

# How to Ensure Compliance When Working with Freelancers: The Ultimate Guide



**In 2021, 59 million Americans considered themselves freelancers. That number is expected to surpass 90 million by 2025. <sup>1</sup>**

This significant rise in the number of freelancers has attracted the attention of both the legal and tax systems in many countries.

The first reason for this attention is that tax authorities are losing significant amounts of revenue from companies not paying employment taxes. On top of that, labor laws offer protection only to employees and not freelancers, so governments are looking for ways to protect freelancers, too.

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<sup>1</sup> <https://investors.upwork.com/news-releases/news-release-details/upwork-study-finds-59-million-americans-freelancing-a...>



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Therefore, governments have been taking a long, hard look at how companies are classifying their workers, defining whether a worker is an employee or a freelancer, how companies and freelancers should report payments to freelancers, how international payments to freelancers should be carried out and better defining the legal relationship between companies and freelancers.

The result of this increased government involvement has created a complex patchwork of evolving laws and regulations regarding legal, tax and worker classification – and an increasingly aggressive framework of penalties.

This ebook will cover all the aspects you should consider when working with freelancers to ensure you are well covered and not adding any risk to your company due to compliance issues.

We will cover:

- Legal documentation
- Payment regulation
- Tax reporting
- Additional liability/protection
- Worker classification



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# 1. The Legal Documents Every Freelancer Should Sign



It's always best to start a relationship with a non-employee by defining your agreements and commitments with legal documentation.

It may feel overwhelming for some freelancers, but it's important not to skip this essential step. This is true regardless of the scope or duration of the relationship.

After all, we all hope legal issues never arise. That relationships with freelancers are always friendly, beneficial, and clear. That small issues can be solved through candid conversations and rational solutions.

But this isn't always the case. And in those cases, legal documents will protect both your company and your freelancer.

Here are the main documents you need to consider:

## 1.1 Freelance Contract

A freelance contract is a legally binding agreement between your company and your freelancer. It includes the terms and agreements of your work arrangement.

It protects you and your company from future legal claims, miscommunication, changes in scope or compensation, and getting ghosted by your freelancer.

It protects your freelancers too. It ensures they get paid an agreed upon amount within an agreed upon timeframe for agreed upon work.

 **It's a win-win.**

And often, it's illegal to work without one.

That's true in many US states and other countries worldwide which legislated laws, like New York's Freelancing isn't Free Act of 2016<sup>2</sup> or the Philippines' freelance protection law<sup>3</sup>, to protect freelancers from exploitation and withheld payment.

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<sup>2</sup> <https://www1.nyc.gov/site/dca/about/freelance-isnt-free-act.page>

<sup>3</sup> <https://hrmasia.com/bill-to-protect-freelancers-in-the-philippines-fast-tracked-for-approval/#:~:text=The%20proposed%2...>

The following 9 elements should be included in your contract:

- **Contact Details.** Full name, phone numbers, and email addresses — for both your company and your freelancer.
- **Project Scope.** This describes the work you're hiring your freelancer to do. Try to be specific when defining the requested deliverables, timelines, deadlines and the payment.
- **Pricing and Rates.** Document how the payment is calculated (fixed, per time, per deliverables), possible bonuses or extra compensation, and how expenses should be handled.
- **Payment Schedule and Options.** Explain how and when your freelancer gets paid. What happens if the company is late in making the payment?
- **Ownership and Copyright.** This clarifies who owns the work upon project completion.
- **Legal Term definitions.** Provide definitions of important legal terms and concepts to ensure both the freelancer and hiring manager understand their legal obligations.
- **Early termination and kill fee.** What happens if you need to cancel the project before it's finished?
- **Equipment and Expenses.** Mention any equipment needed by your freelancer and any expenses incurred by your freelancer while working for your company.
- **Dispute Reconciliation.** What happens if the contract terms are breached, on either side?
- **Signatures.** Both a representative from your company and your freelancer need to sign the contract. Otherwise, it's not valid.

## 1.2 IP Agreement

The next document you might want to consider is an IP agreement.

Contrary to the word on the street, you do not automatically own the work your freelancer does for your company — even if you pay them for it.

But there is a simple way to get ownership of their work — an IP agreement. An Intellectual Property (IP) agreement describes the transfer of ownership that takes place once a freelancer turns over work to your company.

For example, if a designer created a logo for your company, your IP agreement would explain that your freelancer is transferring rights and ownership of the logo to your company. The same applies to your Google ads, API documentation, or even your branding and messaging.

**Your IP agreement should include:**

- The nature of the Intellectual Property
- Exactly how the IP rights are being transferred
- The exceptions your company is prepared to offer

## 1.3 Non Disclosure Agreement

An NDA, or Non-Disclosure Agreement, protects your proprietary company information.

It's a legally enforceable document that explains that the signee cannot disclose certain information about your company, even once the terms of your arrangement are complete.

### It can protect information about your company, including:

- Your customers' names and information,
- Proprietary business information, including sales data and financial data
- Marketing and sales leads
- Your product roadmap
- Design or implementation processes that show how a product is created or maintained
- Company data and research

An NDA is not a non-compete, as it does not prohibit freelancers from working with your competitors. All it prevents them from doing is sharing any information you provided with others.

## 1.4 Data Protection Agreement

As part of the work freelancers do, you might need to give them access to your employees' or customers' data. This is considered sensitive data by data protection regulations, such as GDPR.

Unlike employees, freelancers and agencies are considered as third parties which means that regulators will define them as "processors" of any sensitive data they access.

In this case, you must ask your freelancer to sign a data protection agreement that includes what data they will be accessing under what lawful basis, your expectations around what data they will utilize, and what your own obligations are as the controller or joint controller.

There are additional requirements to comply with data protection regulations, such as documenting your freelancers' tools and processes and ensuring they comply as well.

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<sup>4</sup> <https://www.stoketalent.com/blog/freelancer-nda/>



## 1.5 Non-Compete

First, what is a non-compete? It's a legal document that attempts to prevent freelancers or full-time employees from working with competitors or similar companies in your industry.

However, they are almost impossible to enforce legally. Most US states and the EU won't side in favor of your company if a non-compete is breached. And many freelancers won't sign them.

We don't blame them.

After all, freelancers often acquire new clients via referrals. 46% say word of mouth is their top method of finding work. Clients that arrive through word of mouth are likely to work in the same industry. If freelancers have signed a non-compete, they limit their ability to land new clients and talk about the work they've done for other companies.

However, most freelancers will naturally avoid working with direct competitors, because it's a conflict of interest. Plus, you can use the NDA to protect you from any sensitive information being shared.

Once you've collected the information you need, make sure to carefully archive your freelance contracts, because you will be requested to show them in any basic due diligence.



**NDA**

Only if system access needed



**IP assignment**

Always required



**Non-compete**

Always required



<sup>5</sup> <https://www.stoketalent.com/blog/gdpr-for-contractors/>

<sup>6</sup> <https://s29814.pcdn.co/wp-content/uploads/2019/06/MBO-SOI-2019.pdf>

## 2. How to Pay Freelancers



Now that you've signed your freelancers on the relevant legal documents, let's turn our minds to how to pay them. Your payment methods can be a serious competitive edge in the talent war. 40% of freelancers say faster payments are a great reason to choose one company over another. <sup>7</sup>

And it's not all about speed. Payment method and payment terms matters.

While your company might prefer paper checks, freelancers don't. 70% of freelancers prefer electronic payments. Yet, 31% of freelancers have been paid via paper check, despite only 14% of them wanting it that way. <sup>8</sup>

The reason most companies are not paying freelancers the way they want is because it's very problematic for companies to pay multiple invoices in different payment methods, currencies and cycles unless they have the infrastructure, processes, and tools required to do that.

However, you should know finding a simple, fast approach to paying your freelancers isn't just good for them. It's good for you and your company too. At Stoke we've found from our customers that it makes freelancers happy at the same time as boosting internal productivity.

Here are the main things you need to focus on when it comes to paying your freelancers:

### 2.1 Payment Methods and Currency

There are many payment methods you can use. The best way to choose is to ask the contractor which method they prefer, then see if your company can accommodate it.

Transaction fees and foreign exchange rates can vary significantly from one method to another and can be quite costly. When you decide the allowed payment methods and currencies for your freelancers, your finance team needs to be involved.

You can break almost all payment methods into 3 categories:

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<sup>7</sup> <https://www.pymnts.com/news/faster-payments/2021/real-time-payroll-gig-economy/>

<sup>8</sup> <https://www.fiserv.com/en/about-fiserv/the-point/what-gig-workers-want.html>

### **2.1.1 Bank Transfers**

Payment methods like ACH, wire transfer, check/e-checks, and credit cards are all payments transferred directly into the freelancer's bank account.

The fee is usually per transaction and varies significantly between checks (cheapest fee, but also less secure and slow) to ACH payments (best cost and security, but only relevant for companies and contractors within the same country) and wire transfers which are the most expensive payment method (\$25-\$50 per transaction).

### **2.1.2 Payment Systems**

Online payment solutions, like Bill.com, Payoneer, Tipalti, Wise and more, offer a different cost structure. A subscription fee is required to use these payment systems, but the fees per transaction are lower.

Your company's costs will be lower the more you pay through the same platform. Therefore, most companies will prefer working with one payment system and will force their freelancers to work with that system.

Another advantage is that it allows you to pay your freelancers in their local currency, which makes it a good choice for companies that work with a globally dispersed freelance workforce.

### **2.1.3 Freelance Management Systems (FMS)**

A freelance management system (FMS), like Stoke, utilizes virtually every available payment method so it is the best route to pay freelancers in any way they prefer, while companies will pay only one monthly payment for all freelance work in one payment.

It significantly reduces the subscription and transaction costs as these systems process millions of dollars through each system and it frees your finance team from managing multiple invoices for freelancers in different payment methods, currencies and cycles.

You should be aware that there are also freelance services marketplaces that can handle the payment aspect for you through credit cards, but they charge a marketplace fee of anywhere between 10% to 25% and they'll only be able to offer a specific level of freelance talent.

## **2.2 Payment Terms**

Freelancers use different pricing strategies to charge their customers, such as hourly fees, pricing per deliverables (like cost per word), a fixed price per project, and more complex value-based pricing, too.

It can be complicated to work out the true cost of a freelance project if it isn't provided as a single cost for the result. For example, an hourly cost can easily get out of control, or expectations can vary on the price of the whole project. When working with a new freelancer it is therefore advisable to calculate the range of possible amounts for your project and ensure it meets your budget. You can also suggest capping the number of hours at a certain amount to ensure the project will not fall out of your budgetary requirements.



## 2.3 Payment Schedule

Freelancers are used to negotiating payment schedules, and their demands are usually flexible. It depends on their type of business, operational costs and their previous experience with past clients.

Here are the most common freelancer payment schedules to know:

- **Payment upon delivery:** your company will pay for the products or services rendered within 24 hours of receiving the invoice. Most companies — especially those that work with numerous vendors — are unable to accommodate this request.
- **Net 10, 30, and 60:** A net payment means that the payment is due within a specified number of days from the date the contractor issued the invoice. Net 10, Net 30, or Net 60 (found on the invoice) simply indicates that the contractor's payment is due 10, 30, or 60 days from the date of the invoice. This is the most common payment term for independent contractors.
- **End of month:** This term means the paying company must issue the payment by the end of the month during which they receive the contractor's invoice.
- **Prepayment:** Some freelancers request a pre-payment (such as 50% of the total fee) to be paid before they begin a job. The motivation is to ensure the company won't "ghost" them, and guarantees they receive a portion of the payment.

## 2.4 Payment Regulation

AML (Anti Money Laundering) checks are mandatory when paying employees and third-party vendors. The idea of the checks is to help spot suspicious or illegal activity before you transfer money in any capacity.

The problem is that with more people using the gig economy than ever before, there are plenty of opportunities for misuse and fraud. In 2020 alone, there were more than 4.7 million incidents of identity theft and fraud, up from 3.2 million in 2019.<sup>9</sup>

For companies working with freelancers there is only one mandatory process and that is a KYC (Know Your Customer) check. This means that if you're working with freelancers, before you pay your freelancer, you are required to show that you have verified their identity and that they are exactly who they claim to be.

If you pay through bank transfer and B2B payment solutions they will run the check through you.

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<sup>9</sup> <https://www.iii.org/fact-statistic/facts-statistics-identity-theft-and-cybercrime>

# 3. Freelancer Taxes 101



Unlike with a full-time employee, your company doesn't need to withhold taxes for freelancers.

Freelancers are solely responsible for paying their income, social security, and medicare taxes. This simplifies things for you. And also saves you money. It's one of the reasons that freelancers cost 30% less than full-time employees. <sup>10</sup>

So zero responsibility on your end, right? Not quite.

If you pay a freelancer \$600 or more in a year, you do need to report what you paid them to the IRS.

For US-based freelancers, you must submit a 1099-NEC tax form by January 31st every year, and a new form for every freelancer. For non-US based freelancers, you need to submit a 1042-S by February 28th.

In order to know whether your freelancers are required to pay taxes to the IRS, you are obligated by law to collect a W9 (for US-based) or W-8BEN (for foreign citizens) that contains their tax identification so you'll know which tax form you need to submit to report on their earnings.

## Here are the most common freelancer payment schedules to know:

1. Ask your freelancers to send you a W-9/8 when they begin working with you. This form is valid for 3 years. So set a reminder to ask your freelancer to update it after 3 years.
2. Submit a 1099-NEC for each freelancer who you paid \$600 or more within a year or 1024-S for non US-based freelancers.
3. If you pay a freelancer through a freelance marketplace or a freelancer management systems (FMS), like Stoke, you need to ensure the platform submits the relevant tax forms on your behalf as it is still your responsibility.

(UK-based company? Follow the IR35 guidelines instead<sup>11</sup>)

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<sup>10</sup> <https://www.stoketalent.com/blog/what-is-a-1099-employee/>

<sup>11</sup> <https://www.stoketalent.com/independent-contractors-taxes/ir35-changes/>

If you miss the filing deadline, the fines can be steep. You'll pay a fine between \$50 and \$270 per independent freelancer, depending on how late you submit the form. These fines cap at \$556,500 in a single year.

And if the IRS suspects you intentionally didn't submit forms, there's no max on the penalties they can throw your way.

**To make sure that you're never late, it's best to have documented processes in place. We recommend that you:**

- Keep a full list of your independent freelancers in one place, noting whether they are US-based or not.
- Ask freelancers to complete a W-9 or W-8 during their onboarding.
- Update freelancer tax forms every 3 years — or, better yet, annually.
- Keep W-8s and W-9s on file for 4 years, even when you pay a freelancer less than \$600. That way, if the IRS has questions, you've got answers.





# 4. Workers Classification



## 4.1 What is Employee Classification?

Classifying each worker as a freelancer or an employee is not a matter of opinion.

It is a legal definition that explains the relationship between the company and the worker. It affects everything from taxes owed to whether the worker is protected by local labor laws.

When a company classifies a worker as a freelancer, they are responsible for ensuring that the worker meets local worker classification tests as defined by the local law in the freelancer's jurisdiction.

## 4.2 The Risks of Worker Misclassification

The types of penalties for misclassification vary under each law, as does how each penalty is calculated. Penalties may be imposed on a per employee or per statement basis. It's also common for penalties to be calculated as a percentage of compensation or benefits owed.

**State and federal penalties generally fall into the following categories:**

- Administrative fines and penalties for noncompliance
- Criminal penalties, including potential jail time, for intentional misclassification
- Paying back pay and benefits with interest
- Damages as part of a civil lawsuit, including punitive damages

For example, the IRS could impose administrative penalties on a company equal to the taxes it should have paid for the misclassified worker. If it's also found that the worker was underpaid under a state wage law or the FLSA, then the company may also owe back pay and benefits to the worker, which the worker may be able to sue in court to recover. In both cases, interest and late fees will also be applied.

Because each applicable law sets out its own penalties and legal remedies, the total costs for misclassifying a worker can quickly compound.

Governments also seek to increase the reputational costs for companies that misclassify workers. The recent New Jersey misclassification laws allow its department of labor to publish the names of companies that have violated any state wage, benefit, or tax laws, making it public knowledge. The proposed federal Worker Flexibility and Small Business Protection Act would require companies to post publicly their level of compliance with labor laws. The law also provides severe penalties for not posting.

## 4.3 How to Classify A Worker?

All companies are working with freelancers, regardless of their size, industry or type of business. However, too many are unaware of the number of freelancers their company is working with.

Most CFOs underestimate the number of freelancers working in their company by more than 70%.

These companies need to first start by properly documenting all the freelancers their company is working with. You can not manage what you do not know you have.

Only then can you begin reviewing your company's relationship with your freelancers.

The law demands companies conduct an audit of all of their independent contractors every 6 months as working terms and conditions are flexible by definition and federal and state law may change.

### 4.3.1 Manual Audits

First, create a list of all the freelancers your company engages with and their locations. The location of your freelancers determines which test will be used to classify them as a freelancer.

Then gather data from both the freelancer and the hiring manager to better understand the relationship, like the engagement type, company's control over the work hours, whether there is a similar service provided to other companies, company equipment used, if the freelancer is economically dependent on the company, and more.

This data will help the legal counsel to establish the precise risk level and suggest actionable next steps to reduce the risk level according to the relevant classification test.

### 4.3.2 Automated and Continuous Audits

Due to the complexity of worker classification audits, Stoke has developed an automated solution to track and identify risky relationships with freelancers in real time.

This is an automated and continuous process, therefore we are able to provide an early warning before there's a risk of misclassification.

We continuously monitor over 25 data points that define your company's relationship with your freelancers in order to alert if there's a relationship that needs to be better analyzed.

In case of an alert, a detailed questionnaire is sent to both the hiring manager and the freelancers. Data is processed in our AI engine to understand the risk and what needs to be modified.

Once data is processed, a detailed report is sent to the hiring managers and the company admins with risk classification and actionable insights on how to reduce the risk.

# 5. Freelancer Insurance



Insurance is one of the most overlooked steps when it comes to working with freelancers.

Companies must understand whether their business insurance covers freelancers and if not – work out what they can do to limit the exposure of the business and the freelancers that you hire.

Let's discuss an example to explain why it's so important. Assume your company hires Alicia, a freelance legal consultant to fill out some forms on its behalf. Unfortunately, Alicia misses a step or makes a mistake. Your company is able to sue Alicia for damages, but will have a hard time receiving significant compensation if Alicia does not have insurance.

More critically, if Alicia's work impacts one of your own customers, this customer could sue your company and name Alicia in the suit. As Alicia is not an employee – your own insurance policy will most probably not pay out.

So who will? If Alicia has her own insurance, then you can sue her insurance policy. If she does not have insurance, you will still be liable for the damage your independent contractor caused to your customer, but your company will not be able to seek compensation from her.

Now that's a problem none of us want to deal with.

When you consider that most companies do not conduct background checks and reference checks on freelancers, it highlights the need to provide them with proper insurance so that you are both covered.

Freelancers are rarely covered by your company's General Liability Insurance (GLI). However, you can add them to your insurance policy, but it is preferable to ensure they are covered by their own general liability insurance policy.

You are entitled by law to demand proof of insurance from your freelancers as a requirement to start working together. It should be part of the onboarding process to ask for a copy of any insurance policy they have or a certificate of insurance from their provider. This will ensure that they are covered against liability.

It's also important to understand exactly what this insurance protects, including what your independent contractors are covered against, and where your legal gaps might be.

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<sup>12</sup> <https://www.thehartford.com/general-liability-insurance/what-is-general-liability-insurance#:~:text=General%20liability%...>



# 6. Building an Internal Process



Now we know what we need to do in terms of legal documents, tax forms, payment checks and even workforce classification.

But how can we make sure all freelancers are documented and are being managed properly?

Now it's time to agree on a clear onboarding and off-boarding process with all relevant departments (HR, legal, IT and finance), document the process and lay out the infrastructure to ensure the company follows it.

A good process can be the difference between a needle-moving freelance project and never working with a freelancer again. So let's go over what we've learned so far, and organize all the steps (plus a few new ones) into a single, streamlined onboarding process.

1. **Collect Contact Information:** Think email address, billing address, phone number, and more.
2. **Sign and Save Legal Documents:** All the documentation listed above, IP agreements, freelance contracts, and NDAs.
3. **Collect Tax Forms:** Your freelancers must send you a W-9/8 before they begin working with you so you'll know which tax forms to submit at the end of the year.
4. **Collect Your Freelancers Payment Info:** Bank account information, currency, and preferred payment method. Don't forget to share it with Finance.
5. **Provide System Access:** Speak to IT and make sure the freelancers have the credentials and access they need.
6. **Define Offboarding:** Include in your plan a system for offboarding once the project is complete, including removing access to shared systems.
7. **Review the Plan with Other Teams:** Speak to Legal to make sure you have all the checks you need, and HR to get the green light for your process.

# Want to Make Onboarding Freelancers Simple, Compliant and Smooth?

Why not consider a freelance management platform like [Stoke](#) to reduce the time you and your team spend chasing after — and worrying over — sourcing, legal docs, tax forms, payment terms, budget approvals, granting system access and much more.

If you're committed to beginning your journey to leverage the amazing pool of freelance talent out there, Stoke can help you get rid of all the administrative, financial, and legal headaches that come with it.

**Book a demo with Stoke Talent  
to begin your journey**

[Book a Demo](#)