



CLASSIFYING EMPLOYEE AS INDEPENDENT CONTRACTOR CAN BE COSTLY

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Q: I own a small service-oriented business, employ a small staff and experience a lot of turnover. To avoid lengthy and tedious filings for Social Security, income tax and FICA every time I hire a new employee, is it legal to write a contract and have future employees agree to being contract labor/subcontractors and therefore, responsible for paying their own income taxes at the end of the year?

A: Your question classifies the workers as employees and the I R S may also. If they are found to be employees, rather than independent contractors, then you may be in for more trouble and expense than you might save by an incorrect classification of your workers.

The I R S has many free informational publications, such as Publications 937, 533, 15, and Form SS-8, which can be received by calling 1-800-829-3676. Most of these publications will give you examples of situations you can compare to your own to determine if a prospective worker will be deemed an employee or independent contractor.

The contract you may sign with a worker designating that person as an independent contractor and requiring them to take care of their own taxes, may not bind the I R S or other government agencies to the classification you set out there. Regardless of what you call a worker, an "employer" must withhold income taxes on wages, must pay social security (FICA) taxes and withhold the employee's portion of FICA; must pay unemployment tax (FUTA) and is subject to workers compensation and other state and local filings, payments and withholdings.

Its no wonder more small businesses are trying to designate workers as independent contractors rather than employees for cost and paperwork reasons. Generally, you can depend on the I R S 20 point test (described in detail in the I R S publications) to determine the classification of a worker.

Basically, if you set the work hours, provide the tools of the trade, tell the worker what to do and how to do it and can fire them, then the worker is an employee. Receptionists and secretaries are typically deemed employees. An additional factor tending to indicate an employment relationship is whether you or your predecessor has treated any worker holding

a similar position as an employee.

An independent contractor, generally, is a worker who controls when and how he or she works and may have some liability for completion of a project. If payments of \$600 or more are made within a year to that worker, a 1099 should be issued, as opposed to the W-2 an employee would receive.

Misclassification can be costly to the employer. If the I R S finds you had no reasonable basis for the misclassification, you can be held liable for employment taxes, social security, Medicare taxes and may be held personally liable for a penalty equal to taxes that should have been paid if you are the person responsible for the collection and payment of the withholding taxes. Obviously your time and professional fees for attorneys and accountants could add to your cost for a mistake. There may be other implications, such as in terms of disqualification of pension and group health care insurance plans.

If you want the I R S to assist in a determination, file Form SS-8, "Determination of Employee Work Status."

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