
Are Your Independent Contractors Putting Your Business At Risk?

Many small businesses utilize independent contractors in their daily operations. They can be a great tool for lowering operating costs and maximizing work force flexibility. Employers do not pay FICA taxes or benefits for independent contractors and do not incur severance costs when their services are no longer needed. However, using independent contractors exposes your business to significant risks.

In these tough economic times, the Department of the Treasury is looking for ways to collect more tax revenue, and they have pegged small businesses as their target. What are they after? Payroll taxes. The IRS has determined that many companies are incorrectly classifying workers as independent contractors and has launched a massive "Misclassification Initiative." The IRS will be auditing 6,000 randomly selected companies over the next three years looking for employees that have been improperly classified as independent contractors, and if they find them, the employer will be hit hard with back taxes, interest and penalties.

Do you use independent contractors? Have you carefully reviewed IRS guidelines to ensure your classification complies with their requirements? If not, and you have the right to control and direct the worker regarding the job he/she does and how he/she does it, then you are at risk if the IRS examines your company.

To know for sure whether your independent contractor is an employee for federal income and employment tax purposes can be a tough determination. In fact, there is no guidance in the tax code that defines an "employee." Many times it has been left up to the courts to determine the status, but IRS Publication 1779 can be used as a guide.

Another consideration when using independent contractors is who owns the copyrighted works they create? If you hire an independent contractor to create material that can be copyrighted (i.e., a photograph, article, book or financial model) you might not be considered the owner of the material. To mitigate this risk, it is very important that you have a written agreement transferring copyright ownership from the independent contractor to you. In contrast, you will own the material an employee creates automatically in most circumstances.

These are just a few of the considerations your company should make when hiring independent contractors. Many thanks to the folks at Meadows Urquhart Acree & Cook, LLP for providing this information.

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