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# Hiring Contractors Without Getting Into Trouble

By KATHERINE REYNOLDS LEWIS

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.

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."

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 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.

**HIRE CAREFULLY** Because contractors are fundamentally different from employees, you should anticipate the associated management and communications challenges. You do not want to save 50 percent of the cost of a function, like software programming, just to end up adding 80 percent in management costs.

**ORI**, a research firm based in Herndon, Va., solves that problem by detailing the scope of every project carefully, screening contractors intensely and setting clear expectations. Contractors are a quick and cost-effective way to bring in high-level talent with specialized expertise for the data-intensive projects the company completes for government and association clients. “In research, our needs change based on the types of studies our customers need,” said Kathleen Benson, president.

As soon as ORI submits a proposal to a client, managers begin to think about the type of contractor needed, the specific job components and who in the firm’s database might be a good fit. Ms. Benson

has learned the hard way to match the individual's capabilities to the project carefully.

“One of the benefits of an independent contractor is that you can really zero in on very specific needs and skill sets,” said Ms. Benson, who uses temporary staffing firms like [Flexforce Professionals](#) in addition to ORI's network. During the screening process, ORI checks references and conducts background checks. To ensure legal compliance, contractors must show proof of insurance and a record of self-employment tax payments. They must also maintain a dedicated work space, since many work from home. Ms. Benson looks for signs that the contractors may be exaggerating their experience or are overextended with other projects.

ORI sets up a communication plan, establishes shared expectations from the beginning and trains managers on the role of a contractor. Typically, contractors will submit status reports on a weekly basis that include any challenges they are encountering or anything they need from ORI. “It's important to document everything early and up front, what the expectations are, when you expect to get the stop-go decisions,” Ms. Benson said.

**RETAIN THE KNOWLEDGE** It also helps to select the work that goes to contractors strategically. Before committing to a large-stakes venture, Edward Hechter, owner of [PartyPail](#) in Enumclaw, Wash., always runs a small test project with each new contractor to make sure the person is reliable.

“It is generally not about quality of work,” Mr. Hechter said. “It's about the ethos side: are they going to do what they said they were going to do? It's when they go silent or they miss the deadline and tell you after the fact, ‘I need another two weeks,’ that you have a problem. If they're managing expectations with us, then we love it.”

Mr. Ready of Scale Computing often assigns work that requires creativity or special expertise to his staff and supplements with contractors for more mundane tasks, like having employees develop marketing materials and hiring contractors to copy-edit and produce the actual documents.

His goal, he said, is to make sure he doesn't lose the knowledge base completely, especially since a

contractor is always “one phone call away from taking another full-time job again, and that could be in the middle of a project.”



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