



NGOs and independent contractors:

How to protect your mission from the costly risk of noncompliance



CONTENTS

- 3 Introduction
- 4 Using independent contractors
- 6 Employment noncompliance
- 10 Protecting your mission
- 12 Conclusion



INTRODUCTION

How detrimental would an unexpected \$150,000 cost be to advancing your mission?

If your nongovernmental organization or nonprofit has a limited budget and relies on private donors, philanthropic foundations and government grants for funding—and what NGO doesn't?—there's no doubt, an expense like that could be crushing.

Take it from an NGO that came to us after it was hit with a \$150,000 bill in back taxes and penalties from two African governments. The infraction? Employee misclassification. The NGO's use of independent contractors didn't comply with the local labor laws.

The noncompliance ruling meant the NGO had to temporarily shut down projects in Burkina Faso and Zimbabwe so it could raise additional funds to pay for its mistake—a huge setback to its mission of providing access to potable water, sanitation and hygiene education programs.

When it comes to engaging workers internationally, NGOs and nonprofits may be unwittingly putting themselves at risk of noncompliance and mission-derailing penalties by using independent contractors incorrectly. This guide is based on our years of experience helping organizations navigate labor requirements and hire around the world.

We'll cover:

- Using independent contractors
- Ways noncompliance can be costly to your mission
- Ways to protect your mission when hiring internationally

As for the clean water NGO? We helped by providing the organization with an alternative, compliant hiring solution for the workers it needed in Africa. (More on that later.)



Why hire independent contractors?

There are several reasons NGOs and nonprofits may choose to use independent contractors to help carry out a mission in a foreign country.

Project completion. If you have a need for a specific skillset in a project that has a clearly defined start and end date, an independent contractor could help by contributing their expertise for the project's duration.

No entity. If the mission is in a country where your organization does not have an entity, you can't legally hire workers directly. Many NGOs have deemed it too costly—in both time and money—to establish international entities for hiring purposes. Others may plan on entity establishment, but they're new to a region and they need workers before the lengthy entity process has been completed.

Lack of HR expertise. As you know, NGO budgets are often limited to what they receive in donations from private individuals and for-profit companies, or grants from philanthropic foundations or governments. Because of this, many NGOs don't have in-country HR resources and are unfamiliar with the country's labor laws. The NGO may decide that hiring full-time employees—which entails understanding tax withholdings and social entitlements—is too complicated and opt to use independent contractors instead. Sound familiar?



WHAT IS AN INDEPENDENT CONTRACTOR?

An independent contractor is a professional whom an organization engages with on a project basis to provide a specific function or area of expertise. Independent contractors may do work for multiple organizations at a time, and they are generally responsible for handling their own taxes.

So, what's the problem?

Regardless of *why* an NGO or nonprofit decides to use independent contractors for international projects, *how* the contractors are used is where the organization can run into trouble.

Although labor laws vary from country to country, both in breadth of requirements and severity of penalty for noncompliance, virtually every government around the world has at least some definitions for how workers should be treated and classified, and these often include rules for employment contracts.

Just like with the clean water NGO we referenced earlier, if a local government finds that your organization is in violation of the country's labor laws, you can expect to be penalized. The extent of the financial hit would depend on the specific rule broken, the severity of wrongdoing, and the local government's propensity to pursue legal action.

But given the rise of lawsuits challenging how independent contractors are used—mostly geared toward for-profit companies, although the repercussions would likely be felt by all employers—evaluating and re-evaluating labor rules has become a priority for legislators around the world. Many lawmakers are “addressing the protection gap to varying degrees and through diverse initiatives, including legislative bills, executive orders and task forces,” according to the Business & Human Rights Resource Centre, a nonprofit consortium of global researchers dedicated to advancing human rights in business and eradicating abuse.¹

It's also important to remember that for many NGOs and nonprofits, donor funds often come with strict requirements for how money may be used for initiatives, including hiring, so any legal trouble with a local government could potentially jeopardize future funding. Meaning, if your use of independent contractors doesn't align perfectly with the employment rules in the country where you're operating, you could be putting your NGO's mission at risk.

What else to consider

Beyond the financial impacts, NGOs should also heed the ethical considerations of using—and potentially misusing—-independent contractors. One way to do that is by respecting labor rights set forth in the U.N. Guiding Principles on Business and Human Rights.² According to the Business & Human Rights Resource Centre, employers who respect human rights should abide by these principles:

- Correctly classify workers to ensure labor rights and social protections, and refrain from challenging policies that afford such protections.
- Put in place human rights policies and processes, remediation and human rights due diligence processes.
- Provide for, or cooperate in, legitimate remediation processes, and abolish forced arbitration clauses in workers' contracts.³

Following these principles, however, shouldn't be a big ask for an NGO or nonprofit. After all, for many NGOs, serving the underserved is a cornerstone of the mission.

¹“Corporate Legal Accountability Annual Briefing, March 2019,” Business & Human Rights Resource Center.

²https://www.ohchr.org/documents/publications/GuidingprinciplesBusinesshr_eN.pdf

³“Corporate Legal Accountability Annual Briefing, March 2019,” Business & Human Rights Resource Center.

The hefty cost of employee misclassification

The biggest compliance risk NGOs face when hiring workers as independent contractors is employee misclassification. But what does that mean?

Simply, because of an independent contractor's scope of work, they should be classified as an employee who receives the full complement of entitlements and benefits required by local labor laws.

There are several criteria and questions NGOs should consider when evaluating whether independent contractors pose a risk of misclassification. These include:

Pay. Are contractors paid for time worked rather than per project, or are they paid in the same manner—for example, the same type of checks⁴—and at the same time as employees?

Equipment. Does a contractor use your equipment or tools to complete a job?

Exclusivity. Does the contractor only provide services to your NGO and does so for an extended period? Have you required the contractor to sign a noncompete agreement?

Management. Do contractors report directly to someone on your team, and is their day-to-day work managed by one of your supervisors? Do they go through progressive discipline if there are performance problems, and if so, are their contracts terminated?⁵

Expenses. Do your contractors have expense accounts or company credit cards?

A “yes” answer to one or more of these questions indicates potential misclassification of your independent contractors—along with far-ranging penalties, should the local government catch wind of any employment infractions.



⁴ “Misclassification of Independent Contractors Can Be Remedied,” SHRM June 28, 2016.

⁵ “Misclassification of Independent Contractors Can Be Remedied,” SHRM June 28, 2016.

JOB TITLES THAT MAY RAISE SUSPICION

Certain job titles, by nature of their associated roles, are more susceptible to misclassification scrutiny, so beware if you've hired any of your independent contractors with the following:



Manager



Director



Coordinator



Penalties for employee misclassification

As we mentioned, consequences for employee misclassification can vary depending on the country's labor laws, severity of the infraction, and local priorities regarding enforcement. The risk can be focused on taxes, social entitlements—or both. In some countries, noncompliance can even be subject to criminal prosecution.

Here's a sampling of employee misclassification penalties from around the world.

United States. In the U.S., employers can be penalized for misclassification whether it was intentional or not (that's right; you can't plead ignorance with the IRS!). For unintentional worker misclassification, penalties include:

- \$50 for each Form W-2 not filed because the employer was classifying workers as independent contractors
- 1.5% of employee wages for not withholding income taxes, 40% of Social Security and Medicare taxes not withheld, and 100% of the employer portion of the Social Security and Medicare taxes; all of these are also subject to daily interest
- 0.5% of the unpaid tax liability for each month, up to 25% of the total tax liability

If an employer is found to have intentionally misclassified workers—perhaps to save on administrative, benefits or tax costs—they could be subject to criminal penalties of up to \$10,000 per misclassified worker, and the individual responsible for tax withholdings could also be held liable for uncollected tax.⁶

⁶ "Employee Misclassification Too Big to Ignore," Bloomberg Tax, July 1, 2021.



Brazil. In Brazil, employers may be fined up to BRL 3,000 per worker misclassified. Additionally, the employer may be required to retroactively pay social security contributions due for an independent contractor who should have been hired as an employee, along with a 75% penalty of the required contributions.⁷

Singapore. In recent years, the Ministry of Manpower in Singapore has increased enforcement of employment noncompliance, finding an average of 100 cases per year of misclassification (see an example in box at right).⁸ When an employer is found to have misclassified a worker, i.e., an independent contractor who should be considered an employee, the employer is required to retroactively provide all employee benefits, overtime pay and Central Provident Fund (social security) contributions mandated under Singapore labor law. Employers who object to the back pay are subject to prosecution.

Germany. In cases of employee misclassification in Germany, the employer is liable for worker entitlements, social security payments and tax withholdings, and employee protection rights for termination become applicable. Additionally, if employers are found to have intentionally misclassified employees, they are subject to criminal prosecution.⁹ Financial penalties include:

- **Social security:** The employer is required to pay both the employer and employee contributions,¹⁰ about 40% of the salary amount, as well as 1% of the contribution as a late payment fine.
- **Tax:** The employer is liable for wage taxes not withheld from the worker; however, the employer can attempt to recoup the amount from the worker. If the employer is not able to take recourse against the worker, the wage tax paid is treated as additional taxable benefit in kind and is subject to wage tax.¹¹

⁷ "Contingent Worker Misclassification Risk Map & Comparison Tool," Baker McKenzie, October 12, 2021.

⁸ "Written Answer by Mrs Josephine Teo Minister of Manpower to Parliamentary Question on Misclassification of Workers as SEPs," Singapore Ministry of Manpower, April 1, 2019.

⁹ "Freelancers and Misclassification Risks in Germany - New legal Boundaries for Gig Economy?" Lexology, August 11, 2021.

¹⁰ "Contingent Worker Misclassification Risk Map & Comparison Tool," Baker McKenzie, October 12, 2021.

¹¹ "Freelancers and Misclassification Risks in Germany - New legal Boundaries for Gig Economy?" Lexology, August 11, 2021.

South Africa. When determining whether a contractor should be classified as an employee, the Employment Tribunal in South Africa considers the employment relationship as a whole rather than individual factors, as well as case law precedence. If a contractor is found to have been classified as an employee, they are entitled to all worker protections, including terminations rights, and social security benefits, and the employer is liable for paying statutory contributions for these entitlements.¹² An employer is subject to criminal prosecution and up to a year in prison if they are found to commit one or more of the following:

- Failure to deduct employee tax or to pay the deductions to the South African Revenue Service
- Issuing a false or altered IRP5/IT3 certificate or not providing an IRP5/IT3 certificate to employees
- Failure to maintain tax records for the requisite five-year period
- Failure to submit a required return

¹² "Contingent Worker Misclassification Risk Map & Comparison Tool," Baker McKenzie, October 12, 2021.

The high cost of misclassification

Here are a few recent examples of employers who had to pay dearly for hiring workers as independent contractors when they should have been employees:

A country club in Singapore was ordered to pay **\$416,924 SGD in social security contributions** that should have been paid to a gym instructor over 18 years.¹³

Weight Watchers was ruled to pay **\$37 million in back taxes** when it was found to have misclassified high-level employees.¹⁴

A U.K. window company was responsible for **13 years of back holiday pay** after a court ruled that a worker should have been classified as an employee.¹⁵

¹³ "Q&A: Labour & Employment Law in Singapore," Lexology, June 12, 2019.

¹⁴ "UK Misclassification Spat Costs Weight Watchers \$37M," Law360 Tax Authority.

¹⁵ "Key Case: King v Sash Window Workshop Ltd - The Employment Law Implications," Bird & Bird, 2017.



Hiring international workers doesn't have to be risky

Although hiring independent contractors internationally can be fraught with compliance risk, hiring international workers doesn't have to be.

There are alternatives to getting the people you need to carry out your mission, in the countries you need them, that don't put your NGO or nonprofit in the precarious position that independent contractors do.



A global employment solutions partner

Various types of providers around the world offer HR and payroll services. But for the specific need of hiring people in foreign countries where you don't have an entity, a **global employer of record (EOR)** can help you add these workers—either for a defined timeline or an ongoing project—and ensure compliance with all pertinent labor laws.

A global EOR has in-country HR and payroll experts who understand the local employment regulations, no matter how complex—including whether a contractor is putting the NGO at risk of employee misclassification. When you partner with an EOR, it takes on the legal role of employer, so it can hire talent for you as employees instead of potentially risky contractors. The EOR is then responsible for ensuring that all contracts, payroll, tax withholdings and social entitlement contributions adhere fully to the local labor laws. This frees you to focus on your workers and how their day-to-day responsibilities and activities can help you achieve your mission.

In addition to helping ensure compliant employment, an EOR can also help assure NGOs that you're hiring workers under ethical standards, with full labor rights and social protections. In-country HR partners give workers the confidence that they're being hired fairly and that they're receiving all social benefits—for example, pensions and healthcare—they're entitled to.

AN EMPLOYER OF RECORD IN A NUTSHELL



Your own local entity

A global EOR is a good option for hiring when you don't have an entity, but your NGO or nonprofit may decide that it makes sense to establish a legal presence in a country because fulfilling the mission is a long-term endeavor that would require a significant number of workers.

Although establishing an in-country entity could come at a significant cost, in both time and money, if you have a sizable workforce in a country that's made up of independent contractors, there's likely a compliance risk, and that could prove to be even costlier (remember the clean water NGO that had to shell out \$150,000 for employee misclassification?). Having your own local entity eliminates the need for hiring independent contractors—and the risk of misclassification—because you have the ability and freedom to hire workers directly.

You may even find that setting up an entity could improve opportunities for funding in the long term because it indicates your NGO's stability in a country—and a commitment to the mission—to potential donors or grantors.

ENTITY CONSIDERATIONS

Setting up a legal entity in another country can be a complex undertaking. Here's a sampling of the tasks you'll need to account for:

- ✓ Entity registration documents
- ✓ Corporate governance structure
- ✓ Tax ID
- ✓ Articles of incorporation
- ✓ Business license
- ✓ Bank account setup

CONCLUSION

Don't let independent contractors jeopardize your mission

Whether it's protecting the environment, providing resources to underserved areas, distributing medicine and first aid, or filling other critical societal gaps—your mission helps make our world a better place.

Getting into compliance trouble because of your independent contractors wouldn't just cost your NGO, it could also hurt the communities you serve if you're forced to pause or even end your projects.

Our employer of record solution, [Global Employment Outsourcing \(GEO\)](#), has been helping NGOs and nonprofits avoid—or repair—their contractor compliance issues for over a decade. That clean water NGO we told you about? We helped by providing in-country HR expertise and converting the problematic independent contractors into employees who were hired in accordance with all local labor laws.

Your mission is critical. And hiring the right people—in the right countries and in compliance with all employment laws—is critical to the mission. Our global solutions advisors can assess your challenges with independent contractors and propose a solution that helps you advance your mission around the globe.

[Contact us today to get started.](#)





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