



Employee v Independent Contractor Audit

As entrepreneurs, you hire various individuals to perform services for your business. Your company set up might be of just independent contractors, employees or a mix of both. During the course of your business cycles, there comes a time when the lines are blurred between the two classifications of employment; and what you once might have hired as an independent contractor is now actually an employee. Naturally, the change in status of the business relationship means that the employer has more fiscal responsibility towards the government and the employee. However, not all business relationships evolve into an employee status but as employers you should have a working knowledge of the differences between an employee and independent contractor.

As part of your annual review and preparations for the new year, I've created a quick Employment Classification Audit to help you better understand your company employment set up.

How much control do you, as an Employer, have over the work performed by the worker? Generally, the more detailed the instructions get, the more control the company has over its worker, which indicates a employee relationship. The key is not whether the company is actually exerting this control but that the employer has the right to direct and control the work performed by the worker. Other aspects to determine is the degree of financial and business control the employer has over its worker's job performance. Lastly, consider what the perception of the relationship is between the parties.

Each situation is different but below is a quick reference guide for your ease. If you check more than one of these boxes then I recommend reassessing your classification for the independent contractors that you have hired because they just might be an employee!



Is your Independent Contractor actually functioning as your Employee?

- ☐ Employer provides your worker with tools to complete its job such as the following:
 - Laptop, computer, and/or mobile phone
 - Tools of the trade (i.e. lab products, camera, software)
 - Uniform
- ☐ Employer gives instructions to Worker on **when/where/how** to work, such as:
 - Worker has to work at the office or a designated location from 8-5 p.m. M-F.
 - Which workers to hire and/or to assist for the work.
 - Where to purchase supplies and services.
 - Which sequence to follow when performing the work.
- ☐ Evaluation systems set in place to gauge **how** the work is done, whether periodically or at the completion of the project.
- ☐ Training systems set up by employer for the worker on how to do the job, procedures and methods, whether periodic or on-going.
- ☐ Lack of significant investment by worker in the equipment they use to perform their job. (While this is not an absolute indicator, but independent contractors tend to have a significant investment in the equipment they use for their work.)
- ☐ Reimbursement of expenses.
- ☐ Limited to no opportunity for profit or loss for your worker in the course of their job duties.
- ☐ Worker's services aren't available to the market. Generally, an independent contractor has the ability to market their services and seek out more business opportunities
- ☐ A regular wage amount is guaranteed for an hourly, weekly, or other period of time to your worker.



- ☐ Written contract terms states the employer/employee business relationship. The contract isn't sufficient to determine status but it definitely goes to the perception of the relationship between the parties.
- ☐ Worker receives benefits such as insurance, pension plans, paid vacations, sick days, and disability insurance.
- ☐ Hiring the worker with expectation of a continued, indefinite business relationship.
- ☐ Services provided by the worker are part of the key activities of the business. The thinking is that if the worker performs services that are the business' key activities then the employer is more likely to have control over worker's performance.

Misclassifying your workers can lead to penalties and back taxes if there isn't a reasonable basis for the classification. It's important to have a basis for your classification and to know when certain business activities can cause an evolution in the relationships. While this list isn't exhaustive and each factual situation is different, having this checklist handy is a great business tool. For more information, check out www.irs.gov.

Do you have more questions about business' and employment law ? We are always happy to help you with your legal needs!

I hope these Tips of the Trade help you start your entrepreneurial journey on the right path. I would love to provide a solid legal foundation for your business needs. You can contact me, Girija Bhargava Patel at GBP@GBPLaw.com. To get more information on how to make your business legally solid, sign up for our tips of the trade at gbplaw.com and follow us @gbplaw on Instagram and Facebook.



Just a little disclosure, I'm based in Texas and licensed to practice in Texas, so I may share information about Texas laws and requirements. If you are based in another state, you will want to consult an attorney licensed to practice law in your state. Thank you for joining our GBP Law Family and while I enjoy sharing tips of the trade with everyone, please remember that this Employment Classification Audit does not constitute legal advice. It does not establish attorney-client relationship between us. If you need legal help with any matter relating to your business, I recommend seeking out the advice of an attorney who can help you specifically. Additionally, for further questions about tax or accounting, I advise reaching out to other professionals which include CPAs, tax attorneys and other consultants that can help protect your business and take it to new levels.