

EMPLOYEE OR CONTRACTOR



CARMEN TORRES

Employee or Independent Contractor

Classifying Your Next Hire!

By Carmen Torres, CEO and Chief Specialist
My HR Specialist

Copyright © 2015 by Carmen Torres, Owner and Chief Specialist at My HR Specialist. All rights reserved. No part of this publication shall be reproduced, stored in a retrieval system, or transmitted by any means, electronic, mechanical, photocopying, recording, or otherwise, without written permission from the publisher.

Any unauthorized reprint or use of this material is expressly prohibited.

Contents

Introduction	3
Employee or Independent Contractor?	4
The Risks of Misclassifying Employees.....	7
Best Practices and Playing it Safe	8
Safe Harbor – §530 of the Revenue Act of 1978	9
Conclusion.....	10
About the Author	Error! Bookmark not defined.

Introduction

Deciding to hire a new employee can be difficult enough for you, the business owner or hiring manager, but deciding what type of worker your business needs is much more challenging; Employee or Independent Contractor?

Many business owners are not familiar with the difference between hiring a regular employee and hiring an independent contractor, and this causes them to improperly classify their workers, resulting in significant liability. Knowing the difference and making the best choice for your position saves your company money and protects your business from liability.

Classifying a worker as an independent contractor has its benefits. The business has very little record keeping and financial responsibility to manage on a regular basis. The company is not required to offer benefits such as worker's compensation insurance or group health benefits. In many cases, this type of working relationship simply requires employers to provide tax Form 1099-MISC by January 31 each year.

On the other hand, classifying a worker as an employee requires ongoing recordkeeping and withholding of federal, state, and local income taxes. Additionally, the employee may have rights to benefits such as healthcare, worker's compensation, paid sick leave, vacation, holidays, or retirement plans.

Classifying workers entails much more than selecting which classification you find to most benefit your business. This guide will help you understand the difference, the requirements, and consequence to help you *properly* classify your workforce.

Let's classify your next hire!

Employee or Independent Contractor?

Employers are not alone when it comes to determining appropriate worker status. The IRS has established guidelines to help businesses properly classify their workforce and considers a basic question to determine whether a worker is an employee or an independent contractor.

Who Has Control Over the Work Being Done?

Common law rules are being considered to determine proper classification and courts closely evaluate the relationship between the business and the worker including factors of control and independence.

These factors fall into three categories:

- Behavioral Control – does the business have control over how the worker completes the job for which they are hired to do and does the business provide training to the worker?
- Financial Control – does the worker have the possibility of incurring a loss or does the business accept all financial liability including expenses to complete the work?
- Relationship between Parties – what type of contract or agreement exists between the parties and does the worker qualify for any employee-type benefits, such as insurance or paid time off?

Many businesses make a crucial mistake when classifying workers as independent contractors simply because:

- the worker asked to be classified as an independent contractor,
- the worker agreed to sign a contract classifying him or her as such, or
- the worker does not have a set schedule, instead works on an as-needed-basis.

In the following section, we will review a 20-Factor Test provided by the IRS which provides more clarity when determining your worker classification and protects you from *intentionally and unintentionally* misclassifying workers.

The Difference Between Employees and Independent Contractors

(Source: IRS)

An employer generally has the right to determine how an employee completes a task, whereas, independent contractors determine for themselves how the assignment will be completed.

Employees are usually offered training or provided onsite training by one of the company's established employees, while an independent contractor is hired for their expertise and uses his or her own methods to complete the service hired for.

An employee has a set number of hours or a schedule established by the employer in order to complete an assignment and an independent contractor establishes their own time and pace to complete a project.

Employees typically do their work at the employer's site, indicating that the employer has a right to direct, supervise, and question the whereabouts of the worker when not on the premises, while an independent contractor is free to work without supervision and/or control.

An employee is customarily paid by the hour, week, or month and guaranteed a minimum salary for time worked at specific intervals each pay period. An independent contractor is paid by the job, lump sum, or by commission for services rendered as agreed upon in the contract for services.



As mentioned in the previous section, the IRS provides guidelines to help make the distinction between an employee and an independent contractor. To clearly make this decision, the following 20-Factor Test has been used as an analytical tool, however, since the IRS may give more weight to a certain factor, businesses are encouraged to focus on the overall occupation and circumstances of the individual.

*“Yes” answers generally indicate Employee.
“No” answers generally indicate Independent Contractor.*

Yes	No	IRS 20-Factor Test For Classifying a Worker as Employee or Independent Contractor
<input type="checkbox"/>	<input type="checkbox"/>	1. Must comply with employer’s instructions about how, when, and where to do the work?
<input type="checkbox"/>	<input type="checkbox"/>	2. Receives training from or at the direction of the employer
<input type="checkbox"/>	<input type="checkbox"/>	3. A continuous working relationship is dependent on performance of services
<input type="checkbox"/>	<input type="checkbox"/>	4. Provides services that are integrated into the business
<input type="checkbox"/>	<input type="checkbox"/>	5. Employer controls the means and the results of the work
<input type="checkbox"/>	<input type="checkbox"/>	6. Hires, supervises, and pay workers on behalf of the employer
<input type="checkbox"/>	<input type="checkbox"/>	7. Required to follow a schedule or set hours of work
<input type="checkbox"/>	<input type="checkbox"/>	8. Must work full time for the employer
<input type="checkbox"/>	<input type="checkbox"/>	9. Worker is provided a work station at the employer’s premises
<input type="checkbox"/>	<input type="checkbox"/>	10. Must do the work in a sequence as requested by the employer
<input type="checkbox"/>	<input type="checkbox"/>	11. Required to submit regular oral or written reports
<input type="checkbox"/>	<input type="checkbox"/>	12. Receives a set payment amount without requiring an invoice from the worker
<input type="checkbox"/>	<input type="checkbox"/>	13. Employer provides tools, materials, and equipment to complete the work
<input type="checkbox"/>	<input type="checkbox"/>	14. Worker is eligible for business/travel expense reimbursement
<input type="checkbox"/>	<input type="checkbox"/>	15. Works for one employer at a time, rather than multiple projects for another employer
<input type="checkbox"/>	<input type="checkbox"/>	16. Lacks major investment in facilities to perform the work, such as renting an office
<input type="checkbox"/>	<input type="checkbox"/>	17. Does not make a profit or suffer a loss by performing the services
<input type="checkbox"/>	<input type="checkbox"/>	18. Does not offer the services to the general public
<input type="checkbox"/>	<input type="checkbox"/>	19. May quit work at any time without incurring liability
<input type="checkbox"/>	<input type="checkbox"/>	20. Can be discharged by the employer

The Risks of Misclassifying Employees

Of course, there are some significant financial benefits to classifying workers as independent contractors, such as not being required to withhold taxes or make unemployment and worker's compensation contributions. Taking precautionary steps to avoid the hefty fines and penalties can be challenging, but the risk for misclassifying is far more costly than any savings you may be tempted by. Misclassifying employees as independent contractors may result in:

1. Penalties plus interest
2. Fees as much as 100 percent for federal and state employment tax due
3. May be liable for all federal income tax, social security tax, and unemployment insurance not withheld during the period of misclassification
4. No rights to recover from the employee what is due to the IRS
5. Employer may be required to pay back any missed break and meal periods
6. Employer may have violated overtime rules and required to pay the employee for time not paid per the FLSA guidelines

Best Practices and Playing it Safe

Complying with applicable tax and employment laws is the best way to classify a worker when it's not clear if they are truly an independent contractor or when the work they perform can be directed by the employer.

Once it is determined that the company plans on classifying workers as independent contractors, the company should follow an established process for assessing classification status. The assessment should be done prior to onboarding and throughout the course of the relationship to ensure the workers' status has not changed to that of an employee.

Here are some best practices to keep in mind when utilizing independent contractors:

- Require independent contractors to sign a document stating that they are not subject to the at-will employment law (where applicable) nor entitled to unemployment benefits
- Require a signed Form W-9 from all independent contractors
- Complete a 20-point checklist for all independent contractors
- Avoid having independent contractors do the exact same work as employees
- Prohibit uninsured contractors (liability policies)



Maintain proper recordkeeping and supporting documentation, and adhere to the established policies regarding workers classified as independent contractors to diminish the risk of an audit due to employee misclassification.

Safe Harbor – §530 of the Revenue Act of 1978

Employers are not liable for employment taxes due for misclassified workers if that employer meets all three of the requirements described in section 530 of the Revenue Act of 1978, as amended:

1. The employer must have had a reasonable basis for not classifying the workers as employees. The employer will be considered to have a reasonable basis if the classification resulted from dependence on any of the following:

- Judicial precedent, published rulings, or technical advice with respect to the taxpayer;
- A past IRS audit in which there was no employment tax penalty due to the classification of the workers holding positions considerably similar; or
- A long-standing recognized practice of a significant division of the industry in which such workers were engaged.

2. The employer (and predecessors) must have classified the workers, and any similar workers, as independent contractors for all applicable periods beginning after December 31, 1977.

3. The employer must have filed Form 1099-MISC (Miscellaneous Income) for each worker, if such form was required.

The employer may be denied the protection of a safe harbor if that employer inconsistently or intentionally classified workers who are doing the same tasks, or if it has not filed the appropriate tax forms consistent with the treatment of a worker as an independent contractor. Therefore, an employer is encouraged to treat all individuals considered to be “independent contractors” consistently, and to file federal tax forms as required.

Conclusion

Certain factors will determine whether your workers are employees or independent contractors and employers should not rely on the business or managers as the sole decision makers as to how each should be classified. Reference the 20-Factor Test and follow the guidelines established by the IRS, keeping in mind that independent contractors do not rely on just one source of income, nor do they qualify for employee-type benefits, adhere to their own schedule, and should not give up elements of control and independence.

Understanding the difference between employee and independent contractor is a key factor for the success of your working relationships. Correctly classifying workers prior to the start of the work will save you from unnecessary confusion, audits, fines, and loss of time.

Seek the advice of an experienced human resource specialist, accountant, or attorney to establish appropriate guidelines to follow when deciding if your workers are employees or independent contractors.

About the Author



Carmen Torres brings over twenty years of experience creating equitable, safe, and collaborative workplace environments for both, employers and employees. As a trusted adviser to many organizations, she has successfully helped countless small to mid-size businesses and non-profit organizations establish reliable, stable human resources departments. Her approach includes a 360° analysis of the human resources function that results in building job descriptions, policy and procedures manuals, conflict resolution, employee retention and terminations structures, compliance/audits standards, and employee communications.

Ms. Torres brings a deep understanding of the complexities of managing human beings and meeting regulatory requirements while maintaining the organizational mission, achieving business goals and meeting quality standards – a perspective that converts her into an invaluable resource.

Ms. Torres speaks, has been interviewed, and can present on the following topics: Top 10 ways to show appreciation to your employees, Respect in the workplace, Employee vs. Contractor, The Benefit of an Employee Handbook, Interns: To Pay or not to Pay?.

Carmen Torres is a member of PIHRA (Professionals in Human Resources Association) and in 2003 she received her Human Resources Management Certification through the extension program at Loyola Marymount University in Los Angeles, CA.

In her spare time, Ms. Torres enjoys gatherings with her family and you'll often find her improving her swing at the golf course!

Did you find this report helpful? Carmen's goal is that you find the information helpful when classifying workers. To receive other reports similar to this and to learn more about Carmen Torres and My HR Specialist use the following contact information:

Contact Carmen Torres
CEO & Chief Specialist at My HR Specialist
www.MyHRSpecialist.com
[Facebook.com/myhrspecialist](https://www.facebook.com/myhrspecialist)
[Linkedin.com/in/carmentorreshr](https://www.linkedin.com/in/carmentorreshr)
Skype: MyHRSpecialist