

# INDEPENDENT CONTRACTOR VS EMPLOYEE

## BUSINESS ADVISORY ACTIONABLE PRINCIPLES

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## HOW SHOULD A WORKER BE CLASSIFIED?



### Employee (W-2) vs. Independent Contractor (1099)

- » If classified as an employee, you must
  - Withhold federal income and payroll taxes
  - Pay the employer's share of FICA taxes on the wages plus FUTA and SUTA tax
  - Often provide the worker with fringe benefits
- » If classified as an independent contractor, you must
  - Issue Form 1099-MISC for the year showing the amount paid to the contractor if over \$599

**Are your people classified correctly?**  
**Have you defined and documented the nature of the working relationship?**



## INDEPENDENT CONTRACTOR (1099)

### Independent Contractor - defined



***General rule: An individual is an independent contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done***

- » Pay their own taxes
  - Significant tax savings on Federal employment (Social Security and Medicare) savings
  - Federal (FUTA) and state unemployment (SUTA) tax savings
  - The Independent contractor pays these taxes instead of the company
- » Typically, short-term or project basis
- » Need to provide their own tools and equipment to do the work
- » Does not receive employer provided benefits



## IRS THREE TESTS



### Behavioral Control

A worker is an employee when the business has the right to direct and control the work performed by the worker, even if that right is not exercised. Behavioral control categories are:

- » Type of instructions given
- » Degree of instruction
- » Evaluation systems to measure the details of how the work is done
- » Training a worker on how to do the job



### Financial Control

Does the business have a right to direct or control the financial and business aspect of the worker's job?

- » Significant investment in the equipment the worker uses
- » Unreimbursed expenses
- » Opportunity for profit or loss
- » Method of payment



### Relationship

The type of relationship depends upon how the worker and business perceive their interactions.

- » Written contracts which describe the relationship
- » Benefits
- » The permanency of the relationship
- » Services provided which are a key activity of the business

## DOCUMENTING THE PAYMENTS

### IRS Form 1099 – payments of more than \$599 per person per year

- » Payments should be paid to a Corporation name or business with a tax ID
- » Corporations in most cases are not required to get a Form 1099
- » LLC – maybe (if not taxed as an S-Corporation)




## FORM 1099 REQUIREMENTS

### Independent Contractors – is Form 1099 needed?

- » All Independent Contractors complete an IRS Form W-9
- » You can access an updated copy – IRS.gov
- » Box checked below determines if Form 1099 is needed

#### Check box here



The image shows a sample of IRS Form W-9, titled "Request for Taxpayer Identification Number and Certification". The form is from the Department of the Treasury, Internal Revenue Service. It includes fields for the taxpayer's name, business name, and address. A section for "Check appropriate box for federal tax classification" is highlighted in yellow, with options for Individual/sole proprietor or single-member LLC, C Corporation, S Corporation, Partnership, Trust/estate, Limited liability company, and Other. A note specifies that for a single-member LLC that is disregarded, the taxpayer should check the appropriate box in the line above for the tax classification of the single-member owner. The form also includes fields for the requester's name and address, and a section for exemptions from FATCA reporting code.

#### Who gets a 1099?

- » S-Corporation – NO
- » LLC – S-Corporation/C-Corporation – in most cases NO
- » LLC – Sole Proprietor/Partnership – YES
- » Individual – YES





## DOCUMENTATION NEEDED - CONTRACTOR

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### Written Agreement

- » Agreement in Corporation/LLC name when possible
- » Have Federal Tax ID number

### Expenses – Contractor to have their own expenses

- » Can reimburse expenses if allowed in agreement
- » Contractor should be responsible for their own “business operational expense”

### Insurance – Can your service provider show proof of insurance?

- » Proof of business/liability insurance is strongly suggested
- » NOTE: You may be charged with workers compensation insurance on your contractors if you do not have proof of insurance

## EMPLOYEE (W-2)

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### Employee - defined

- » General rule: If the company they work for has the right to control and direct them regarding the job they are to do and how they are to do it
- » Employer provides most of the tools to do the work
- » Employer covers most of the expenses
- » May receive benefits from the employer including health insurance, retirement and vacation time
- » Typically, more of a long-term relationship






## DOCUMENTATION NEEDED – EMPLOYEE

### New hire paperwork should include

-  » W-4
-  » I-9
-  » State withholding form
-  » Direct deposit
-  » Benefit enrollment

A form titled "Employee Eligibility Verification" with a header for "Department of Homeland Security" and "U.S. Citizenship and Immigration Services". It contains sections for "Employee Information", "Employer Information", and "Verification Information". The form is used to verify the identity and employment eligibility of new hires.

### Records to be Maintained

-  » Pre-Employment documents – Job descriptions, applications, offer letters
-  » Employment documents – Job performance, warnings, compensation
-  » Separation of employment documents – Exit interviews, resignation letters

A form titled "W-4 Employee's Withholding Certificate" with a header for "Department of the Treasury" and "Internal Revenue Service". It contains sections for "Employee Information", "Employer Information", and "Withholding Information". The form is used to determine the amount of federal income tax to be withheld from an employee's wages.

## FAQS

### » Is there such a thing as a 1099 employee?

- » No. A worker can be either an independent contractor issued a 1099 to report payments made for the year or an employee who is issued a W-2 to report payments.

### » What are the differences between an independent contractor and an employee for tax purposes?

- » Generally, you must withhold and deposit income taxes, social security taxes and Medicare taxes from the wages paid to an employee. Additionally, you must also pay the matching employer portion of social security and Medicare taxes as well as pay unemployment tax on wages paid to an employee. Generally, you do not have to withhold or pay any taxes on payments to independent contractors.

### » Can an employee also be an independent contractor for tax purposes?

- » According to IRS guidelines, it is possible to have a W-2 employee who also performs work as a 1099 independent contractor so long as the individual is performing completely different duties that would qualify them as an independent contractor.

### » What could happen if I misclassify a worker?

- » Misclassifying workers as independent contractors adversely affects employees because the employer's share of taxes is not paid, and the employee's share is not withheld. If a business misclassified an employee, the business can be held liable for back pay, overtime, and benefits to a misclassified worker, the employer may be ordered to pay back taxes, interest, and fines.

### » What should I do if I am unsure whether to classify a worker as an independent contractor or employee?

- » If you are unsure whether to classify a worker as an independent contractor or employee, you should seek legal advice from an employment attorney or tax professional with expertise in this area. Classification of workers can have significant legal and financial implications for employers, so it is important to get it right.

### » Are the factors weighed differently when determining whether a worker is an employee or an independent contractor?

- » Businesses must weigh all the factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another. The keys are to look at the entire relationship and consider the extent of the right to direct and control the worker. Finally, document each of the factors used in making a determination.

