The Mythology of Risk Mitigation

An Exploration of Five Persistent Myths

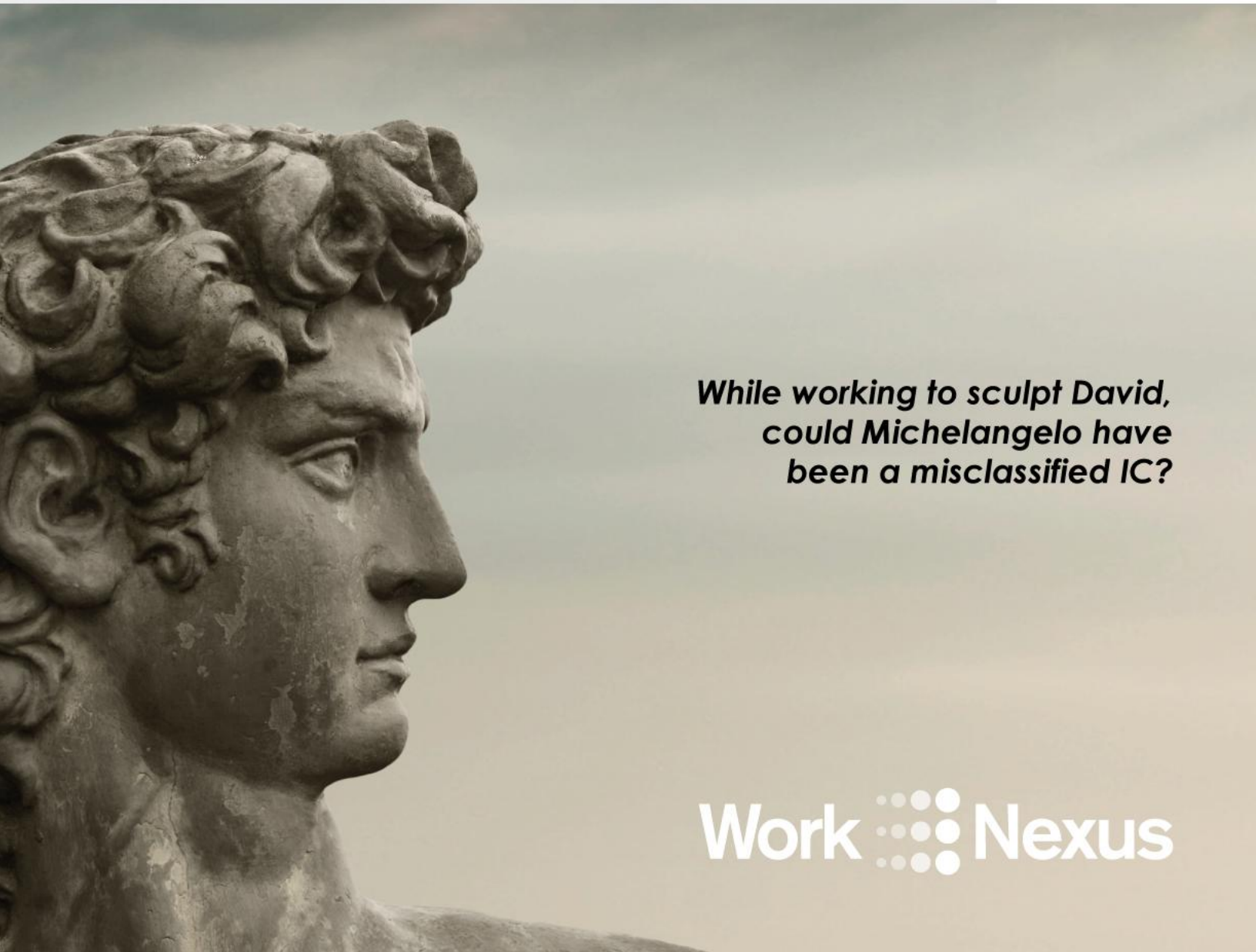
Articles of Incorporation

Longevity Rules

IRS Audits

Classification Stability

High-Risk IC Types



While working to sculpt David, could Michelangelo have been a misclassified IC?

Work Nexus

We've heard the buzz regarding potential financial penalties for Independent Contractor (IC) or contract worker misclassification—some have even experienced the sting. That sting can be particularly debilitating to a company's bottom line, and thoughtful risk mitigation policies need to be instituted. Based on conversations with current customers, potential customers, and conference attendees, a number of practices aimed at reducing misclassification risk have been implemented by well-intentioned organizations.

Do they work? Well, not all of them. Some work very well. Others work only in combination. Some, though, are simply myths. For a variety of reasons, these myths are embraced and can be difficult to dispel. Vendor Management Systems (VMSs) can help, but—before we get into that—let's meet the myths through the eyes of a fictitious hiring manager, Mr. Ben There.

Myth #1: Articles of Incorporation are the Be-All and End-All

Mr. Ben There views articles of incorporation to be the ultimate misclassification cure-all. While bona fide ICs should have their business credentials in order, the credentials themselves do not categorically appease government auditors. Focus not on Articles of Incorporation, but on the manner and the extent to which your organization exerts behavioral and financial control over ICs. The degree and nature of this control is key.

Myth #2: Longevity Rules Drive Risks into Oblivion

The mere fact that a time-on-assignment rule exists offers little protection against worker misclassification or co-employment concerns. Somewhat connected to this myth is the notion that as soon as an IC and/or temporary worker has gone beyond 12-months on assignment, they magically become an employee of the customer. By itself, time-on-assignment does not define employment status; however, if the temporary resource is treated as a direct employee, a longevity rule won't help during an audit.

Myth #3: Watch Out for the IRS

The majority of misclassification cases that we have seen were the result of Department of Labor and/or state agency audits and IRS investigations. Of all the cases of misclassification we have evaluated, the following are the most common reasons why audits commenced:

- An off-boarded IC struggles to land his/her next consulting gig and—as financial resources dwindle—puts in a claim for unemployment insurance that identifies the former customer as the employer of record.
- The IC suffers an injury and submits a workers' compensation claim that identifies the former customer as the employer of record.
- Wishing to receive overtime pay, an IC submits a complaint to the Department of Labor's wage and hour division.

Myth #4: Once an IC, Always an IC

This is one of our favorite myths because it gets right to the heart of misclassification. Here's how Mr. Ben There's story unfolds…

Ben has a process by which an IC is evaluated prior to engagement. For all the right reasons, his evaluation determines that the resource is, indeed, a true IC. The IC even has business insurance that meets your requirements, maintains workers' compensation, works off-site, and charges Ben's organization not on an hourly basis, but by deliverable or milestone. These are all great steps. But, twelve months into the engagement and due to the demands of the project, the IC has dropped all other customers, has become an integral member of Ben's team, and now follows Ben's specific day-to-day instructions, as would direct employees.

The once bona fide IC has undergone a transformation and is now a misclassified IC.

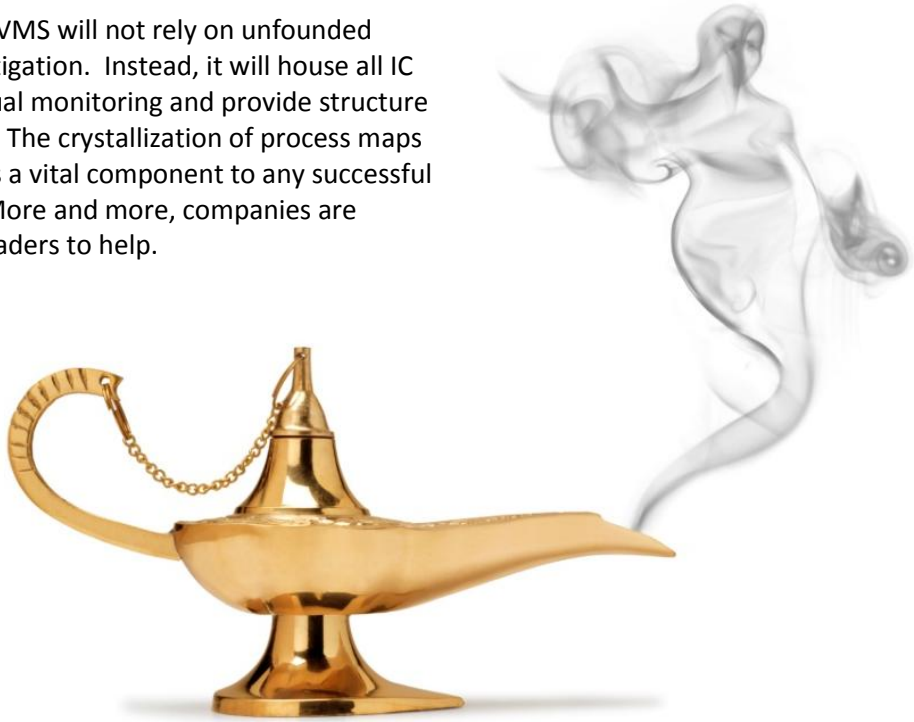
Myth #5: Certain Service Providers Must Watch Their Steps

Mr. Ben There believed he was safe because he didn't engage ICs for high-risk needs like courier services, construction, or security. Although these types of ICs have seemingly been targeted for audits in the past, many states have passed legislation to uncover instances of misclassification regardless of industry. No longer can companies take the position that they are untouchable by virtue of their lines of business. For example and over the last few years, the majority of misclassification cases that we have encountered have been in the information technology industry.

Truth #1: Innovative Vendor Management Systems (VMSs) Can Help

A genie in a bottle won't help. Due diligence must be applied to your organization's use of ICs and temporary employees. Today, your governance efforts can be bolstered through the deployment or repurposing of already-deployed VMSs. While these solutions have been providing value to contingent labor processes since the mid 90s, their application to IC management is a relatively new development.

A thoughtfully-configured VMS will not rely on unfounded myths for effective risk mitigation. Instead, it will house all IC documentation for continual monitoring and provide structure to engagement processes. The crystallization of process maps and IC engagement rules is a vital component to any successful risk mitigation program. More and more, companies are turning to VMS industry leaders to help.



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