



# Flexibility in a Changing Economy

## Hiring A-List Contract Employees

When headcount constraints impede critical project completion, professional contract employees help finish the job. The case for contractors and flexibility.

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### Introduction

In most cases, when company management is asked what the most valuable asset in the company is, they respond “our people.” And they are right. Sometimes this relates to the specialized skill sets of the staff; other times this is based on knowledge and experience. Regardless of how that value is determined, the critical nature of how talented employees are identified, recruited, and retained remains a constant concern for today’s companies—especially with the decreasing years of average tenure at many companies.

Even with all the investment in providing a sound strategy for building a strong team, there are still opportunities to do more. Certainly, many companies conduct recruiting fairs, post their jobs on boards, and institute a consistent interviewing process. This age-old process can breed great results, but often it is not enough when searching for the best experience in the industry.

Many employers are concerned with the risk taken when bringing on new people with only references representing their past work and a few meetings during the interviewing stage. In some scenarios, this is the only option for filling a critical role in a company, but in many cases, the best way to mitigate risk of a bad investment is to contract the personnel first. Contract-to-hire has become the best approach to give both the company and the new employee a chance to understand what each offers for the long term. This is the best “reference” of all.

### Background

It has become commonplace for many of the human resource savvy employers to leverage the option of using contract labor. More than two million people work as temporary employees in the United States, according to the U.S. Bureau of Labor Statistics. This

includes independent contractors, on-call candidates, freelance, and temporary or part-time workers.

On the surface, the hiring process is fairly simple: a contractor is brought in when a position becomes available and works for a period of time before they are either offered a full-time position or let go. Naturally, all the best screening processes are still required, both during the recruitment stage and during the first several months of employment. Companies can utilize similar evaluation techniques used for permanent employees.

For contract-to-hire employees, management requires a laser-tuned focus to make a long term decision within three to six months of engagement. Many companies use some form of a requirements checklist that the contractor must demonstrate by the end of their term. The checklist is based on the critical knowledge and results expected for the position. As long as the checklist is realistic, the process is almost automated. The goals must be achievable in a short period of time and the knowledge must be industry standard, not necessarily company specific (although, the ability to retain new knowledge should also be evaluated).

### **Advantages for Companies**

The advantages of hiring contract employees address many typical hiring manager concerns. One key advantage is he or she makes a more informed decision about offering the candidate a full-time position, while covering all key functions in the meantime. Statistics indicate that the likelihood is high that the contract employee will turn permanent when expectations and long-term vision is communicated during the contract period. In fact, over 70 percent of temporary employees surveyed by the American Staffing Association obtained permanent positions with the employer after a contract period. Although many talented candidates are looking for permanent positions,

they are willing to offer their services on a contract basis in hopes of proving their worth and landing the permanent role.

Bringing in a temporary worker also provides the manager with an opportunity to observe the applicant's personality. Many companies identify cultural fit as a key concern in hiring candidates. Recruiting firms and some companies employ testing and/or involved screening for addressing this aspect. As good as these tools are, nothing beats observations that can be made of a candidate in the environment they could be working in long-term.

This trend toward using contract employees is growing, in part, due to several other advantages:

**Cost** – There is a significant savings of payroll administration and fringe benefit costs. Generally, hiring an employee adds another 30 to 40 percent to the salary or hourly rate due to workers compensation, benefits and other expenses. In many cases, there is also an overhead cost of employing people.

Companies can also save on cost-per-hire and the “opportunity costs” associated with making a bad hiring decision. Many of the on-boarding costs of a permanent hire are not as obvious or have specific line items on the balance sheet. Time to train new employees is not just classes or books—it is the time peers and managers spend helping the employee get in tune with processes, tools, and procedures unique to each company. If a permanent employee must be let go (often times much later than six months from the onset), all the investment in time is lost. Although contractors require some training, they typically receive a very concise subset of the permanent hire’s training until they require more. With the focused task they have, they

may not need as much company procedure and policy and other generalized training.

There is also some cost avoidance when a candidate does not work out in the area of “exit costs.” Permanent employees typically require adequate performance reviews/documentation to ensure all opportunities were given to the employee to meet job requirements. There may also be severance pay, outplacement services, and payment of accrued bonuses.

On-going time considerations are advantages, too. Companies do not need to manage the day to day activities of contract help nearly as much. This is a welcome benefit for managers at smaller businesses as many tend to be lean on managers. For permanent hire employees, these managers will have to devote more time to ongoing day to day management of overseeing work assignments, handling performance issues, and training. The oversight of a contractor can be “outsourced” to the placement firm. These days, time is a critical asset, and has a cost both financial and economic (opportunity cost).

**Quick recruitment** – An additional time-related benefit is the ability to reduce the amount of time spent recruiting. Often, talented contract candidates can be found quickly and evaluated within whatever time period a company wants. The hiring process does not have to be lengthy since the risk of making a long-term mistake is removed. If a contract worker does not meet the qualifications, it can be remedied quickly. One option for ensuring quick recruitment is to establish a strong relationship with a service provider or recruiting firm who specializes in placing contractors in your type of business. Once this service provider knows the company culture, typical requirements, and selling points to working there, it can readily and continually provide good candidates for consideration.

**Flexibility** – In some cases, the needs of the company are centered on a specific project at first and evolve to a longer engagement later. Contract-to-hire allows for the immediate project to be started and can easily migrate to long-term employment, if needed.

In addition to project work, contractors can be ideal in other situations where flexibility is necessary:

- When a business is growing but still has uncertain future revenues, the budget may not be able to justify hiring a “permanent” employee.
- During economic downturns – it is easier to turn the switch on and off for a contractor when expenses need to be reduced and headcount contained. Terminating a permanent employee has more emotional, legal and financial difficulties.

Another flexibility advantage with offering project-centered roles relates to fluctuations of available staff. Many companies face periods when the team is temporarily unavailable due to popular vacation periods or other time-off options. The void filled by hiring a temporary worker can relieve the strain placed on the remaining staff. This candidate now becomes a possible replacement for a current full-time employee should one ever leave the company. As a double bonus, since the candidate already had worked at the company, their integration into the new job would be seamless.

**Specialized needs** – If a highly specialized skill is needed, especially for a short time, a contractor is ideal. Often small to medium-sized businesses find it difficult to hire subject matter experts as employees at the start of an engagement since their budgets are tight and therefore lean towards hiring employees with more broad experience.

## Advantages for Candidates

Contact-to-hire can benefit the employee as well. Just as the company gets to evaluate the candidate without the long term commitment, a contract employee gets to “test drive” the company.

The benefits of this extend past the obvious. Many candidates are sensitive to having a short “permanent” engagement on their resume (raising questions as to why this position was terminated so quickly). With contract-to-hire positions, candidates can state the engagement as a contracted relationship and not an expected long-term assignment or role.

There are several other benefits, as well. They also can have more control over their schedule and type of assignments.

Where relocation may be required, a contract-to-hire team member may be able to work remotely during the contract phase of the relationship before making the commitment to move to a new location. Some contract employees enjoy a higher rate of compensation. Often times, people choosing contract work do not need the same benefits or pay structure as permanent hires.

Savvy companies who are aware of and leverage these advantages for the candidates can be very successful in recruiting the “A-List candidates.”

## Which Positions to Contract

Contract-to-hire personnel can be used for many positions, and in some cases, strictly contract personnel are appropriate. Companies should consider a few aspects when making this decision.

**Type of work** – The more independent the role is, the more easily it can be contracted. In many cases, contractors can work remotely. This can be another cost savings with no immediate relocation costs or overhead. Many roles are

naturally independent, such as marketing, some types of sales, application development, web site design/maintenance, and bookkeeping.

Newer or smaller companies often have needs that do not yet require a permanent resource like a full-time marketing specialist. In this case, when a certain level of growth has been attained and a company begins allocating a significant percentage of its revenue to marketing, converting a contractor to a permanent position may be warranted.

**Cost differences** – As discussed previously, cost is typically a big advantage for contracting personnel. The direct and indirect costs associated can vary depending on position. Therefore, companies need to assess the anticipated deltas and weigh this against the other aspects in the decision. The following example compares the actual yearly cost for hiring a .NET programmer, as opposed to outsourcing to a contractor.

The rate for this type of contractor may be \$75 per hour. Assuming the contractor works 40 hours per week, over a year the actual cost would be: \$75 x 40 hours per week x 50 weeks = \$150,000. In many cases, contractors are not paid for their vacation time. Of course, there are no benefits or company overhead to consider.

The salary of an in-house programmer could easily be \$95,000 (including paying for two weeks of paid vacation valued at \$3,654). In order to calculate the actual cost of the in-house employee, the benefits need to be added in which usually total about 30 to 40 percent of salary. In most cases, in-house overhead (usually about 35 to 50 percent of salary) needs to be considered, too. Assuming the low end for these additional costs, this brings the actual cost of a permanent employee up to \$156,750. This calculation is conservative

and does not include the costs of making the wrong hiring decision as discussed earlier.

**Quality/type of work needed** – When a high level of quality (or specialization) is required, the salaries demanded by candidates increase dramatically. Sometimes these candidates prefer the security of a steady paycheck and benefits. Often times, the candidate will initially have benefits if working through a recruiting firm/service provider and will still have a potential long term opportunity with the company. The contract-to-hire option can work very effectively in locating a skilled individual, then hiring the person at an appropriate salary when both parties see the clear advantages to a longer term relationship.

### **IRS Considerations**

Companies structuring the hiring arrangements with candidates on their own must be careful in differentiating an individual as a contractor versus permanent employee. The IRS has special considerations for addressing this issue. Many top-notch companies have had costly legal action taken against them because they have not followed the IRS guidelines. In the Addendum, information is provided that covers the complex analysis required for this determination.

One way to minimize risk of incorrectly categorizing an employee is to hire contractors who work for another company that is in the business of being a service provider. That way the company is hiring contractors who truly arrange their work as contractors, not as employees in disguise. Service providers, such as A-List Solutions, can also help in finding the right person based on the requirements.

### **Summary**

In conclusion, companies looking to add to the staff should consider all the advantages they can leverage through contracting personnel. Hiring contract and contract-to-hire team members can

be a cost effective, flexible and easy way to staff a growing business. With contracting, companies leverage many benefits without taking on extra issues and workload which can distract management from business-critical activity.

Companies looking to effectively match job requirements to the marketplace and find the best talent for their employment openings should consult with companies like A-List Solutions who can help them achieve optimal results.

## Addendum: IRS Contractor Test

The IRS formerly used what has become known as the "Twenty Factor" test. More recently the IRS made an effort to simplify and refine the test, consolidating the twenty factors into eleven main tests, and organizing them into three main groups: behavioral control, financial control, and the type of relationship of the parties. Those factors appear below, along with comments regarding each one. The IRS web site [www.irs.gov](http://www.irs.gov) should always be consulted for the latest information.

After reviewing the three categories of evidence, companies that are still unsure if a worker is an employee or an independent contractor, can file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding (PDF) with the IRS. The form may be filed by either the business or the worker. The IRS will review the facts and circumstances and officially determine the worker's status. It can take up to six months to get a determination, but a business that continually hires the same types of workers to perform particular services may want to consider filing the form.

### 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' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work:
  - When and where to do the work
  - What tools or equipment to use

- What workers to hire or to assist with the work
- Where to purchase supplies and services
- What work must be performed by a specified individual
- What order or sequence to follow

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

- *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.

### 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 are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. 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 employee usually has no investment in the work other than his or her own time. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.
- *The extent to which the worker makes services available to the relevant market.* An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.
- *How the business pays the worker.* An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for 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 loss.* Since an employer usually provides employees a workplace, tools, materials, equipment, and supplies needed for the work, and generally pays the costs of doing business, employees do not have an opportunity to make a profit or loss. An independent contractor can make a profit or loss.

### **Type of relationship**

Facts that show the parties' type of relationship include:

- *Written contracts describing the relationship the parties intended to create.* This is probably the least important of the criteria, since what really matters is the nature of the underlying work relationship, not what the parties choose to call it. However, in close cases, the written contract can make a difference.
- *Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.* The power to grant benefits carries with it the power to take them away, which is a power generally exercised by employers over employees. A true independent contractor will finance his or her own benefits out of the overall profits of the enterprise.
- *The permanency of the relationship.* If the company engages 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 the 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 the company's regular business activity, it is more likely that the company will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will 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.