



Employee vs. Independent Contractor: The Stakes are High so Make Sure You Do it Right

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Fourth quarter. Year-end in sight. Tax season right around the corner (sigh).

Along with preparations for holiday parties and family festivities, there's one other important (albeit less exciting) piece of planning to undertake: properly classifying your workers.

CLASSIFICATION ISSUES

Classifying an individual as an employee versus an independent contractor has important legal and financial implications for businesses. Proper classification of a worker as an independent contractor can lead to savings on taxes and employee benefits, such as FICA and unemployment taxes, as well as health and workers' compensation insurance. No tax withholding is required.

Classifying a worker as an employee, on the other hand, requires withholding of federal, state, and local income taxes. The employer is also responsible for one half of FICA tax due, as well as federal and state unemployment taxes. The employer must pay for workers' compensation insurance and is responsible for filing numerous returns during the course of the year with the various taxing authorities. An employee may also have rights to available employee benefits, such as health insurance or retirement plans.

Misclassification can result in significant liability for employers, including liability for unpaid payroll taxes, claims based on denial of employees' participation in benefit plans, and possible out-of-pocket liability for workplace injuries resulting from the lack of a workers' compensation insurance policy.

Proper classification involves a rigorous factual analysis of a number of factors related to various statutes, rules and regulations and case law. Taxing authorities and other governmental agencies at the federal and state levels are increasing audits and reviews of employers related to

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PRACTICE AREAS

Employment Law

Tax Law



their worker classification decisions, as the decision to classify workers as independent contractors can lead to decreased tax revenue.

It is important to consult with legal counsel to ensure compliance. As a starting point, Foster Swift has created an easy to use employer "**cheat sheet**" that identifies many of the issues and points of distinction that are relevant to classifying a worker as either an employee or independent contractor.

TAX FORMS AND REPORTING

As tax season approaches, and as classifications issues are resolved, employers must provide workers with the appropriate tax documentation.

W-2 forms document income earned by employees and must be provided to employees by January 31. W-2 statements include wages, tips and commissions earned, as well as total amounts of state, federal and FICA taxes withheld by the employer.

Independent contractors who earn \$600 or more must receive 1099 forms from employers by January 31. 1099 forms list amounts paid to independent contractors. Because taxes are not withheld from independent contractor payments, it is the expectation of taxing authorities that independent contractors pay estimated taxes throughout the year. Independent contractors are allowed to deduct certain work-related expenses associated with fulfilling their work duties.

If you have any questions about how to classify your workers, or how to properly account for and report worker income, please contact a Foster Swift attorney.