

# Making the Classification Call: **Employee or Independent Contractor?**



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## Executive summary

On the crucial question of whether a worker is an employee or an independent contractor, you had better answer correctly. Otherwise, expect scrutiny from government agencies at the federal and state levels.

At the federal level, that's the U.S. Department of Labor and the Internal Revenue Service.

The DOL cares about worker classification because it enforces the Fair Labor Standards Act, which covers how employers handle wage-and-hour issues affecting employees, but not independent contractors. The DOL also oversees employer-sponsored benefits programs, which cover employees but not independent contractors. The IRS cares because it needs to know how much employees and independent contractors alike owe Uncle Sam; the two groups are taxed differently.

Similar interests play out at the state level, where labor departments and taxing agencies look at wage-and-hour, benefits and tax issues in the context of state law.

### *Specific criteria*

In general, the law assumes most workers are employees unless they meet specific criteria that allow them to be classified as independent contractors.

Employers have many incentives to classify workers as independent contractors. They don't have to pay contractors a minimum wage, don't have to pay overtime, don't have to provide benefits and don't have to withhold income taxes and Social Security taxes.

Employers that use independent contractors must ensure they're following federal and state classification rules that determine who is an employee and an independent contractor. Unfortunately,

there is no one standard or test employers can use that will satisfy every federal and state agency. That's why it is important to assess your relationship with the independent contractor against all the major tests for who is an independent contractor.

### *3 classification tests*

Most of this Deep Dive Special Report will focus on the three major tests that define who may be classified as an independent contractor.

The first test is the most restrictive and is increasingly used by states. Referred to as the **ABC test**, it assumes a worker is an employee unless it is clear the worker controls their own work, the work being performed is outside the work that's integral to the company's business and the worker is running an independent business doing the kind of work the company is having them perform.

The second test is favored by the U.S. Department of Labor as detailed in a recently issued regulation. This test, used to determine if a worker is an employee under the Fair Labor Standards Act, is best characterized as the **economic-realities test**. The main consideration is whether the worker is economically dependent on the business contracting the work. It uses a six-part test that includes assessing whether the worker earns a profit or a loss, the investments the worker and the employer make, the length of the work relationship, the nature and degree of control each has, the extent to which the work is an integral part of the potential employer's business and the worker's skill and initiative.

Finally, there is the IRS's **common-law test** to determine whether a worker is an employee or an independent contractor responsible for paying their taxes directly. This is the most complicated test because it considers 20 factors, each looking at an aspect of control over how, when and where the work is done.

Knowing how to structure the independent contractor relationship can prevent costly and time-consuming lawsuits and agency enforcement actions.

This Deep Dive Special Report will walk you through all three ways to classify a worker as an employee or an independent contractor, and let you choose the one that's right for your circumstances.

## Using independent contractors

There are good reasons for employers to engage non-employees to perform some of the work they need done. Those non-employees are called independent contractors, and they are part of what's called the contingent workforce or the gig economy.

The use of independent contractors is increasing. Employers like the idea of not having to withhold taxes from contractor compensation, pay the required portion of Social Security contributions or worry about having to lay off or fire an employee when business needs change. It is simpler to tell a contractor their services are no longer required than it is to terminate or lay off an employee.

Gig work is appealing to many workers, too. They like being their own boss and seeking out multiple opportunities to succeed on their terms.

But here's the thing: Just calling workers independent contractors and having them sign contracts doesn't make them contractors.

### *Proceed with caution*

The problem is that tax and labor regulations have not kept pace with the rise of the contingent workforce. For tax and labor-law purposes, someone can be either an employee or an independent contractor; there is no middle ground that covers so-called gig workers or self-created hybrid worker/employee arrangements.

This means you must proceed with caution. Otherwise, the IRS, Department of Labor or a state agency may find that your independent contractors, leased employees or temporary employees are just plain employees, defeating your intent in the first place. Stiff penalties and interest charges for misclassifying employees

will make your mistakes even more costly. You must be fully aware of the pros and cons of using workers who aren't employees, the different tests for determining whether workers are employees and the full cost of misclassification.

Properly classifying employees is often a complicated task, not least because more than one federal agency defines independent contractors differently. The IRS has one set of rules and the DOL has another, because each enforces different laws. The IRS collects taxes and has designed its independent contractor rules to ensure it collects all taxes due. The DOL enforces the Fair Labor Standards Act, which only covers employees and not independent contractors. It is most interested in making sure the maximum number of workers have FLSA protections, such as receiving at least the minimum wage and getting overtime pay when they work more than 40 hours in a workweek. In the view of the DOL, the more workers classified as employees, the better.

Plus, states are allowed to set their own rules, and employers operating in those states must make sure they follow state rules.

### *Choose your classification test*

There are three major tests for classifying employees as either employees or independent contractors:

- 1.** The ABC test, which many states use
- 2.** The economic-realities test that is the basis of the Department of Labor's recently finalized independent contractor rule
- 3.** The common-law test that the IRS uses.

As a practical matter, some employers choose to use the most restrictive test—the ABC test—to determine who should be classified as an independent contractor and who should be an employee. That's because if a worker is an independent contractor under that test, they almost certainly will also be an independent contractor under other tests.

That's not to say that the other tests aren't relevant. They are, depending on your circumstances. Take, for example, a business that doesn't operate in an ABC state and has no plans to do so soon. It may make sense to use the DOL's economic-realities test instead. That's especially true if there's no way to meet an ABC test because the work you've engaged the worker to do is the same kind of work your business routinely does and was organized to perform.

Another way to look at the three classification tests is to consider what each presumes. The ABC test starts with the presumption that a worker is an employee and then asks three questions to determine whether that presumption is true. The common-law test begins with the presumption that the worker is an independent contractor, then asks 20 questions to determine whether they're not, in fact, very independent at all. The economic-realities test lands somewhere in between these extremes.

## The ABC test

The ABC test, which many states use to classify workers as either employees or independent contractors, is the most worker-friendly test. California uses the ABC test, as do more than half of other states.

ABC stands for:

**Absence of control:** Workers are free from the employer's control in connection with how they perform their services.

**Business of the worker:** The worker's services are performed outside the usual course of the employer's business or outside all the places of the employer's business.

**Customarily engaged:** Workers are customarily engaged in an independently established trade or business.

Some states use a modified ABC test to avoid the highly restrictive conditions opposed by the "B" requirement. Those states skip that



requirement in favor of meeting just “A” and “C.” That’s because part “B” greatly limits an employer’s ability to temporarily add workers during crunch times to help it do more of what it ordinarily does.

For example, let’s say a homebuilder has an employee who is an HVAC installer. If that employee goes out with a workers’ compensation-covered injury, the builder would not be able to engage an independent contractor to temporarily take the installer’s place because installing HVAC systems is an integral part of building houses.

Employers outside the states that use the ABC test may find value in using it if they have difficulty determining the appropriate worker classification after reviewing the DOL and IRS guidance. Since the ABC test is more restrictive than any of the federal guidelines, a worker who passes is likely to be safely classified as an independent contractor in other areas of the country unless covered under other state or local laws.

### *As goes California ...*

Some of the 27 states that use the pure ABC test have carve-outs for specific professions. For example, most states don’t exclude doctors, dentists and pharmacists from being independent contractors.

California is considered ground zero for the ABC test because 1) it is so large and has outsized influence on regulatory trends nationwide, and 2) California underwent a wholesale review of its ABC test criteria in 2020, one of the most recent such efforts in any state.

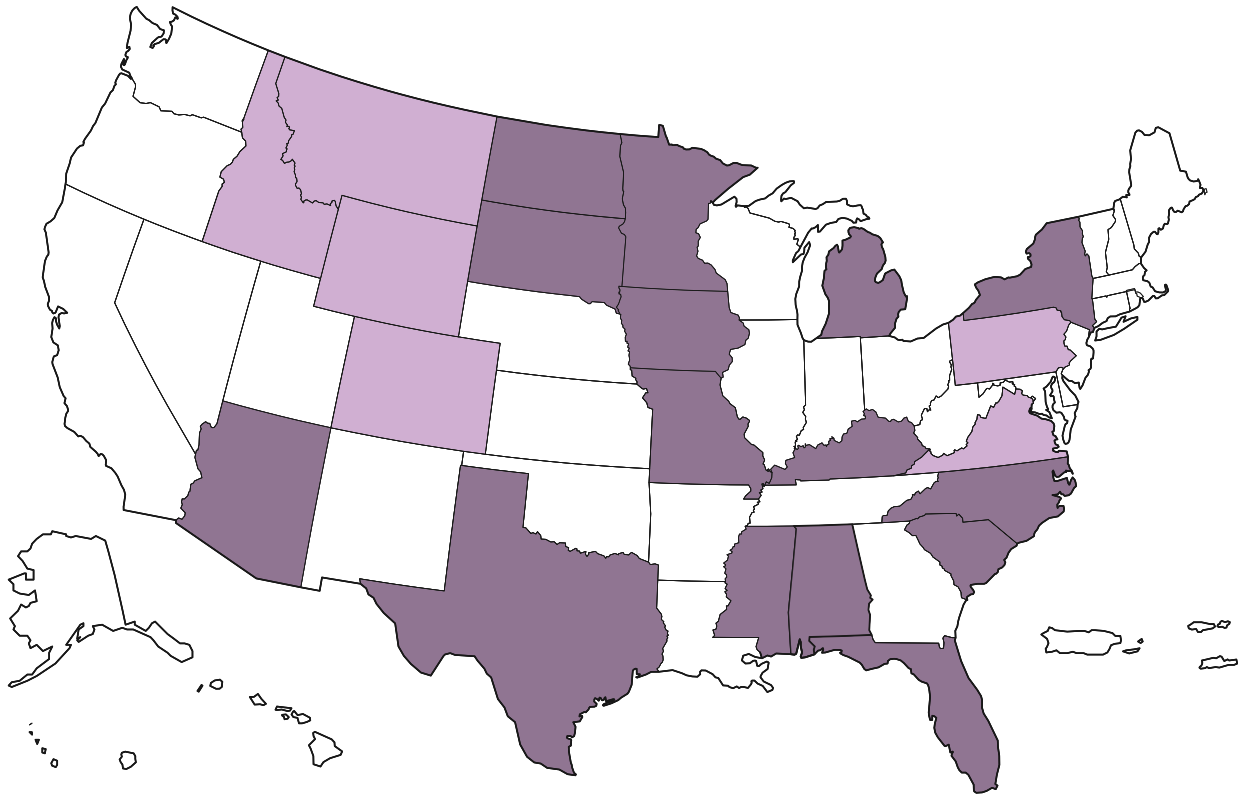
California excludes single-event engagements like adding independent contractors to staff when a catering company has extra events.

California also went back and forth about exempting writers from being classified as independent contractors. When California first passed legislation requiring the ABC test, it included freelance



## Who uses the ABC test?

Currently, twenty-seven states use the ABC test. Another six states use parts A and C. Two use either A and B or A and C. The rest use a version of the common law tests.



Here are the fifteen states and the District of Columbia that use the common law test:

Alabama	Missouri
Arizona	New York
Florida	North Carolina
Iowa	North Dakota
Kentucky	South Carolina
Michigan	South Dakota
Minnesota	Texas
Mississippi	

Here are the eight states that use a variation of the ABC test:

Colorado  
Idaho  
Montana  
Pennsylvania  
Virginia  
Wyoming

The remaining 27 states use the pure ABC test, with some limited carveout for specific professions.

For example, most states don't exclude doctors, dentists and pharmacists from being independent contractors. California also excludes single event engagements like independent contractors hired to perform add to catering staff when a catering company has extra events.

writers and photographers as presumed employees if they were engaged to provide services akin to those the entity typically did.

For example, freelance writers engaged to write obituaries for a newspaper were considered employees. That legislation was modified to place a limit on assignments per year. Later, still another modification removed the limit as long as the freelancers had a written contract that specified the rate of pay, intellectual property rights and an obligation to pay by a defined time; the individual doesn't replace an employee; they typically work off-site; and they are free to work for other entities as they wish.

California now has a long list of exempt, presumed independent contractors that includes medical professionals, grant writers, graphic designers and many other traditionally independent professionals.

**Bottom line:** Even if your organization operates in an ABC state, be sure to check for any exemptions to the basic ABC rule in that state before concluding that the independent contractor you want to engage is or is not eligible for independent contractor status.

### *Examples under the ABC test*

Here are a few examples of working relationships that apply to the ABC test:

- **Employee:** A grocery store hires “freelance” cake decorators to work on special-order cakes that customers request by filling out a form at the in-store bakery counter. The cake decorators are likely employees because the work they do is an integral part of what the grocery store or a section of the grocery store is in business to do.
- **Independent contractor:** The same grocery store experiences an electrical malfunction that shuts down the freezer section. It engages a licensed electrician to repair the malfunction. The electrician is an independent contractor because, among other reasons, the grocery store is not in the business of providing electrical repair services.

- **Employee:** A builder engages carpet installers to install carpeting in a new subdivision. They have their own tools, but do not have a separate office, business cards or website and do not advertise their services. They spend all their carpet-installation time working in the subdivision and receive no income from any other source while working in the subdivision. They are employees, not independent contractors.
- **Independent contractor:** An auto-repair appraiser holds a state license to perform estimates, has his own equipment to assess repairs and solicits business via a website and other advertisements but performs most appraisals for one company. The appraiser likely is an independent contractor.

## Economic-realities test: New DOL independent contractor rules

There is no single rule for determining whether an individual is an independent contractor or an employee under the Fair Labor Standards Act. Instead, the Department of Labor looks to an economic-realities test.

The DOL issued its final rule, [Employee or Independent Contractor Classification Under the Fair Labor Standards Act](#), in January 2024. The rule went into effect in March 2024.

Under this regime, what counts is whether a worker is economically dependent on an employer. It generally does not matter that a written contractual arrangement between the worker and an employer exists, nor that the worker operates as a business such as an LLC or as a sole proprietor.

In assessing economic dependence, courts and the DOL have historically analyzed the circumstances of the employment relationship, considering multiple factors to determine whether a worker is an employee or an independent contractor.

To analyze whether a worker is an employee or independent contractor, the new final rule uses six factors. These factors make up the economic-realities test:

1. Opportunity for profit or loss depending on managerial skill
2. Investments by the worker and the potential employer
3. Degree of permanence of the work relationship
4. Nature and degree of control
5. Extent to which the work performed is an integral part of the potential employer's business
6. Skill and initiative.

No single factor carries more weight than any other when determining whether a worker is an employee or independent contractor. That depends on the facts and circumstances of the particular relationship. Additional factors not listed may also be relevant if they in some way indicate if the worker is in business for themselves rather than economically dependent on the employer for work.

The six factors are considered more completely below.

## **Factor 1: Opportunity for profit or loss depending on managerial skill**

Does the worker have opportunities for profit or loss based on managerial skill that affect the worker's economic success or failure? Managerial skill can include initiative or business expertise or judgment. Among the relevant considerations are whether the worker:

- Determines or can meaningfully negotiate the charge or pay for the work provided
- Accepts or declines jobs or chooses the order or time in which the jobs are performed

- Engages in marketing, advertising or other efforts to expand their business or secure more work
- Makes decisions to hire others, purchase materials and equipment or rent space.

If a worker has no opportunity for a profit or loss, that suggests the worker is an employee. Some decisions by a worker that can affect the amount of pay he or she receives—such as deciding to work more hours or take more jobs when paid a fixed rate per hour or per job—generally do not reflect the exercise of managerial skill indicating independent contractor status under this factor. In other words, simply taking on more work to earn more money isn't enough. For a worker to be classified as an independent contractor, the worker would have had to negotiate a higher rate of compensation rather than taking on more hours.

Here are two examples of how the opportunity for profit or loss may determine classification as an employee or contractor:

- **Employee:** A worker for a landscaping company performs assignments only as decided by the company for its corporate clients. The worker does not independently choose assignments, ask for additional work from other clients, advertise the landscaping services or try to reduce costs. The worker regularly agrees to work additional hours to earn more money. In this example, the worker does not exercise managerial skill that affects their profit or loss. Rather, their earnings may change based on the work available and their willingness to work more. This lack of managerial skill affecting their opportunity for profit or loss indicates employee status.
- **Independent contractor:** In contrast, a worker provides landscaping services directly to corporate clients. The worker produces their own advertising, negotiates contracts, decides which jobs to perform and when to perform them, and decides when and whether to hire helpers to assist with the work. This worker exercises managerial skill that affects

their opportunity for profit or loss. These facts indicate independent contractor status.

## Factor 2: Investments by the worker and the potential employer

Are any investments by a worker capital or entrepreneurial in nature? The following facts, among others, can be relevant to that determination.

Costs to a worker for tools used on a specific job and costs the employer imposes on the worker are not capital or entrepreneurial investments that indicate independent contractor status. Investments that are capital or entrepreneurial in nature and indicate independent contractor status generally support an independent business and serve a business-like function, such as increasing the worker's ability to do different types of work, do more work, reduce costs or extend market reach.

Additionally, the worker's investments should be considered on a relative basis with the employer's investments in its overall business. The worker's investments do not have to be equal to the potential employer's investments and should not be compared only in terms of the dollar values of the investments.

The focus should be on whether the worker makes similar types of investments as the employer (even if on a smaller scale) or investments of the type that would allow the worker to operate independently in the worker's industry or field. Such investments by the worker in comparison to the employer weigh in favor of independent contractor status, while a lack of investments that support an independent business indicates employee status.

Here are two examples of how this factor might be applied:

- **Employee:** A graphic designer provides services for a commercial design firm. The firm provides software, a computer, office space and all the equipment and supplies for the worker. The company invests in marketing and finding clients, and maintains a central office from which to manage

services. The worker occasionally uses their own preferred drafting tools for certain jobs. In this scenario, the worker's relatively minor investment in supplies is not capital in nature and does little to further a business beyond completing specific jobs. These facts indicate employee status.

- **Independent contractor:** A graphic designer occasionally completes specialty projects for the same commercial design firm. The graphic designer purchases their own design software, computer and drafting tools, and rents their own workspace. The graphic designer also spends money to market their services. These types of investments support an independent business and are capital in nature—that is, they allow the worker to do more work and find new clients. These facts indicate independent contractor status.

### Factor 3: Degree of permanence of the work relationship

Is the work relationship indefinite in duration, continuous or exclusive of work for other employers? That would weigh in favor of the worker being an employee. Is the work relationship indefinite in duration, non-exclusive, project-based or sporadic based on the worker being in business for themselves and marketing their services or labor to multiple businesses? That would weigh in favor of the worker being an independent contractor.

This may include regularly occurring fixed periods of work, although the seasonal or temporary nature of work by itself would not necessarily indicate independent contractor classification.

Where an individual cannot perform work on a permanent basis due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ, this factor would not necessarily indicate independent contractor status unless the worker is exercising their own independent business initiative.

Here are examples of how the permanence factor might apply:



- **Employee:** A cook has prepared meals for an entertainment venue continuously for several years. The cook prepares meals as decided by the venue, depending on the size and specifics of the event. The cook only prepares food for the entertainment venue, which has regularly scheduled events each week. The relationship between the cook and the venue is characterized by a high degree of permanence and exclusivity, as the cook does not cook for other venues. These facts indicate employee status under the permanence factor.
- **Independent contractor:** A cook has prepared specialty meals intermittently for certain events at an entertainment venue over the past three years. The cook markets their meal-preparation services to multiple venues and private individuals, and turns down work from the entertainment venue for any reason, including because the cook is too busy with other meal-preparation jobs. The cook has a sporadic or project-based non-exclusive relationship with the entertainment venue. These facts indicate independent contractor status under the permanence factor.

## Factor 4: Nature and degree of control

Does the potential employer have control, including reserved control over the performance of the work and the economic aspects of the working relationship? Reserved control means the employer has the right to control even if they do not actually exercise the control. An example of reserved control is when an employer reserves the right to discipline a worker for declining assignments.

Facts relevant to the potential employer's control over the worker include whether the potential employer:

- Sets the worker's schedule
- Supervises the performance of the work

- Explicitly limits the worker's ability to work for others, or places demands or restrictions on workers that do not allow them to work for others or work when they choose
- Uses technological means to supervise the performance of the work (such as by means of a device or electronically)
- Reserves the right to supervise or discipline workers
- Controls economic aspects of the working relationship, such as the prices or rates for services and the marketing of the services or products provided by the worker.

Actions taken by the potential employer for the sole purpose of complying with a specific, applicable federal, state, tribal or local law or regulation are not indicative of control. However, actions taken by the potential employer that go beyond compliance with a specific, applicable federal, state, tribal or local law or regulation and instead serve the potential employer's own compliance methods, safety, quality control or contractual or customer-service standards may be indicative of control.

More facts that show control by the potential employer indicate employee status; more facts that show control by the worker indicate independent contractor status for this factor.

Here are two examples of how this factor might be applied:

- **Employee:** A registered nurse provides nursing care for Alpha House, a nursing home. The nursing home sets the work schedule, with input from staff regarding their preferences, and determines the staff assignments. To protect residents, Alpha House's policies prohibit nurses from working for other nursing homes while employed with Alpha House. In addition, the nursing staff are supervised by regular check-ins with managers, but nurses generally perform their work without direct supervision. While nurses at Alpha House work without close supervision and can express preferences for their schedule, Alpha House maintains control over when and where a nurse can work and whether a nurse can work

for another nursing home. These facts indicate employee status under the control factor.

- **Independent contractor:** Another registered nurse provides specialty therapy to residents of Beta House. The nurse maintains a website and was contacted by Beta House to assist its residents. The nurse provides the therapy for residents on a schedule agreed upon between the nurse and the resident, without direction or supervision from Beta House, and sets the price for services on the website. In addition, the nurse provides therapy sessions to residents at Beta House as well as other nursing homes in the community at the same time. These facts—that the nurse markets their specialized services to obtain work for multiple clients, is not supervised by Beta House, sets their prices and has the flexibility to select a work schedule—indicate independent contractor status.

## **Factor 5: Extent to which the work performed is an integral part of the potential employer's business**

Is the work performed an integral part of the potential employer's business?

If the work performed by a worker is critical, necessary or central to the potential employer's principal business, that indicates the worker is an employee.

If the work performed by a worker is not critical, necessary or central to the potential employer's principal business, that indicates the worker is an independent contractor.

This factor does not depend on whether any individual worker is an integral part of the business, but rather whether the function they perform is an integral part of the business.

Here are two examples of how this factor might be applied:

- **Employee:** A large farm grows tomatoes that it sells to distributors. The farm pays workers to pick the tomatoes during the harvest season. Because a necessary part of tomato farming is picking the tomatoes, the tomato pickers are integral to the company's business. These facts indicate employee status.
- **Independent contractor:** Alternatively, the same farm pays an accountant to provide accounting support, including filing its annual tax return. This accounting support is not critical, necessary or central to the principal business of farming tomatoes, so the accountant's work is not integral to the business. Therefore, these facts indicate independent contractor status under the integral factor.

## Factor 6: Skill and initiative

Does the worker use specialized skills to perform the work and do those skills contribute to business-like initiative?

This factor indicates employee status where the worker does not use specialized skills in performing the work or where the worker is dependent on training from the potential employer to perform the work.

Where the worker brings specialized skills to the work relationship, this fact is not indicative of independent contractor status because both employees and independent contractors may be skilled workers. It is the worker's use of those specialized skills in connection with business-like initiatives that indicates the worker is an independent contractor.

Here are two examples of how this factor might be applied:

- **Employee:** A highly skilled welder provides welding services for a construction firm. The welder does not make any independent decisions at the jobsite beyond what it takes to perform the assigned work. The welder does not determine the sequence of work, order additional materials, think about bidding for the next job or use his or her welding

skills to obtain additional jobs. The welder is told what work to perform and where to do it. In this scenario, the welder, although technically highly skilled, is not using those skills in a manner that evidences business-like initiative. These facts indicate employee status under the skill and initiative factor.

- **Independent contractor:** A highly skilled welder provides a specialty welding service, such as custom aluminum welding, for a variety of area construction companies. The welder uses those skills for marketing purposes, to generate new business and to obtain work from multiple companies. The welder is not only technically skilled but also uses and markets those skills in a manner that evidences business-like initiative. These facts indicate independent contractor status.

## Additional factors

Additional factors that answer the question of whether a worker is economically dependent on an employer may be relevant. Factors that do not help answer this question, such as whether an individual has alternate sources of wealth or income, are not relevant.

## The IRS common-law test

The IRS determines workers' status under the common law by using a 20-factor test. You should look at the factors as guidelines. Not every factor will apply in every situation, and the degree of importance of each factor varies depending on the type of work and individual circumstances.

Over the years and for a variety of reasons, the IRS has pegged the following industries as prone to worker-misclassification problems, whether intentional or inadvertent because of industry practices:

- Building and construction, where the interaction of general and subcontractors creates classification issues for some subcontractors

- Trucking, where the issues of who owns the equipment and who pays operating expenses give rise to classification decisions
- Automobile repair, where the issue of who supplies tools, parts and facilities affects mechanics' status
- Cab drivers who rent their cabs, but who receive instructions from dispatchers and benefit from the advertising of the lessor
- Salespersons, who may or may not be statutory employees under other provisions of the tax code.

## The IRS 20-factor classification test

These are the factors that decide employee or independent contractor status under the IRS's common-law test:

- 1. Instructions.** Employees must comply with instructions about when, where and how to work. Even if no instructions are given, the control factor is present if the employer has the right to control how the work results are achieved.
- 2. Training.** Employees may be trained to work in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
- 3. Integration.** Employees' services are usually integrated into the business operations because they are important to the success or continuation of the business. This shows that employees are subject to direction and control.
- 4. Services rendered personally.** Employees render services personally. This shows that the employer is interested in the methods as well as the results.
- 5. Hiring assistants.** Employees work for an employer that hires, supervises and pays workers. Independent contractors can hire, supervise and pay assistants under a contract that requires them to provide materials and labor, and to be responsible only for the results.

- 6. Continuing relationship.** Employees generally have a continuing relationship with an employer. A continuing relationship may exist even if work is performed at recurring, although irregular, intervals.
- 7. Set hours of work.** Employees usually have set hours of work established by an employer. Independent contractors generally can set their work hours.
- 8. Full-time required.** Employees may be required to work or be available full-time. This indicates control by the employer. Independent contractors can work when and for whom they choose.
- 9. Work done on premises.** Employees usually work on the employer's premises or at a location designated by an employer.
- 10. Order or sequence set.** Employees may be required to work in the order or sequence set by an employer. This shows that they are subject to direction and control.
- 11. Reports.** Employees may be required to submit reports to an employer. This shows that the employer maintains a degree of control.
- 12. Payments.** Employees are generally paid by the hour, week or month. Independent contractors are usually paid by the job or on a straight commission basis.
- 13. Expenses.** Employees' business and travel expenses are generally paid by an employer. This shows that they are subject to regulation and control.
- 14. Tools and materials.** Employees are normally furnished with significant tools, materials and other equipment by an employer.
- 15. Investment.** Independent contractors have a significant investment in the facilities and equipment they use when working for someone else.
- 16. Profit or loss.** Independent contractors can make profits or suffer losses.



- 17. Works for more than one person or firm.** Independent contractors are generally free to provide their services to two or more unrelated persons or firms at the same time.
- 18. Offers services to the general public.** Independent contractors make their services available to the general public.
- 19. Right to fire.** Employees can be fired by an employer. Independent contractors can't be fired, so long as they produce a result that meets the specifications of the contract.
- 20. Right to quit.** Employees can quit their jobs at any time without incurring liability. Independent contractors usually agree to complete a specific job and are responsible for its satisfactory completion, or they are legally obligated to make good for failure to complete a job.

## How to craft an independent contractor agreement

When you are ready to engage an independent contractor, carefully consider how you will draft your agreement. *Key point:* Bear in mind that the less control over the independent contractor you build into the agreement and the less economically dependent the independent contractor is on your organization, the more likely the DOL will conclude the worker is indeed an independent contractor and not an employee.

Consider the following terms and conditions:


- **The rate of compensation.** Independent contractors are typically paid either by billable hours or per deliverable. There may be different rates based on different projects or deliverable types or sizes. When drafting a contract, try to be as clear as possible when detailing compensation to avoid confusion and frustration down the road.
- **Payment terms.** Businesses that work with many independent contractors may have more detailed processes for

paying contract workers. For example, some businesses provide standardized templates they want all contractors to use to bill them or have set dates when invoices must be submitted each month. List any of those details here. If you don't have a process in place yet, you can simply include the processing time for invoices. Net 30 days is standard, but some businesses pay on net 60 days or other terms. When you pay an invoice, make sure it is separate from the payroll processing run. Treat the independent contractor payments as you would any other business expense.

- **Project details.** Describe the work that the contractor will perform and the expected deliverables.
- **Ownership of work completed.** Agree on who owns the rights to any deliverables or intellectual property created during the contractual relationship. Typically, anything that the contractor delivers should be noted as being work-for-hire. Sometimes independent contractors will want to add language regarding whether work completed for your business may be showcased in their portfolio or on their website. That's fine as long as it is clear that the intellectual property, if any, belongs to your organization.
- **Length of the contract.** If it is a short-term contract for a specific project or to cover a busy season, detail the projected end date in the contract. If it is an ongoing contract, you may skip this or choose to set the length to one year to allow for annual updates and contract revisions. If you don't set an end date, the DOL is more likely to conclude the worker is an employee.
- **Responsibility for tools and business expenses.** Detail whether the contractor is expected to provide their own tools for completing the work and what, if any, tools or expenses your business will be responsible for. Often independent contractors are expected to provide their own tools if those tools are standard for the service that they provide. For example, a graphic design contractor should have their own computer and design software. However, it is common to reimburse

contractors for work-related travel expenses. Again, remember that the more the independent contractor looks like they're in business for themselves, the more likely the DOL will conclude he or she is a contractor, not an employee.

- **Confidentiality.** Many contracts include nondisclosure agreements or confidentiality clauses to protect the business' trade secrets. This can be important when working with independent contractors, as it is common for a well-established contractor to provide services to several businesses within the same industry and even work with competing businesses. Set contractual terms protecting your intellectual property if you do not want them to share private details of your business or product with your competitors.
- **Termination conditions.** Detail how and when the contract may be terminated. Many businesses provide general language: "This agreement may be terminated by either party at any time for any reason with 30 days' written notice." You may also list actions that would be grounds for immediate termination of the agreement.



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