

Employee? Or Independent Contractor?

Make sure you have the records to support which classification you are using.

The Internal Revenue Service (IRS) uses a 20-point checklist split into the three major categories below, to determine if a contractor is truly independent, or if he/she is, in fact, an employee. In the state of New Jersey, all workers are assumed to be employees, unless all three categories give the clear indication that a worker is an independent contractor. This assumption will likely vary from state to state, however the IRS uses the same points of clarification in all of the United States.

Penalties for misclassification are steep, including back pay, and “failure to withhold” penalties, that far exceed what the actual withholding amounts would have been, and going back as many as five years.

The three categories are:

1. **Behavioral Control:** this test determines whether the business hiring the worker has retained the right to direct and control how the work is performed.
2. **Financial Control:** this test determines who controls the financial aspects of the worker’s services, the method of payment, and whether those same services and terms are offered to the public.
3. **Relationship of the Parties:** this tests determines how the business entity and the worker perceive their relationship. Is there a continuing, ongoing relationship between the two that does not have an initiation date, a service period and a conclusion?

KEY: This last category defines whether the worker holds themselves out to the public as a business owner, able to be hired by a variety of business entities.

If so, they would have:

- Employment identification number
- Registered with the IRS or the State Division of Taxation as a business owner
- Business address and phone number
- Business cards and letterhead
- Printed invoices
- Trade name
- Liability insurance
- Website which makes it clear they are in business for themselves, as opposed to a website where it appears they are working for some other business

- Advertisements for their own business services
- Ongoing business expenses unrelated to a specific business entity
- Filings of IRS Schedule C

NOTE: the burden of proof that a worker is NOT an employee, is on the business entity, and therefore these records must be kept on all independent contractors.

Here are some additional guidelines that may help you avoid independent contractor misclassifications:

- **Provide a FORM-1099.** Independent contractors should receive a FORM 1099 at the end of a calendar year, not a W-2 form. A FORM 1099 show that the worker was treated as any other accounts receivable vendor, and not as an employee requiring taxation.
- **Record-keeping.** Businesses should maintain information that demonstrates the independent contractor is in business for themselves and not an “employee” of the organization. Such evidence would include business cards, letterhead, signed contracts, federal taxpayer ID number, copies of business (liability) insurance and worker’s compensation insurance policies for all independent contractors.
- **Create an Independent Contractor Agreement.** Make sure that the contract spells out that the worker is not an employee, and they are not eligible for benefits provided to employees. Make sure there are no terms or statements indicating you as the hiring entity maintaining control over the work performed.
- **Be Consistent.** Independent contractors should not be treated as employees, with handbooks, training materials, uniforms or company email addresses. Payment should be made only after a submitted invoice.
- **Conduct a Self-Audit.** When in doubt, employers are well advised to engage an attorney or knowledgeable accountant in your state to conduct a self-audit on behalf of the employer to ensure all workers are properly classified.