

Managing Co-Employment Risk When Using a Staffing Agency

Prepared by Aquent

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Please note: The information contained in this white paper is intended to provide useful information on the topic covered, but should not be construed as legal advice or a legal opinion.

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Introduction

Co-employment is an important issue for any company using long-term contractors.¹ In 2000, Microsoft's \$97 million settlement for benefits liability to the contract workers who provided services from 1987 to 2000 raised co-employment awareness nationally. To limit exposure to co-employment benefits risk, companies have enacted various policies for using contractors such as placing time limits on their use, rotating staffing firms, etc.

However, these policies don't get to the crux of the co-employment issue, but rather, underserve the companies that need long term contractors. A solid understanding of both co-employment and how to work with a staffing firm to best handle this issue is an important step in managing risk.

This paper will address these points by defining co-employment and co-employment liability as they relate to benefits, discussing the implications of the *Microsoft* case, and suggesting ways to lessen co-employment risk when using a staffing agency.

¹ By "contract workers" or "contractors," we are referring to "temporary workers," "temps," and "freelancers" who work through a staffing firm.

Co-Employment Defined

Co-employment is defined as “a relationship between two or more employers in which each has actual or potential legal rights and duties with respect to the same employee.”² In a single employer/employee relationship, the employer bears certain responsibilities to employees, including paying wages, overtime pay, and taxes; providing worker’s compensation, benefit, and pension plans; and ensuring civil rights compliance, appropriate labor/management relations, and a safe work site. In a co-employment situation, these responsibilities may be shared.

Co-employment is inherent in the staffing firm/client relationship; since both have sufficient contact with an assigned employee, each company will be viewed as an employer. Generally, in this sort of relationship, the staffing firm is viewed as the “primary employer” and bears most of the responsibility for the employee. The following chart lists the duties of each.³

THE STAFFING COMPANY	THE CLIENT
Pays the employee	Supervises and directs day-to-day work
Pays and withholds payroll taxes	Controls working conditions at the work site
Provides workers’ compensation	Ensures a safe work site, including civil rights compliance by employees
Provides benefits and pension plans (if applicable)	Determines the length of the assignment
Ensures civil rights compliance	
Has the right to hire and fire	
Hears and acts on complaints from the employee about working conditions	

Co-employment: a relationship between two or more employers in which each has actual or potential legal rights and duties with respect to the same employee.

² As defined in Edward A. Lenz’s *Benefits & Compensation Solutions*, September 1995.

³ Lenz, Edward A. and Dawn R. Greco, *Co-Employment: Employer Liability Issues in Third-Party Staffing Arrangements (Sixth Edition)*, Alexandria, VA: American Staffing Association, 2007, p.19.

Co-Employment Issues

Co-employment issues arise when the client company extends its control beyond the staffing firm/client division of tasks and takes on the role of the primary employer, as specified in the “common law” test.⁴

The IRS and many state statutes use the “**20-factor**” or the “**common law**” test, a checklist of 20 criteria, to identify the degrees of behavioral and financial control a company has over an individual to determine employment status.⁵ If a contractor meets the majority of the criteria in the common law test and the client is found to be the primary employer, the contractor becomes their “common law employee” and the client will bear greater liability for that contractor. This was the issue in the *Microsoft* case.

Common law test: a checklist of 20 criteria used by the IRS to determine employment status by identifying degrees of behavioral and financial control a company has over an individual. A company must include common law employees in its employee population to qualify for certain tax breaks in a qualified benefits plan.

THE MICROSOFT CASE

Vizcaino v. Microsoft involved individuals who performed services for Microsoft between 1987 and 2000. Most of these were long-term contractors—both independent contractors (ICs) and employees of staffing firms—who performed the same or similar job duties for the same supervisors as Microsoft employees, and who met many of the criteria for employee status as described in the common law test.⁶

The workers filed suit in 1993, claiming benefits from Microsoft on the grounds that 1) they were really the company's common law employees and 2) the IRS had reclassified them as employees, so they were thus entitled to participate in Microsoft's stock purchase plan (SPP), its 401(k) plan, and other benefit plans. When a company has a qualified benefits plan,⁷ it must include common-law employees in its employee population to qualify for certain tax breaks, and those common law employees are then covered by the qualified benefits plan. The 9th U.S. Circuit Court of Appeals in San Francisco sided with the workers, and Microsoft agreed to pay \$97 million to settle the lawsuit.

⁴ This paper discusses the common law test, or 20-factor test, used by the IRS. Not all state statutes adopt this test. Different tests may determine co employment liability or obligations under varying state laws, such as state workers' compensation, unemployment benefits, and wage and hour laws.

⁵ Appendix A lists the 20 factors that the IRS uses to determine worker status.

⁶ The two classes of workers were 1) those who worked directly for Microsoft from 1987 to 1990 as independent contractors (ICs) and 2) those who were employed by staffing firms after the IRS reclassified them as Microsoft employees for tax purposes in 1990 (Lenz, p. 39).

⁷ A company can qualify its benefit plans—e.g., its pension plans (401(k) plans, etc.—to get certain tax benefits if it can prove that it is allocating benefits fairly (i.e., don't discriminate in favor of high-paid employees). These are called “qualified plans.” To qualify, a business needs to pass a “coverage test” where it proves that it is providing sufficient benefits to a given percentage of low-paid employees. The Internal Revenue Code 414 states that “leased employees” (see Definitions in Appendix A) must be included in the employee population of the coverage tests.

The settlement was based on a measurement of what would have been the workers' benefits under the company's discount SPP, a component of the total benefits package. The settlement did not provide for a 401(k) plan or other benefits because the wording of these plans expressly excluded ICs and staffing firm employees from participating in these plans. The SPP was valid because it was a qualified plan and therefore extendable to all employees, including common-law employees.

Other companies have faced lawsuits from ICs and staffing firm employees claiming entitlement to participate in company benefit plans in the wake of the *Microsoft* settlement.

The lessons learned from the Microsoft case are:

- Companies should clearly set forth in their contracts with ICs and with staffing agencies that the ICs and the agencies' employees are excluded from participation in company benefit plans.
- Company benefit plans and benefit documentation should explicitly exclude ICs and staffing firm employees from eligibility to participate in benefit plans.⁸
- Companies should avoid controlling the manner and hours of performance put forth by ICs and employees of staffing firms so that these individuals do not become common law employees.
- Companies should consider offering only nonqualified SPPs.⁹

Companies may lessen the risk of a "Microsoft problem" by offering a nonqualified stock purchase plan, by including clear language in all of its benefit plans excluding ICs and staffing firm employees, and by avoiding control of the performance of such persons.

⁸ Both ERISA and TAM permit exclusionary language in a benefits program as long as it is not discriminatory.

⁹ This is because the IRS rules applicable to those plans require that virtually all employees be covered.

Managing Co-Employment Risk

In an effort to avoid the risk of co-employment, some companies limit the length of service of a contract worker to under 1,500 hours over 52 weeks. Some of these policies are based on the belief that such workers are automatically eligible for coverage under the company's plan after a certain period of time, which is not true. In fact, assignment limits may even carry some risk of violating ERISA if they are construed as an unlawful effort to prevent workers from reaching the hours needed for plan participation.¹⁰ In addition, "churning"¹¹ workers is inefficient and not a good solution for companies with long-term temporary staffing needs.

Limiting a contract worker's hours to avoid benefits liability is not a good solution for companies with long term temporary staffing needs.

So, what should a company do to minimize co-employment risk? Here are some recommendations:

- **Cover your legal bases.** Review—with experts—agreements with all staffing agencies and independent consultants to establish the boundaries of the relationship, responsibilities, liabilities, etc.
- **Have contract workers sign contracts and waivers.** It's a good idea to have all contract workers sign a document stating that they are employees of the staffing firm and that they waive any claim to compensation or benefits from the client. Legal counsel should be consulted when drafting these agreements because the language of the contracts and waivers needs to be specific to the client and the benefits it provides.
- **Have company benefit plans explicitly exclude contract workers, or have nonqualified plans.** The IRS upheld that companies can use exclusionary language in their benefit plans as long as it is non-discriminatory. Therefore, companies can explicitly exclude temporary staff and independent contractors in their benefits wording. Alternatively, companies can have components of their benefits plans, such as SPPs, that are nonqualified. All wording, however, should be reviewed by legal counsel.
- **Work with reputable staffing firms.** Ensure that the staffing firm plays an active role in maintaining primary employer status. Validate that the firm is financially sound, up to date with all their workers' compensation and unemployment coverage, and knowledgeable about all aspects of its business.
- **Have the staffing company control certain tasks and maintain its employer status.** While client day-to-day supervision may be unavoidable in the staffing firm/client relationship, it should be minimized when possible. Thus, in addition to issuing paychecks, withholding employment taxes, and providing required insurance, the staffing firm should handle the following:

¹⁰ (Lenz, p. 44). Limiting a contract worker's hours to avoid benefits liability is not a good solution for companies with long term temporary staffing needs.

¹¹ "Churning" is when a company hires a contract worker for a limited period and then hires another to take his or her place.

- > Interview, test, hire, and fire
 - > Assign and reassign
 - > Set pay rates and benefits
 - > Negotiate with clients regarding the nature of the work, the hours, duration of the assignment, and working conditions
 - > Maintain general supervisory responsibilities regarding performance, discipline, and complaints
 - > Evaluate performance and provide counseling
 - > Provide general training¹²
- **Have the staffing firm provide on-site supervision when hiring a large number of contractors for an extended period.** It is natural for supervisory lines of control to become blurred on long-term assignments. Contract workers are more inclined to get training through the client, attend status meetings, and so on, and supervisors are more likely to give direct feedback, administer performance reviews, etc. To minimize this risk, the client should have the staffing firm provide a project manager or supervisor on site to supervise the contract workers. This drastically reduces co-employment risk, as it reinforces that the staffing firm is the primary employer, and it is a better option than limiting the contract workers' tenure.¹³

DECREASE CO-EMPLOYMENT RISK BY:

- Covering your legal bases
- Working with reputable staffing firms
- Having staffing firm provide on-site supervision, especially if you work with a large number of contract workers from that agency
- Minimizing contact with contract workers wherever possible and having them take up issues directly with staffing agency
- Avoiding discriminatory conduct
- Maintaining a safe work site for all employees

¹² Work-site-specific orientation and training should be done by the client.

¹³ "Merely providing nominal supervision...by designating one of the workers assigned as the supervisor will not negate the customer's co-employer status" (Lenz, p. 86). As such, the company should make sure that this on-site project manager/supervisor signs an agreement that states that he or she is an employee of the staffing firm who is acting on behalf of the staffing firm to monitor and supervise the other staffing firm employees, and that he or she waives any rights to benefits from the client. Legal counsel should be consulted when drafting this document.

Conclusion

By utilizing these guidelines, companies can minimize their exposure to co-employment risks. Co-employment is a natural element of the staffing firm/client relationship, and by managing it effectively and proactively, companies can maintain their long-term contractors and reap the benefits of a flexible work force.

About Aquent

Aquent is the world's largest marketing, creative, and interactive staffing firm, with 74 offices in 19 countries. We're a solid, fully-insured, privately-owned company with revenues of more than \$460 million. Aquent can help you avoid co-employment risk in several ways.

Aquent takes great care to maintain its primary employer status. We take significant measures to ensure that we maximize behavioral and financial control over our talent to limit your co employment risk. To do so, we provide the following services:

- **Rigorous screening.** All of our agents are well-trained in Aquent's qualification process, which includes behavioral interviewing, skills assessments based on real-world projects, and thorough reference checking.
- **Assigning the right talent for the job.** Our agents strive to understand both your project and cultural needs in order to make the most appropriate match. We have a 110% guarantee if you are not satisfied.
- **Financial control and thorough recordkeeping.** We handle all financial matters by taking care of payroll, taxes, reimbursable expenditures, and more. We also maintain extensive employee profiles as part of our employee records management system.
- **Proactive management of talent performance and career planning.** We provide constructive feedback to talent, manage performance issues, and remove and reassign talent if necessary. We handle questions and concerns from the talent and help them manage their career goals.
- **Benefits for talent.** We provide and contribute to a comprehensive benefits plan that includes 401(k); health, dental, and vision insurance; holiday pay; vacation pay; and more.

We provide project outsourcing for clients who want to contract out all or part of their creative services, marketing, or content development projects. Our team scopes the job, designs the solution, manages the work, and delivers according to client specifications. Work can be done on- or off-site, or even offshore, depending on your needs. In essence, clients enjoy the benefits of a design studio or ad agency without the associated costs or long-term commitment.

Aquent is committed to partnering with our clients to manage co employment risk. If you have any questions about our services, please contact an Aquent agent at an office near you—**877 2 AQUENT** (877 227 8368).

Appendix A: IRS 20 Factors Checklist

The IRS has a checklist of 20 factors to determine worker status. Often referred to as the “common law” test of employment, this test establishes the degree of direction and control a company has over workers. To help clarify the IRS checklist, here are 20 questions to ask yourself when attempting to determine whether an individual is an employee or a contract worker.

20 FACTORS FOR DETERMINING WORKER STATUS

- **Instructions.** Who gives them, and must the worker obey them? A worker who must obey company instructions about how to perform the job is usually determined to be an employee of the company.
- **Training.** Who trains the employee? An independent contractor comes to a company fully trained.
- **Integration.** How integrated is the employee’s work with the operations of the company? The closer the relationship between the work of the company and the work of the worker, the more likely the worker is an employee.
- **Services Rendered Personally.** Does the job need to be performed by a specific worker? If the company demands that services be performed personally by the worker, this shows control by the company over the worker, which makes it more likely that the worker is an employee.
- **Hiring, Supervising, and Paying Assistants.** Who hires, supervises, and pays a worker’s assistants? If a company hires, supervises, and pays a worker’s assistants, this also shows company control, making the worker most likely an employee.
- **Continuing Relationship.** Does a continuing relationship exist between the worker and the company? A continuing relationship between worker and company tends to show an employer/employee relationship.
- **Set Hours of Work.** Is the worker required to work set hours? Independent contractors have the freedom to plan their own work day.
- **Full-time Work.** Is the worker required to work full time? An independent contractor should be free to accept or reject a job offered by the company.
- **Place of Business.** Does work need to be done on the premises? An independent contractor should possess his or her own place of business separate from the company.
- **Work Schedule.** Does the worker need to follow certain established routines and schedules? An independent contractor will set his or her own work schedule.
- **Reports.** Is the worker required to submit reports, and if so, to whom? Employees are often required by employers to turn in reports, a practice that is viewed by the IRS as evidence of control.
- **Method of Payment.** Is the employee paid by the hour, week, month, or in a lump sum? Payment to independent contractors should be by the job, rather than by the day or by the hour.

- **Business/Travel Expenses.** Who pays for any travel expenses? An independent contractor should pay for all of his or her own expenses.
- **Furnishing Tools, Equipment, and Materials.** Who covers the cost of a worker's tools, materials, or equipment? If a company covers the cost of a worker's tools, materials, or equipment, independent contractor status is weakened.
- **Significant Investment.** What degree of investment does the worker have in his or her own business? The larger the worker's investment in his or her own business, the more likely the IRS will accept independent contractor status.
- **Realization of Profit or Loss.** Does the worker bear profit or loss responsibility? An independent contractor should be capable of either realizing a profit or suffering a loss.
- **Working for More Than One Company.** Does the worker have a diverse client base? Independent contractor status is strengthened when a worker has a diverse and significant client base. However, a worker can perform services for several companies and still be classified as an employee at one or all of them.
- **Making Services Available to the General Public.** Does the worker make himself or herself available for other jobs? An independent contractor's name should be advertised or held out to the general public as being in business for himself or herself.
- **Right to Discharge.** Who holds this right, and is there a notice requirement? While an employer may discharge an employee, parties to an independent contractor agreement typically have an obligation to terminate their contract according to a notice requirement.
- **Right to Quit.** Can the worker terminate without incurring liability? If a worker can terminate employment with a company at any time without incurring liability, it suggests an employee-at-will relationship. An independent contractor, on the other hand, cannot simply walk away from a contractual relationship with a company.

Source: CCH Incorporated, as found on <http://www.workforce.com/archive/feature/22/14/96/224209.php?ht=> with slight modifications

Appendix B: Employee or Independent Contractor?

The following article provides further clarification on how the Internal Revenue Service (IRS) interprets the 20 Factors in behavior control and financial control.

EMPLOYEE OR INDEPENDENT CONTRACTOR?

An Explanation from the IRS

To determine whether an individual is an employee or an independent contractor under common law, the relationship between the worker and the business must be examined. All evidence of both control and independence must be considered.

In any employee/independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered. Facts that provide evidence of the degree of independence fall into three categories: behavioral control, financial control, and the type of relationship between the parties.

1) BEHAVIORAL CONTROL

Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include:

- **The type and degree of instructions the business gives the worker.** An employee is generally subject to the business's instructions about when, where, and how to work. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to direct how the work results are achieved.
- **The type and degree of training the business gives the worker.** An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

2) FINANCIAL CONTROL

Facts that show whether the business has a right to control the business aspects of the worker's job include:

- **The extent to which the worker has unreimbursed business expenses.** Independent contractors are more likely to have unreimbursed expenses than employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially significant. However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.
- **The extent of the worker's investment.** An independent contractor often has an investment in the facilities that he or she uses in performing services for someone else. However, an investment is not required.
- **The extent to which the worker makes services available to the relevant market.**
- **How the business pays the worker.** An employee is generally paid by the hour, week, or month.

An independent contractor is usually paid by the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

- **The extent to which the worker can realize a profit or incur a loss.**

3) TYPE OF RELATIONSHIP OF THE PARTIES

Facts that show the parties' type of relationship include:

- **Written contracts describing the relationship that the parties intended to create.**
- **Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.**
- **The permanency of the relationship.** If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was to create an employer/employee relationship.
- **The extent to which services performed by the worker are a key aspect of the regular business of the company.** If a worker provides services that are a key aspect of your regular business activity, it is more likely that you'll have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely to present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer/employee relationship.

IRS HELP

If you want the IRS to determine whether a worker is an employee, file **Form SS-8 Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding** with the IRS.

Source: IRS, Workforce Extra, December 1998, pp. 12-13.

Appendix C: Additional Resources

For more information regarding co-employment and other HR issues, refer to the following:

BOOKS

Co-Employment: Employer Liability Issues in Third-Party Staffing Arrangements (Sixth Edition) by Edward A. Lenz. Published by the American Staffing Association, 2000.

The facts on this important and complex issue and how it affects staffing businesses. Includes detailed discussions on workers' compensation, taxes, ADA, OSHA, etc.

WEBSITES

<http://www.workforce.com>

<http://www.hr-today.com>

<http://www.staffingtoday.net>

The American Staffing Association's website contains useful information on staffing issues, including different employment options, such as outsourcing that companies might consider. Its search function can help you find more articles on co-employment and other HR-related issues.

<http://hr.cch.com>

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