

The Power of Simplicity**Independent Contractor vs. Employee: What Can These Workers Offer Your Business?*****As independent contractor growth outpaces employee hiring, employers should have a strong understanding of worker classification***

Determining the differences between an independent contractor and an employee can be confusing. While you must take the appropriate steps to correctly classify each worker, the process can become complex. And with the recent growth of independent contractors in the U.S., employers should take time to understand what this group of workers can offer a business, as well as applicable compliance considerations.

The IRS, the National Labor Relations Act, Title VII of the Civil Rights Act, and the Fair Labor Standards Act include references to assist in determining coverage for employees under the applicable laws. Workers may be considered an independent contractor for tax purposes, but an employee under another law i.e., coverage may be different under wage and hour laws. Employers will want to ensure compliance with all applicable laws.

This article will be limited to the IRS' test for independent contractor classification.

Tax requirements

An employee is generally considered an individual who works for wages and salary, while an independent contractor signs a contract to provide specified services at an agreed-upon price and time and during a specific time frame. It may seem as though the categories occasionally overlap, but non-compliance with IRS rules in this area can lead to stiff financial penalties for an employer.

The level of control an employer has over a worker generally determines whether a worker should be considered an employee or contractor for tax purposes. Here are commonly accepted indicators of control:

- Behavioral: Does the employer control how and when the worker does their job?
- Financial: Does the employer control when and how the employee is paid and which expenses, if any, are reimbursed by the employer?
- Relationship type: Does the worker have a written contract or receive any type of benefits such as sick leave, paid vacation days, or health insurance? Is the relationship ongoing or finite in length?

For independent contractors

With an independent contractor, an employer generally:

- Assigns specific projects and/or responsibilities;
- Establishes a deadline for project completion and delivery of services; and
- Has limited reporting or tax obligations.

Business owners should request that independent contractors complete a Form W-9. This form requires a contractor's taxpayer identification number, which is a Social Security number or an employer identification number. This form should be on file for four years in the event any questions arise from either the contractor or the IRS.

IRS Form 1099-MISC is used by businesses to report the total compensation paid to an independent contractor in the previous tax year. This form is filed with the IRS and provided to the contractor for reporting income. Contractors who were compensated \$600 or more for services rendered during the tax year are required to be issued a Form 1099-

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MISC. Businesses must file the Form 1099-MISC with the IRS by January 31 if reporting non-employee compensation (box 7) or February 28 (March 31, if filed electronically) for all others. They are also responsible for providing independent contractors with a copy of Form 1099-MISC by January 31 of the year following payment.

Businesses should also file Form 1096, which includes the combined totals for all independent contractors paid \$600 or more during the previous tax year. Employers should not withhold any taxes from a contractor's wages. Contractors pay taxes directly to the federal government and employers don't have to match any of their Social Security or Medicare taxes, as they do with employees. No unemployment tax is owed for those workers.

For employees

If someone is classified as an employee, the employer must follow certain federal employment laws and regulations, including providing those workers with overtime pay for hours worked over 40 in a workweek, unemployment insurance, and workers' compensation insurance.

With an employee, an employer generally:

- Has total control and direction over that person's work activities;
- Can train the individual any way they desire;
- Can require the employee work only for them; and
- Can terminate that employee at any time.

For each employee hired, the employer must collect a Social Security number to enter on an annual Form W-2 wage and tax statement, as well as a signed Form W-4 that provides the information needed to calculate the amount of federal income tax to be withheld from each paycheck.

Certain forms need to go to the IRS and the Social Security Administration, such as the quarterly federal tax return for employers ([Form 941](#)) and the annual Federal Unemployment (FUTA) Tax Return ([Form 940](#)).

Independent contractors vs. employees: which worker should you choose?

You may want to consider hiring an employee if the job entails ongoing supervision, control of the time and resources used by the employee, and if the work is indispensable to a business. An independent contractor might be more desirable if the task is peripheral to your business, can be completed by an expert who doesn't need supervision, and/or entails a short-term time frame.

With an increasingly competitive labor market, independent contractors now differentiate themselves by becoming proficient in highly specific niche markets. As advancements become more broadly adopted within an industry, they may require industry specialization to apply them effectively. Employers working to keep pace with sophisticated technologies may see a significant advantage in drawing on the specialized expertise and experience of independent contractors.

New research finds independent contractor growth outpaces employee hiring

Independent contractors have established themselves as a significant and important part of the U.S. labor market. In fact, independent contractor growth peaked in August 2017 at 11 percent year-over-year, according to new Paychex research. And while that has since slowed (5 percent in August 2018), it has far outpaced the growth rate for employee hiring for the past five years among businesses with 1-49 employees and at least one independent contractor. The infographic below offers more insights into how this group of workers is shaping the business landscape.

Independent Contractors are Changing the Business Landscape



Digging into the Data by...

<p>Business Size</p> <p>1-4 Employees</p> <p>Among small businesses that utilize independent contractors, businesses with one to four employees utilize the most independent contractors (6.7 per employer).</p>	<p>Gender</p> <p>1.5% Increase</p> <p>Of the small businesses that use independent contractors, there is a slightly higher percentage of male independent contractors (51 percent nationally), but the percentage of female independent contractors is on the rise, increasing 1.5 percent during the past five years.</p>
<p>Region</p> <p>South</p> <p>38% utilize independent contractors</p> <p>Among the businesses analyzed, the South has the highest percentage of small businesses with independent contract workers among regions (38 percent) and the Northeast has the lowest percentage (26 percent).</p> <p>North</p> <p>26% utilize independent contractors</p>	<p>State</p> <p>37% of total workers in Texas</p> <p>In Texas, total worker growth slowed at businesses that utilize independent contractors from the middle of 2016 through 2017. When it increased once again, it was led by independent contractors, which averaged 33 percent of total workers in 2016 through 2017, and 37 percent in 2018.</p>
<p>Metro</p> <p>47% of total workers in Miami</p> <p>Independent contractors have driven worker growth in Miami, especially during the past five years. Among small businesses that utilize independent contractors, independent contractors make up 47 percent of total workers in Miami, compared to a national average of 36 percent.</p>	<p>Industry</p> <p>+ Trade, Transportation, and Utilities</p> <p>Of the small businesses that use independent contractors, businesses in Trade, Transportation, and Utilities use the most independent contractors and businesses in Manufacturing use the fewest.</p> <p>- Manufacturing</p>

About the Data
The data included in the "Independent Contractors are Changing the Business Landscape" infographic was taken from a historical analysis of a subset of Paychex clients, with 1-49 employees and at least one independent contractor (filed as a 1099-MISC), comparing the rate of growth for independent contractors vs. employees since 2010 through August 2018.

The Power of Simplicity**Matching the right resource with your wants and needs**

Knowing which resources to call upon at a given time can help you determine whether a contractor or an employee is best suited for the business's needs.

Independent contractor examples

For example, if you face an impending deadline on specific tasks on a major project, it might be wise to utilize a contractor who can focus on the task at hand and be contracted to meet your deadline. This can be preferable to having one or more full-time employees put in extra hours to complete the task.

A skilled contractor might also be a solution if the task includes a highly-specialized skill. From computer programming to graphic design, contractors may get the task done quicker than an in-house employee whose main duties lie elsewhere, and who must be specially trained to meet the demand.

Employee examples

On the other hand, if your company requires a specific type of skill as part of its ongoing business, hiring an employee probably makes more sense. Having this in-house resource ready to meet a consistent demand may be a better option than searching for a contractor at the last minute.

Service-based businesses are often best served with a full-time staff, because these individuals offer the valuable element of business continuity. Repeat customers know who they're dealing with and can expect that an employee familiar with their needs will serve them in an efficient, knowledgeable manner.

Take time to assess the pros and cons of each type of worker; both offer certain advantages, challenges, and other considerations. When you're ready to bring them on board, take care to correctly classify them as an employee or independent contractor. Given that there are many factors in determining the correct classification, you may want to consider working with a [payroll or HR provider](#) to help you with this process.