

Golden Bullets

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EMPLOYEES AND CONTRACTORS: THINGS TO CONSIDER

I work with lots of new business owners. Many of them are interested in knowing the difference between **employees and independent contractors**.

The IRS and other government agencies have a vested interest in making sure that businesses which have employees treat them fairly. There are all kinds of **tax and labor rules designed to pursue the goal of protecting employed workers**.

Independent contractors, on the other hand, generally do not get the same protections that employees do. The **government treats contractors as business owners** in their own right—and assumes, rightly or wrongly, that they can take care of themselves.

Business owners may be **tempted** for administrative or financial reasons to try to classify people who should be **employees as independent contractors**. The **IRS knows this** and has been involved with developing a body of regulations and case law to properly identify which contractors should be classified as employees.

An employer who has mistakenly made an employee a contractor may be on the hook for substantial financial penalties. Here are a couple of examples:

1. In the 1980s and 1990s, **Microsoft Corporation** classified some of its workers as independent contractors. These people were engaged when Microsoft needed to expand its workforce to meet the demands of new product schedules. The company did not provide them with any of the employee benefits regular employees received.

The **freelancers sued Microsoft**, seeking to get retroactive credit for certain retirement benefits available for employees. The federal Ninth Circuit Court of Appeals ultimately decided that the former independent contractors were employees instead of contractors—and **entitled to certain employee benefits**.

Vizcaino v. Microsoft Corp., 97 F.3d 1187 (9th Cir. 1996).

2. John and David Keller were the equal owners of Action Auto Body, an auto body repair shop. David Keller treated the company's auto workers as contractors and paid all of AAB's weekly by check; the amount varied depending on commissions and the type of work they performed.

David treated three office administrative staff as contractors as well. **He did not withhold any payroll tax from the amounts paid to any of the workers at AAB.**

The Tax Court decided that the three workers who did not perform repairs should have been classified as employees. David Keller and AAB were thus liable for the employment taxes related to those three employees. **The court also imposed penalties for the failure to make the required deposits, file the correct forms and timely pay tax for the three employees.**

Keller v. Commissioner, T.C. Memo. 2012-62

Do you have friends who own one or more closely-held businesses? Do they have employees or contractors? I can help new business owners sort out whether their workers could be classified as employees or contractors. Please let me know if there's a situation where I can provide my input.

AS ALWAYS, PLEASE FEEL FREE TO CALL TO DISCUSS THESE OR OTHER FINANCIAL SECURITY ISSUES OF CONCERN.

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