

Labor and Employment Law

Ten Additional Guidelines for Avoiding IRS Problems

When Employing Independent Contractors

A little more than a year ago, we wrote an article that offered [10 guidelines for avoiding IRS problems when employing independent contractors](#). As a Congressional committee observed, [the 20 common law factors used by the IRS](#) to make reclassification decisions are "extremely subjective and are often inconsistently applied by the IRS." Obviously, the IRS certainly has a bias towards finding the existence of an [employer-employee relationship](#) because that finding, forms the basis for the most efficient and effective method for collecting taxes in its system.

We therefore offer some additional guidelines or suggestions to help you avoid potential adverse IRS determinations. Here they are:

1. Do not have a [policy](#) preventing the independent contractor from working for other customers, including competitors (stated or unstated) unless there are trade secret or other compelling reasons to have one.
2. If a job performance is deficient, then the independent contractor who did it should be given the opportunity to correct or cure the defect, or stand the risk of financial penalty.
3. It is recommended that a separate file be kept for each independent contractor containing a copy of the contractual agreement (ideally, it should be for each work order), copies of 1099 Forms, certificates of insurance, etc. If there ever is an audit, these documents will be critical.
4. Do not automatically deduct expenses or make chargebacks without independent contractor approval.
5. An independent contractor should be able to negotiate rates for extra work and decide whether to accept such work.
6. If a company vehicle is used, there must be a fair payment for its use. It is far more preferable to insist the contractor provide all the necessary equipment. If this is not possible, then be certain adequate rent is paid for equipment use.
7. If one has both independent contractors and regular employees who do similar work, distinguish the treatment of each in as many ways as practicable. For example, employees can earn overtime premium pay.
8. Be careful of terminology. Employees are paid on the basis of payroll agreements; the payment for the independent contractor is based upon the terms of a contract. Remember, you can terminate employees but, in the case of independent contractors, you choose to end the "contractual agreement." You should not "fire" independent contractors.
9. Do not specify that certain individuals be part of work crews of independent contractors.
10. If state licenses are required for independent contractors to perform services, make sure independent contractors furnish proof they have secured the necessary licenses.

As mentioned in our earlier post, in some situations it may not be an easy matter to determine whether an individual is an employee or an [independent contractor](#). The more structure and documentation you have that identifies the differences can be a great benefit should you encounter challenges to the worker's relationship.

The above article is from "What Every Business Manager and HR Professional Should Know About Federal Labor And Employment Law."

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