

When businesses hire a worker, they must determine if their relationship with the worker is as an “employee” or “independent contractor.”



If they are employees, the business is responsible for withholding taxes, paying their share of Social Security and Medicare tax, providing workers' compensation insurance, unemployment insurance and paying overtime.

However, if they are independent contractors, the hiring company does NOT withhold taxes, nor pay a share of the Social Security and Medicare tax. They also do not have to provide worker’s compensation insurance (*in certain industries there is a requirement for a minimal policy for independent contractors*), unemployment insurance, or pay overtime. Thus, Business owners often prefer to hire independent contractors, as, on the surface, it saves them money.

The IRS and Labor Department prefer when workers are classified as employees. Not only do these agencies have an easier time collecting income information, but they know that a worker will have more rights/benefits. e.g., overtime pay, unemployment claims, workers' compensation payment for work-related injury/illness, state disability.

If the IRS or Labor Department believes a worker has been misclassified, they look at:

1. **Behavioral!**: Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. **Financial!**: Are the business aspects of the worker’s job controlled by the payer? (these include how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. **Type of Relationship!**: Are there written contracts or employee-type benefits (i.e., pension plan, insurance, vacation pay, etc.)? Will the relationship continue, and is the work performed a key aspect of the business?

To be more specific and consistent, in making a determination of the appropriate factors, the IRS developed a test of 20 common-law factors to watch.

These factors are only guidelines, not strict rules. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. Each case is judged separately on its own merits.

TWENTY COMMON LAW FACTORS TO WATCH

	TEST QUESTION	EMPLOYEE	INDEPENDENT CONTRACTOR
1	Does the hiring company give specific instructions on how they want the work completed throughout the process, not just the result?	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
2	Does the hiring company train the employee	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
3	Is the worker providing services which are integral and integrated into the business’s normal operation	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
4	Is the worker expected to do the work themselves without “subcontracting” to others,	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
5	Is the hiring company providing the worker with supervisors and assistants.	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
6	Is the work being performed recurring, with no end date in site.	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
7	Does the hiring company set the work hours and conditions?	If yes, it supports the argument that the worker is an employee.	If no, it supports the argument that the worker is an independent contractor.
8	Does the worker devote themselves substantially to the business? (they have no other customers)	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
9	Does the hiring company have the right to control where the work is performed?	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
10	Does the hiring company have the right to control the order and sequence in which the work is done?	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.

MONEY 101

2.05 Employee (W-2) vs Independent Contractor (1099) – The IRS’s 20-point test to determine classification

11,	Is the worker required to make regular written or oral progress reports on the work being performed?	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
12	Is the worker paid on an hourly or salaried basis? (not per job) – payment of commissions is a gray area	If yes, it supports the argument that the worker is an employee	If no, it supports the argument that the worker is an independent contractor.
13	Does the business retain the right to regulate, direct and restrict the workers business activities?	If yes, it supports the argument that the worker is an employee.	If no, it supports the argument that the worker is an independent contractor.
14	Does the hiring company provide significant tools, equipment, or material to get the work done?	If yes, it supports the argument that the worker is an employee.	If no, it supports the argument that the worker is an independent contractor.
15	Does the worker have a significant investment in the facilities or equipment?	If no, it supports the argument that the worker is an employee.	If yes, it supports the argument that the worker is an independent contractor.
16	Does the worker have a risk of loss in addition to a realization of profit based on the outcome of the work?	If no, it supports the argument that the worker is an employee.	If yes, it supports the argument that the worker is an independent contractor.
17	Does the worker, provide the same services for more than one company at at time?	If no, it supports the argument that the worker is an employee.	If yes, it supports the argument that the worker is an independent contractor.
18	Does the worker make the same services available to the public regularly and consistently?	If no, it supports the argument that the worker is an employee.	If yes, it supports the argument that the worker is an independent contractor.
19	Does the hiring company have the right to fire the employee?	If yes, it supports the argument that the worker is an employee.	If no, it supports the argument that the worker is an independent contractor.
20	Does the worker have the right to terminate/quit without liability for non-performance?	If yes, it supports the argument that the worker is an employee.	If no, it supports the argument that the worker is an independent contractor.

MORE INFORMATION CAN BE FOUND ON THE IRS WEBSITE:

<https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>

HOW EMPLOYERS GET IN TROUBLE

The IRS, Labor Department, and other agencies that oversee employment use audits, computer crosschecks, and often tips from workers to ferret out abuses in employment classification.

An investigation is often started when a worker realizes that they would be better off being considered an employee, for example, if they are hurt on the job, or realize they are not being paid overtime. They then approach the Labor Department with a retroactive claim that they were improperly classified.

If the IRS or Labor Department determines the worker should have been paid as an employee (via W-2), the business, not the worker, is penalized.

The employer can face:

- A requirement to pay back payroll taxes plus penalties & interest,
- Related litigation or settlement costs,
- Criminal sanctions with possible imprisonment & fines
- Personal liability for officers (if a corporation).

SUMMARY

Save aggravation - properly classify workers based on the above 20-point test.