

Employee or Independent Contractor?

How to Classify a Worker to Protect Your Business

THE PIKES PEAK SMALL BUSINESS DEVELOPMENT CENTER HAS BEEN DEDICATED TO HELPING EXISTING AND NEW BUSINESSES GROW AND PROSPER FOR MORE THAN 30 YEARS.



FREE
CONSULTING



PRACTICAL
TRAINING



BUSINESS
RESOURCES



Funded in part through a cooperative agreement with the U.S. Small Business Administration

WWW.PIKESPEAKSBDC.ORG/CONSULTING

WWW.PIKESPEAKSBDC.ORG/WORKSHOPS



Christina Gilbertson, Esq.

Attorney and Founder at Gilbertson Law Office

Consulting Expertise Includes:

- Risk Management
- Legal Contracts
- Insurance
- Legal Issues
- Employment Issues & Employee Training
- Mergers & Acquisitions
- Succession Planning
- Business Formation
- Construction-related legal issues

[Schedule Consulting](#) with an SBDC Consultant

EMPLOYEE OR INDEPENDENT CONTRACTOR

HOW TO CLASSIFY A WORKER TO
PROTECT YOUR BUSINESS

DISCLOSURES

-
- These materials have been prepared by Gilbertson Law Office, LLC (“GLO”) for informational purposes only and are not legal advice. This information is not intended to create, and receipt of it does not constitute, an attorney-client relationship. GLO makes no warranties, representations or claims of any kind concerning the information presented on or through this presentation.
 - Limitation of Liability. The materials presented in presentation may not reflect the most current legal developments, verdicts or settlements. GLO is not responsible for any errors or omissions in the content of this video presentation or for damages arising from the reliance on materials addressed in this presentation.

Definitions

Pros & Cons of
Employee v.
Independent
Contractor

Distinguishing
Between Employees
& Independent
Contractors

Special IRS
Classifications

Asking for Help
with Classification

Risks &
Repercussions of
Misclassification

Best Practices

Questions

TOPICS WE'LL COVER

DEFINITIONS – EMPLOYEE (W-2)

- An individual who performs personal services for the institution where the institution has the right to control and direct the individual who performs the services, not only as the result to be accomplished, but also as to the details and means by which that result is to be accomplished. **It is not necessary that the institution actually direct or control the manner in which the services are performed; it is sufficient to establish an employee-employer relationship that the institution has the right to do so.**
- An employee is defined as a person hired for a regular, continuous period to perform work for an employer who maintains control over both the service details and the final product.

DEFINITIONS – INDEPENDENT CONTRACTOR (1099)

- The term independent contractor generally refers to a worker who performs services for others, usually under contract, while at the same time retaining economic independence and complete control over both the method by which the work is performed and the final product.
- In the United States, any company, or organization engaged in a trade or business that pays \$600 or more to an independent contractor in one year is required to report this to the Internal Revenue Service using Form 1099-MISC. This form is a report of monies paid to independent contractors. Independent contractors do not have income taxes withheld from their pay as regular employees do.

WHAT'S REALLY THE DIFFERENCE?

- The difference between employees and independent contractors boils down to control. In exchange for a steady wage or salary, employees are generally expected to give up a certain degree of control over their financial and work life. Their schedule is usually set by the company, they usually work on-premises, and the work they do is crucial to the functioning of the business.
- Independent contractors, however, are exactly that: independent. They're paid hourly or per project, they're free to set their own schedule, and their work is often not core to the business.

PROS & CONS - EMPLOYEES

PROS

From employee's perspective:

- Enjoys benefits (vacation/PTO, insurance, retirement plans)
- Greater legal and financial protections
- Permanence, but with the right to quit

From employer's perspective:

- Generally easier to recruit and retain
- Training/Control
- Right to terminate (at-will employees)

CONS

From employee's perspective:

- Earnings are subject to withholdings.
- Cannot deduct “business” expenses such as depreciation and mileage

From employer's perspective:

- Generally more expensive to hire employees.
- Greater compliance costs and reporting responsibilities.

PROS & CONS – INDEPENDENT CONTRACTORS

PROS

From contractor's perspective:

- Greater flexibility – hours, methods of work, hire subs
- Potentially greater earning potential due to multiple clients

From client/company's perspective:

- Worker generally has a higher level of skill and industry knowledge than an in-house employee
- Control over workforce based on business decisions or economic situations
- No benefits/insurance

CONS

From contractor's perspective:

- Greater financial burden for paying for health benefits, retirement savings, disability insurance, self-employment tax, etc.
- Instability

From client/company's perspective:

- Loses greater immediate control over worker and right to fire employee at will (liable for breach of K).
- Cannot dictate how a job is to be performed.



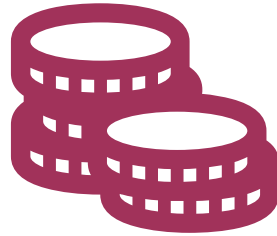
TESTS FOR DISTINGUISHING BETWEEN EMPLOYEES & INDEPENDENT CONTRACTORS



3 TESTS COMMONLY USED



COMMON LAW TEST



ECONOMIC REALITY
TEST



STATE-SPECIFIC

COMMON LAW
TEST

MOST COMMON

USED BY THE IRS

20 FACTORS TO CONSIDER

3 MAIN FACTORS/CATEGORIES

Behavioral Control

Financial Control

Type of Relationship

20 FACTORS OF
COMMON LAW
TEST



INSTRUCTION



TRAINING



LOCATION OF
WORK



WORK
SCHEDULE



TOOLS



MEETINGS



REPORTS



PROVIDING
SERVICES
PERSONALLY

BEHAVIORAL CONTROL

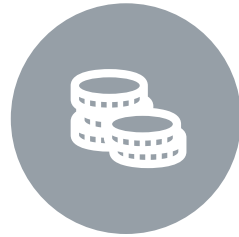
FINANCIAL CONTROL



UNREIMBURSED
EXPENSES



WORKER
INVESTMENT



PROFIT MOTIVE



FREQUENCY
AND METHOD
OF PAY



LIABILITY
COVERAGE

Written Contracts

Benefits

Discharge/termination
rights

Permanency

Integral function/key
function of the
business

TYPE OF RELATIONSHIP

COMMON LAW TEST - 20-FACTORS

1 –
INSTRUCTION

2 – TRAINING

3 – SUCCESS
DEPENDENT

4 – PERSONAL
PERFORMANCE

5 – ASSISTANCE

6 –
CONTINUING
RELATIONSHIP

7 – SET HOURS

8 – FULL TIME

9 – COMPANY
PREMISES

10 – SEQUENCE
OR ROUTINE

COMMON LAW TEST – 20-FACTORS– CONT'D

11 – REPORTS

12 – PAY
FREQUENCY

13 – TRAVEL
EXPENSES

14 – TOOLS &
MATERIALS

15 –
INVESTMENT
IN FACILITIES

16 – PROFIT OR
LOSS

17 – EXCLUSIVE
PERFORMANCE

18 – GENERAL
PUBLIC

19 – COMPANY
TERMINATION

20 – WORKER
TERMINATION

ECONOMIC REALITY TEST

- **There is an employer-employee relationship when a worker is economically dependent on the business for which services are rendered.**
- **Used by US Department of Labor and some states**



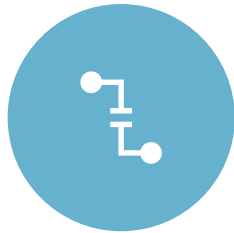
DEGREE OF CONTROL



OPPORTUNITIES FOR
PROFIT OR LOSS



INVESTMENT IN
FACILITIES



PERMANENCY OF THE
RELATIONSHIP



SKILL & INITIATIVE ARE
REQUIRED TO
PERFORM THE SERVICES

ECONOMIC REALITY TEST – 5 FACTORS

COLORADO TEST

Under Colorado Law, an individual is presumed to be in covered employment unless and until it is shown that the individual is free from control and direction in the performance of services, both under contract and in fact, and that the individual is customarily engaged in an independent trade, occupation, profession or business related to the work performed.

TO CREATE THE PRESUMPTION OF AN INDEPENDENT CONTRACTOR RELATIONSHIP, THE WRITING OR CONTRACT MUST CONTAIN THE FOLLOWING CLAUSES:

- The company does not require the individual to work exclusively for the person for whom services are performed; except that the individual may choose to work exclusively for the said person for a finite period of time specified in the document;
- The company does not pay a salary or hourly rate but rather a fixed or contract rate;
- The company does not establish a quality standard for the individual; except that such person can provide plans and specifications regarding the work but cannot oversee the actual work or instruct the individual as to how the work will be performed;
- The company does not provide anything more than minimal training for the individual;

TO CREATE THE PRESUMPTION OF AN INDEPENDENT CONTRACTOR RELATIONSHIP, THE WRITING OR CONTRACT MUST CONTAIN THE FOLLOWING CLAUSES:

- The company cannot terminate the work during the contract period unless the individual violates the terms of the contract or fails to produce a result that meets the specifications of the contract;
- The company does not provide tools or benefits to the individual; except that materials and equipment may be supplied;
- The company does not dictate the time of performance; except that a completion schedule and a range of mutually agreeable work hours may be established;
- The company does not pay the individual personally but rather makes checks payable to the trade or business name of the individual; and
- The company does not combine their business operations in any way with the individual's business, but instead maintains such operations as separate and distinct.

COLORADO'S REQUIRED DISCLOSURES

The independent contractor is not entitled to unemployment insurance benefits unless unemployment compensation coverage is provided by the independent contractor or some other entity, and that the independent contractor is obligated to pay federal and state income tax on any moneys paid pursuant to the contract relationship.

SPECIAL IRS CLASSIFICATIONS



STATUTORY
EMPLOYEES



STATUTORY NON-
EMPLOYEES

**IF YOU'RE
NOT SURE,
ASK FOR
HELP!!**

-
- SS-8: ASK THE IRS TO EVALUATE AND DETERMINE WHETHER YOU HAVE EMPLOYEES OR INDEPENDENT CONTRACTORS
 - CONTACT CO DEPT OF LABOR (<https://www.colorado.gov/pacific/cdle>)
 - WORK WITH YOUR ATTORNEY AND ACCOUNTANT

RISKS & REPURCUSSIONS OF MISCLASSIFICATION

- FINES
- PENALTIES
- BACK-TAXES
- LITIGATION
- WORKERS' COMP CLAIMS
- PENSIONS/401(k) PLANS
- INSURANCE PLANS
- OFFICERS MAY BE HELD PERSONALLY LIABLE

ADMINISTRATIVE REQUIREMENTS/CONSIDERATIONS

- Make sure you're filing the proper paperwork.
- Citizenship & Immigration Issues
- Taxes (Income, Social Security & Medicare, Unemployment)
- Workers Compensation
- Unemployment
- Intellectual Property
- Company's liability for worker's actions related to classification

MAKE SURE YOU HAVE THE PROPER PAPERWORK

Employees

- Get a W-4 BEFORE paying
- File forms W-2 and W-3
- File form 941 for employment tax withholding

Independent Contractors

- Get W-9 BEFORE paying
- File form 1099 and 1096
- Form 945 for backup withholding

WHAT CAN TRIGGER AN INQUIRY OR AUDIT?

Worker Files For Unemployment



Employer Disputes Eligibility, Claiming Worker is an Independent Contractor



Review of 1099-MISC filings (IRS data sharing)



Change in Employee Status/Classification (from W-2 to 1099)



Worker Complaint

IRS

US Department
of Labor

National Labor
Relations Board

Federal & State
Equal
Opportunity
Agencies

POTENTIAL AUDITING AGENCIES

BEST PRACTICES

- Centralize worker classification decisions
- Be consistent!
- Perform regular audits
- Classify workers performing the same/similar work the same
- Look to Industry Practice
- Ensure Written Independent Contractor Agreement Is In Place
- Independent Contractors Should Be Paid Via Invoice to legal business entity
- Utilize Federal Employer Identification (FIN) Number
- Utilize Temporary Help Agencies

BEST PRACTICES – CONT'D

- Independent contractor should not perform the same work as regular employees
- Red Flag: Did the Worker previously provide the same services as an Employee?
E.g., retired and brought back as an independent contractor.
- IRS will look at how worker was previously classified and what is the difference, if any, in services provided.
- File 1099 for any Independent Contractor you pay \$600 or more in any given year.
- **WHEN IN DOUBT, CLASSIFY AS AN EMPLOYEE!**

ACTUAL CASES

- A California based company was charged with misclassifying a group of its employees as independent contractors. The end result was \$11 million in penalties. This company had employees and independent contractors handling many of the same tasks. The court found that the company didn't do enough to clearly distinguish between the two positions.
- A task force in New York found 20,200 instances of workers treated as IC's, representing more than \$282.5 million in unreported wages.
- In Connecticut a 12-month audit reclassified 3,487 workers and uncovered \$68.2 million in unreported wages.
- Massachusetts identified 5,491 misclassified workers, carrying a \$46 million dollar price tag of unreported wages.



QUESTIONS?



THE PIKES PEAK SMALL BUSINESS DEVELOPMENT CENTER HAS BEEN DEDICATED TO HELPING EXISTING AND NEW BUSINESSES GROW AND PROSPER FOR MORE THAN 30 YEARS.



FREE
CONSULTING



PRACTICAL
TRAINING



BUSINESS
RESOURCES



Funded in part through a cooperative agreement with the U.S. Small Business Administration

WWW.PIKESPEAKSBDC.ORG/CONSULTING

WWW.PIKESPEAKSBDC.ORG/WORKSHOPS



Pikes Peak Small Business Development Center

559 E. Pikes Peak Ave., Suite 101, Colorado Springs, CO 80903

719-667-3803

sbdc@elpasoco.com

www.pikespeaksbdc.org

OUR SPONSORS:

