

INDEPENDENT CONTRACTOR OR EMPLOYEE?

Has anyone ever told you that you can avoid having to pay payroll taxes by making your workers independent contractors instead of employees? Like most advice that is too good to be true, this isn't quite true. While it is true that independent contractors are responsible for payment of their own taxes, simply calling someone an independent contractor is not enough. The Internal Revenue Service has rules for determining whether someone is an employee or an independent contractor.

Generally, the Internal Revenue Service looks at three things: behavioral control, financial control, and the nature of the relationship. With regard to behavioral control, the IRS looks at who is supervising the work, who is providing training, and who is setting hours. A worker who is being trained and closely supervised by you, and who works a schedule set by you, is probably an employee and not an independent contractor.

In considering financial control, the IRS wants to know whether the worker buys his own tools and supplies, and whether the worker can make a profit or suffer a loss, just like any other independent business. If a worker is using your tools and is being paid a fixed amount, he is likely to be considered an employee by the Internal Revenue Service.

Finally, the IRS will consider the type of relationship between you and the worker. It will look for any written contracts that describe the relationship that the parties intended to create. It will also consider whether the worker provides services to other businesses similar to your business. The IRS will also consider whether the work performed by the worker is a key component of the business of your company. The IRS will also consider whether the relationship between the worker and your company is temporary or permanent. If the worker works exclusively for you and performs a service that is a key aspect of your business, then he is probably an employee.

The IRS is concerned about the independent contractor/employee issue, because it needs to fix responsibility for payroll taxes. If the Service determines a worker is an employee, even though you have treated that worker as an independent contractor, it will hold you responsible for payroll taxes on all wages that were paid. It can also have an impact on any retirement plan that your company sponsors. If a worker who is treated as an independent contractor is subsequently found to be an employee, you may have to include that worker in your retirement plan retroactively.

What if you already have independent contractors and are challenged by the Internal Revenue Service? Don't cave in. A temporary 1978 law, which has been extended indefinitely, provides protection to employers in certain circumstances. For example, if you can show that businesses like yours in your part of the country have historically treated certain workers as independent contractors, the IRS may be required by law to accept your position, even if it doesn't agree with it. You can also get this protection if you were previously audited by the IRS and the IRS didn't challenge the status of your independent contractors in the previous audit.

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