor.

Misclassifying employees as independent contractors can lead to financial and administrative nightmares for your company. Make sure these workers are truly independent. Comply with the common-law test of employment by allowing them, at a minimum, to control how the work is done. Specifically exclude them from your employee benefit plans in case they are later reclassified. Finally, if doubt persists, classify workers as employees.