

Independent Contractor or Employee?

Understanding the Risk of Misclassification
and How to Avoid It

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What You'll Learn...

- Practical benefits of using independent contractors
- Legal tests government agencies use to determine worker status
- Penalties for classifying workers incorrectly
- The types of events that can trigger an investigation
- How to manage contractors so you don't cross the line

Employee vs. Contractor

It really comes down to control.

- Independent contractors are responsible for delivering a certain result
- Contractors decide what to do and how to do it to achieve that result
- Employees do what you tell them, when you tell them and how you tell them to do it

Why Use Contractors

Using independent contractors is a practical and common tactic for U.S. businesses.

- Offers flexibility
- Limits legal obligations and liability
- Reduces administrative burdens
- Can save time and money

Why Use Contractors Cont'd

- Using independent contractors is not a legitimate way to avoid complying with labor and tax laws
- You can't treat everyone as an independent contractor
- You must follow the rules for classifying workers

Why Classification Matters

Many federal and state agencies watch for misclassification.



**UNITED STATES
DEPARTMENT OF
LABOR**



Why Classification Matters Cont'd

Consequences can be steep if you get it wrong.

- Back taxes (e.g., Social Security, Medicare, unemployment) plus penalties
- Back wages, including overtime pay, for up to three years (sometimes doubled) plus penalties
- Back premiums for workers' comp insurance
- Possible employee lawsuits

What Triggers an Investigation?

- IRS conducts an audit
- DOL or state agency conducts a random investigation
- Worker gets hurt on the job
- Worker files for unemployment
- Worker requests IRS review (Form SS-8)
- Disgruntled worker files lawsuit

Consider This ...

- A national study found that 30 percent of businesses got it wrong
- In most cases, misclassification wasn't intentional
- Independent contractor use continues to rise
- Agencies are cracking down and sharing info

What Are the Rules?

Independent contractor status is determined by certain tests.

- Federal and state agencies – and courts – use different tests
- Rules overlap but there are meaningful distinctions
- In all cases, the *totality* of the circumstances is what matters

Right to Control Test

The “Right to Control” test (also known as the “Common Law” test) looks at the degree of control exerted over the worker.

It considers 3 categories of control:

1. Behavioral Control
2. Financial Control
3. Relationship of the Parties

Behavioral Control

In the Behavior category of the Right to Control test, the main question is whether you are acting like the worker's boss.

- Do you instruct the worker on how, when and where to do the work?
- Do you provide training to do the work in a particular way?
- Is performance closely monitored or documented?

Financial Control

In the Financial category of the Right to Control test, these are the questions to ask:

- Are business expenses paid by the worker?
- Does the worker own his or her own equipment?
- Does the worker have other customers?
- Does the worker have potential for profit or loss?
- Is the worker paid by the project?

Relationship Category

In the Relationship category of the Right to Control test, these are the questions to ask:

- Is there a written contract specifying an independent contractor relationship?
- Is the relationship temporary or permanent?
- Does the worker provide core business services?
- Is the worker eligible for benefits?

Economic Reality Test

The second test is the “Economic Reality Test.”

- Preferred by the Department of Labor and OSHA
- Focuses on the economic relationship with the worker
- Comprised of six factors

Six Factors of the ERT

- 1. Right to control:** Does the worker control how the work is performed?
- 2. Investment:** Who pays for equipment, materials and helpers?
- 3. Length of relationship:** Is the relationship permanent or temporary?

Six Factors of the ERT Cont'd

- 4. **Skill:** Does the work require special skills?
- 5. **Level of risk:** Does the worker's ability to make money depend on his or her managerial skills?
- 6. **Level of integration:** To what extent are the worker's services an integral part of the employer's business?

Contractor Agreement

Have a signed agreement that includes:

- Payment amounts and terms
- Specific end date or concrete deliverables
- Language that the contractor is responsible for tools, equipment and expenses
- Language that the contractor can pursue other customers or clients
- Liability clause

Contractor Don'ts

When it comes to working with a contractor make sure to NOT do the following:

- Let the worker decide if he or she is a contractor
- Set or track work hours
- Give company business cards or an email address
- Provide PTO or other benefits
- Assign helpers or support workers

Contractor Don'ts Cont'd

When it comes to working with a contractor make sure to NOT do the following:

- Provide a dedicated office or phone line
- Pay hourly or salary
- Withhold taxes
- Issue a W-2
- Use full-time for an extended amount of time

Contractor Do's

When it comes to working with a contractor make sure to DO the following:

- Choose contractors with skills and expertise to work independently
- Work with contractors who don't require training or supervision
- Pay by the project
- Treat as a vendor under accounts payable

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