

Employee vs. Independent Contractor: What businesses should know about the benefits (and pitfalls) of worker status

By Robert Verzi, Partner

In today's economy, companies are looking for ways to reduce the cost of doing business. Understandably, the opportunity to cut total labor costs substantially often proves irresistible.

Businesses that hire employees are responsible for payroll taxes, employee benefits, and the related administration and compliance tasks. Businesses generally do not have these responsibilities for independent contractors; they need only file a Form 1099-MISC for the payments they make to the contractor.

For some businesses, the reduction in human resource paperwork is sufficient motivation to have work performed by independent contractors. If potential payroll tax and employee benefit savings are also factored into the equation, it is easy to see why many businesses prefer to hire independent contractors for specialized tasks and jobs of relatively short duration.

Classifying a worker as an independent contractor can simply be too good to pass up. However, the IRS is concerned that some employers are classifying true employees as independent contractors merely to avoid payroll taxes. As the IRS continues its relentless assault on worker classification, it becomes increasingly important that businesses take precautionary steps to ensure compliance with all IRS requirements in order to avoid a costly reclassification of workers from independent contractor status to employee status.

Independent contractor status generally is available if the business meets the following requirements:

- Files all information returns (i.e., Form 1099-MISC) for the workers or classes of workers at issue.
- Has not and will not treat the workers at issue (or classes of workers in substantially similar job positions) as employees on income tax returns, payroll tax returns, or other returns filed by the business.
- Has a reasonable basis for treating the workers as independent contractors. The law provides certain safe harbors to meet this requirement, or the business can rely on some other reasonable basis.

These requirements must be met each year. If the company fails to file Form 1099-MISC on a worker, it loses the independent contractor status for that worker for that year. More importantly, if the business fails to treat the workers (and workers in substantially similar job positions) as independent contractors during a particular year, it loses independent contractor

status for the year of violation and subsequent years for the entire class. Thereafter, the company cannot obtain independent contractor status for that class of workers.

Changes in the business work environment, job positions, or the treatment of workers within particular classes may dramatically impact the business's eligibility to classify workers as independent contractors.

Please contact us to discuss worker classification or any tax planning or compliance issues.

Robert Verzi is an International Tax Partner at HA&W with more than 25 years of experience providing international tax solutions to publicly and privately held corporations on an array of international tax matters, such as foreign tax credit management and utilization, structuring foreign and domestic operations, international mergers and acquisitions, and export tax incentives. He also has many years of experience serving foreign-owned U.S. businesses.

Robert has also managed more than 100 transfer pricing-related projects, including pricing planning studies, documentation studies, advance-pricing agreements, cost-allocation studies and effective tax-rate management projects. Previously, he was an international tax partner with the global accounting and consulting firm Deloitte & Touche in Atlanta and New York City, where he was a member of the national transfer pricing team.

He is frequently invited to speak about international tax issues. Recent speaking engagements include conferences sponsored by the Council for International Tax Education, SCACPA and the U.S. Department of Commerce. In addition, he has served as a guest lecturer at the University of Georgia and Clemson University.