

*Independent Contractor or Employee?*

# How to Get It Right Every Time (and Protect Your Business from Devastating Penalties)

Presented by



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On behalf of



# About Today's Speaker

- ✓ President and Owner of Financial Horizons, Inc.
- ✓ 1099 Queen
- ✓ Has worked in accounting, tax and management consulting with emphasis on representing small business owners for over 35 years
- ✓ Author and live speaker for various national companies and accounting organizations
- ✓ Has been appointed for a three year term to the Internal Revenue Service's Information Reporting Program Advisory Committee (IRPAC)

# *Independent Contractor or Employee:*

## First Things First ...

- ✓ What is an “independent contractor” (IC)?
  - **Independent contractors (ICs)** are workers who are responsible for delivering certain *results*, and maintain full control over the means and methods of achieving those results.
  - **Employees** are workers who do *what you tell them, when you tell them and how you tell them to do it.* (*You maintain control over how they do their work.*)

# *Independent Contractor or Employee:* **First Things First ...**

- ✓ What is an “independent contractor” (IC)?
  - Often referred to as freelancers, consultants, project workers, contract workers or “1099ers”
  - No such thing as a “1099 employee”!

## Time for a Quick Poll

**Do you currently use  
independent contractors to  
help run your business?**

# *Independent Contractor or Employee?*

## First Things First...

- ✓ Using ICs is a practical and common tactic for U.S. businesses
  - Offers flexibility (get what you need, when you need it)
  - Limits legal obligations and liability
  - Reduces administrative burdens
  - Can save time and money

# *Independent Contractor or Employee?*

## First Things First...

- ✓ Using ICs is NOT a legitimate way to avoid complying with labor and tax laws
  - You can't treat everyone as an IC
  - Follow the *rules* for classifying workers
    - Complex, subjective and inconsistently applied
  - Take smart steps to get it right

# Independent Contractor or Employee: Why Does It Matter?

- ✓ Many federal & state agencies are *watching*



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# *Independent Contractor or Employee:* **Why Does It Matter?**

- ✓ Penalties are steep if you get it wrong
  - **Back taxes** (Social Security, Medicare, unemployment) plus penalties
  - **Back wages**, including overtime pay, for up to three years (sometimes doubled) plus penalties and possible employee lawsuits
  - **Back premiums** for workers' comp insurance for as many years as the (worker?) relationship has existed, plus possible employee lawsuit

# *Independent Contractor or Employee:* Why Does It Matter?

- ✓ Investigation can be triggered when...
  - IRS conducts an audit
  - DOL or state agency conducts a random investigation
  - IC gets hurt on the job
  - Employee files for unemployment
  - Employee requests IRS review (Form SS-8)
  - Disgruntled employee(s) file lawsuit

# *Independent Contractor or Employee:* **Why Does It Matter?**

- ✓ National study found 30% of businesses got it wrong
- ✓ Use of ICs has been rising steadily
- ✓ Agencies are cracking down... and sharing info

# *Independent Contractor or Employee:* What ARE the Rules?

- ✓ IC status is determined by certain *tests*
  - Different federal and state agencies and different courts use different tests
  - Rules overlap but there are meaningful distinctions
    - sometimes the same situation results in two different classifications
  - In all cases, the *totality* of the circumstances is what matters

# *Independent Contractor or Employee:* So, What ARE the Rules?

- ✓ “Right to Control” (or “Common Law”) Test
  - Looks at degree of control exerted over the worker
  - Considers 3 categories of *control*:
    1. Behavioral Control
    2. Financial Control
    3. Relationship of the Parties

# *Independent Contractor or Employee:* So, What ARE the Rules?

- ✓ “Right to Control” Test
  - Behavioral Control
    - Does the business instruct the worker on how, when and where to do the work?
    - Does the business provide training to do the work in a particular way?
    - Is **performance** closely monitored/documentated?

# *Independent Contractor or Employee:* **So, What ARE the Rules?**

- ✓ “Right to Control” Test
  - Financial Control
    - Are **business expenses** paid by the worker?
    - Does the worker own or lease **equipment or facilities**?
    - Does the worker have **other customers/clients**?
    - Is the worker paid by **project** (vs. by time)?
    - Does the worker have potential for **profit or loss**?

# *Independent Contractor or Employee:* So, What ARE the Rules?

- ✓ “Right to Control” Test
  - Relationship
    - Is there a **written contract** specifying IC relationship?
    - Is the worker eligible for **benefits**?
    - Is the relationship **temporary or permanent**?
    - Does the worker provide **core business services**?



# *Independent Contractor or Employee:* So, What ARE the Rules?

- ✓ “Economic Reality” Test
  - Focuses on economic relationship with the worker
  - Preferred by the Department of Labor and OSHA
  - Comprised of six factors

# *Independent Contractor or Employee:* So, What ARE the Rules?

- ✓ “Economic Reality” Test
  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?

# *Independent Contractor or Employee:* So, What ARE the Rules?

- ✓ “Economic Reality” Test
  - 4. SKILL: Does the work require special skills?
  - 5. LEVEL OF RISK: Does the worker’s ability to make money depend on his/her managerial skills?
  - 6. LEVEL OF INTEGRATION: To what extent are the worker’s services an integral part of the employer’s business?

*Independent Contractor or Employee:*  
**So, What ARE the Rules?**

**Confused?**

## Time for a Quick Poll

**Which of these documents is most important in order to validate contractor status?**

# *Independent Contractor or Employee:* How to Protect Yourself

- ✓ Sign an “Independent Contractor Agreement” that includes:
  - Payment amounts and terms
  - Specific end date or concrete deliverable(s)
  - Contractor is responsible for tools, equipment, supplies and all expenses related to doing the work
  - Contractor can pursue other customers/clients (confidentiality, non-compete clauses okay)
  - Liability clause

# *Independent Contractor or Employee:* How to Protect Yourself

## ✓ DON'T:

- Let the worker decide he/she is an IC
- Set or track work hours
- Provide company business cards or email address
- Do performance reviews or take disciplinary action
- Provide paid time off or other benefits
- Provide helpers or support workers

# *Independent Contractor or Employee:* How to Protect Yourself

## ✓ DON'T:

- Pay hourly or salary (project-based pricing is best)
- Pay worker out of payroll system or account
- Withhold taxes or issue a W-2
- Contract former employees for similar duties
- Use an IC full-time for an extended period of time



# *Independent Contractor or Employee:* How to Protect Yourself

## ✓ DO:

- Choose ICs with skills and expertise to work independently, without training and supervision
- Treat as a *vendor* under accounts payable
- Be consistent with workers who perform similar duties

# *Independent Contractor or Employee:* How to Protect Yourself

- ✓ Ideally:
  - Work with ICs who have a business name and EIN
  - Choose ICs who have other customers
  - Write checks to the business name
  - Request proof of liability insurance

*Independent Contractor or Employee:*  
**So, What ARE the Rules?**

**When in doubt, treat as  
an employee!**

*Independent Contractor or Employee:*  
**How to Protect Yourself**

Questions?