

## **Employee or Independent Contractor?**

For most companies, it is easier and cheaper to hire an independent contractor (IC), especially when the work may be temporary. You don't have to provide benefits for ICs and you don't have to collect and pay taxes or contribute company taxes. Problem is, most of the time, these workers are misclassified and should actually be treated as employees. This misclassification is serious and can result in huge penalties and interest on taxes that should have been paid.

There seems to be a misunderstanding among employers regarding ICs. No limits to amounts earned or hours worked requirement exists in the determination of employment status. The determination is made based on what the person is doing for the company, who is giving direction and how the work is getting done. The common law rule for the employment determination is the "right of control." An employer-employee relationship exists when the person for whom the services are performed has the "right to control and direct" the individual performing the service with regard to the results of the work and the measures used to accomplish those goals.

There are three agencies that get involved in employment classification: the IRS, Unemployment, and Workers Compensation. Each agency has a set of determining factors they use when reviewing employment situations. These factors are not the same for all three agencies. Many times the factors overlap and the agencies agree on determinations, but in some situations one agency may determine one way and another agency determines the opposite. This makes classification even more difficult for an employer.

Unemployment and Workers Compensation agencies have certain conditions for IC determination and a worker must meet a set amount of them to qualify. The IRS has a set of conditions; however, they review substance over form and look at each case and condition individually. In one situation the worker may only meet seven of the twenty conditions, but the IRS could conclude that they are an IC based on the substance of those seven conditions. On the other hand, there may be a situation where a worker meets seventeen of the twenty conditions and is still determined to be an employee. The IRS has broken the twenty conditions into three categories to help in determination. The three categories are behavioral control (who has the right of control), financial control (who has a significant investment) and the relationship of the parties (written contract).

Because of these inconsistencies between agencies and the complexity of identifying an IC, it is often recommended that you consult with your tax professional or attorney before making a determination.

With the current economic situation, many companies are hesitant to hire employees due to taxes and benefits. Classifying workers as ICs can be very tempting, but beware of the consequences of misclassification. The determining agencies can go back through years of payrolls and IC payments and require you to make good on all taxes, interest, and penalties for improperly classified employees.

Starting in February 2010, the IRS began the process of randomly selecting 6,000 companies for employment audits. One of the areas they will be looking into is employment determination and ICs. These audits will be held over the next three years. You can view the specific conditions for the IRS on their webpage [Independent Contractor \(Self-Employed\) or Employee?](#)

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