

A Major Crackdown on Independent Contractor Classification May Be Coming

Under the new administration in Washington, we can expect a major crackdown on a variety of tax loopholes that are currently being used by dentists. Although independent contractors have been a target for IRS auditors for many years now, recent developments suggest that many independent contractors may no longer be eligible for this status under their current arrangements. It is essential that all independent contractors, and dental practice owners who hire them, be aware of these changes and take the proper steps to avoid a costly audit.

The most essential step to avoid scrutiny with the IRS is to correctly classify workers as employees and not independent contractors, if in fact an employee/employer relationship exists.

Classifying a worker as an independent contractor can be a great tax benefit, both to the dental practice and the worker, if that classification is lawful. In these cases, dental practices can avoid having to pay payroll taxes or to provide benefits, and the independent contractors can take a long list of business deductions that would not have been available to them if they were classified as employees.

Under the current law, the Internal Revenue Service (IRS) typically looks at a list of 20 criteria to determine whether you should be treated as an independent contractor or an employee. Depending on how you answer these questions and the surrounding facts, the appropriate classification may be determined. The less control the worker has, the more likely they will be classified as an employee.

The following states have recently adapted new standards for independent contractor classification, called the **ABC test**: California, Connecticut, Delaware, Illinois, Indiana, Massachusetts, Nebraska, Nevada, New Hampshire, New Jersey, Vermont, Washington, and West Virginia. ***These tests are much stricter than the current criteria used by the IRS as stated above.***

The ABC test states that a worker should be considered an independent contractor **only if they meet each of these 3 criteria:**

- A) The worker is **free from the control and direction of the hiring entity** in connection with the work's performance, both under the contract for the performance of the work and in fact.
- B) The worker **performs work that is outside the usual course of the hiring entity's business.**
- C) The worker is **customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.**

The Biden administration now plans to implement the ABC test at the federal level. They also plan to dramatically ramp up an already strict enforcement of these rules, substantially

increasing the number of labor investigators and aggressively going after dental practices who have intentionally misclassified independent contractors.

The results would be disastrous for these dental practices and their improperly classified independent contractors, who may owe additional taxes, plus interest and penalties. Furthermore, the independent contractor may lose out on the tax deductibility of their business retirement plan contributions, which would subject them to even more penalties.

The key takeaway is that the ABC test must be performed to determine if a worker is an independent contractor. This test could vary by state, but may soon become a federal law. An employer must answer yes to all three parts of this test to qualify a worker as an independent contractor. The IRS will automatically categorize a worker as an employee unless you can prove otherwise. You are guilty until proven innocent.

The safest thing to do is to treat all individuals as employees unless they meet the criteria of the ABC test **and** have their own business entity with a separate employer identification number. **Since only individuals can be treated as employees, the best way to minimize added scrutiny is for the worker to establish a separate business entity.** This separate legal entity can then enter into a contract to provide goods or services to its customer (the hiring entity).

If you think your practice might need to re-examine the status of some of its workers, or you are an independent contractor yourself, you should reach out to an employment law attorney. Your attorney will look at your state's current employment laws and advise you on any issues or changes. It is critically important to take every step possible to classify yourself or your workers correctly in order to avoid significant financial consequences.