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## The Benefits and Risks to Schools in Classifying Individuals as “Independent Contractors”

Schools today, as employers, can engage the services of independent contractors to help craft an effective and efficient workforce. Independent contractors can assist schools in achieving objectives such as receiving specific assistance to meet technical needs, providing flexibility in staffing and controlling costs related to employment. While the use of independent contractors can provide great benefits to employer, employers must proceed with caution to ensure that they do not misapply the independent contractor label to an individual who actually serves as an employee. The misclassification of an individual as an independent contractor can lead to potentially significant employer liability.

Schools can derive a variety of benefits from engaging an independent contractor. These benefits include the ability to hire the best personnel on an as-needed basis and the freedom to make personnel changes relatively easily. Like other employers, schools may have a need for services that do not support the creation of ongoing positions, such as psychometrists, substitute teachers, athletic and academic coaches, and specialized maintenance workers. As a general rule, independent contractors are not within the purview of statutes governing an employer's obligations to its employees. Therefore, an independent contractor is not an employee for purposes of the Fair Labor Standards Act, worker's compensation laws, unemployment compensation statutes, and federal and state fair employment statutes.

Additionally, employers do not have the same tax obligations for independent contractors as they do for employees. Employers do not have to pay a portion of payroll taxes for independent contractors. Independent contractors are required to make their own estimated payments of income tax on a quarterly basis, and must pay their own social security and Medicare taxes through self-employment taxes. In contracts, employers are obligated to pay federal income tax, Medicare taxes and unemployment tax for employees. To determine whether an individual is an employee or an independent contractor, the relationship of the worker and the business must be examined. An individual is designated an employee when the employer has the right to control how the employee performs services for the employer. Conversely, as a general rule, an individual may be classified as an independent contractor when the employer has the right to control or direct only the result of the work performed. The employer does not have the right to control the means and methods of how the independent contractor accomplishes the result. The independent contractor, therefore, performs work according to his or her own methods and is not subject to the control of the employer except for the result.

A worker's status may vary depending upon the circumstances surrounding the worker and employer's relationship. When evaluating the classification of an individual as an independent contractor, the IRS and courts will look at the totality of the relationship. In determining whether an individual is an independent contractor, the IRS has summarized its lengthy list of relevant factors to the following three sets of factors: behavior control, financial control and the type of relationship. Behavior control involves the factors that demonstrate whether the employer has a right to direct and control how the work is done, through instructions, training or other means. Independent contractors usually have their own methods for completing the job, while employees need to be trained in how to perform the work. Financial control relates to factors that show whether the employer has a right to control the business aspects of the individual's job. These factors include how the employer compensates the individual and the extent to which the individual makes his or her services available to the general market. The type of relationship factors cover: written contracts describing the relationship the parties intended to create, the permanency of the relationship, the availability of the worker to perform services for other employers, and whether the individual receives employee-type benefits, such as insurance, pension plan, vacation pay and sick pay.

Generally, an employer-employee relationship will be found if the employer furnishes the necessary tools, materials and other equipment to the individual performing the required services. Additionally, if the worker is an essential part of the employer's business and there is a continuing relationship between the employer and the individual, it is most likely an employer-employee relationship. The status of an individual as an independent contractor or employee is critical in determining an employer's tax reporting and withholding obligations. In the last few years, the Internal Revenue Service has become more aggressive in its review and audit of employers who claim the use of independent contractors. Thus, employers must keep in mind the risks of erroneously classifying an individual as an independent contractor. Employers who improperly classify their workers as independent contractors (as opposed to employees) may be subject to tax, interest and penalties.

The IRS has collected millions in back taxes and penalties from employers. However, the employer may be able to avoid liability if the employer: (1) has a “reasonable basis” for treating an individual as an independent contractor; (2) since 1978 has treated workers (and similarly situated workers) as independent contractors consistently; and (3) for the tax year at issue the employer has complied with Form 1099 reporting requirements with respect to the compensation paid to the worker. In other words, the employer must have acted consistently in its treatment of workers engaged in similar work and must have followed the formalities of working with an independent contractor. Furthermore, employers who misclassify individuals as independent contractors may be liable for worker’s compensation insurance premiums and any unemployment compensation taxes that should have been paid. Employers may also be liable for the value of health insurance, pension plan contributions and other benefits denied to employees misclassified as independent contractors.

Schools looking to hire individuals as independent contractors must carefully evaluate the status of each individual. A methodical analysis of the individual’s relationship with the school may assist the employer in avoiding the risks associating with designating an individual as an independent contractor.

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