

Five IC Compliance Issues You May Not Know You Have

Compliance Officers are trained to lead companies through the labyrinth of government regulations. A good CO sees compliance issues in black and white, according to rules that are clear and well defined. Unfortunately, government regulations that determine whether a worker is reported as an employee or independent contractor (IC) are not clearly defined. To accommodate the myriad occupations and unique working relationships that exist, IC regulations are complex and very subjective. Even the most diligent COs, working with cooperative and well-intended workforces, can find their companies out of compliance.

This paper is not about the well-known IC compliance concerns COs expect to see. A solid IC compliance program that mandates appropriate business policies and rules would undoubtedly anticipate any “Top Ten List” of IC compliance issues, and have processes in place to inform and educate staff members about the company’s policies.

Instead, we have identified a number of lesser known, but statistically significant, compliance threats in our work evaluating more than 20,000 IC classifications over the last 15 years. In this paper, we describe five of those threats of which you may not be aware.

In general, these issues arise when ICs, in their exuberance to win your business, unintentionally compromise their independence, and when hiring managers look to solve a problem by working around an issue or skipping a step in order to expedite the process. While work ethic and resourcefulness are to be encouraged, in these cases, it can lead to non-compliance.

1. **ICs overstate the number of current clients they have.** The IRS questions whether an IC with only one client can be truly independent. Experienced contractors know this and will sometimes overstate the number of clients they have to pass this screening question. If this deception is uncovered in an audit, the IC and project classification will fail the IRS’s financial control test.
2. **Hiring Managers understate project billings.** Many companies reasonably forego a full evaluation process for projects below a certain dollar value. We have seen many Hiring Managers then intentionally understate their project’s value to avoid full evaluation of their ICs. When that happens, those classifications are invalid, and your company is out of compliance. The problem spreads when other Hiring Managers rely on that first evaluation to engage those ICs for other projects.
3. **ICs deliver services that are unrelated to their businesses’ charter.** The IRS is predisposed to consider businesses providing services as ICs. Eager contractors know this and will attempt to work under any business entity – even if that business is completely unrelated to the services they provide (ex. a graphic designer billing through a dry cleaner’s federal tax ID number). We have even seen Hiring Managers suggest this ruse to their ICs. The IRS considers this fraud and will almost certainly audit your company.
4. **A compliant IC working relationship evolves into a non-compliant Employee relationship.** The IRS believes that, over time, ICs tend to act more like employees, and Hiring Managers tend to treat ICs more like employees. The working relationship can

begin to exhibit any number of non-compliant tendencies. For the purposes of this paper, we only note that you should monitor relationships more closely as projects last longer.

5. **Former employees return as IC subcontractors.** A standard policy for many companies restricts former employees from returning as ICs within 12 months of their departure in a RIF or layoff. It seems many Hiring Managers mistakenly assume that engaging those workers indirectly – as a subcontractor for another vendor – avoids that restriction. In fact, to the IRS, the company that benefits from a worker’s services is responsible for the proper classification and treatment of that worker, regardless whether the worker is engaged directly or as a subcontractor.

How Can You Protect Your Company From These Threats?

Obviously, employees should be encouraged to find creative and expeditious solutions to problems. However, when staff makes decisions in an ad hoc manner, it can have devastating effects. To prevent problems like those described above, companies should:

- **Formalize process improvement.** Companies should be disciplined and methodical in how they monitor staff and IC behavior. Evaluate processes from their perspectives to identify the issues they face that lead to their misguided actions, and then fix them or better train your people to work through issues according to policy.
- **Employ a village.** From program design to implementation to ongoing management, involve your stakeholders in IC compliance. No one department will be able to identify and address every possible problem. For example, a Hiring Manager could not undervalue a project if both HR and Procurement were monitoring the program and communicating effectively.
- **Consider whether ICs are too valuable for a DIY compliance strategy.** ICs provide competitive advantage and are a critical component in the success of many companies. IC compliance should be a priority. However, the complex and subjective nature of government regulations are simply beyond the expertise of most HR departments while the penalties for non-compliance are too steep to risk. Fortunately, there are experts in the field, and when the total costs to implement and maintain IC compliance expertise are considered, their services are very affordable.

To learn more about the latest in IC compliance laws and legislation, contact the IC compliance experts at ICon: www.icontract.com