

It's your business



A thriving business often relies on a high-performance mix of employees and independent contractors to get the company's work done. But while the team may act as a cohesive unit, the IRS treats these two kinds of workers very differently from a tax standpoint.

Citing an epidemic of misclassification, the IRS is cracking down on businesses who incorrectly categorize workers as independent contractors. The IRS's motivation is two-fold: lost payroll taxes to the government and lost employee benefits for the workers. When someone is classified as an employee, the business owner must pay social security, Medicare, and unemployment taxes associated with that employee. Other costs such as group health insurance and retirement coverage can also apply.

But when a worker instead is classified as an independent contractor, none of those extra costs come into play. What's more, a contractor can be let go at any time and for any reason within contractual restraints. It's no wonder that contractor status is preferred by businesses.

What is a contractor?

But desirable or not, business owners must classify its workers correctly or face stiff penalties. So who can rightly qualify as an independent contractor? There are many factors to consider, but generally a contractor is someone who controls how they do the work, is paid as the work is done (as opposed to just hourly), and is not permitted to leave the project prematurely without adverse financial consequences. These are just some general guidelines; each situation can be impacted by special circumstances.

In the face of increased IRS scrutiny, employers should take steps now to determine if they are making the right call regarding their workers. This might involve a thorough self-review of each assignment to

see if the factors supporting independent contractor status are valid. To help prevent future problems, employers should insist on signed agreements with contractors that thoroughly specify the scope of the work and how compensation is structured. And if it is necessary for contractors to use your equipment or insurance coverage, be sure to keep such transactions at arm's length, meaning that they pay the market rate for any such benefits.

Settle up with the IRS

What do you do if you discover a misclassification, perhaps one that goes back many years? Fortunately, the IRS has established the Voluntary Classification Settlement Program (VCSP) whereby businesses can settle up with the IRS for past mistakes. Those who opt in pay just 10% of the past year's payroll taxes that would have been due had the workers been properly categorized. To qualify, the business must have consistently classified the workers in question as contractors, filed Forms 1099 for the past three years, and not currently be under federal or state classification audit.

Running an efficient workplace is hard enough, but when you add in complex tax rules to boot, the task becomes that much harder. That is where we come in. To help you navigate through the regulatory maze, give our office a call.



20 factors the IRS looks at

Formerly, the IRS used a “20 Factor” test to determine whether a worker was an employee or an independent contractor. Though these have been consolidated into three general categories (behavioral control, financial control, and relationship of the parties), the old 20-factor test remains useful in properly classifying workers. Keeping in mind that the IRS assumes employee status for workers, here’s a quick review of the 20 factors.

1. How many instructions are given about how, when, and where the work is to be done?
2. How much training is provided by the company?
3. How closely integrated is the work with the company business?
4. Does the worker have to do the work personally?
5. Does the worker hire, supervise, and pay assistants?
6. How long-term is the arrangement?
7. Who sets the working hours?
8. Does the individual work full-time for the company?
9. Is the work done on the employer’s premises?
10. Who dictates the order or sequence of the work?
11. Are written or oral reports required?
12. Is payment by hour, week, or month – or by the job?
13. Are business or traveling expenses reimbursed?
14. Who provides tools, material, and equipment?
15. Does the worker have a significant investment?
16. Is there a potential for profit or loss?
17. Is work done for different companies at the same time?
18. Are services available to the general public on a regular basis?
19. Can the worker be fired?
20. Can the worker terminate relationship without liability?



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