

Are Independent Contractors Putting Your Operation at Risk?

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We all remember when a lethal combination of rising fuel costs and product liability lawsuits sent the aviation industry into a tailspin in the 1980s. General Aviation found its wings again when Congress imposed limits on the suits in 1994. Of course, we had a major setback after the 9-11 tragedy, but we are now gaining altitude again.

The past 20 years of ups and downs have left us a little wiser, but are we prepared to face the new challenges of this turbulent industry? A quick scan of the nation's leading newspapers offers at least anecdotal evidence that aviation-related lawsuits are on the rise, including pilots suing operators. Let's face it. Legal liabilities are a reality that operators must take measured steps to avoid.

While product liability suits have rightfully been the focus of significant attention over the years, the issue of independent contractors is like a ticking time bomb waiting to explode on unsuspecting aircraft operators. It's not a new dilemma. The risk of lawsuits demands operators recognize and mitigate every potential liability – old or new.

Independent contractors have become a business staple for aircraft operators that need additional affiliate pilots without making a long-term employment commitment, dealing with the administrative hassles involved in the hiring process, or incurring additional overhead costs. But the industry is learning that what has been a convenience could be a blow to the coffers of a business in the aftermath of exposed liabilities.

Aircraft operators with independent contractors are exposed to three key liabilities: tax, workers' compensation, and perhaps most potentially devastating, lawsuits arising from bodily injuries or wrongful death of the independent contractor pilot. Identifying and understanding the risks will help you steer clear of the financial pitfalls.

Nobody likes wading through IRS rules and regulations, and working with independent contractors can open a proverbial can of tax worms. Despite well-crafted contracts, the IRS usually rules independents as full-fledged employees and penalizes operators for not paying employment-related taxes. That's because the IRS has determined it loses as much as \$1.5 billion in uncollected employment tax revenues each year. One wrong step and you could be fined for a backlog of withholding and social security taxes – plus a 100 percent penalty.

Historically, the IRS has used a 20-factor analysis to determine worker status. Congress has also

enacted what's called Section 530 Safe Harbor based on consistency of treatment and reporting. Under the ruling, businesses are required to demonstrate that workers designated as independent contractors are consistently treated as such and that workers who perform similar functions are also treated as independent contractors and not employees. This is where aviation misses the flight. Independent contractor pilots and maintenance technicians typically perform similar functions as full-time employees. Operations hoping to find protection under the Safe Harbor ruling should consult with a labor attorney.

Workers' compensation is another gray area overshadowing the independent contractor issue. If the independent pilot injures himself on assignment, guess whom he comes after? Your business. It's a well-known fact that most independents don't carry their own workers' compensation insurance. It's also a well-known fact that courts have ruled in favor of the injured independent in lawsuits. Once again, you could find yourself paying a backlog of premiums and interest to your workers' compensation insurance company when the judge decides you should compensate the independent for his on-the-job injury.

But perhaps the greatest risk is legal liability. Independent contractors should carry the same level of insurance as the company for which they work for two reasons. First, the operator's aircraft liability policy has no obligation or provision to cover pilot injuries that a workers' compensation policy should have covered. Second, if the independent pilot is named in a lawsuit related to the aircraft operator's business, then that pilot can find himself standing alone with no investigation, defense or liability protection.

Also keep in mind that there is a distinct difference between a pilot that is approved to fly the aircraft and a pilot that is actually insured against legal liabilities. In fact, aircraft insurance policies are specifically designed not to cover any person or organization engaged in the operation of any flying school, flight service or aircraft or piloting service. Again, an independent pilot is expected to maintain his own insurance for any flight activity. Unfortunately, just as most independent contractors don't typically carry workers' compensation insurance, they don't typically carry adequate, if any, liability insurance.

So when pilot or maintenance technician negligence causes injuries or property damage that results in a lawsuit, the independent contractor may very well be named in the suit. But your operation is the one with the deep pockets – and the insurance – and you could and probably would end up footing the bill for the independent contractor's mistake. The end result is unnecessary expense and litigation. The independent, on the other hand is exposed to legal liabilities of his own. He may also have to provide his own defense and possibly even have to pay his own medical expenses before moving on to work for the next operator.

When you calculate the risk of liability and financial distress versus the reward of lower employment costs and flexibility, it makes less sense to contract with independents. The line between employees and independent contractors is getting blurrier all the time and there are plenty of myths about the issue that can wind up costing your operation thousands of dollars in fines and taxes every year. One of the most dangerous myths is that hiring firms aren't liable for an independent contractor's actions. By now we are learning that this is just plain false. Armed with the truth and facts, aircraft operators can avoid these liabilities.

So just how do you protect yourself in this hiring quagmire? The safest way to avoid liabilities is not to hire independent contractors. This simply may not be a practical solution for some flight departments. One option is hiring independents as part-time employees instead of independent contractors. It may require more administrative work, but it acts as a safeguard against liabilities typically associated with independent contractors. Working with part-time employees also allows operators to avoid special reporting for worker's compensation and aviation liability insurance purposes.

Another solution would be to utilize a well-established temporary labor company who can demonstrate evidence of Worker's Compensation and adequate liability insurance. At a minimum,

you need to declare any independent contractors that you are using to your insurance broker and arrange the proper liability and worker's compensation insurance to cover those independent contractors.

At the end of the day, if you still plan to use an independent contractor, investing time in understanding and complying with Safe Harbor rules today could pay dividends in the future. The bottom line is that the employee versus independent contractor distinction is one of the most important issues facing American businesses today. How you choose to handle the issue in your aircraft operation could mean the difference between a smooth-running operation and a liability nightmare.

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