

**From the desk of  
Peter S. Muffoletto, C.P.A.**

## Independent Contractor or Employee?

Employers tend to look to potentially save expenses by classifying employees as Independent Contractors.

This is not only dangerous but can come to haunt an employer several years later should the IRS or any other taxing authority involved in collecting payroll taxes determine that what would have otherwise been an employer/employee relationship was misclassified and the appropriate payroll taxes were not paid.

The question that arises is whether workers are in fact independent contractors, or employees which in instances where workers were previously determined to be employees, the change to Independent Contractor will be set aside with substantial penalties and back taxes being assessed against an errant employer.

The answer lays in the relationship between the business and the worker.

Generally whether a worker is an employee or an independent contractor depends upon how much control exists between the business and the worker(s).

Should the employer have the right to control or direct the work, the work product, and how that work is to be done then workers are most likely employees.

In addition one of the more persuasive criteria that both the IRS and other taxing authorities rely upon is whether the employer provides the workplace, and tools of the trade to the worker. If so, generally an employer, employee relationship exists, but with the ever growing working from home aspect of the economy has evolved, other criteria are used to determine the nature of the relationship such as if the worker has any other businesses that they perform work for, and lacking that, an employer employee relationship probably exists.

Should direction or control exist only as to the result of the work done, and not the means and methods of accomplishing the result, then there may exist an independent contractor relationship, but this is also dependent upon other factors.

The IRS has published over 21 specific criteria (these can be found at our website [www.petemcpa.com](http://www.petemcpa.com) under FAQ's – Independent Contractor Guidelines).

Three broad characteristics are used by the IRS to determine the relationship between businesses and workers:

- Behavioral Control
- Financial Control
- Type of Relationship.

Behavioral Control covers facts that indicate whether the employer has a right to direct or control how the work is done through instructions, training, or other means.

Financial Control relates to facts that indicate whether the business has a right to direct or control the financial and business aspects of the worker's job.

The Type of Relationship factor relates to how the workers and the business owner perceive their relationship.

While the answers can have a profound impact on how much tax a business will incur, knowing whether your workers are or are not employees will affect the amount of taxes you must withhold from their pay.

The determination will also affect the additional costs the business entity must bear, and what documents and information that must be provided, and what tax documents must be produced.

Employers who misclassify workers as independent contractors can face substantial assessments as well as penalties for failing to pay employment taxes, and failure to file required tax forms.

There also exists the problematical area of whether workers have lost benefits as to their employment status and therefore have a defensible claim against the business for those lost benefits.

Both employers and workers can ask the IRS to make a determination on whether a specific individual is an independent contractor or an employee by filing a Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

Should your business have a pension plan or any other benefit programs relating to employees that have been misclassified and therefore effectively lost benefits, or effectively barred from inclusion as to those plans, there exists substantial penalties in regards to the pension plans themselves.

Knowing the proper worker classification can be critical to your business. Don't guess, as it can be very costly in terms of the potential assessments of back taxes, penalties, and interest, defense costs, and potential employee litigation relating to lost benefits.

Bottom line here is to ask us before making a decision. If there is any doubt then we will suggest obtaining a determination from the IRS.

---

We here at Muffoletto & Company believe that the more informed you are in regards to the rules and regulations that affect you the more we can be of service.

Should you have questions relating to tax or financial matters  
give us a call at  
(818) 346-2160,  
or you can visit us on the web at  
[www.petemcpa.com](http://www.petemcpa.com)!

**Providing individuals, small businesses, corporations,  
partnerships, professionals, and other business entities with the  
necessary guidance and answers for a complex world.**