

The Independent Contractor: To Be or Not to Be

Article By:

Jessica W. Catlow

Just because an employer calls someone an **independent contractor** does not make him or her so. Because revenue-starved states have been increasingly focusing on independent contractor classification issues, challenges to the proper classification of service providers arise most commonly in the context of claims before an applicable state unemployment division.

The story is a familiar one: employer engages services of an independent contractor, subsequently terminates those services, and the independent contractor files a claim for unemployment insurance benefits. The employer responds to the unemployment insurance claim by stating that the individual is not entitled to benefits because he or she is an independent contractor. The state unemployment insurance division then commences an investigation into the claim and, oftentimes, commences a full audit into the employer's payments to all independent contractors. Like many states, the federal government has also increasingly focused on classification issues. Challenges often arise in audits of the employers by the US Department of Labor.

There is another manner in which a classification may be challenged, and that is when the independent contractor, who, because he or she is deemed "self-employed" must pay double the rate of Social Security taxes he or she would be required to be paid as an employee, refuses to remit the employment taxes. That is what happened in a case recently decided by the federal tax court. In that case, the individual taxpayer was responsible for managing a group home for adults. The employer issued him an IRS Form 1099 reporting the compensation, which the taxpayer filed with his tax returns. On audit, the IRS determined there was a deficiency because the taxpayer did not remit the self-employment taxes. It was in this context that the taxpayer challenged the classification. The tax court agreed with him and found that he should have been properly classified as an employee, and therefore was not responsible for the self-employment taxes.

Though the tax court decision gives no indication that the IRS would pursue the claim for the employment taxes against the employer, we would not be surprised if it did do so and/or commenced an audit of the employer as result of the decision. As we have stated repeatedly, classification issues are not black and white, and the employer's appetite for risk will often dictate the decision. Nevertheless, it is increasingly clear that there are numerous avenues for challenges, and employers should keep that in mind when it makes decisions concerning proper classification.

National Law Review, Volume IV, Number 114

Source URL: <https://natlawreview.com/article/independent-contractor-to-be-or-not-to-be>