



Employee or Independent Contractor

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Employee or Independent Contractor?

In order for a business owner to know how to treat payments made to workers for services, he or she must first know the business relationship that exists between the business and the person performing the services. A worker's status determines what taxes are paid and who is responsible for reporting and paying those taxes.

A worker performing services for a business is generally an employee or an independent contractor. If a worker is classified incorrectly, the IRS may assess penalties on the employer for nonpayment of certain taxes.

Penalties and Interest

When the IRS determines that a worker is actually an employee rather than an independent contractor, the employer is subject to penalties for failure to withhold and remit income, FICA (Social Security and Medicare) and FUTA (federal unemployment tax) taxes, interest on the underpaid amounts, and penalties for failure to file information returns. The state will also seek to collect workers' compensation and unemployment compensation premiums for unreported wages.

Independent Contractor

An independent contractor is self-employed and is generally responsible for paying his or her own taxes through estimated tax payments. A business issues Form 1099-NEC, *Nonemployee Compensation*, to any one independent contractor, subcontractor, freelancer, etc., to whom the business made \$600 or more in payments over the course of the tax year. The business is not generally responsible for withholding income tax or FICA for an independent contractor.

Employee

A worker treated as an employee will be issued Form W-2, *Wage and Tax Statement*, for wages paid. The business hiring the worker is responsible for withholding income tax and FICA. The employer is also liable for FUTA and various state employment taxes. Also, the employee may be eligible for certain fringe benefits offered by the employer, such as health care.

Factors to Determine Worker Status

The general rules for classifying workers as independent contractors or common-law employees center on who has the right to control the details of how services are to be performed. The factors can be grouped into three categories.

- 1) **Behavioral control.** Factors that indicate a business has the right to control a worker's behavior include the following.
 - **Instructions that the business gives to the worker.** Employers generally control when and where work is to be done, what tools or equipment to use, what workers to hire or to assist with the work, where to purchase supplies and services, what work must be performed by a specified individual, and what order or sequence to follow.
 - **Training that the business gives to the worker.** Employees may be trained to perform a service in a particular manner. Independent contractors generally use their own methods.
- 2) **Financial control.** Factors that indicate a business has the right to control the business aspects of a worker's job include the following.
 - **Extent of the worker's unreimbursed business expenses.** Independent contractors are more likely to incur expenses that are not reimbursed, such as fixed