

# Independent Contracting

Deciding to practice as an independent contractor requires consideration of many factors. Being a self-employed practitioner depends on meeting the Internal Revenue Service guidelines, state regulations, physician availability, and third-party payment policies. You also should carefully examine your own goals and motivations.

Opinions vary about whether PAs qualify to be independent contractors. *Appendix G* contains opinions from two lawyers. The first, a California lawyer, believes that PAs cannot meet the IRS guidelines for independent contractors. The second, from a Michigan lawyer, looks only at state law and concludes that PAs can meet Michigan's requirements for independent contractors. There also was a 1988 case in Maine in which the IRS fined the Penobscot Valley Hospital for improperly classifying some PAs in its Emergency Department as independent contractors. On appeal, however, the IRS decided that the PAs in question were not employees of the hospital and that the hospital was correct in classifying them as independent contractors.

There are PAs working as independent contractors whose attorneys believe they legitimately qualify under the relevant laws and guidelines. Every case is different, and each PA has to determine whether he or she meets the relevant state and federal rules. It is prudent to consult a tax attorney or accountant before choosing to work as an independent contractor.

Be aware that this is a hot IRS issue. The employment tax status of

workers has become the most frequently litigated tax issue today. The IRS has estimated that it loses \$2 billion annually from worker misclassification.

Recent articles in the medical press report that the IRS is cracking down on physicians working as independent contractors. For example, in two technical memoranda issued in March of 1995, the IRS held that independent contractor physicians were technically employees of hospitals and other entities under the tax code. While not directed at PAs, these memoranda could apply to PAs. You should discuss their implications with your lawyer or accountant. In the memoranda, the IRS determined that the physicians were employees because their services were integral to the ventures' business operations, the physicians were subject to some direction and control by the entities, and they were at no risk for profits or losses. The IRS reached this decision, despite the physicians providing for their own medical liability insurance, receiving no employee benefits, working part time, and having significant outside practices that accounted for most of their incomes.

# Independent Contracting

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## Pros and Cons

In addition to meeting all the legal requirements, you should also consider other factors when exploring the possibility of independent contracting. What motivates one PA may not motivate another. Although being an independent contractor may increase your freedom of choice and income, it can also increase your work hours and decrease benefits and vacation time. You may have greater latitude in deducting certain expenses and funding large retirement benefits, but you will be paying self-employment taxes, malpractice premiums, benefits, and the costs of owning or leasing equipment. Issues that did not concern you as an employee become essential to your practice as an independent contractor, such as billing and reimbursement collection, administrative tasks, and negotiations with regulatory agencies, insurance carriers, and physicians.

From the prospective employer's point of view, utilizing independent contractors has many advantages. Independent contractors frequently are exposed to a variety of practice experiences and may have a broader perspective than employees. The employer may also have considerable employment tax savings, as well as overall reductions in the cost of providing employee benefits. The biggest savings for the employer are likely to be in retirement and health benefits provided only to employees. This arrangement also has a few disadvantages, such as worries about confidentiality and loyalty. The possibility exists that the contractors may not be available when needed, since they are not dedicated solely to the hiring company. Another disadvantage is difficulty in preventing contractors from working directly for a company's clients. It has become common to have a contractor sign a "covenant not to compete" that prohibits them from soliciting similar work from a contract client for a specified period of time.

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## Medicare

Medicare reimbursement for services provided by PA independent contractors has been a gray area in the past. However, federal legislation that took effect January 1, 1998, specifically allows PAs to work as independent contractors under the Medicare program. Payment will continue to go to the employer of the PA.

This has been an ambiguous policy area because of Medicare's requirement that payment go to the employer of the PA and because individual Medicare carriers had the authority to determine whether there was a valid employer-employee relationship. For years, the Centers for Medicare and Medicaid Services (CMS), formerly known as the Health Care Financing Administration, defined the employer-employee relationship as a "W-2" relationship.

Medicare PA coverage language in the Balanced Budget Act of 1997, effective January 1, 1998, states that “an employment relationship may include an independent contractor arrangement, and employer status shall be determined in accordance with the law of the State in which the services described in such clause are performed.”

Even though Medicare is now clear about PAs as independent contractors, do not neglect to review state law and IRS requirements. For more information, contact the AAPA at 703/836-2272, ext. 3219.

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## Other Considerations for PAs

CMS, which wrote the regulations for the Rural Health Clinic Services Act, requires that a federally certified rural health clinic have a physician assistant or nurse practitioner (W-2 employee) staffing the clinic 50 percent of the time it is open. Additional nurse practitioners (NPs) or PAs may be hired as independent contractors, so long as the 50 percent W-2 employee requirement is met. If you are considering working for a federally certified rural health clinic as an independent contractor, be sure there is already a PA or NP employee meeting the employee staffing regulation.

State laws or regulations may also exist that would prohibit your practice as an independent contractor. For example, the PA practice regulations in Wisconsin state that “no physician’s [sic] assistant may be self-employed.” Be sure that your attorney reviews all relevant state and federal laws and regulations.

### The IRS common law rules

The IRS keeps a close eye on companies that treat workers as independent contractors. The close scrutiny began in 1987 when the IRS launched its Employment Tax Examination Program targeting independent contractors. The program continues, despite repeated warnings from other government agencies that the rules for determining who is an independent contractor are too vague to be applied consistently. The IRS relies on 20 factors to determine whether an individual is an employee or an independent contractor (IRS Revenue Ruling 87-41). To qualify as an independent contractor, an individual does not necessarily have to meet all 20 guidelines. According to the IRS, an individual must meet a “preponderance” of them. The key to these guidelines is who controls the tasks that are to be performed. The degree of importance of each factor depends on the occupation and the context in which the services are performed. The 20 factors are summarized here. The actual language of IRS Revenue Ruling 87-41 is included as *Appendix F*.

**Instructions.** A worker who is required to comply with other persons’ instructions about when, where, and how he or she is to work is ordinarily an employee.

**Training.** Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner, more common with employees.

# Independent Contracting

**Integration.** Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control, as with employees.

**Services Rendered Personally.** If the services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results.

**Hiring, Supervising, and Paying Assistants.** If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hires, supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status.

**Continuing Relationship.** A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists.

**Set Hours of Work.** The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control over an employee.

**Full Time Required.** If the worker must devote full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and can restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses.

**Doing Work on Employer's Premises.** If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests an employer-employee relationship, especially if the work could be done elsewhere.

**Order or Sequence Set.** If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work, but must follow the established routines and schedules of the person or persons for whom the services are performed.

**Oral or Written Reports.** A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control.

**Payment by Hour, Week, Month.** Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor.

**Payment of Business and/or Traveling Expenses.** If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is usually an employee.

***Furnishing of Tools and Materials.*** The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship.

***Significant Investment.*** If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship.

***Realization of Profit or Loss.*** A worker who can realize a profit or suffer a loss as a result of his or her services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee.

***Working for More Than One Firm at a Time.*** If a worker performs more than *de minimis* services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

***Making Services Available to General Public.*** The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.

***Right to Discharge.*** The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An independent contractor, on the other hand, cannot be fired as long as the independent contractor produces a result that meets the contract specifications.

***Right to Terminate.*** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship.

These tests for determining whether a worker is an employee or an independent contractor are based on “common-law” rules that rely on custom and usage rather than on written codes. Unfortunately, the absence of objective guidelines often results in employment tax controversy between workers and state and federal tax authorities. The key factor is the degree of control, or right to control, that a business has over a worker.

# Independent Contracting

**The following guidelines also may be useful if you decide to be an independent contractor:**

1. Establish yourself as a separate employer (e.g., business cards, Yellow Pages listings, advertisements, letters of incorporation, or the filing of a Schedule C tax form).
2. Be able to show that your income derives from more than one source.
3. Be able to show that you offer special skills that the hiring company does not possess.
4. Provide your own equipment, supplies, and base of operation.
5. Provide your own malpractice and other types of liability insurance.
6. Make sure you receive IRS 1099 forms for all income and that you are reporting such income on your tax return.
7. Avoid frequent changes from independent contractor to employee status.
8. If Medicare reimbursement is essential to your financial success, be sure that your local Medicare carrier will reimburse practices for medical services you provide as a 1099 contractor.
9. Exercise common sense and get advice from an attorney and/or accountant with expertise in this area. Whether a PA is an independent contractor or employee is critical in many areas of law, such as Workers' Compensation, tort liability, tax liability, state certificate of need, reimbursement, and some state prohibitions on the corporate practice of medicine.

If you are in doubt about your tax status, you may file a Form SS-8 to request a formal ruling from the IRS. This could be risky if you already are working as an independent contractor and the IRS rules against you, since you will have disclosed all the information they need to audit you. On the other hand, having a ruling that says you are an independent contractor may protect you against an overzealous IRS agent who decides to review your tax return. □