

CLASSIFICATION OF EMPLOYEES VS. INDEPENDENT CONTRACTORS

I. PURPOSE:

The City of Little Rock will hire individuals as full-time and part-time employees for its regular work force and to meet its short-term labor needs by hiring temporary employees. However, on occasion, in order to meet organization objectives, it may be necessary to consult with experts in a particular field and to engage individuals for specific periods and/or specific assignments to provide short-term expertise; therefore, engaging a wide range of outside service providers and consultants. Some of these service providers and consultants are corporate entities or partnerships, while others are sole proprietors or individuals. Depending upon a number of factors outlined in this guideline, a service provider may be classified by the City of Little Rock as an employee, subject to tax withholdings, or as an independent contractor, as defined by the Internal Revenue Service (IRS). Therefore, with respect to all service providers who are either individuals or sole proprietors, it is important that the City of Little Rock evaluate each service provider's relationship to the City of Little Rock to ensure that each service provider is properly classified as either an employee or an independent contractor. Federal and state laws govern when an employee-employer relationship exists in the workplace. Employers who fail to follow these guidelines and misclassify employees as independent contractors are subject to significant penalties under the law. This guideline is provided to ensure that the City of Little Rock consistently and fairly classifies its workers, complies with state and federal guidelines, and protects the City of Little Rock from penalties or other adverse actions.

II. RESPONSIBILITY:

The responsibility for implementation and monitoring of this procedure guideline rests with the Director of Human Resources. All City of Little Rock Department Directors are responsible for compliance with these procedures within their respective departments.

III. POLICY:

It is the policy of the City of Little Rock that the procedures presented in this guideline must be followed prior to selecting an individual or sole proprietor as an independent contractor. In the event that a City of Little Rock Department fails to comply with this procedure guideline and if, at a later date, an IRS auditing authority determines that employee status should have applied to the service provider, all taxes, penalties and interest assessed to the City of Little Rock will be charged to the respective department. Individuals and Sole Proprietors will not be setup as vendors for payment for services performed as independent contractors until the Employee/Independent Contractor Determination Form and/or Vendor Request Form has been reviewed and approved by the Department of Human Resources.

The City of Little Rock shall not contract with City employees for goods or services without recommendation and approval from the City Manager (CLR Purchasing Manual, Section VIII. Item K.)

Violation of this procedure guideline or failure to timely cooperate in complying with its provisions by the departmental representative responsible for acquiring services on behalf of the City of Little Rock may result in disciplinary action up to and including termination.

IV. PROCEDURE:

A. General

It is incumbent upon the department acquiring the services of a service provider to complete the Employee/Independent Contractor Determination Form (see attached form) and send the form to the Department of Human Resources for review and determination prior to soliciting the needed services. The department should allow sufficient time for the review process to ensure there are no payment delays and that the City of Little Rock is in compliance with IRS regulations.

B. Guidelines

Review the following guidelines and example scenarios to identify the differences between an employee and an independent contractor.

1. **Primary considerations for the determination of whether a service provider is an Employee or an Independent Contractor:**

The determination of whether a service provider is an employee or an independent contractor depends upon the facts and circumstances of each case. In general, the more control the City of Little Rock has over a service provider, the more likely it is that the service provider is an employee rather than an independent contractor. Details that provide evidence of the degree of control and independence fall into three (3) general categories: **behavioral control, financial control, and the nature of the relationship between the parties.**

- a) **“Behavioral control”** relates to whether the City of Little Rock has a right to direct and control how the service provider performs the task for which they are hired. In general, anyone who performs services for the City of Little Rock is an employee if the City of Little Rock has the right to control how the work will be done.
- b) **“Financial control”** looks at whether a service provider incurs financial risk or has the ability to make financial decisions in connection with the services performed.
- c) **“Relationship between the parties”** looks at whether the parties operate independently of one another.

2. Detailed Considerations for the determination of whether a service provider is an employee or an independent contractor:

The following twenty (20) factors have been identified by the IRS as criteria to assist in determination of **employee status** or **independent contractor** status:

- a) **Instructions:** An employee must comply with instructions given about when, where and how to work. Even if no instructions are given, the control factor is present if the employer has the right to give instructions.
- b) **Training:** An employee is trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
- c) **Integration:** An employee's services are integrated into the business operations because services are important to the success or continuation of the business. This shows that the employee is subject to direction and control.
- d) **Services Rendered Personally:** An employee renders services personally. This shows that the employer is interested in the methods as well as the results.
- e) **Hiring Assistants:** An employee works for an employer who hires, supervises and pays assistants. An independent contractor hires, supervises and pays assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.
- f) **Continuing Relationship:** An employee has a continuing relationship with an employer. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.
- g) **Set Hours of Work:** An employee has set hours of work established by an employer. An independent contractor is the master of his or her own time.
- h) **Full Time Work:** An employee normally works full-time for an employer. An independent contractor can work when and for whom he or she chooses.
- i) **Work Done on Premises:** An employee who works on the premises of an employer, or works on a route or at a location designated by an employer.
- j) **Order of Sequence Set:** An employee must perform services in the order of sequence set by an employer. This shows that the employee is subject to direction and control.
- k) **Reports:** An employee submits reports to an employer. This shows that the employee must account to the employer for his or her actions.
- l) **Payments:** An employee is paid by the hour, week or month. An independent contractor is paid by the job or on a straight commission.
- m) **Expenses:** An employee's business and travel expenses are paid by an employer. This shows that the employee is subject to regulation and control.
- n) **Tools and Materials:** An employee is furnished significant tools, materials and other equipment by an employer.
- o) **Investment:** An independent contractor has a significant investment in the facilities and tools that he or she uses in performing services for someone else.
- p) **Profit or Loss:** An independent contractor can make a profit or suffer a loss.
- q) **Works for More Than One (1) Individual or Firm:** An independent contractor can give his or her services to two (2) or more unrelated individuals or firms at the same time.
- r) **Offers Services to the General Public:** An independent contractor offers similar services to the general public.
- s) **Right to Fire:** An employee can be fired by an employer. An independent contractor's services can only be terminated pursuant to the terms of the contract.
- t) **Right to Quit:** An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it.

3. Employee vs. Independent Contractor (examples):

- a) **Example One:** Ann Thompson is a Manager with the City of Little Rock who would like to teach zumba classes part-time at the Fitness Center. This is allowable; however, the employee should be paid as an employee for both assignments and the primary department for this employee would coordinate the hours worked with the secondary department. Under no circumstances should a current employee be paid as an independent contractor for goods or services without recommendation and approval from the City Manager. Ann Thompson is an **employee**.
- b) **Example Two:** Sarah Jones is a former employee of the City of Little Rock. She now owns a catering business, and the City of Little Rock would like to hire her to cater an event. Since the City of Little Rock does not have a catering service and she is no longer an employee of City of Little Rock. Sarah Jones is an **independent contractor**.
- c) **Example Three:** William Brown has an oral agreement with the City to do carpentry work on any house designated by the City. He supplies his own tools, and the City supplies the material for each job. He must complete the work himself and he works on a full-time basis for the City. For some work he is paid on a piecework basis and for some he is paid on an hourly basis. He has no assistants, does not have an office and does not advertise in newspapers or otherwise hold himself out to the public as being in the carpentry business. The City can discharge him at any time before he finishes a job without contractual liability. William Brown is an **employee** of the City.
- d) **Example Four:** Ron Smith, a mason, has an oral agreement with the City to face a building with brick. The City supplies all material for the job, and he supplies only his hand tools. He must complete the work himself and is paid on an hourly basis. The City employs two (2) other masons on the job, who are supervised by Mr. Smith. Detailed supervision over him is neither necessary nor warranted due to his skill in the work. He can quit the job at any time, and the City can discharge him at any time. He has no investment of proprietary interest in a business that offers these services to the public. Ron Smith is an **employee** of the City.
- e) **Example Five:** The City enters into a contractual agreement with Webster Consultants, Inc. for the services of Mr. Terry Jones. The contract is for a fixed fee and does include for reimbursement of travel expenses not to exceed a predetermined limit. Mr. Jones will provide an analysis of the proposed benefit programs before the City Board of Directors. The City is one of many clients represented by Mr. Jones. If for any reason Mr. Jones is unable to perform such services, Webster Consultants, Inc., has an obligation to replace Mr. Jones with another one of their employees. Webster Consultants, Inc., is an **independent contractor**.

C. Required Procedure

After review of the guidelines and examples provided above, and you feel that the needed service will be provided by an independent contractor, the following process must be initiated prior to soliciting a service provider.

Initial Determination

- Step 1** The departmental representative most familiar with the service to be provided must complete the Employee/Independent Contractor Determination Form with all available information and required signatures before the service is solicited.
- Step 2** The completed Employee/Independent Contractor Determination form must be submitted to the Department of Human Resources for an **initial** review and determination to confirm that the information provided demonstrates that the service to be provided meets the requirements for classification as either an employee or independent contractor.
- Step 3** The Department of Human Resources will notify the department of the determination status via email or written correspondence.
- Step 4** If the Department of Human Resources determines that the service provider should be compensated as an employee, the departmental representative responsible for the work to be performed should contact the Department of Human Resources to initiate the employment process.
- Step 5** After the initial review, if the Department of Human Resources determines that the service to be provided meets the requirement for treatment as an independent contractor the process of selecting a service provider may be initiated.

Final Determination

This step is only required if you are selecting a service provider through a formal or informal bid process. Once a service provider is selected, a new Employee-Independent Contractor Determination Form must be completed and submitted to the Department of Human Resources for review and final determination. If the Department of Human Resources determines that the selected individual should be compensated as an employee, refer to Step 4 above. If the Department of Human Resources determines that the selected individual meets the requirements for treatment as an independent contractor, the requesting department should obtain the City Manager's authorization for legal review of the contract by the Office of the City Attorney. A copy of the final Employee-Independent Contractor Determination Form approved by the Department of Human Resources must be submitted to the City Manager with the request for legal review of the contract.

A copy of the final Employee-Independent Contractor Determination Form approved by the Department of Human Resources must be attached to all applicable invoices and requisitions submitted to the Department of Finance for payment.

Approved:

Bruce T. Moore
City Manager