

IRS, states crack down on independent worker status

By Dave Gram, Associated Press

NASHUA, N.H. — The [Internal Revenue Service](#) and 37 states are cracking down on companies that illegally try to trim payroll costs by changing employees' status to independent contractors, The Associated Press has learned.

The practice costs governments billions in lost revenue and can leave workers high and dry when they are hurt at work or are left jobless.

Many who've studied the problem believe it's worsened during the economic downturn — fueling states to be even more aggressive with their recovery efforts.

By designating workers as independent contractors, businesses can save as much as 30% of payroll.

They can also avoid unemployment insurance and workers' compensation payments, as well as the employer's share of payroll withholding.

EMPLOYEE VS. INDEPENDENT CONTRACTOR: [10 tips for business owners](#)
SMALL BUSINESS ADVICE: [Should you hire an employee or independent contractor?](#)

Employee vs. Independent Contractor – Ten Tips for Business Owners

IRS Summertime Tax Tip 2009-20

If you are a small business owner, whether you hire people as independent contractors or as employees will impact how much taxes you pay and the amount of taxes you withhold from their paychecks. Additionally, it will affect how much additional cost your business must bear, what documents and information they must provide to you, and what tax documents you must give to them.

Here are the top ten things every business owner should know about hiring people as independent contractors versus hiring them as employees.

1. Three characteristics are used by the IRS to determine the relationship between businesses and workers: Behavioral Control, Financial Control, and the Type of Relationship.
2. Behavioral Control covers facts that show whether the business has a right to direct or control how the work is done through instructions, training or other means.
3. Financial Control covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker's job.

4. The Type of Relationship factor relates to how the workers and the business owner perceive their relationship.
5. If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees.
6. If you can direct or control only the result of the work done -- and not the means and methods of accomplishing the result -- then your workers are probably independent contractors.
7. Employers who misclassify workers as independent contractors can end up with substantial tax bills. Additionally, they can face penalties for failing to pay employment taxes and for failing to file required tax forms.
8. Workers can avoid higher tax bills and lost benefits if they know their proper status.
9. Both employers and workers can ask the IRS to make a determination on whether a specific individual is an independent contractor or an employee by filing a Form SS-8 – Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding – with the IRS.
10. You can learn more about the critical determination of a worker's status as an Independent Contractor or Employee at [IRS.gov](https://www.irs.gov) by selecting the Small Business link. Additional resources include IRS Publication 15-A, Employer's Supplemental Tax Guide, Publication 1779, Independent Contractor or Employee, and Publication 1976, Do You Qualify for Relief under Section 530? These publications and Form SS-8 are available on the IRS Web site or by calling the IRS at 800-829-3676 (800-TAX-FORM).

Should you hire an employee or independent contractor?

By **Rhonda Abrams**, Special for USA TODAY

When finding help, one of the first things you'll have to figure out is whether the person you hire will be an:

- Employee or
- Independent contractor

Many companies would prefer to classify workers as independent contractors rather than employees. Here's why: Employees are subject to payroll taxes and come under labor laws; independent contractors do not.

And some workers would rather be classified as independent contractors. Here's why: Independent contractors do not have payroll taxes deducted from each paycheck, and many of their business expenses are tax deductible.

While classifying workers as independent contractors may benefit you financially, even if both you and the worker agree to such classification, employment law limits that choice. If you misclassify a worker, penalties will likely include fines and back taxes for:

- Employee and employer's share of Social Security and Medicare taxes
- Federal and State income taxes that should have been withheld
- Unemployment taxes

Criteria for employee vs. independent contractor

The main issue the IRS uses to determine employee status is who "controls" the worker. The IRS looks at three areas:

1. Behavioral. Does the worker control how they do the work? The IRS looks at issues such as who determines the employee's work hours and location, who controls the order or sequence of the employee's work processes and who owns the tools or equipment the worker uses to get the job done.

2. Type of relationship. How permanent is the relationship? Is the work performed a critical and regular part of the business? Is there a written contract? Is the worker responsible for their own benefits?

3. Financial. Does the worker have a significant investment, i.e., do they own their own tools? Do they make their services available to other and/or work for other businesses?

If you plan on using independent contractors in addition to full-time employees, ask your attorney about how to stay well within the law, and check with your accountant about filing all necessary tax forms.