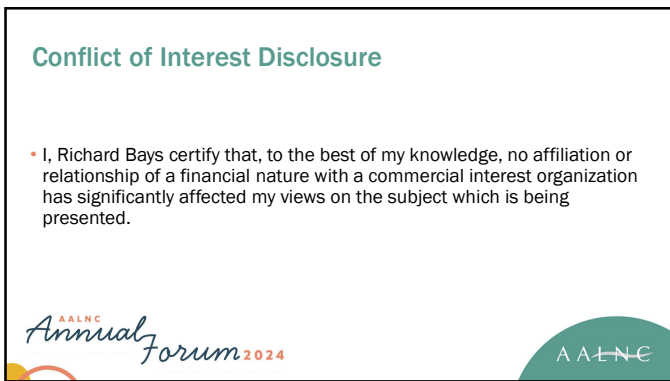




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Learner Outcomes/Objectives

- Learning Outcomes for this activity as a result of participating in the activity:
- 1) understand guidelines for subcontracting work
- 2) understand guidelines for being a subcontractor
- 3) understand risks for subcontracting



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Subcontracting Basics

- Sub-contracting involves the delegation of specific duties and obligations by the contracting parties
- Subcontracting is "where a person has contracted for the performance of certain work and they, in turn, engage a third party to perform the whole or part of that which is included in the original contract, their agreement with such third person is called a subcontract and such person is called a subcontractor."

Black's Law Dictionary





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Subcontracting Basics


Subcontracting is necessary in many circumstances and provides benefits such as:

- Specialized skills
- Cost effectiveness
- Expediting milestones of a project
- Decreasing risk





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Subcontracting Basics



01 PRINCIPLE → 02 AGENT → 03 SUBCONTRACTOR



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Guidelines for Subcontracting Work

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Guidelines for Subcontracting Work

- Can I subcontract any work at all?
- Is there a prohibition / restriction?
- Incorporate a sub-contracting clause, explicitly stating whether the parties can sub-contract their rights and obligations and if prior written consent from the other party is required.

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Employee vs Independent Contractor

- It is critical to correctly determine whether the individuals providing services are employees or independent contractors.
- Generally, you must withhold and deposit income taxes, social security taxes and Medicare taxes from the wages paid to an employee. Additionally, you must also pay the matching employer portion of social security and Medicare taxes as well as pay unemployment tax on wages paid to an employee.

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Employee vs Independent Contractor

- Generally, you do not have to withhold or pay any taxes on payments to independent contractors.
- In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

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Employee vs Independent Contractor

Facts that provide evidence of the degree of control and independence fall into three categories:

- 1) **Behavioral:** Do you control or have the right to control what the worker does and how the worker does his or her job?
- 2) **Financial:** Are the business aspects of the worker's job controlled by the payer? (These include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
- 3) **Type of Relationship:** Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?



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Employee vs Independent Contractor

- You must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. No one factor stands alone in making this determination. Factors which are relevant in one situation may not be relevant in another.
- You must look at the entire relationship and consider the extent of the right to direct and control the worker.



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Employee vs Independent Contractor

Misclassification of Employees

Consequences of Treating an Employee as an Independent Contractor

- If you classify an employee as an independent contractor and you have no reasonable basis for doing so, then you may be held liable for employment taxes for that worker.

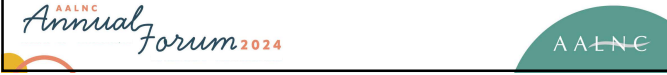


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Reporting Payments to Independent Contractors

If you pay independent contractors, you may have to file Form 1099-NEC, Nonemployee Compensation, to report payments for services performed for your trade or business.

- If the following four conditions are met, you must generally report a payment as NEC.
 1. You made the payment to someone who is not your employee.
 2. You made the payment for services in the course of your trade or business (including government agencies and nonprofit organizations).
 3. You made the payment to an individual, estate, or, in some cases, a corporation.
 4. You made payments to the payee of at least **\$600** during the year.
- If you intentionally disregard the requirement to provide a correct Form 1099-NEC or Form 1099-MISC, it's subject to a minimum penalty of \$630 per form (tax year 2023) or 10% of the income reported on the form, with no maximum.



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Guidelines for being a Subcontractor

- Sub-contracting creates many opportunities but can potentially lead to legal issues – particularly intraparty disputes.
- Disputes typically concern payment conditions, such as the sub-contractor's compensation being linked to the principal contractor's receipt of payment from the client.
- Drafting specific terms and obligations can avoid problems that cascade down the contractual chain.



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Guidelines for being a Subcontractor

Novation

- The substitution or swap of two parties in a contractual agreement is formalized through the use of the novation agreement.



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Guidelines for being a Subcontractor

- Generally, obligations under a contract cannot be assigned without the consent of the client. When such consent is given, it effectively results in a Novation, leading to the substitution of liabilities.
- Obtaining prior consent for the assignment of obligations under a contract is critical unless explicitly allowable in the agreement.



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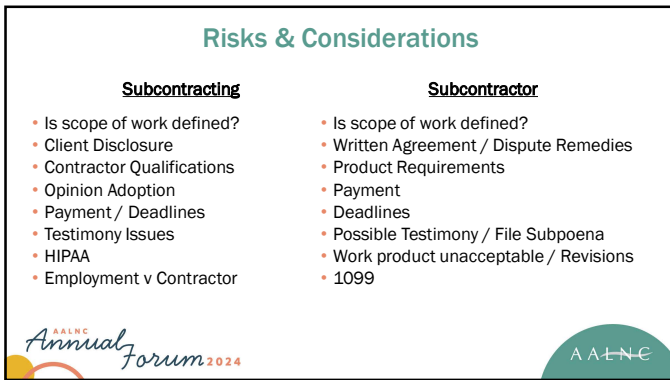
Is The Subcontractor Liable to the Principle?



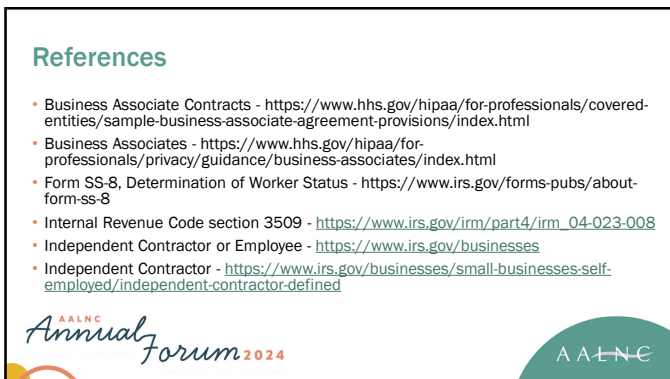
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