

Should I classify a new hire as an employee or contractor?

Should he or she receive a 1099 or w-2?

These are questions we often get from clients. From our experience, there is definitely a benefit to a company if it can legitimately classify an individual as an independent contractor, as opposed to as an employee of the company. The key word noted above is “legitimately”. Misclassifying an employee as a contractor presents problems for the company with the both IRS and the Department of Labor.

Benefits of classifying someone as a contractor as opposed to an employee include savings on payroll tax (social security and Medicare payments), savings on payroll processing cost, etc. Also, producing and filing 1099s for contractors are much less expensive, time consuming and complicated than producing and filing w-2s for employees.

However, the IRS takes very seriously the issue of improperly classifying an employee as a contractor. If you find yourself in this situation of misclassifying an employee, you will pay back all previous payroll tax (since the time of misclassification). You will also pay the employee portion of payroll taxes, plus penalties and interest. Also, the department of labor will collect back unemployment insurance, along with penalties and interest.

Below is a list of 20 questions that should help you in determining whether someone is an employee or contractor.

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Is Your Worker An Independent Contractor Or An Employee?

Listed below are 20 questions from a 1987 IRS guide in which a “yes” answer is an indicator that an employee relationship might exist:

1. Is the worker required to comply with instructions about when, where and how the work is to be done?
2. Is the worker provided training that would enable him or her to perform a job in a particular method or manner?
3. Are the services provided by the worker an integral part of the business' operations?
4. Must the services be rendered personally?
5. Does the business hire, supervise or pay assistants to help the worker on the job?
6. Is there a continuing relationship between the worker and person for whom services are performed?
7. Does the recipient of the services set the work schedules?
8. Is the worker required to devote his full time to the person for whom services are performed?
9. Is the work performed at the place of business of the company, or at specific places designated by the company?
10. Does the recipient of the services direct the sequences in which the work must be done?
11. Are regular oral or written reports required to be submitted by the worker?
12. Is the method of the payment hourly, weekly or monthly (as opposed to commissions or by the job)?
13. Are business and/or travelling expenses reimbursed?
14. Does the company furnish tools and materials used by the worker?
15. Has the worker failed to invest in equipment or facilities used to provide the services?

16. Does the arrangement put the company in the position of realizing either a loss or a profit on the work?

17. Does the worker perform services exclusively for the company rather than working for a number of companies at the same time?

18. Does the worker in fact not make his services regularly available to the general public?

19. Is the worker subject to dismissal for reasons other than nonperformance or contract specifications?

20. Can the worker terminate his relationship without incurring a liability for failure to complete a job?