



Compliance Overview: Independent Contractors

Not unlike making employees salaried across the board, many employers will hire someone as an independent contractor because the employee “prefers to be paid that way” and it again seems win/win for the employer and the employee. But alas, it’s not that simple. Understanding the laws around hiring employees is important for any business, but many employers make the unintended mistake of bringing “employees” on as independent contractors instead of regular employees. However, classifying someone as an independent contractor is risky because misclassification can have costly legal consequences.

There is no bright-line test to determine when a worker should be an employee versus a contractor, and the distinction is not always clear, but the responsibility for classifying a worker rightly falls on the employer. There is a common misconception that you can just reclassify a 1099 worker as an employee and be safe treating them as such if both parties agree, but that’s not the case. Employers must apply all applicable “tests” and follow the guidance and regulations set forth by both the Department of Labor (DOL) and Internal Revenue Service (IRS).

If an independent contractor is found to meet the legal definition of an employee, the organization may be required to:

- » Reimburse the worker for wages that should have been paid to them under the Fair Labor Standards act (FLSA) overtime and minimum wage requirements.
- » Pay back taxes and penalties for federal and state income taxes, Social Security, Medicare, and unemployment.
- » Pay any misclassified injured employees workers' compensation benefits.
- » Provide employee benefits, including health insurance, retirement, etc.

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Some Independent Contractor Pre-Engagement Questions:

- » Is this a legal entity (LLC, Sub Chapter S Corp, Corporation, etc.)? If so, then you should get a copy of their federal tax ID.
- » Do they maintain professional liability coverage, such as errors and omissions (E&O) insurance? Liability insurance provides coverage in the event something goes wrong, such as injuries that occur on your property or when they are visiting clients.
- » Do they have commercial auto coverage? This coverage protects not only the contractor but also the hiring entity in the event an accident occurs while the contractor is driving as part of the job he or she was hired to do. For example, if a contractor is taking your client out to lunch and causes an injury or accident, his or her commercial auto coverage will take care of the accident costs, rather than having your organization held liable.
- » Does your current workers' compensation Insurance cover contractors?

Best Practices

1. We recommend that employers **always** make the presumption of employment when there is a question as to whether an individual is a contractor and classify the individual as w-2 employee, if the work is temporary as part of a project you can classify them as a part-time, temporary employee.
2. If your organization hires independent contractors, all contractors should have a W-9 on file. Make sure to gather the W-9s at the start of the contract and not at the end of the year. IRS guidelines state that if a W-9 is not on file, you should be withholding a standard 28% in backup withholdings.
3. Contractors should be invoicing for all agreed-upon work and they should dictate the payment terms.
4. We recommend having a contract on file for all independent contractors confirming that their independent business is compliant with all labor, immigration, and tax laws and

I've determined my 1099 should be a W-2 employee; how do I reclassify this worker?

Employers often ask how to reclassify their independent contractors and we've written about it [here](#).

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