

Susko Wealth Management, LLC

Employee vs. Subcontractor

The IRS uses a 3-factor system to determine if an individual is an employee or an independent contractor: behavioral control, financial control, and a relationship test. If the employer misclassifies an individual as an independent contractor when they are actually a W-2 employee, penalties of \$250 per offense, up to \$1.5 million, may apply for both current and previous years.

- **Behavior Test** – This test focuses on whether the company controls or has the right to control what the worker does and how they do their job, such as when to come to and leave from work, how to do the job, break periods and more. This includes instructions about completing, performing the work, evaluation criteria and training. If the company demonstrates control, the worker is an employee.
- **Financial Test** – This test looks at who controls the economics of the worker's job. Factors favoring employee status include payment on a regular basis (weekly, biweekly, monthly, etc.), eligibility for reimbursement of travel costs, and payment based on hours worked. Providing your own tools needed for the job is indicative of independent contractor status, as is being able to work for more than one firm.
- **Relationship Test** – The relationship test looks at evidence of employer-employee status including giving paid time off, fringe benefits, retirement benefits, as well as hiring the worker to render services indefinitely rather than for a specific project.

A written contract stating that the worker will be treated as an independent contractor will not relieve you of these requirements!