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Independent Contractors: 5 Key Facts You and Your Clients Need to Know

When a worker qualifies as an independent contractor, the employer is generally relieved of obligations related to payroll taxes, minimum wage and overtime requirements, benefits, workers' compensation, and unemployment costs for that individual. However, only a small fraction of workers qualify for independent contractor status.

The IRS estimates that millions of workers nationally are misclassified as independent contractors.* As both federal & state governments continue to take enhanced steps to combat this problem with increased fines & penalties, it is important for small business owners to understand how to properly classify their workers.

Here are five key facts you need to know before classifying a worker as an independent contractor:

Fact #1: Workers are presumed to be employees.

The presumption is that a worker is an employee, unless he or she meets certain criteria established by federal and state tests. If an independent contractor classification is ever challenged, you will need to show that the worker meets these criteria.

Fact #2: Several tests assess status.

Employers can use a number of tests to evaluate a worker's status. The most common is the Internal Revenue Service (IRS) [Common Law Test](#), which is used for federal tax purposes. This test generally looks at the extent to which the employer has the right to control the worker. The [Department of Labor \(DOL\)](#), The [Equal Employment Opportunity Commission](#) and several states also have independent contractor tests.

No single factor stands alone in making a classification determination. Carefully review the test and consult legal counsel if you have specific questions before classifying any individual as an independent contractor.

Fact #3: The DOL recently provided new guidance on its test.

Under the DOL's "economic realities" test, an employee is someone who, as a matter of economic reality, is dependent upon the business to which he or she renders service, while an independent contractor is generally not. In July 2015, the DOL issued an [interpretation letter](#) to provide further guidance on the test. Some economic realities for the DOL's guidance include:

- The extent the work is integral to the business.
- The opportunity for profit and loss.
- The permanency of the relationship.
- The investment in facilities and equipment.
- The level of skill and initiative.
- The nature and degree of control.

Independent Contractors (continued)

Fact #4: The existence of a contract or Form 1099 does not prove independent contractor status.

The DOL has made clear that an agreement between an employer and a worker designating or labeling the worker as an independent contractor is not indicative of the worker's status. Simply having an agreement in place is not an indicator of the economic realities of the working relationship. Additionally, under the IRS Common Law test, the mere existence of a contract does not in itself prove that the worker is an independent contractor.

Fact #5: Misclassification is being enforced and can result in significant penalties.

Misclassification can deny workers the rights and protections to which they are entitled and reduce tax revenue collected by the federal and state government. For these reasons, federal and state agencies have identified misclassification of employees as independent contractors as one of their top enforcement priorities. The penalties for misclassification can be significant.

[Download Form-1099](#)

Conclusion:

Before classifying a worker as an independent contractor, make sure you satisfy all applicable federal and state tests. If, after applying the tests, you are still in doubt, it's a best practice to classify the worker as an employee. You may also request an official determination from the IRS using [Form SS-8](#). Keep in mind, however, that it ordinarily takes at least six months to get an IRS determination.

ADP's payroll & small business HR solutions can help you and your clients stay in compliance with proper classifications. To learn more, contact your ADP sales associate, or visit us at adp.com/accountant.

* Source: <http://dpeaficio.org/programs-publications/issue-fact-sheets/misclassification-of-employees-as-independent-contractors/>

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