

Hiring Independent Contractors

Legal issues to keep in mind when using independent contractors rather than full-time employees

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By Susan Wilson Solovic

Many business owners are tempted to categorize workers as independent contractors (ICs) rather than employees, and for good reason. By categorizing workers as ICs, businesses can usually save time, money and headaches. However, tread cautiously. If you misclassify a worker, the results can be costly.

Independent contractors are people who are considered to be in business for themselves. Therefore, your business is not required to pay state and federal payroll taxes or other employee benefits, which can add 20 to 30 percent to payroll costs. Instead, the independent contractor is expected to pay estimated taxes directly to the IRS four times per year. However, if the IRS determines that the worker you've classified as an IC is actually an employee, get out your checkbook. Not only will you have to pay the back taxes, but you'll also be hit with a penalty of 12 to 35 percent of the total tax bill.

To avoid that, make sure you understand the criteria used to judge the status of a worker. Different federal and state government agencies use a variety of tests to determine whether an actual independent contractor relationship exists. These agencies include: state taxing authorities, the U.S. Department of Labor, and state unemployment and workers' compensation agencies. The most commonly recognized assessment is the IRS's 20-factor test. Primarily, the decision hinges on the degree of control you exercise over the individual. For example, some of the criteria the IRS considers include:

- The individual's ability to set his own hours and do the job in his own way.
- The individual's ability to use her own methods as opposed to being required to undergo training from the purchaser of her services.
- The individual can earn a profit or suffer a loss from the activity.
- The individual is able to assign his own workers to do the job and is not required to do it personally.
- The individual is hired for one job and does not have a continuing relationship.
- The individual has more than one client at a time.
- The individual pays her own business and traveling expenses.
- The individual works off the employer's premises and uses his own offices, desks and equipment.
- The individual agrees to complete a specific job and is responsible for satisfactory completion, or she is obligated to make good for any failure.

Sometimes a written IC agreement may help establish the nature of the relationship. The agreement should spell out the scope of the work the individual will perform and when it will be performed, as well as how much he or she will be paid. However, an agreement alone will not be enough to avoid an IC being reclassified as an employee.

So before you take the easy way out, make sure you've carefully reviewed what your relationship will be with the individual you are going to hire. A few dollars saved today could be a costly mistake tomorrow.

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