



Insight Paper # 07:

Independent Contractors - How to Classify Workers

One of the steps we recommend to clients who use independent contractors, and who therefore face a heightened risk of a costly IRS payroll tax or benefits audit, is a quick review of some of the key factors the IRS instructs its agents to focus on in determining whether a worker should be classified as an employee.

The primary inquiries fall into three categories: (1) Who has financial control of the job?; (2) Who can exercise control over how the worker performs the specific task?; and (3) How do the parties themselves view the relationship? When reviewing the checklist, keep in mind that the IRS will make its decision based on all circumstances, not just a single factor.

Workers are more likely to be classified as independent contractors if they:

- Make a significant investment in business property (a home computer is not significant);
- Pay their own business expenses;
- Receive a flat fee that is not based on an hourly or similar rate;
- Are not prohibited from doing work for other companies;
- Can pay subcontractors to get the job done;
- Are not performing services as an integral part of your regular business;
- Have a contract with an enforceable liquidated damages provision;
- Can make a profit;
- Can suffer a loss.

Workers are more likely to be classified as employees if they:

- Are given specific instructions and on-going training in how to get the work done;
- Cannot work for others;
- Have expenses paid by your company;
- Are paid with a salary or hourly wage;
- Do not have a significant investment in their trade or business;
- Are an integral part of your regular business;
- Receive direct reimbursement for all, or almost all, expenses.



Less important factors include:

- Whether or not the work is performed on the business's premises;
- Whether the worker has flexibility in setting hours;
- Whether the relationship is temporary or short-term;
- Whether the work is full- or part-time;
- Whether the worker performs services for one or more businesses.

If you suspect from this list that there might be a problem, we would be happy to help you analyze your hiring practices and suggest effective solutions if necessary.

The Marston Group, PLC