

Comprehensive Guide to Peace of Mind When Engaging Independent Contractors



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Advancing the way the world connects with talent.

What is an Independent Contractor?

An independent contractor is a self-employed individual contracted to perform work or provide services to another entity on a temporary or contracted basis. They are NOT employees of the contracting entity while doing the work. These individuals are also referred to as freelancers, consultants, or gig workers. Almost any occupation can be performed by independent contractors. Common examples include writers, software designers, business consultants, actors, musicians, and many others.

Independent contractors are considered self-employed. As such, they are not eligible for employment benefits offered by the contracting entity to their employees. Independent contractors must pay their own income taxes, social security and Medicare taxes, and must fund their own health insurance and retirement programs.



The Growth in Independent Contractor Status

Independent contractors represent a large and rapidly growing percentage of the U.S. workforce. In 2022, the U.S. Bureau of Labor Statistics reported 31.9 million independent workers, doubling the number two years earlier, and more than tripling the number five years earlier and estimates for the current year are as much as double that of 2022. Of these workers, two-thirds worked full-time, exclusively as independent contractors. One out of every five independent contractors are in professional occupations such as healthcare, IT, R&D engineering, and other highly sought after skills.

Highly skilled workers, especially those categorized as Gen Z or millennials, constitute the majority (combined estimates are as high as 70%) of all independent contractors, choosing this form of temporary assignment primarily for greater freedom:

- Flexible hours, choice of assignments, higher likelihood of remote work
- Complete control over building their business
- No cap on earnings potential
- Ability to rapidly develop new skills and experiences through assignment selections

Benefits of Using an Independent Contractor

Can you ignore this population when seeking the talent you need to drive your business? Here are the top reasons to engage independent contractors:

Talent Access

Given the growing number of talented professionals opting for independent contractor assignments, the inclusion of independent contractors in your overall talent plans will expand your access to talent potentially not available through other sources.

Cost Savings

Even though you may pay an independent contractor more per hour than an employee who would do the same work, the total cost is usually lower as you don't have to pay for government required taxes and contributions, employer-provided benefits, office space, and equipment. Elimination of these costs represents savings of as much as 30 percent.

Greater Agility

Working with Independent Contractors gives you greater leeway in hiring and offboarding workers, which can be especially advantageous for seasonal adjustments or fluctuating workloads. You can hire an Independent Contractor for a specific task or project, knowing that the worker's engagement with you ends when the job is finished. You won't experience the expense and potential legal issues that often accompany terminations.

Reduced Time to Productivity

Independent contractors are engaged based on their specific skills. Most are productive immediately, eliminating the time and cost of training.

Protection From Employee Relations Litigation

Legal protections that are available only to employees may result in lawsuits by employees who feel that their rights have been violated. Extensive litigation has been filed by employees regarding minimum wage, overtime, employment discrimination based on inclusion in a protected class (independent contractors are protected from race discrimination but other protected classes do not apply), collective bargaining, family leave, and wrongful termination. As independent businesspeople, independent contractors are not afforded these protections.

Government Regulation of Independent Contractors

Independent contractor status is a legal determination. The criteria used to determine whether a worker should be classified as an independent contractor varies but is generally based on assessments of the level of control the contracting entity has over the worker.

The U.S. Internal Revenue Service (IRS) has set the standard for defining whether a worker qualifies as an independent contractor, with most states also applying their own criteria. It is possible for a worker to be compliant in one jurisdiction and fail to meet requirements in another. The cost of being found non-compliant? Fees, fines, and reputation loss.

Federal and State-level commissions combine audits with unemployment insurance and workers' compensation data to document the scope of independent contractor misclassification. Confirming the findings of earlier national studies, these reports estimate that 10 to 30 percent of employers (or more) misclassify their employees as independent contractors, which indicates that several million workers nationally may be misclassified, depriving workers of their rights while costing State and Federal agencies to lose billions in annual revenues.

This is an area of intense focus by the Department of Labor (DOL), which has recently hired additional investigators to review wage compliance, which would include ensuring that employers are not improperly classifying workers as independent contractors. Each state has also established auditing bodies. Recent examples of adverse audit findings include:

- \$5.6 million in back wages and liquidated damages paid by an auto parts distributor to hundreds of delivery drivers
- \$350,000 in back wages for 50 workers misclassified by a home health services provider

Risks Associated with Misclassification of Employees as Independent Contractors

Misclassification of workers can also simultaneously violate dozens of laws, with actions taken by numerous government agencies.



Fair Labor Standards Act

Failure to pay overtime and minimum wage



State Wage Laws

Failure to pay state-regulated overtime and minimum wage



Federal Insurance Contributions Act

Failure to withhold and remit Medicare and Social Security payments



Federal WARN Act and state mini-WARN Act

Failure to count/notify misclassified workers in the event of a business closing or mass lay-off



State Unemployment Regulations

Failure to pay state unemployment fees



Occupational Safety and Health Administration (OSHA) and OSHA-Approved State Programs

Failure to comply with state Workers Compensation regulations



Department of Homeland Security, Immigration and Customs Enforcement (ICE), and the Department of Labor

Failure to verify employment authorization through completed Form I-9s



Employee Benefits Security Administration (EBSA) and Internal Revenue Service (IRS)

Failure to give access to an employer's employee benefits programs



Family and Medical Leave Act (FMLA) and the Uniformed Services Employment and Reemployment Rights Act (USERRA)

Failure to provide leave to eligible employees



Equal Employment Opportunity Commission (EEOC)

Discrimination against individuals protected under state and federal anti-discrimination laws

Worker Litigation

Much attention has been given to the class action lawsuits filed against workers claiming that rideshare companies have illegally categorized them as independent contractors, denying them protections and benefits. But that's not the complete story. Thousands of cases have been filed in all 50 states and the District of Columbia. While most lawsuits have been brought by class action attorneys, many cases have also been brought by federal and state enforcement agencies. The financial impact of class action suits far outweighs the amounts typically paid because of a misclassification finding when an audit is conducted by a government agency. Some recent judgements and settlements include:

- A baked goods company agreed to a \$55 million settlement, and then spent an additional \$50 million to convert distributor routes back to an employee-based model
- Nearly \$230 million paid for a group of delivery drivers
- Nearly \$12 million for drivers at an airport shuttle company
- \$10 million for more than 100 custodians
- \$6.5 settlement for a major home improvement chain's contractors

Misclassification happens in every industry, and all are subject to potential audits and litigation. While high profile cases have been in the construction, transportation and hospitality industries, misclassification is of growing concern to financial services institutions, high tech companies, life sciences firms, and academic institutions.

Engaging a Third Party to Address Independent Contractor Compliance

Misclassification risks can be mitigated by outsourcing responsibilities for independent contractor engagement. The levels of service that best fits your needs depends on your internal capabilities and desired risk profile:

Spot Checks

Conducted on a one-time basis, providing a "moment in time" assessment of independent contractor usage and overall level of compliance.

Periodic Evaluations

Offered on a retainer basis. The third party evaluates all independent contractors at time of engagement, and then re-evaluates periodically (typically every 6 – 12 months) or whenever there is a significant change to the Statement of Work.

Agency of Record (AOR)

These solutions provide the highest level of risk protection. Acting on your behalf, the AOR directly contracts with the independent contractor. The AOR evaluates each worker, verifies compliance with classification requirements, establishes a written statement of work, pays the worker, and offboards the worker at assignment end.

Questions to Ask When Engaging a Third Party

- In testing compliance, which standards are used?
- How often are independent contractors tested for compliance?
- What triggers a re-evaluation?
- What tools are used to evaluate an independent contractor?
- If a worker fails to classify as an independent contractor, what corrective actions will you take?
- What level of support is provided in the event of a government audit?
- What level of indemnification is offered?

nextSource Delivers a "Peace of Mind" Independent Contractor Experience

nextSource offers a comprehensive solution to meet your unique needs. You can count on nextSource:

1. OUR APPROACH MITIGATES RISK

- Compliance testing based on your legal team's vetting requirements and regulations specific to each work location
- Rigorous assessment by two compliance specialists of worker and manager questionnaire responses, Statement of Work (SOW), and Certificates of Insurance
- Suggested modifications to eliminate causes of misclassification
- Manager education on risks associated with non-compliance
- Strategic alliance with Worksome, an industry-Leading IC Technology platform offering streamlined onboarding and assessment processes, built-in country-specific compliance regulations, and automatic updates as regulations change

2. YOU GET THE BEST TALENT AT BEST RATES

- Market Rate Analyses – Use of industry-standard tools to evaluate rates by work content and location
- Workforce Composition Planning – guidance on the most cost-effective worker type for each assignment

3. WE STAND BEHIND THE ACCURACY OF OUR EVALUATIONS

- Indemnification & Audit Support – We contractually commit to provide you with indemnification against any misclassification mistakes made by nextSource and full audit support. We have never had a worker classification overturned as a result of a Federal or State Agency Audit.
- Electronic Storage of all Documentation – The questionnaires and all documents used during the evaluation and validation process are stored electronically and available to support a worker classification audit.
- Service Level Agreements –We will conduct a quarterly audit of performance against Key Performance Indicators with an SLA of 100% compliance.



4. WE DELIVER INCREASED OPERATIONAL EFFICIENCY RESULTING IN LOWER OPERATIONAL COSTS

- Consolidated Invoicing & Payment – You process one payment to nextSource for consolidated usage of all IC's and nextSource processes payments to IC's on your behalf.
- Configurable Fee/Payment Schedule aligned with Statement of Work – nextSource can process multiple fee schedules to include Time & Materials, Fixed Fees, Scheduled Payments, or Milestones/Deliverables in accordance with the SOW.
- Efficiency through Repeatability – We establish a standard SOW applied to contractors performing the same role.
- Diversity Credits – nextSource is a Woman-Owned Business Enterprise. All independent contractor spend under management is counted as Tier 1 Diversity Spend Credit.

About nextSource

nextSource applies simple methods, clear tools, and expert resources to identify workforce challenges, to systematically build a shared understanding of their implications, and to create a wider set of alternatives to navigate forward change.

nextSource is a privately held, woman-owned professional services firm with 24 years' experience in contingent workforce management. We provide services such as:

- Managing the entire temporary worker process (MSP)
- Acting as your Employer of Record/payrolling service provider for internally sourced workers (EOR)
- Identifying and managing the risk associated with Independent Contractors (AOR/IC)
- Administering project services under a Statement of Work (SOW) agreement
- Acting as an advisor to ensure the program is at peak performance (Consulting)
- Leveraging your brand to find resources by skill set, location, and strategic business initiatives such as diversity and inclusion goals (Talent Communities)

We do this by designing our clients' programs to fit their exact needs, offering a dedicated (not shared) program office, and conducting an annual roadmap that ensures that your program will continue to add value as business conditions and your needs change.

