

MEMORANDUM

TO: Kay Love
City Administrator

FROM: Dan Roach
Human Resources Director

SUBJECT: Use of Independent Contractors

DATE: March 5, 2012

The purpose of this correspondence is to provide the legal/regulatory foundation we, and other employers, rest upon when utilizing independent contractors in the performance of the City's business, in lieu of regular, full-time employees of the City.

First and foremost, I would like to point out that this is an issue that has received much scrutiny in recent years from the Internal Revenue Service (IRS) and the U. S. Department of Labor (DOL). From an HR perspective, I would recommend priority consideration of an internal compliance audit of those situations in which we are currently using independent contractors, before we opt to further utilize this employment option. The regulatory agencies have broadly viewed this as an "overutilization" issue...one in which they feel employers and contractors are attempting to bypass wage/hour and taxation compliance.

The regulatory guidance addresses three main categories for consideration of whether an individual is an "independent contractor" or an "employee." **Behavioral Control** addresses the extent to which an employer can direct or control how the worker does the work. The greater the instruction, the more likely the individual is an employee, not an independent contractor. **Financial Control** addresses the extent to which the parties benefit and/or contribute from the financial aspects of the employment relationship. An independent contractor may have a significant financial investment in their business (i.e., the tools required to perform their jobs), may have unreimbursed expenses related to the work performed, and may have greater opportunity to realize profit or loss from the business relationship...the less these conditions apply, the more likely the individual is an employee and not an independent contractor. Finally,

Relationship of the Parties addresses how the parties perceive the relationship. Whether an individual receives insurance benefits (employee) or not (contractor) is the primary example used in assessing the relationship of the parties.

In the immediate case, I understand we have been asked about utilizing an independent contractor for project management duties in the Stormwater function within the Environmental/Public Works Department. Using the framework above, I would be concerned that the type of work being sourced would not lend itself easily to the definition of an independent contractor as, at a minimum, the nature of the work would suggest hands-on supervision by City staff (Behavioral Control). The pendulum would need to swing more in the direction of a virtually unsupervised expert, providing their own tools and equipment, who substantially controls the financial risk/reward of the relationship before I would feel at ease with the utilization of independent contractors, especially in the current regulatory environment.

Please let me know if I may provide additional information or clarification. Much of what I have provided here is detailed in IRS Publication 1779 entitled, "Independent Contractor or Employee..." as revised 08/2008. I would be pleased to provide copies of that publication, or respond to any questions you may have.

Thank you.