Employee vs. Contractor

A guide and checklist for practice owners regarding the IRS' Common Law Test

Brand Your Practice

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Common Law Test

Practice owners often have questions about the best way to structure their businesses. One question that comes up a lot is whether to hire 1099 contractors or W-2 employees.

What's at stake is the misclassification of an independent contractor (when they should be an employee) and being hit with large fines and back taxes.

In the past, the IRS used a 20 Factor Test to determine whether a worker should be classified as an employee or an independent contractor. This test looked at 20 factors including how much control the employer has over the worker and whether the worker is paid on a regular basis.

They've now simplified this process using the Common Law Test. This test looks at 3 factors to help businesses determine whether or not a worker should be classified as an employee or contractor.

3 Factors The IRS Considers:

- **Behavioral -** Does the business control (or have the right to control) how a worker does their job?
- **Financial -** Does the business control how the worker is paid (including expense reimbursement, paid training, etc.)?
- **Type of Relationship -** Does the employee receive benefits, or paid time off, and is the work performed a key part of the business?

Use the information in the checklist below to determine whether your clinicians and other administrative staff should be classified as employees or contractors. And at the end of the checklist, check out the additional list of resources to help you determine which direction to take for your practice and its workers.

CONTROLLING METAPHOR IDEA: Plumber

Before we jump in, consider the metaphor of The Plumber. If you have a leaky faucet or a broken pipe in your bathroom and need to hire a plumber, do you treat them as an employee or a contractor?

Do you treat them as an **Employee** and:

- Tell them when to show up?
- Provide them with tools and equipment?
- Pay for their training and other expenses so they can complete the work?

Or, do you treat them as a **Contractor** and:

- Let the plumber provide you with an appointment time for them to show up?
- Let them use their own specialized tools and equipment to get the job done?
- Trust that they have years of training and experience based on the plumbing company's reviews and ratings?

If you can keep those thoughts in mind as you go through the checklist, you'll have a better understanding of how to classify your own clinicians and staff.

Let's get started!

Behavioral Control

Behavioral Control refers to how you, as the practice owner, control how your clinicians or administrative staff do their job. This includes when and where the work is performed, what tools they use, where and how to purchase supplies, and even what order the work must follow to be completed correctly.

Behavioral Control	Employee Status	Contractor Status	Check✔
Type of Instruction	• **When & where work should be completed.** • What tools or equipment to use. • What order to follow when completing given work or tasks.	• Provides their own timeline & location of where work is completed. • Doesn't rely on the company for tools and supplies. • **Doesn't follow a set schedule or sequence to complete tasks.**	☐ Employee ☐ Contractor
Degree of Instruction	• Includes detailed descriptions and/or instruction on how work should be completed. When a worker receives instructions on when and how to do work, plus the schedule and equipment, then they should probably be classified as an employee.	• Fewer details show lesser control by the employer, meaning the worker is more likely to be considered an independent contractor.	☐ Employee ☐ Contractor
Evaluation Systems	• Measures the details from start to finish on how a project or task is completed. • Worker provides regular check-ins or updates on how the project is progressing. (Weekly check-ins)	• Measures only the end result of a project or task. • Regular reports not required.	☐ Employee ☐ Contractor
Training	• **On the job training provided by the business** • Ongoing training as new policies and procedures are added.	• Specialized individual that requires no additional company sponsored training.	☐ Employee ☐ Contractor

Financial Control

Financial Control refers to whether the practice owner has a right to control the economic part of a worker's job. This includes expense reimbursement, method of payment (regular salary or project based compensation), as well as opportunity for profit or loss.

Financial Control	Employee Status	Contractor Status	Check✔
Significant Investment	• **Supplies and equipment are provided by the company or business.(Business cards?)**	• Provides and pays for their own equipment to complete the task or job.Pays for own business cards, malpractice insurance.	☐ Employee ☐ Contractor
Unreimbursed Expenses	• **Worker is reimbursed for travel or expenses accrued. (including continuing education).**	• Fixed ongoing costs that don't require reimbursement.	☐ Employee ☐ Contractor
Opportunity for Profit or Loss	• No opportunity for profit or loss based on complete or incomplete work. The employee is paid a salary and cannot incur a loss from equipment, or time on the job, or task.	• Increased possibility of incurring loss from equipment or time on a job or task under the contract. For instance, contractors may be able to negotiate higher pay for jobs that require more risk. On the other hand, employees usually receive a set wage regardless of how well the business is doing. • No incentivization like bonuses.	☐ Employee ☐ Contractor
Services Available to the Market	• Only employed by one company. • Often signs a non-compete.	• Free to seek out other business opportunities or clients. • Available to work in their independent market.	☐ Employee ☐ Contractor
Method of Payment	• A regular wage is provided weekly, monthly, etc.	• Usually paid a flat fee based on project or scope of work. • Has their own incorporated buisness that employer cuts their checks to.	☐ Employee ☐ Contractor

Type of Relationship

Type of Relationship refers to how the practice owner and worker perceive their relationship to each other. This includes written contracts that clearly state “employee” or “contractor”, the distribution of employee benefits, as well as the perceived length of your working relationship.

Type of Relationship	Employee Status	Contractor Status	Check✔
Written Contracts	• Contract refers to the worker as an “Employee”.	• Contract refers to the worker as a “Contractor”.	☐ Employee ☐ Contractor
Employee Benefits	• Includes paid time off, sick leave, disability insurance, etc.	• Responsible for their own sick leave, insurance, etc.	☐ Employee ☐ Contractor
Permanency of the Relationship	• Expectation that employment will continue indefinitely or with no set end date. • The right to fire or discharge worker at any time.	• Indefinite, ongoing relationships resemble employment. Fixed project-based relationships are more typical of independent contractors. • Limited time use.Usually project based. • Business relationship ends once project or task is completed. • Cannot dictate whether or not they work at another practice or have their own practice.	☐ Employee ☐ Contractor
Services Provided as Key Activity of the Business	• Employee’s work is representative of the business as a whole.The right to control or direct the work. • Could be indicated if they are on your “team” page on your website.	• Work or project is separate from those done by regular employees. • Project or task isn’t integral to the success of the business.	☐ Employee ☐ Contractor

Tax Implications of Misclassification

As a practice owner, if you've classified a worker as an employee or contractor without reason, you may be liable for paying employment taxes or other fees. This is especially important when contracts are involved.

If a contract doesn't clearly state "employee" or "contractor" and/or the worker believes they've been misclassified, they can file with the IRS and report discrepancies in their compensation as it relates to unemployment benefits and taxes, including Medicare and Social Security taxes. This means you'll be liable to pay for any back taxes, unpaid overtime, and any other worker's compensation fees.

It's also important to note that a contract alone will not excuse a practice owner from the implications of misclassification, as the IRS isn't required to follow the rules of a business/worker contract in determining worker status. They will always look to the Common Law Test **first** before considering other factors.

FAQ's

What financial risks are we opening ourselves up to for misclassification?

When you're treating someone as an independent contractor, but the IRS thinks they should be classified as an employee:

- You're liable for paying any outstanding employment and/or social security taxes, as well as any outstanding pay or unpaid overtime for all years the employee has worked. (ex. If an employee makes $100k/year for the past 2 years, that's a minimum of $14k you would owe for employment taxes, not including any social security taxes or overtime they may have accrued during those years)
- During an audit, the IRS can look at employment records dating back at least 10 years to determine the amount you owe for misclassifying an employee as an independent contractor.
- This is true on the Federal as well as State level. When being audited by the IRS, this could potentially trigger a state audit as well.

What do employers have to abide by for paid days off?

So there's no confusion, it's in your best interest to make sure that the Employee Handbook outlines the set holidays and the days that the office will be closed. If the employee wants to take off outside of those set dates, they need to use Paid Time Off or Unpaid Time Off (depending on the # of employees and your state regulations).

Contractors set their own hours/schedules and therefore do not need to abide by the hours/days the office is open.

FAQ’s

Can you give contractors a bonus?

Contractors are paid a set amount for the job they were contracted for. Providing them bonuses or other incentives outside the terms of their signed contract terms blurs the line between them being an employee and an independent contractor in the eyes of the IRS.

What are the limits to office supplies for contractors?

Proving internet and basic office furniture is okay. However, do not provide laptops, supplies (such as pens & paper), and other extras such as providing lunches or other meals. An independent contractor is responsible for providing their own tools and equipment to complete their job, as well as their own meals and any additional extras.

Non-compete clause for Independent Contractors?

No, you cannot include a non-compete clause in the contract for an independent contractor.

However, employee contracts can include a non-solicit or non-compete clause in their employment contract that can be set to last for a certain period of time based on your individual state regulations.

Resources

Brand Your Practice Podcast

In this episode of the Brand Your Practice Podcast, I sit down with Daniel Mayer, a Maryland-based attorney and the principal attorney of Mayer Law, which specializes in working with and representing mental health practitioners and mental health practices.

We discuss:

- The difference between a 1099 Contractor and a W2 Employee
- The financial risk for a practice owner if they misclassify a contractor
- How to use the IRS Common Law Test to determine if your contractor should be classified as an employee

Resources

Form SS-8, Determination of Worker Status

If after using this checklist, you're still unsure whether your clinicians or administrative staff should be classified as employees or contractors, we recommend that you take a look at **Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding**. This form can be filled out and filed with the IRS where they will review and determine a worker's status.

Please note: It can take up to six months to receive a reply.

Voluntary Classification Settlement Program

When using this checklist, if you've realized that your workers have been misclassified, you can apply for the Voluntary Classification Settlement Program.

This program gives practice owners a chance to reclassify their workers for future tax periods and provide partial relief from federal employment taxes. It also relieves them from liability for any interest or penalties accrued in previous years' misclassification.

You can *learn more* about eligibility and requirements for the program **here.**

Resources For Mental Health Professionals

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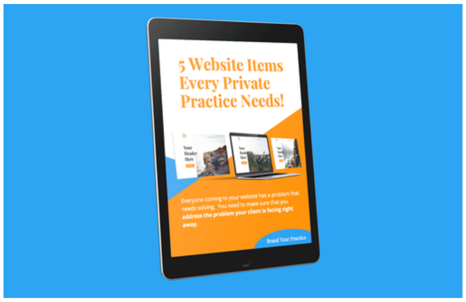

5 Website Items Every Private Practice Needs

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