

HR In the Crosshairs

By Andrew E. Schultz, President, Pro Unlimited

If you're not talking about it yet, you soon will be.

A court case involving Federal Express and some of its independent contractors has enormous – and potentially chilling – implications for Human Resource professionals.

The case revolves around a question that's central to any HR administrator: Are you treating your independent contractors as true "independents? Or, in reality, are you treating them more as employees?

And are you sure you know the difference?

The IRS knows the difference. And increasingly, so do contractors themselves – like the ones who have brought 28 different lawsuits (in 22 different states) against Federal Express. And if HR managers are blurring the line, their companies – not to mention their jobs – could be in jeopardy.

So far, things have not been going well for Federal Express. A California court has already found for a group of contractors against the company, saying that these workers had been functioning, in reality, as employees rather than contractors – and, therefore, deserve all the rights and benefits of regular employees.

State labor boards in New Jersey and Montana have chimed in with similar rulings. And, recently, the workers also managed to consolidate all the class-actions pending in different states into a single case in an Indiana federal court.

The workers are claiming that they were made to follow strict rules laid down by the company, regarding matters such as appearance, routes, and starting and finishing times, and that the company controlled virtually every aspect of their "independent" operations.

FedEx, of course, is hardly the first company to be hauled into court over its independent contractors. Microsoft, IBM, Coca-Cola, Time Warner, Hewlett-Packard, and Verizon (among others) have already been there. Nor does it matter, in this particular case, that the contractors in question are drivers for FedEx's Ground division. The job-titles are irrelevant. (Independent Contractors, in fact, can range from drivers to CEOs.)

The potential financial hit to FedEx is staggering – according to some experts, the pre-tax hit could be as high as \$1.4 billion. And that figure doesn't even include things such as retirement benefits and paid vacations.

And that's making companies – and HR directors – all over America sit up and take notice.

Contingent Workforces Growing

If you're an HR professional, you already know that every large and mid-size company in America uses independent contractors, often extensively. Several studies have identified "contingent" workers as the fastest-growing sector of the general workforce...growing five times as fast, in fact, as the permanent one. In some companies, particularly those with shortages of qualified professionals, the contingent workforce is already twice the size of the employee workforce.

And in light of Corporate America's stunning ignorance about how to source, track and manage these workers, the implications are chilling.

Chilling, also, is Corporate America's ignorance of federal and state regulations regarding these workers, non-compliance with which can land a company in trouble that can last for years.

HR people, of course, are often the ones managing a process that has grown increasingly complex. Faced with a multitude of sometimes-contradictory regulations (many of which are very subjective), many HR administrators are finding the process somewhat akin to wrestling an octopus – as soon as you get one tentacle tied down, two more pop up.

In addition, human resources professionals are often on the front lines in employee-vs.-contractor determinations.

The Microsoft case, settled five years ago, is a landmark in this area. Microsoft ended up paying \$98 million to plaintiffs whose claims about company control were somewhat similar to those at Federal Express – in addition to the cost of restructuring its benefits plans.

And it's not only cases brought by your own contractors that you have to worry about. The government is watching, too...

The IRS vs. Independent Contractors

Independent Contractors raise a red flag with the government, because the company may be utilizing them as it would employees...but without paying taxes on them, nor taking taxes out of their weekly paychecks.

The criteria used by the IRS (and many states) to determine if a worker is truly independent, has traditionally been a series of common law questions, known in tax circles as "The Famous Twenty Questions."

These questions generally point to how much control a company has over a worker's performance. The more control the company exerts, the more likely your Independent Contractor will be classified as an employee.

If your company is the worker's primary (or sole) source of income, for example, and/or the worker is a former employee of your firm, you're going to have a heck of a time proving that an independent contractor relationship truly exists.

Don't assume, by the way, that merely having a written contract with a worker will make the IRS close up shop and go away. If the IRS can prove that this person is actually functioning as an employee, your contract is not worth the paper it's written on.

And the price of ignorance can be staggering. Fines and penalties can easily exceed \$10 million. And they can also destroy the special tax status of a company's qualified pension plan, by making a large number of misclassified workers suddenly eligible. In addition, the workers themselves could potentially find themselves caught in a dangerous situation – responsible for back taxes.

By the way, the IRS has been steadily boosting its enforcement staff – and focusing particularly on white-collar workers.

And make no mistake about it – you do not want to get into the ring with the IRS. In 90% of the companies it investigates, the agency finds some misclassified contractors.

Compliance System Set Up

If your company is classifying some professionals as 1099/Independent Contractors, it's important to come up with a plan to ensure that you can keep using them. A good compliance system should include the following:

- ❖ A method of analyzing the proper classification of all potential independent contractors.
- ❖ A file documentation system for all Independent Contractors whom you determine to be truly "independent." It's imperative that the arrangements with these workers are set up properly...or your company's at risk. There must be very strong contracts with each worker, stipulating clearly that they meet the IRS guidelines. And, remember, too, that you must also arrange for the protection of the company's intellectual property.
- ❖ A third-party payroll for those ICs and/or Returning Retirees who probably would not pass the test of the tax authorities. This third-party provider should offer co-employment protection that includes comprehensive benefits for payrolled workers.

If you do decide to work with a consulting firm on these issues, make sure you get one that's experienced at navigating the maze of federal and state regulations. Make sure the firm is experienced, also, in your field. Try to determine their ability to respond quickly to your needs, as well as their after-hours capabilities.

You need to be comfortable with their ability to master technology, and their ability to support internal and external systems. And you need to make sure this firm truly understands exactly who is and who is not an independent contractor.

If you find it necessary to use a third-party payroll, take the time to ensure that it's set up properly, with contracts that protects intellectual property and includes non-disclosure terms.

In addition, make sure your third-party employer understands – and adequately addresses – all co-employment issues; it should be crystal-clear as to exactly who the contractor is working for. This should include offering these workers significant benefits that will not only make them happy, but also protect you from potential benefit claims in the future. And always – always! – insist on strong documentation from an independent contractor that he/she truly is an independent contractor.

Don't forget, also, a liberal dollop of common sense here. We've seen independent contractors on company softball teams, and eating in the employee cafeteria. We've seen them in positions where their phone is answered by a company employee, and even, in some instances, where they're included on the company org chart.

If these things go on at your company, you're asking for trouble...and not only from the IRS or disgruntled contractors. Think of the effects these practices might have on a workforce already wary of the contractors in their midst.

A lot of companies have already been taken to the courts by their former contractors, but the Federal Express case may set several new precedents, especially with the potential financial impact.

If you're in HR, you probably already know that many experts – including the government – predict that, one day soon, the largest employer in American will be "Me." So, the trend toward using contingent workers will only accelerate in the coming years.

In this day and age, you probably can't get very far without them.

But make sure you do your homework first.

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