

How to Manage Freelancers the Legal Way



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The future of the freelance worker is at a crossroads.

On the one hand, the sharing economy has made independent contractors the new normal. Forward thinking, alternative business models, such as Uber's, can't function without freelancers. Likewise, as millennials become a more and more powerful constituency in the workforce, they make clear their desire to be their own bosses and work when and where they want.

On the other hand, the courts and the Department of Labor (DOL) have recently issued severely restrictive opinions and interpretations that make it extraordinarily difficult for businesses to engage freelancers legally. Headlines are regularly littered with companies hit by massive lawsuits for misclassifying employees as independent contractors, including Uber and [FedEx](#). Understandably, these multi-million-dollar suits have put small business owners in fear that simply mislabeling a worker could cost them their company.



So are freelancers the future or foil of American small business?

The real issue is not whether your business engages independent contractors at all, but rather how you engage them. Recent litigation and rulings have made clear the narrow line small businesses have to toe to stay compliant. This guide will show you how.

Correctly Classify Your Contractors

To understand the legality of engaging freelancers, you first have to know the definition of a freelancer, also called an independent contractor. In general, people qualify as [independent contractors](#) if you — the payer — have the right to control only the result of their work, not how or what will be done.

For example, with a freelance photographer, you would have the right to the final photos, but you couldn't tell the photographer how much time to spend editing, what hours to work, or what shooting methods he'll use.

Auditors trained by the IRS in worker classification follow a manual that indicates the following as the most important factors in discerning an employee from a freelancer:



Individual's ability to turn a profit or take a loss

You can demote, reward, discipline, or terminate an employee based on performance. Still, only freelancers can actually make a profit or suffer a loss from their work. This means employees always get paid, whereas freelancers have a personal financial stake in their work.



Instructions from payer

If your workers have to follow your instructions in completing work — such as how, where, and when to work — they are most likely employees. Your degree of control must be significant, though. For instance, if you told your mechanic you wanted to use generic parts instead of original manufacturer equipment, that doesn't make him your employee. You would still have little control over the rest of the process.



Training

Training your workers signals that you expect work to be completed in the way you want it, which suggests an employer/employee relationship. Keep in mind that the IRS has a loose definition of what constitutes training. For example, requiring a worker to work with a more experienced person or attend a meeting may qualify as training.

Overview of Department of Labor Interpretation and Case Law

You're already familiar with the IRS test for classifying workers, but the tests that may apply to your business don't stop there. The Department of Labor (DOL) and the courts have weighed in many times on the [difference between an employee and a freelancer](#), offering different tests to guide business owners.

Recently, the DOL issued an [interpretation of employment law](#) to give small businesses specific factors to look to in deciding if a worker is an employee. The interpretation requires businesses to apply the economic realities test. In short, this test focuses on whether the worker is "in business for him or herself" or is "economically dependent" on the company.

Here are the DOL's criteria:

- 1 Does the worker have the ability to earn a profit or incur a loss?**
This criterion is the same as the IRS test we mentioned earlier.
- 2 How significant is the worker's investment relative to the employer's?**
True freelancers tend to invest a lot in their equipment, office space, etc., while employees' investments are typically paltry in comparison to their employers.
- 3 Does the work require special business skills?**
Workers who show special business skills and initiative — such as marketing their own services or working for multiple clients — are likely independent contractors.
- 4 Is the company's relationship with worker finite or ongoing?**
The longer-lasting and more exclusive the relationship, the more likely the scales tip toward employee status.
- 5 How much control does the payer have?**
If you can control the way workers complete work, they are most likely employees.
- 6 Is the work an integral part of the company's business?**
The more integral the work, the more likely that the worker is economically dependent and thus an employee. For example, a carpet cleaning service couldn't function without carpet cleaners. However, if the company wanted to hire a graphic design artist to create its website, that artist would be a freelancer because the work is not integral.



The common-law test established by the courts is much simpler, although case law has expounded on this definition over the years. The common-law test for classifying employees looks at whether the payer, or business, has the right to control the manner and means by which work is done.

Use Legal Tools To Safeguard Your Business

While legally classifying a worker as an independent contractor isn't easy, you can reap myriad benefits by doing so. Specifically, you can reduce overhead, limit liability, and give your company more flexibility by using workers only when you need them. To preserve those benefits without running afoul of the law, try these three legal tools to manage your freelance workforce:

1 Business-freelancer agreement

This contract should discuss a description of the work and associated compensation. Your provisions should include a work-for-hire agreement, which makes the work product of the freelancer your company's intellectual property (IP) at the end of the relationship.

You might also include a confidentiality agreement to ensure that the freelancer will keep in confidence the nature of the work, clients' information, and, in some cases, the freelancer's contribution to the work.

Finally, in the event of an IP infringement by the freelancer, you'll also want to include liability protection in this agreement. This means that you'll be insulated from liability if the freelancer improperly uses a third party's intellectual property.

2 Business-Freelancer IP Assignment

If you fail to document the assignment of IP rights up front with the initial agreement, you'll need a separate IP agreement. Your business can't infringe on freelancers' copyright in their work unless they have expressly surrendered IP rights up front. Make sure you get a written assignment of the rights in the work you want the freelancer to do.

3 Freelancer Errors and Omissions Insurance

When freelancers serve multiple clients or businesses, it's reasonable to ask them to secure E&O insurance coverage on their own. If not, you might consider adding the freelancer to your own policy to mitigate the liability risk.

E&O insurance — or professional liability insurance — will cover legal costs in the event that the freelancer makes a major error or omission. Such an error could be financially devastating for your company, so you want to reserve the right to hold the freelancer financially accountable for the mistake. Without E&O insurance, it's unlikely that a freelancer would be able to cover the cost of a major problem.

Stay Compliant

Small businesses stand to gain a lot by engaging freelancers, but they also expose themselves to massive liability if they misclassify employees. Here are some tips to help your company [stay compliant](#) while working with independent contractors:



Work with a variety of freelancers

The more extensive your relationship with any single freelancer, the more likely it is that you have an employer-employee relationship.



Don't require exclusivity

You want your freelancers working for a variety of clients, not just you. This minimizes the chance that they'll be economically dependent on you.



Take a hands-off approach to how the freelancer handles a project

If you want to dictate the hours freelancers work and where, you'll end up with an employment relationship. Remember also to avoid paying freelancers by the hour. Pay on a per-project basis is more consistent with freelance status.



Use employees for integral jobs

For example, if you run a painting company, you can't survive without painters. As a result, any painters you hire are more likely to be employees, not freelancers.



Contractually limit the relationship

Indefinite, permanent relationships resemble employment more than they do freelance arrangements. In your business-freelancer initial agreement, make sure you include a start and end date for the associated project.

Although treating an employee as a freelancer seems like a minor oversight, the stakes are incredibly high for small businesses that make that mistake. To avoid facing costly litigation and tax consequences down the road, make sure you engage freelancers properly from the start.

Written contracts can help establish a freelance arrangement, but they won't protect you completely. Using the strategies we've provided in this guide will help you stay on the right side of employment law.

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Everything you need to take care of your team.



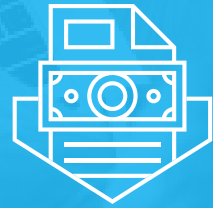
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