



## **10 Best Practices When Using Independent Contractors**

**Commercial and Contracts**

**Employment and Labor**



There are many articles regarding classifying workers as either contractor or employee and the risks of [misclassification](#). But there are not as many providing clear practical guidance on how to proceed once you have decided to use contractor resources.

There are many situations where it is appropriate to use an independent contractor or 1099 resource. For example, the following situations may be appropriate for an independent contractor:

- Short-term projects;
- Projects that require specialized experience; and
- Temporary assignments for [less than a year](#).

There are ways to work with independent contractors in a manner that limits potential accusations that the worker was misclassified. For example, providing project requirements and deliverables instead of a job description, paying the contractor after they have provided your company an invoice, and ensuring there are end dates in your contractor agreements.

This article will delve into the following 10 best practices:

1. Be clear up front
2. No job description
3. Insurance

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4. Expenses
  5. End date
  6. Payment
  7. Equipment
  8. Benefits
  9. Control
  10. Written contractor agreement

## 1099 vs W2

The basic difference between an independent contractor and an employee is the degree of control and independence the worker has. The IRS views independent contractors as freelancers who are essentially running their own businesses and are self-employed, with a high degree of control over both [the work they do and how they do it](#). On the other hand, [an employee typically has a boss](#) who tells them what to do, how to do it, and provides the tools and equipment needed to get the job done.

The IRS weighs a variety of factors in determining whether an employment relationship exists. The factors fall into three broad categories: behavioral control, financial control, and relationship. All of the factors must be weighed in determining whether the worker is an employee or independent contractor.

## Risks of misclassification

There are many risks of misclassifying an employee as an independent contractor. These risks include:

- Federal, state, and labor authority investigations;
- Civil and criminal penalties;
- Payment of back wages, overtime, and benefits owed to misclassified employees;
- Additional fines, penalties, and liquidated damages; and
- Damage to the company's reputation.

For these reasons, it is best to take steps to mitigate the risk of a misclassification claim.

## Best practices

While there is no magic number of factors that makes a worker an employee versus an independent contractor, there are things one can do to make the relationship more unambiguous.

### 1. Be clear up front

A worker should not be surprised to receive a 1099 form instead of a W-2 form. Review advertisement wording across all platforms (including any social media posts) to ensure consistency. Talk about the difference with business partners in advance of any discussions with contractors regarding the proposed project so that any information they convey to an independent contractor is accurate.

Anywhere that the independent contractor is identified, it should be clear to the public that the contractor is not a company employee. Depending on the nature of the work, this may include

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badges/identification cards, email signatures, and social media profiles (such as LinkedIn). The same practices should apply to your files as well. Any contractor files (W-9 forms, contractor agreement etc.) should be labeled differently and kept separately from employee files.

## **2. No job description**

When searching for, and preparing to work with, an independent contractor, put together a detailed list of specific work and deliverables that you need completed, similar to a request for proposal. The contractor should not receive a job description or job offer in the same manner as a potential employee would.

## **3. Insurance**

Contractors should obtain and pay for their own insurance and licensures, as applicable. Depending on the scope and nature of the work, your agreement with the independent contractor may include minimum coverage requirements for things such as commercial general liability insurance, professional liability, umbrella or excess liability coverage, and cyber risk insurance.

## **4. Expenses**

Carefully review which, if any, expenses you are going to reimburse and identify them in writing with the contractor. Generally, expenses of their business are their own responsibility and should be built into their quote for the work. The independent contractor should expect to pay their own business and travel expenses instead of being reimbursed separately for them by your company.

## **5. End date**

The written agreement with the contractor should have a clear end date for *each* project or assignment. A long-term, ongoing open-ended relationship starts to look more like an employment relationship. It may be helpful to set a calendar reminder to periodically review your relationship with contractors to evaluate whether their duties and treatment warrant a change in classification.

## **6. Payment**

Pay independent contractors a flat project fee or for the result instead of hourly. The contractor should assume the risk of a loss if they quoted a fee that ends up being too little for the work performed.

Then ask your contractor to submit invoices, and pay them through your company's Accounts Payable (AP) system, instead of adding them to your employee payroll. Employees are paid on a set schedule (e.g., weekly or bi-weekly). On the other hand, you should only pay contractors after they have submitted their invoice. Thereafter, each invoice should be saved in the same manner as any other vendor's invoice.

The invoice payment should be the full amount without taking out any taxes since independent contractors are responsible for reporting their own income and paying their own taxes.

## **7. Equipment**

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Contractors should be using their own equipment and resources. If the work requires something specific, outline the specifications for the project and have them decide what tools they need and obtain them. If you must provide a specific tool or equipment, document why, so that it is clear that your company is not trying to control the means and method of their work.

If an independent contractor will need to access your systems, work with your IT and business team to review settings to limit permissions and access only to the extent needed. These permissions should be tailored to the project and the credentials should then be revoked at the end of the contract.

## **8. Benefits**

Independent contractors should not receive employee benefits. Since they set their own schedule, they do not get paid time off. They are self-employed and should maintain their own health insurance and retirement plans. You should not provide the same training and development that you would provide an employee. Likewise, while on the face of it, it seems like a nice gesture during the holiday season, you should not invite independent contractors to the company's holiday party or pay an independent contractor an annual bonus.

## **9. Control**

The independent contractor should control their own schedule, hours, and location of work. They should decide the order and sequence of the services they provide. Since you should not be controlling the independent contractor's work activities or how they execute the assignment, you will need to be very clear upfront regarding the work needed for the project and deliverables.

You should not prevent the resource from advertising their services and working with other clients. If you do not want them working with other clients because you are concerned about competition or intellectual property rights, frame the discussion around these concerns rather than prohibitions on working with others. Ideally, the contractor should have multiple clients in addition to your company and be actively marketing for other work.

## **10. Written contractor agreement**

*Before* the contractor starts working on a project, they should sign a contract clearly specifying that they have an independent contractor relationship with your company. This agreement should formally document the points described above including a detailed description of services, deliverables, insurance requirements, project end date, and payment terms. You should put a new contract in place each time the contractor performs work for your company.

Remember, the existence of a written contract stating that a worker is an independent contractor alone is not enough to establish a contractor relationship, but it can help set clear expectations for both parties.

Taking the steps above will limit possible accusations that the independent contractor was misclassified.

## **Conclusion**

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Effectively using contractor resources allows you to meet business needs while minimizing risks to the company. Although there are some points above that may not be relevant or work for each particular situation, in the overall relationship you should be acting in a manner consistent with your independent contractor determination. Finally, don't forget to review the relationship periodically to evaluate whether anything has changed that would affect your conclusion that someone is an independent contractor.

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