



Ouch! Independent Contractor or Employee[®]

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Independent contractors (“ICs”) contract to perform services for others but don't have the legal status of employees. Are ICs right for your veterinary practice?

I. SOME ADVANTAGES PERHAPS

A. Saves Practice Owner Money? With ICs, the veterinary practice avoids the following expenses incurred with employees:

- federal payroll taxes;
- state unemployment;
- employee benefits; and
- workers' compensation.

On the other hand, ICs demand more pay than regular employees (20% to 40% more according to some estimates). To see if ICs will save the practice money or not, you need to do the math.

B. Less Liability? Unlike employees, ICs can't sue the practice for job discrimination or, if you have a properly drafted contract, wrongful termination. ICs, however, can sue the practice if injured on the job (employees must rely on workers' compensation).

II. BUT POSE A SERIOUS TAX RISK

A. Tax Risk. If the IRS reclassifies an IC as an employee, the veterinary practice must pay all back taxes, plus a penalty ranging from 12 to 35% of the amount owed. Moreover, every agency with jurisdiction to collect the contributions the practice saved by hiring ICs is also gunning to reclassify ICs as employees. Such agencies include state tax departments, state unemployment agencies, state workers' compensation agencies, the US Labor Department and the National Labor Relations Board. Audits by state agencies are even more frequent than IRS audits (and typically occur when terminated ICs apply for state unemployment benefits).

B. The Bureaucratic Jungle. Each agency has different concerns, approaches and practices, sometimes resulting in conflicting decisions. Where one agency finds an IC, another may find an employee. Worse, the *same* agency may arrive at conflicting results, such as the IRS, which found in the same year a Methodist minister to be an employee and a Pentecostal pastor to be an IC of their respective churches! Remember, if the practice gets audited, you may eventually win, but the legal costs of defending your position could very well bankrupt you (not an unheard of occurrence with the IRS).

C. Three Group Test. Under pressure from Congress and from representatives of labor and practice, the twenty factor test has recently been simplified by consolidating the twenty factors into three main groups: behavioral control, financial control, and the type of relationship of the parties. Those groups appear below, along with comments regarding each one (source: IRS, [Publication 15-A](#), 2014 Edition, page 7). The practice must look at the entire relationship, not just one group, weigh multiple factors, consider the extent control is exercised and document each factor.

(1) The first group to test is behavioral control. Behavior control relates to whether or not the practice has the right to control how the worker does his or her job. If the practice controls the behavior of the worker, this indicates the worker is an employee. The following factors will help determine who controls behavior.

When determining who has behavior control, look at the types of instructions given to the worker and to what degree. For example, who decides: What methods are used to get the work done? What tools are used? Where supplies are purchased? The sequence in which the work must be performed? When and where will the work be performed? If the answer to these types of questions is the practice, it is more likely the worker is an employee. The more extensive the instructions, the more likely it is the worker will be found to be an employee, not an IC.

Other things to consider when determining behavior control are performance evaluation and training. If the practice provides training to the worker to ensure the work is done a particular way this would indicate the worker is an employee not an IC.

(2) The second group to consider when determining if the worker is an employee or IC is who has financial control. This refers to whether or not the practice has the right to control economic aspects of the worker's job. Examples of financial control include: Does the worker have a significant investment in the project? Are there unreimbursed expenses? Is there an opportunity for a profit or loss for the work? Are the worker's services available to the market? What method of payment is used when compensating the worker?

An IC often has "significant investment" in the equipment being used to perform the task. Significant investment means an acknowledgeable sum of money invested in the project. There is no exact number being used by the IRS to define significant. The greater the financial investment in the project, the greater chance the worker is an IC.

ICs are also more likely to have unreimbursed expenses than are employees. An expense could include buying parts, transportation to and from the job or even tools necessary to complete the job. Having an investment and incurring expenses puts the worker at risk for financial loss. In other words there is a possibility the worker's expenses will exceed the amount he or she will be paid for the work. The more financial risk the worker is exposed to, the more likely it is the worker will be found to be an IC.

ICs are usually free to seek out other practice opportunities while working at the current practice. They are able to advertise and be available to work in the current market place. Employees, especially fulltime employees, are usually restricted from marketing and providing their services to other companies. If there is a restriction on seeking out practice opportunities, it is more likely the worker is an employee.

The last factor to consider when looking for financial control is what method of payment is being used? Employees are usually given a regular salary amount for a set period of time. Some employees are paid hourly or weekly, but any set period of time is acceptable. ICs are usually paid a flat fee for the job. Please note, not all ICs are paid a flat rate; some submit invoices for services and are paid accordingly.

(3) The third group to consider is relationship type. The type of relationship refers to how the worker and the practice perceive their relationship to each other. The factors for determining type of relationship are written contracts, employee benefits, permanency of the relationship and services provided as a key activity of practice.

ICs often have a written contract with the company stating they are ICs and responsible for paying their own employment taxes. The contract may also outline other factors listed in this article. While having a contract may be helpful, neither the IRS nor any other agency is required to follow the contract. If the way the parties work together, looking at all the factors, leans more towards employee than IC, the IRS may rule the worker is an employee in spite of what the contract says.

Another factor is employee benefits. Benefits can include insurance, paid vacation, sick days, pension and disability insurance. ICs do not generally receive these benefits from a company. If these benefits are given, it is likely the worker is an employee. Please note that not all employees receive these benefits, so the lack of these benefits does not necessarily mean the worker is an IC.

The next factor to consider when evaluating relationship type is permanency of the relationship. If a worker is hired indefinitely, they are more likely an employee; however, if a worker is hired for a specified period of time or particular project, it is more likely they are an IC.

The importance of the project the worker is working on can also be a telling factor when debating IC or employee. If the service provided by the worker is a key part of the practice, it is more likely the practice will have the right to control how the work is done; leading to a conclusion the worker is an employee. Workers who are part of the key activity of the practice are more likely involved in an employer-employee relationship due to the practice directive.

When determining if a worker is an employee or an IC, practices must look at multiple factors from each group. While using these factors will help a practice in making a determination, there is no exact formula that will give the company the answer. Each situation is different. Factors relevant to one worker may not be relevant to the next. The practice must look at the entire relationship and consider the directive rights of the company.

D. IRS Safe Harbor. In an effort to improve matters, the IRS in 1997 established a safe harbor (also known as Section 530) under which the IRS will not challenge a worker's status if the practice has:

- filed all required 1099-MISC forms reporting to the IRS the payments made to the workers in question;
- consistently treated the workers involved and others doing substantially similar work as ICs; and
- a reasonable basis for treating the workers as ICs.

Aside from the 1099 formalities (which requires the practice to treat ICs as such *ab initio*), the second requirement will prevent the practice from having employees and ICs doing the same job. Finally, the practice will need to show that treating its workers as ICs had a "reasonable basis." Some commentators have suggested that a practice demonstrate that ICs are common in the industry or that in other cases (or a previous audit) the IRS classified similar workers as ICs.

It will be difficult for veterinary practices to point to industry custom or other known cases, since the overwhelming norm is still to hire employees, not ICs (exception being relief veterinarians and visiting specialists). Deprived of an industry practice defense, veterinary practices will be forced to argue “reasonable basis” by returning, in some fashion or another, to the vagaries of the 20 factor test.

E. Tests Used by Other Agencies. As noted above, even if the IC relationship with the practice passes muster with the IRS, it can still run afoul of other federal and state agencies. While many agencies use the IRS 20 factor test (but emphasizing different factors) others use different tests, such as:

- examining whether a worker is economically dependent upon a hiring firm also known as the “economic reality” test); and
- focusing on: (1) whether the company controls the worker on the job; (2) whether the worker is operating an independent business; and (3) who determines where the worker will work (also known as the “ABC test”).

III. PUTTING IT TOGETHER

A. There are situations where the risks of using ICs appear minimal; for example:

- an animal hospital or large practice with a specialty. The specialists are not under the control of the hospital to any significant extent and, if their operations are properly structured, are basically running their own practice within a practice;
- a practice giving certain discrete tasks such as grooming or laboratory work to an IC (provided such IC is not working exclusively at that practice); and
- one or more enterprising veterinarians (who like to drive) joining together to provide temporary or emergency help to surrounding practices.

B. We don’t see veterinary practices under existing rules being able to successfully and consistently convince each auditing agency that a full time veterinary associate or technician is an IC because such personnel: (1) have no other “clients”; and (2) are subject to the control and direction of the practice owners. Let’s face it, most veterinary practice owners are control freaks when it comes to practicing veterinary medicine a certain way and maintaining diagnostic and therapeutic integrity and consistency. These are the very foundations of any serious veterinary practice. Given this reality, it’s hard to argue with a straight face that full time veterinary associates and technicians are “independent contractors.”