

Employee or Independent Contractor - Which Is It?

Minimize the Risk of Misclassification

If you misclassify an employee as an independent contractor, you may end up before a state taxing authority or the IRS.

Sometimes the issue comes up when a terminated worker files for unemployment benefits and it's unclear whether the worker was an independent contractor or employee. The filing can trigger state or federal investigations that can cost many thousands of dollars to defend, even if you successfully fight the challenge.

There are ways to reduce the risk of an investigation or challenge by a state or federal authority. At a minimum, you should:

- Familiarize yourself with the rules. Ignorance of the rules is not a legitimate defense. Knowledge of the rules will allow you to structure and carefully manage your relationships with your workers to minimize risk.
- Document relationships with your workers and vendors. Although it won't always save you, it helps to have a written contract stating the terms of employment.

If you have any questions about how to classify your employees, please give us a call. We can help guide you in the right direction in the eyes of the IRS.

Independent Contractor Qualification Checklist

The IRS, workers' compensation boards, unemployment compensation boards, federal agencies, and even courts all have slightly different definitions of what an independent contractor is, though their means of categorizing workers as independent contractors are similar.

One of the most prevalent approaches used to categorize a worker as either an employee or independent contractor is the analysis created by the IRS. The IRS considers the following:

1. What instructions the employer gives the worker about when, where, and how to work. The more specific the instructions and the more control exercised, the more likely the worker will be considered an employee.
2. What training the employer gives the worker. Independent contractors generally do not receive training from an employer.
3. The extent to which the worker has business expenses that are not reimbursed. Independent contractors are more likely to have unreimbursed expenses.
4. The extent of the worker's investment in the worker's own business. Independent contractors typically invest their own money in equipment or facilities.
5. The extent to which the worker makes services available to other employers. Independent contractors are more likely to make their services available to other employers.
6. How the business pays the worker. An employee is generally paid by the hour, week, or month. An independent contractor is usually paid by the job.
7. The extent to which the worker can make a profit or incur a loss. An independent contractor can make a profit or loss, but an employee does not.
8. Whether there are written contracts describing the relationship the parties intended to create. Independent contractors generally sign written contracts stating that they are independent contractors and setting forth the terms of their employment.
9. Whether the business provides the worker with employee benefits, such as insurance, a pension plan, vacation pay, or sick pay. Independent contractors generally do not get benefits.
10. The terms of the working relationship. An employee generally is employed at will (meaning the relationship can be terminated by either party at any time). An independent contractor is usually hired for a set period.
11. Whether the worker's services are a key aspect of the company's regular business. If the services are necessary for regular business activity, it is more likely that the employer has the right to direct and control the worker's activities. The more control an employer exerts over a worker, the more likely it is that the worker will be considered an employee.