
MEMORANDUM

TO: PROSPECTIVE CLIENTS

FROM: AERO LAW GROUP PC – (425) 456-1800 – <http://www.law.aero>
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SUBJECT: INDEPENDENT CONTRACTOR PILOTS: SHOULD YOU JUMP ON THE BANDWAGON?

DATE: OCTOBER 25, 2013

Many aircraft operators hire their pilots as “independent contractors” instead of as employees. This may save on administrative costs, but is there a downside? In short: yes. Most pilots are not properly classified as independent contractors. Although treating pilots as independent contractors is common practice in the aviation industry, recent revenue shortages have triggered government investigation of “employee misclassification.” In fact, the Department of Labor (DOL), the Internal Revenue Service and fourteen states including California now share information as part of DOL’s “Misclassification Initiative.”¹ As a result, you should carefully consider how to classify your pilots.

I. Legal tests for independent contractors.

State and federal agencies use a variety of tests to determine if workers are “independent contractors.” In a nutshell, “independent contractors” need to display a sufficient level of true independence. Factors include whether the worker offers his or her services to multiple clients, acts like a separate business, and has autonomy to decide how to complete the assigned job. Another factor may be whether the worker supplies his own equipment for the job. Pilots, by the nature of their work, do not have much autonomy. They must fly at the times and places directed by their employers and the employers provide the principal piece of work equipment: the aircraft. Further, because most employers want their pilots to be available as needed, many pilots only fly for one operator. As a result, the typical pilot would not qualify as an independent contractor.

What about having the pilot sign an independent contractor agreement? While this sounds good in theory, it may not work in practice. Auditors can disregard such contracts if the facts show the pilot is not functioning as an independent contractor. It is not impossible for a pilot to meet the legal tests: he or she could operate like a true business owner by advertising and providing pilot services to multiple clients, paying payroll taxes and workers’ compensation, getting required business licenses and insurance, and even setting up an independent business entity. Many pilots will be deterred by the complexity of operating independently, however, even if they sign a contract saying

¹ See <http://www.dol.gov/whd/workers/misclassification>

they will do so. Then, the operator will suffer the adverse consequences when an auditor concludes the pilot was misclassified.

II. How risky is it to hire pilots as independent contractors?

So what are the risks of hiring pilots as independent contractors? Here are a few:

1. Your pilot makes an unemployment or workers' compensation claim, triggering an audit, or you simply get audited, causing a worker classification review;
2. The administrative costs of these audits include lost staff time and, potentially, legal fees.

If the audit determines that your pilot was misclassified you could face:

3. Penalties, with interest, for failure to collect payroll taxes;
4. Liability for on-the-job injuries that would have been covered by workers' compensation if you had properly collected and submitted payments for the worker (and the additional risk that your insurer could deny coverage for the claim for the same reason); and
5. Penalties for failing to pay workers' compensation.

Also consider whether your insurance will cover losses caused by an independent contractor pilot. As the operator, you can't avoid liability for your pilot's actions, regardless of whether the pilot is an employee or independent contractor, but your insurer might deny coverage for actions of an independent contractor pilot on the basis that it did not insure the pilot's separate business. While many aircraft liability insurers will agree to cover independent contractor pilots on your policy, you need to resolve this with your insurer before a loss occurs.

It is also not unheard of for a pilot, even one who has signed an independent contractor agreement, to sue an operator for loss of income and benefits such as paid sick leave, vacation leave or medical benefits. Regardless of how this lawsuit plays out, just having attorneys and staff responding to it may be a net financial loss to the operator. This loss can be avoided by treating the pilot as an employee from the start.

III. What about substitute pilots?

Even though you only hire substitute pilots occasionally, the legal tests are the same as for regular pilots. That means you should either:

1. Hire substitute pilots as occasional or temporary W-2 employees and pay the required payroll taxes and workers' compensation; or
2. Hire substitute pilots from another employer that treats the pilot as a W-2 employee and pays the required payroll taxes and workers' compensation. If you are hiring the pilot from another company that properly treats the pilot as an employee, then you can treat that company (and its pilots) as independent contractors.

If you choose to hire pilots from another company, your written contract with that company should require it to pay the pilot's employment taxes and workers' compensation, and indemnify you if the

company fails to make these payments. This provides some protection against the risks described in Section II. You should also work with your insurer to make sure you have adequate coverage when using pilots hired from another company.

IV. Make an informed decision.

As an aircraft operator you already know that the easiest solution is not always the best. That is why, before you jump on the independent contractor bandwagon, you should explore the specific issues related to your flight operations with professional advisors and do a thoughtful risk-benefit analysis about how to classify your pilots.

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