

1099 Contractor vs W-2 Employee

It's crucial for business owners to correctly determine whether a worker is an employee of the business or an independent contractor. While independent contractors traditionally demand a higher rate than employees, the expenses incurred with traditional W-2 employees can often offset the difference. Employees who receive W-2 wages are subject to Social Security and Medicare taxes paid in part by the employer (currently 6.2% of gross wages). In addition, employers incur the expense of unemployment tax along with the expense of health insurance, paid vacations, sick days, retirement plans, and payroll processing just to name a few. In general, employers don't incur any of these costs for independent contractors. The consequences of treating an employee as an independent contractor when there is no reasonable basis for doing so, however, may result in the employer/company being held liable for past employment taxes for that worker.

Until recently, the IRS used the "Twenty Factor" test to determine the classification of a worker. These instructions were considered too vague and unclear, making it difficult for employers to determine the classification of workers. In an effort to simplify the test the IRS has revamped the list, organizing the items into three main groups: behavioral control, financial control and relationship to the parties.

Behavioral control

Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of—

1. *Instructions the business gives the worker.* An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work:
 - a. When and where to do the work
 - b. What tools or equipment to use
 - c. What workers to hire or to assist with the work
 - d. Where to purchase supplies and services
 - e. What work must be performed by a specified individual
 - f. What order or sequence to follow

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

2. *Training the business gives the worker.* An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Financial control

Facts that show whether the business has a right to control the business aspects of the worker's job include:

3. *The extent to which the worker has unreimbursed business expenses.* Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important.

However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.

4. *The extent of the worker's investment.* An employee usually has no investment in the work other than his or her own time. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.
5. *The extent to which the worker makes services available to the relevant market.* An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.
6. *How the business pays the worker.* An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.
7. *The extent to which the worker can realize a profit or loss.* Since an employer usually provides employees a workplace, tools, materials, equipment, and supplies needed for the work, and generally pays the costs of doing business, employees do not have an opportunity to make a profit or loss. An independent contractor can make a profit or loss.

Type of relationship

Facts that show the parties' type of relationship include:

8. *Written contracts describing the relationship the parties intended to create.* This is probably the least important of the criteria, since what really matters is the nature of the underlying work relationship, not what the parties choose to call it. However, in close cases, the written contract can make a difference.
9. *Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.* The power to grant benefits carries with it the power to take them away, which is a power generally exercised by employers over employees. A true independent contractor will finance his or her own benefits out of the overall profits of the enterprise.
10. *The permanency of the relationship.* If the company engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.
11. *The extent to which services performed by the worker are a key aspect of the regular business of the company.* If a worker provides services that are a key aspect of the company's regular business activity, it is more likely that the company will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

If an employer believes that a worker has been misclassified as an independent contractor, there is an initiative available to reclassify their workers as employees by making a minimal payment covering past tax obligations. Under the Voluntary Classification Settlement Program (VCSP), eligible employers can make a payment of just over one percent of the past year's wages paid to the misclassified worker. There are certain conditions to qualifying for this initiative. If you would like more information please contact Mays & Associates at Maysandassociates.net