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Employee Status vs Independent Contractor

For the current year, 2000, one of the hottest issues in the eyes of the IRS revolves around determining a true independent contractor from a "disguised employee."

Why is this such a tricky subject, and why do so many businesses try to use independent contractors instead of employees? One main reason is the tax and money savings differences.

A business that uses an independent contractor instead of an employee saves on payroll taxes. There is no required FICA tax, FUTA (federal unemployment), or State Unemployment Tax. Since these taxes can amount to upwards of 15% combined for the business, one can see a decided advantage shaping up.

In addition, no worker's compensation coverage is required for qualified subcontractors. For certain occupations (especially construction, tree work, or other more "dangerous" work) the cost of worker's compensation coverage can exceed 33% of overall payroll!

An independent contractor does not have to be covered under any retirement or fringe benefit plans (such as medical, or insurance) either. The savings here can be equally substantial.

Finally, from an administrative and tax form reporting basis, independent contractors are far easier for businesses to deal with than employees. No quarterly payroll tax returns, no worker's compensation audits, and no yearly W-2 forms are required to be filed--to name a few.

So one can see where the inducement lies in using independent contractors instead of employees. There's nothing wrong with properly using an independent contractor--that's good business practice. However, the temptation--and danger--exists if a business owner tries to claim independent contractor status for a worker when that worker is really a true employee. This is because if the relationship is challenged down the road, and it turns out the business owner cannot properly prove true independent contractor status existed, the penalties can be enormous in a number of ways.

If the business loses on the challenge, all back payroll taxes must be paid as if the worker were an employee. Additionally, a portion of taxes that should have been withheld for income and FICA from the employee's portion must now be paid by the business employer instead. Then various penalties are added in, and they can amount to over 150% of the recalculated taxes! Finally, interest is charged on the total amount due, dating back to the original liability date, not when it was challenged. Also, workers' compensation insurance can then be back-billed to the original date of hire.

Taking it a step further, if the person being used as an independent contractor were to get hurt on the job, and the business owner were to be challenged as to independent contractor status (perhaps even by the worker who was hurt) the risk of being responsible for all medical expenses, workers compensation payments, and legal damages becomes a frightening reality.

From a retirement plan standpoint, if the business were to lose an independent contractor status challenge, the existing retirement plan for all employees could face disqualification for tax purposes on the basis of failure to cover all required employees. This could be a financial and administrative nightmare.



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So, how does a business protect itself from losing these challenges? The answer lies in being able to meet the various legal "tests" the government and insurance companies use to compare an employee with an independent contractor. Note that just because the business owner and the worker both voluntarily agree it will be an independent contractor situation does not make it so.

What makes it so? Unfortunately, there are a number of these so-called tests that are used by the authorities to make a determination so it is not always such a "cut and dry" matter. Overall, the factors used center around the issues of Control, Integration, and a Continuing Relationship.

Control and Continuing Relationship

The more control the business has over the worker in the day to day activities, and the longer the continuing relationship between the business and the worker (especially if it is an exclusive one), the more the stage is set for it being considered an employee relationship.

Integration

This refers to how important the services being rendered are towards the overall day to day survival of the business in question. The more important this service, the more it slants towards an employee relationship.

Listed next are the majority of the issues used in deciding these three main factors to determine if the person is an independent contractor instead of an employee of your business.

Their services are available to the general public, not just your organization. They work for other businesses, too.

All required licenses and registrations for the services being performed should be in the name of the independent contractor, not your business.

Hours for the job are primarily set by the contractor, not by you.

Tools, vehicles and equipment are provided by the contractor, not you. All repairs on such are borne by contractor.

Contractor provides for his/her own work facilities outside of your workplace.

Business expenses—especially travel—are paid by contractor.

Contractor has no significant involvement in various company fringe benefit programs such as insurances, and retirement plans.

Separate liability insurance is maintained.

Payments should be based on a job basis, not an hourly, weekly, or monthly basis.

The work shouldn't require extra specialized training the contractor must receive by the business owner.



The contractor should not wear any business uniform or company insignia from your business.

Any assistants or workers helping contractor should be under contractor's employ, training, and direction.

There should be no regular, mandatory meetings between contractor and business owner similar to meetings that regular employees attend.

Assignments should be in the form of a written contract with a formal method of termination. Contractor should also have other assignments from other businesses along the way.

Record keeping, advertising, and other normal business activities for the contractor should be handled by the contractor, not by the business using the services.

The more the work is done solely on business premises, the less likely it is an independent contractor status.

Work patterns and work schedules should be set primarily by contractor, not business owner. Too many detailed, written instructions by the business can jeopardize independent contractor status.

It should be a profit/loss arrangement, meaning the contractor could conceivably lose on the deal just like any other business—unlike an employee.

The allowable, customary method within the field in question carries some weight as well. As an example, in the real estate field, the agents are treated as independent contractors, not employees.

As you can see, the list for interpretation purposes is lengthy and quite subjective. The more a business can prove that it did not have control, integration, and continuing, exclusive relationships with the worker, the better the case for independent contractor status.

Special note

If a business uses an independent contractor, it is imperative that proper reporting of these payments be made to the government. If the payments to this individual exceed \$600.00 for the calendar year, a form 1099(usually 1099-Misc) should be filed with the IRS.

This form lists the name, address, and tax identification number of the individual, and how much was paid for the year. Failure to file this can result in penalties, and a possible weakening of the case for independent contractor status. So businesses should always get the pertinent tax information from any independent contractors before paying them.



Independent Contractor Agreement

This agreement is made between the client and the independent contractor according to the terms and conditions set forth:

Independent Contractor:

Name: _____

Address: _____

City, State, Zip: _____

Social Security Number: _____

Client:

Name: _____

Address: _____

City, State Zip: _____

Payment Terms:

Client will pay according to the following terms:

Work Description:

The independent contractor will perform the following work:

Term of agreement:

This agreement will terminate on:

Termination without cause:

Either party may terminate this agreement after a period of 30 days from which written notice has been issued. No cause is required.

Termination with cause:

Either party may terminate this agreement immediately if reasonable cause occurs, and said cause is identified in writing.

Notices:

All notices relating to this agreement must be given in writing. They may be hand delivered or sent to the party at the party's stated address.

No Representation:

Neither party is authorized to enter into any agreements or contracts with others on behalf of the other party.



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- Expense Reimbursements:** Unless otherwise agreed to in writing, client is not liable for any expenses incurred by the independent contractor.
- Tools, equipment, transportation:** Independent contractor will supply his/her own tools, equipment, transportation for the stated work purpose.
- Taxes:** No form of any taxes will be paid by client on behalf of independent contractor. It is agreed that this is not an employer/employee status. Independent contractor acknowledges that all required tax payments, and tax filings are solely the responsibility of the independent contractor, including any possible social security taxes.
- Fringe benefits:** Independent contractor will not be eligible for any type of fringe benefit plan the client may have available to the client's employees.
- Worker's Compensation:** Client is not responsible for providing any form of worker's compensation to independent contractor, or employees of said independent contractor. Further, independent contractor states that all required worker's compensation insurance that must be carried for this assignment is current at this time.
- Licenses, permits:** Independent contractor states that all required licenses and permits needed to carry out stated assignment have been obtained.
- Assignability:** Independent contractor may assign this agreement provided written notice is given, and client agrees.
- Severability:** If a portion of this agreement is held to be unenforceable, the rest of the agreement will still remain in force.
- Amendments:** Amendments, and revisions may be made to this agreement only if in writing, and only by joint consent of both parties.

Client Name: _____

Signature of Client: _____

Date: _____

Independent Contractor Name: _____



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Signature of Independent Contractor: _____

Date: _____