

Avoid Pitfalls When Using Independent Contractors

Misclassifying employees as contractors can create problems with tax agencies

Independent contractors are a great way for small businesses to maximize workforce flexibility and minimize labor, tax, and bookkeeping expenses, but you need to tread carefully. The IRS and individual state revenue departments have very specific definitions of what constitutes a contractor versus an employee, and they come down hard on businesses they believe are flouting their rules.



The IRS uses three characteristics to determine the relationship between a business and its workers: behavioral control, financial control, and the type of relationship. Behavioral control means the business has a right to direct or control how the work is done through instructions, training, or other means. Financial control means the business has a right to direct or control the financial and business aspects of the worker's job. And the type of relationship factor is about how the workers and the business owner perceive their relationship.

In a 2010 advisory publication on this topic, *Employee vs. Independent Contractor—Seven Tips for Business Owners*, the IRS wrote, "If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees. If you can direct or control only the result of the work done—and not the means and methods of accomplishing the result—then your workers are probably independent contractors."

To learn more, read the entire [article](#). The site also includes links to relevant IRS publications, including [Independent Contractor \(Self-Employed\) or Employee?](#) and regulations on this topic.

Bear in mind that tax specialists consider the test for independent contractor versus employee status to be highly subjective. "The best advice is to record every independent contractor scenario with as much documentation as possible, evidencing each party's intent for an independent contractor relationship," advises attorney Eric Kalnins, a partner in the Chicago law firm of Handler Thayer, LLP.