

1099 vs. W-2 Employee Checklist

IRS RULES

The IRS Checklist for 1099 vs. W-2 focuses on three main factors that provide evidence of the degree of control and independence:

1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

In general, the classification should be **Independent Contractor (1099)** if the employer/payer has the right to control or direct only the result of the work performed by the contractor and not what will be done and how it will be done. The classification should be **Employee (W-2)** if employee performs services that can be controlled by an employer (what will be done and how it will be done). This applies even if employee is given freedom of action. What matters is that the employer has the legal right to control the details of how the services are performed.

IRS 20-Point Checklist

The IRS has established a 20-point checklist that can be used as a guideline in determining whether or not a contractor can legally be paid on a 1099. This checklist helps determine who has the "right of control". The greater the control exercised over the terms and conditions of employment, the greater the chance that the controlling entity will be held to be the employer. The right to control (not the act itself) determines the status as an independent contractor or employee. The 20-point checklist is only a guideline; it does not guarantee that a person is correctly classified. There is no one single homogenous definition of the term "employee." Most agencies and courts typically look to the totality of the circumstances and balance the factors to determine whether a worker is an employee.

If "No" = Independent Contractor. If "Yes" = Employee

1. Must the individual take instructions from your management staff regarding when, where, and how work is to be done?
2. Does the individual receive training from your company?
3. Is the success or continuation of your business somewhat dependent on the type of service provided by the individual?
4. Must the individual personally perform the contracted services?
5. Have you hired, supervised, or paid individuals to assist the worker in completing the project stated in the contract?
6. Is there a continuing relationship between your company and the individual?
7. Must the individual work set hours?
8. Is the individual required to work full time at your company?
9. Is the work performed on company premises?
10. Is the individual required to follow a set sequence or routine in the performance of his work?
11. Must the individual give you reports regarding his/her work?
12. Is the individual paid at regular amounts by set intervals?
13. Do you reimburse the individual for business/travel expenses?

14. Do you supply the individual with needed tools or materials?
15. Have you made a significant investment in facilities used by the individual to perform services?
16. Is the individual free from suffering a loss or realizing a profit based on his work?
17. Does the individual only perform services only for your company and not others?
18. Does the individual limit the availability of his services to the general public?
19. Do you have the right to discharge the individual?
20. May the individual terminate his services at any time?

IRS Economic Realities Test

- Worker's opportunity for profit or loss depending on the company's managerial skills
- Worker's investment in equipment or materials required for the task.
- Whether services rendered require a special skill.
- The degree of permanency and duration of the working relationship.
- Extent to which the service rendered is an integral part of the employer's revenue potential and business operation.

Risk to Employer of Misclassification of a 1099 (who should be a W-2 Employee)

- Pay back-taxes for misclassified employees
- Fines from IRS
- Liability for benefits
- DOL also monitors 1099 vs. W-2 to ensure Fair Labor Standards Act for employees who should receive them (e.g., benefits).

TAX FILING DIFFERENCES

Independent Contractor (1099)

- Files W-9 with employer.
- Earnings are paid on an untaxed basis and are subject to "self-employment" tax (Social Security and Medicare – both employee & employer portions).
- Must receive 1099-Misc form from employer at end of year outlining net earnings (if over \$600).
- Responsible for filing and paying income and payroll taxes.
- Can deduct travel, home office and other business-related expenses.
- Should have own general liability and E&O insurance.
- Not entitled to receive unemployment benefits (* but could still file).

Employee (W-2)

- Files W-4, VA-4 (or equivalent) and I-9 with employer.
- Income taxes, Social Security and Medicare taxes withheld from paycheck.
- Employer pays Unemployment Tax on wages paid.
- Entitled to receive unemployment benefits.