

Contract employee, independent contractor...there's a difference? (Part 1 of 3)

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Yes, there is a difference. Knowing the difference might save your company a load of fines should you ever have a government audit.

The most basic difference is control. A contract employee (CE) is just that, an employee under contract. Employees are, by the very definition, employed by the company for whom they perform a service. The contract between the employee and the employer can be short or long, by project, by expertise, by anything that is agreed upon by the two parties. A deal is struck, consideration is negotiated and paid, and at the end of the contract, renegotiation or termination occurs.

For a CE, renegotiation or termination is a key to keeping the person as 'contract' and not an actual 'company employee'. If the contract is written so that it is automatically renewed, then the 'contract employee' becomes a 'regular employee' and is due any benefits and status as any other person under traditional employ. The (now) employer is also responsible for all employment taxes...which is what the company wants to avoid.

Think temp-to-perm

The contract employee's contract is held by the company to whom that person reports, which is not always the company for whom the person performs services. Manpower, Kelly, Accountemps, are familiar brand names to many. Temporary employees who work through a Manpower-type service are actual employees, W-2, and are contracted out to either a company that needs to fill a position and wants to "try out" a person's skill sets or needs a particular short-term service performed, but doesn't want to deal with negotiating a contract with a specialist.

Yes, there is a contract between a temporary and temp-to-perm company, but these contracts are for a percentage of wages paid over the course of an assignment (typically one percent of total gross wages). For example, say I need to fill a credit union manager position that has been temporarily vacated by a person going out on family medical leave (FMLA). I know my manager will be out for three full months beginning on a set date and returning on or about another set date. XYZ ManagerTemp agency has a slew of people registered in their databanks with not only managerial experience, but also with skills on our industry-specific computer system. The agency has already completed background checks and has W-2s on file.

When I call the agency, I let them know what I can pay and, though I have the option of just having someone sent over, I can also choose to have a selection scheduled for interviews. From the selection I choose, I can then see the skills-test results and written confirmation of the clear background checks. I choose the person, call the agency, and the person comes to work at my credit union.

Now, even though the temporary employee is under actual contract with the agency and must work under their policies, while performing for my credit union, that person must also work under our policies and follow our procedures. In other words, the agency does not control how the work is done, just the person's schedule. Time off, tardiness, behavioral problems, all of these are handled by the agency. That is, if a temp needs to take time off for a personal matter, that person lets the agency know and the agency informs the credit union of the impending absence. Typically, the temp informs the position manager before the agency, but unless specified in that person's contract with the agency or the agency's contract with the credit union, the temp only needs to inform the agency. Either way, the credit union's human resource contact is notified of the impending absence and is offered a fill-in or replacement at the same or reduced rate.

At the end of the contract, if I have need, or just want to, I can then negotiate to hire the temp in some capacity. I notify the agency of my intent and negotiate with the agency, not the temp, on the terms to buy out the contract. The agency officially contacts the temp with my intent to buy out, and the agency and temp work out acceptable terms, meaning the acceptable wage/salary-range. The agency contacts the credit union human resource contact, not the position manager, to negotiate a final number. If the contract employee accepts the number, the agency finalizes the deal, and the contract employee becomes a regular employee. If I have no more need for the person's skills, the contract is ended. Period.

For more information on different employee statuses, audits, and fines, speak to a local labor attorney or go on-line to [www.dol.gov/wage & hour](http://www.dol.gov/wage&hour).

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Independent contractors have clients; temporaries and temp-to-perms do not

An independent contractor (IC) is independent of any other person or company than h/her own, which could be made up of one person, and is bound only by h/her own company's policies and procedures, not yours. An IC seeks out work, negotiates contracts for work, is free to sub-contract work, sets the time schedule for work to be completed, is responsible for h/her own taxes, benefits, pension, and behavior. The contract between an IC and a company is solely for a result by a particular date, not, unless otherwise negotiated, for a particular person to perform work directed in any form by the client company.

The contract must be able to be terminated at any time and for any reason, or no reason at all, by either party. The IC must also be free to obtain other contracts - and work them - simultaneously. 'Full-time' is not a phrase associated with an IC contract. Specified number of hours, hourly wage, salary, all these words imply 'employee.'

To use the credit union example in part one of this series, if I contracted an IC to be my credit union manager, I would not be able to do a background check or skills test. I would, of course, ask for and call on references to elicit the same type of information, but in the end, I don't have the control to be any more thorough. If appropriate, though, I can ask for work samples. I can interview the person to determine fit and I can also directly negotiate contract length and price. In short, I set my company up at the IC's client.

The contract is everything

As a potential client, I need to think of everything I need and negotiate those needs into the contract. The key here is to be aware of contract law as applied to ICs under the Fair Labor Standards Act (FLSA). Unless there is some sort of regulating body that states a particular job must be done by a set procedure, I cannot write any procedure into a contract. If I do, then I create a regular employee under FLSA. Even if there is a particular person under the IC's employ who has specialized skills necessary to complete the contract, I cannot write in who is to work the project. To do so creates an employee. An IC must be free to subcontract anyone s/he deems qualified to do the work.

Behavioral control

Control is the issue that gets companies into trouble. Behavioral control of both the IC and managers. Managers are not generally schooled in working with a person who represents an entirely different company yet works alongside, or for, h/her.

The moment a manager has a counseling session with an IC is the moment the IC becomes an employee (EE). The moment a company requires an IC wear a particular outfit to represent the client company, and not the contractor, is the moment the IC becomes an EE. In the same vein, when a manager requests or demands a particular procedure from an IC, solely because the procedure is customary or spelled out in the client company's procedure manual, the IC becomes an EE.

But what if the IC is doing something wrong?

It is up to the client company to have a provision written into the contract that any of its employees can stop work on a contract project when it is apparent or suspected that an IC's procedure will cause harm to a person, place, thing, or financially adversely affect the client company. Otherwise, the person who notices the potential harmful procedure must bring the person or matter to the attention to whomever is responsible for administering the contract, usually a top-level manager or a human resource contact, to make the IC stop work. At that time, the sub-contractor is to the IC for counseling or termination, or the client company can discuss the matter with the contracting IC or terminate the contract.

That's actually the beauty of working with an IC: there doesn't have to be any counseling, you can just terminate the contract and find someone else to complete the job, and you don't have to worry about anyone filing unemployment credits against you.

And that's the bad part of working with an IC: if you have to terminate a contract with a person with a special skill-set and experience level, it can be difficult to replace that person from within the company. You will, most likely, need to seek out another IC.

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When should I contract?

Well, if you know you want to have control over when and how work is done, as well as who does the work, then you should either hire an employee or do a temp-to-hire. Between the two, a temp-to-hire saves at least a contract's worth of employment expenses, so if total cost is a factor, choose temp-to-hire, at least for non-managerial positions.

If you need to have specific skill sets and experience right away, a temp-to-hire is also less expensive if the contract is short enough. You have control over how work is done as well as a double-probationary period (the temp-time as well as your own period), which is plenty long enough to see if you have a good personality fit.

If you need a specific project completed that requires a specialized skill set not found in-house and not typically offered through an agency, then an IC is the way to go. No employment costs, no unemployment costs, and you can terminate whenever you want for any reason.

Knowing the difference among these three classifications, should you ever have a government audit, can save your company thousands, if not millions, of dollars, and may even keep you in business. Many a company has felt the pinch of Uncle Sam to the tune of \$10,000 as a flat fine for breaking the FLSA law and the additional \$1000 for every other incident found during an audit.

For more information on different employee statuses, audits, and fines, speak to a local labor attorney or go on-line to [www.dol.gov/wage & hour](http://www.dol.gov/wage%20hour).

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Diane Faulkner is a freelance writer and speaker whose work is seen in such publications as *Credit Union Management*, *The Federal Credit Union*, *The Conference Board Magazine*, *Human Resource Executive*, *Women's Digest* and *The Business Journal*. A former human resource vice-president and certified substance abuse counselor, Faulkner's expertise in human behavior and labor issues helps people work and play well together in the office without later landing in court.

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