

Independent Contractors & Insurance: A Primer for IT Staffing Companies

By Edgar Armstrong & Mark B. Roberts

Background

For many IT Staffing companies, the placement of independent contractors (whether on 1099 or corp.-to-corp. basis) is an integral part of their business. Unfortunately, the placement of independent contractors gives rise to a number of complicated tax, liability and insurance issues. Efforts to minimize exposure in one area, may increase your company's exposure in another area.

From a tax liability perspective, it is important that management of an IT staffing firm avoid taking any actions which are inconsistent with independent contractor status. Such actions could lead the Internal Revenue Service or state revenue agency to reclassify an independent contractor as an "employee", potentially triggering considerable tax liability. What are the implications for IT Staffing Companies' exposure to other kinds of liability and insuring against such exposures? What are the implications for the clients of IT Staffing firms?

The Problem

With traditional employees, an employer's exposure to liability and insurance obligations are straight-forward. For example, by purchasing general liability insurance, an IT Staffing firm is generally insuring against the negligent acts of its employees. Similarly, as an employer, an IT Staffing firm has an obligation to purchase worker's compensation insurance.

With independent contractors, the picture is more complicated. While an IT Staffing firm may be able to insure itself from the wrongful actions of an independent contractor, it generally cannot insure the independent contractor within its own insurance portfolio or purchase insurance on behalf the independent contractor without increasing its exposure to reclassification liability (the risk a taxing authority may reclassify the independent contractor as an employee). While the risk of reclassification is ever-present, the failure to ensure an independent contractor carries appropriate insurance coverage also carries considerable risk for IT Staffing firms and their clients. How should an IT Staffing firm respond to this problem? The good news is that these liabilities can be dealt with very effectively through readily available insurance coverage. This whitepaper is intended to assist NACCB members in understanding these issues and guide them in procuring and employing appropriate insurance protection without increasing the risk of reclassification liability.

Minimizing Reclassification Liability

Companies that place independent contractors can minimize the risk of reclassification liability by ensuring neither the IT Staffing firm, the client, nor the independent contractor act in any way inconsistent with independent contractor status. Is the engagement of the independent contractor for a specific term and not indefinite? Does the independent contractor bear the risk of loss associated with non-payment by the client? Has the independent contractor purchased his or her own insurance? To minimize reclassification risk, the answer to these questions should be “yes”. NACCB has developed the simplified Model Contractor Agreement that incorporates these factors and other indicia of independent contractor status minimizing the risk of reclassification liability.

The Insurance Solution

While the unique liabilities and exposure to loss of independent contractors are complex, an appropriate insurance solution can be effectively structured at a modest cost. Because few insurance professionals adequately understand these complex issues, TechServe, the NACCB Sponsored Insurance Program, has developed a special insurance placement and consulting service in cooperation with one of the leading technology insurance companies. After providing some basic information over the telephone, an independent contractor can obtain recommended insurance coverage in just minutes. It is not just about making an important form of coverage available. The TechServe staff and its carrier partner are available to answer NACCB members’ questions and provide valuable advice and guidance on the following insurance issues:

- Workers Compensation: By law, businesses must generally provide workers compensation insurance for their employees. But what about independent contractors? Generally,* staffing firms are not able to cover independent contractors under their own workers compensation policies. Further, it may not be advisable for a staffing firm to purchase workers compensation policy on behalf of an independent contractor. Such actions may be inconsistent with independent contractor status and expose an IT Staffing firm to reclassification liability. But what if an independent contractor is injured while working at a client’s offices? Absent workers compensation insurance and its “exclusive remedy” protection, a court may hold the staffing firm and/or its client responsible for the contractor’s statutory workers compensation benefits or may even award damages that would not be limited to those typically available under the workers compensation benefit scheme. Further, an IT Staffing firm’s workers compensation carrier may retroactively determine in an audit that it should have paid premiums on independent contractors placed with clients—a significant unanticipated expense. Accordingly, even if not statutorily required, in most cases, it is important for an IT staffing firm to require independent contractors to carry their own workers compensation insurance. Such coverage may also be a contractual requirement under the IT staffing firm’s agreement with its client. Through TechServe’s recently launched independent contractor service, an independent contractor can obtain his or her own coverage in just minutes.

- General or Third Party Liability: Independent contractors may cause injury or damage to the person or property of others. While some of the better insurance companies will extend their coverage to the staffing firm when they are sued for losses arising from an independent contractor's actions, the policy doesn't usually protect the independent contractor. Even with coverage, an IT Staffing firm may be charged with a loss in the event of a claim resulting in future premium increases. Independent contractors should be required to purchase his or her own coverage in order to protect themselves, the IT Staffing firm and the client organization.
- Employee Dishonesty: IT staffing firms have exposure to liability for losses associated with theft of their client's property. Companies should ensure their insurance portfolio includes coverage protecting against dishonesty of their independent contractors.
- Professional or Errors and Omissions Liability: While the best errors and omissions policies for technology protect IT Staffing firms for losses arising from acts committed by other parties (including independent contractors) acting within the scope of an engagement, such a policy will not protect the independent contractor. To minimize the risk of reclassification liability, an independent contractor should procure its own professional liability insurance.
- Employment Practices Liability: Claims by employees alleging wrongful conduct of their employer are all too common today. In response to such exposure, insurance companies developed Employment Practices Liability coverage ("EPLI"). While the typical Employment Practices Liability policy does not protect an insured IT staffing firm from losses attributable to independent contractors, there is a readily available solution. Underwriters with some of the better insurance companies will endorse (i.e. amend) their policies to respond to independent contractor exposure. In our experience, IT Staffing firms have not universally obtained Employment Practices Liability coverage (even fewer firms request an endorsement for third party or independent contractor coverage). We believe this is a mistake. EPLI with an appropriate endorsement for third party or independent contractor, should be a part of every IT Staffing firm's insurance portfolio.

Conclusion

The actions of independent contractors can be a source of liability for the staffing firms and its clients. Fortunately, appropriate cost effective insurance for these exposures is now readily available. TechServe has developed a special insurance placement and consulting service for the independent contractors working with NACCB members. Through this new service, an NACCB member can refer an independent contractor who can obtain appropriate cost effective coverage in a manner of minutes. This is just another of the special insurance and risk management services available through TechServe, the NACCB Sponsored Insurance Program.

*Under the law of some states, IT staffing firms are required to cover the independent contractors it places. Where mandated, it is unlikely such coverage will give rise to increased risk of reclassification liability.

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Ed currently serves as the Managing Director & Senior Consultant for NACCB Services, Inc., which operates Techserve, the NACCB Sponsored Insurance Program. Ed brings an extraordinary level of insurance expertise derived from senior level experience in a variety of roles. He has provided professional consulting advice to hundreds of general business, non-profit organization and financial institution clients for their risk and insurance needs, underwritten for two major insurance carriers, served as risk and insurance manager for Marriott Corporation and managed the general insurance operations of two of the leading consulting organizations in the world (Aon Risk Management Services and The Wyatt Company's Risk Management Services) – organizations which have served a broad spectrum of associations, corporate clients, insurance companies and agencies. He has served as Director of the American Bankers Association's Insurance and Protection Division and Manager of the American Society of Associations' sponsored insurance, financial and retirement programs and was responsible for consulting in the development of captive insurance company operations for these and other association clients. He was also responsible for creating and administering the D&O Insurance Review Service for the National Association of Corporate Directors.

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Mark Roberts currently serves as the CEO of the National Association of Computer Consultant Businesses (NACCB), a national trade association of over 370 IT Services companies. He also serves as CEO of NACCB Services, Inc., NACCB's wholly-owned subsidiary that operates TechServe. Prior to being named CEO by the NACCB Board of Directors in February 2003, Mark served as COO & General Counsel of the association. He writes and speaks frequently on both business and legal issues affecting the IT Services industry. He also serves on the Labor Relations Committee of the U.S. Chamber of Commerce. Before joining NACCB, Mark was a partner in the Labor and Employment Group of Steel Hector & Davis LLP, one of Florida's oldest and most prestigious law firms. Mark's practice consisted of counseling national, international and local companies, including staffing firms, on a wide range of issues arising out of all aspects of the employment relationship. He also served for four years in the Washington, D.C. office of Congressman Benjamin A. Gilman of New York.

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For additional information on coverage issues related to independent contractors or other insurance questions, please contact Ed Armstrong at 703-838-2050 ext. 109 or armstrong@naccb.org or visit the TechServe website at www.techserveonline.com.

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