



Report Compliments of **Homes and Lifestyles of Colorado** - *Finding Your Place Called Home*

Denver Office: <http://www.DenverHomeLiving.com> - (303) 816-9199 Office

Employee or Independent Contractor?



Most employers in our industry, whether the management company or the homeowners association directly, believe that substantial costs can be saved by their associations utilizing independent contractors in lieu of employees. By hiring independent contractors the employer attempts to avoid costs related to salaries, benefits, payroll and unemployment taxes, labor law disputes, wage and hour claims, overtime, workers compensation coverage, and responsibility for most worker negligence occurrences. The employer also avoids having to supply office space, overhead, and equipment/supplies normally associated with an employer/employee relationship. Furthermore, if the employer becomes unhappy with the worker's performance, it can easily change to another independent contractor without having to experience the trauma associated with terminating an employee.

When utilizing independent contractors, the only requirement of the employer is the need to issue to the contractor a Form 1099 at the end of the year which summarizes the total earnings of the contractor - - and this form is only necessary for those contractors who were paid in excess of \$600.00 during the year. The employer must also submit a Form 1096 to the Internal Revenue Service which provides a summary of each of the Form 1099's distributed to the independent contractors.

This type of relationship benefits the independent contractor by allowing them the deduction of many work-related expenses which would not ordinarily be deductible by an employee, in addition to providing the freedom of being one's own boss. The independent contractor has no withholding taxes deducted, allowing them more control of their own cash flow.

Liability for Misclassification

However, while there are certainly financial and operational benefits associated with this approach, the employer needs to fully understand the substantial liability connected with the misclassification of an employer/employee relationship. The Internal Revenue Service (IRS) and the U.S. Department of Labor, as well as various State agencies, monitor employer compliance with employee and independent contractor classification. The criteria for establishing compliance is not always clear, even among those various governmental agencies. Special IRS teams search for misclassified workers under the Employment Tax Examination Program (ETE). These ETE audits typically focus on industries where abuses are suspected to be more common, but could be directed against any business at any time simply because they happen to file a substantial number of Form-1099's for independent contractors.

If found to be in violation, the tax code authorizes the IRS to force the offending business owner to (1) retroactively pay all past due taxes, (2) pay the interest that has accrued since the payments were originally due, and (3) pay a penalty of up to 100% of the original amount due. The employer may also be obligated to pay any required contributions such as the employer's and employee's share of Medicare and Social Security, federal (and state) unemployment taxes, and workers' compensation benefits. It is important to note that these costs are in addition to any expense the employer may have related to attorneys and/or tax advisors in trying to rectify the problem. Clearly, the cost of misclassifying an employee as an independent contractor is high. And, while an employer may recover from the employee his or her share of past income-related taxes that were not properly withheld, the cost of trying to collect those funds might be greater than the recoverable amounts.

IRS Criteria for Employee or Contractor



The IRS has supplied its auditors with the following twenty (20) criteria by which to determine whether a provider of services is an employee or an independent contractor. No single factor is determinative; however the following are used to gauge the degree of the worker's economic dependency on the employer:

1. **Instructions.** Does the business require the worker to follow their instructions on how work is to be performed? If yes, this generally indicates employee status. An independent contractor will usually decide how the project will be completed.
2. **Training.** Does the business provide training to the worker? If you're hiring a person for a job they are not trained for and providing them with the training to carry it out, that person is likely an employee.
3. **Integration.** Are the worker's services an integral part of the business? This indicates employee status because it demonstrates the business maintains control and direction over the worker.
4. **Services Rendered Personally.** Does the business require the worker to perform all services personally? Independent contractors should have the option of hiring other workers to perform the work. Agreements for personal services indicate employee status.
5. **Hiring, Supervising, and Paying Assistants.** Does the business hire, supervise, and pay the worker's assistants? If so, then it is a good indication of employee status. An independent contractor should pay his own assistants.
6. **Continuing Relationship.** Does the business have an ongoing relationship with the worker? This could be viewed as employee status.
7. **Set Hours.** Does the business set the schedule and hours of the worker? Independent contractors generally set their own work schedules.

8. **Full-Time Requirement.** Does the business require the worker full-time? If so, this would indicate employee status because the business controls the worker's availability and prevents them from working for other employers.
9. **Employer's Premises.** Does the business provide the workspace? This could possibly suggest control over the worker, especially if the work could be performed elsewhere.
10. **Order or Sequence.** Does the business determine the order or sequence of the work to be performed? Again, this suggests control over the worker and employee status.
11. **Oral or Written Reports.** Does the business require oral or written reports? The IRS believes that the requirement that a worker submit oral or written reports indicates employee status.
12. **Payment Method.** Does the business pay by the hour, week, month, or some other regular basis? An independent contractor is normally paid at the end of a job, task, or by contractual arrangement.
13. **Payment of Business Expenses.** Does the business pay the worker's business and travel expense? This would be an indication that the business is directing the worker's business activity, and would demonstrate an employee relationship.
14. **Tools and Materials.** Does the business provide tools and materials to the worker? Independent contractors normally provide their own tools and equipment.
15. **Significant Investment.** Does the worker have a significant investment in their own facilities? The lack of any significant investment in the entity on the part of the worker indicates employee status.
16. **Realization of Profit or Loss.** Does the worker have profits and losses independent of the business? A worker who can realize a profit or suffer a loss as a result of services provided generally would be classified as an independent contractor.
17. **Services Available to Others.** Does the worker have other clients? An independent contractor usually provides services to multiple unrelated entities, whereas an employee will provide services exclusively to one employer.
18. **Working for More than One Entity.** Does the worker market their services to the general public? This would indicate that the worker is an independent contractor.
19. **Right to Discharge.** Does the business have the right to discharge the worker at any time? The right to fire a worker is a factor indicating the worker is an employee. An independent contractor would only be discharged for failure to meet contractual obligations.

20. **Right to Terminate.** Does the worker have the right to quit at any time? If so, this would indicate an employee relationship. An independent contractor is under contract and generally cannot quit until the project is completed.

The foregoing listing is not intended to be all inclusive, but merely a guideline for some of the more obvious issues considered in each and every case brought into review by the Internal Revenue Service and other taxing agencies. No one point or grouping of points is conclusive evidence as to the determination of employee vs. independent contractor status. Each of these tests contains a degree of subjectivity, but the primary component in each is the degree of control exercised by the employer over the activities of the service provider. As that control increases, the likelihood of the worker's employee status increases. For that reason, every employer should carefully examine the relevant criteria to ensure the proper classification of its workforce.

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