

# Project Uptime

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## Employee vs. Independent Contractor: What's the Difference?

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### If you misclassify workers, you might hear from the IRS.

Tax season is here. One big challenge for construction companies is classifying its different workers. Are they employees or independent contractors? Misclassify the former as the latter and you could be hit with pricey penalties from the IRS, which follows the construction industry closely, according to **Jim Lundy, a partner at public accounting and advisory service firm Marcum LLP** who specializes in the construction industry.

The line between the two classifications can sometimes seem blurry. For example, said Lundy, “If you have roofing, landscape or drywall contractors on a short-term job, it’s hard to tell the difference between subcontractors and part-time employees. And that makes a big difference on payroll taxes.”

Properly classifying a worker as an employee or independent contractor dictates not only whether you withhold taxes but also whether the worker is entitled to receive employee benefits (such as health insurance or paid vacation) or file for unemployment, and what employment and labor laws you need to follow (including minimum wage laws, which don’t apply to independent contractors).

There are lots of different legal tests to determine independent contractor status, but here are some general things to keep in mind. Consult a qualified accountant or employment attorney in your area to be sure. The IRS also has further information at [“Independent Contractor \(Self-Employed\) or Employee?”](#)

### 1. Who controls how and when the work is done?

Independent contractors typically set their own hours — and take on other work — with the agreement that they meet the contracted deadline. “If I say, ‘This building needs drywall and I don’t care when you do it,’ that person sounds like a contractor,” said Lundy. The more control exercised by a company (in terms of, for example, how and when someone works) the more likely it could be argued that a worker is an employee.

### 2. Who controls the timing of payment?

If someone is paid only for the hours they work, it is more likely they could be classified as an employee, even if they are part-time, while someone who makes a set amount for a certain job is more likely an independent contractor. Employees are paid out of payroll, and contractors submit an invoice — preferably under a company name and Federal Employer Identification Number instead of a Social Security number — to accounts payable.

### **3. Who controls the equipment?**

If a worker uses a company's equipment, tools and materials or buys his own tools and is reimbursed by the company, it is more likely that he or she could be viewed as an employee. On the other hand, if the person is hired to perform a job and is completely responsible for his equipment, tools and materials, he or she is more likely to be classified as an independent contractor.

### **4. Is there a contract?**

While it is not determinative of the ultimate question of classification, it is considered best practice to have a contract with independent contractors, which makes the relationship clear to both parties.

Companies are subject to steep fines for independent contractor misclassification: A failure-to-pay-taxes penalty is 0.5 percent of the unpaid tax liability for each month up to 25 percent of the total tax liability, [according to Justworks](#), an online platform that handles payroll, benefits and compliance issues for businesses. What's more, the IRS can impose criminal penalties of up to \$1,000 per misclassified worker and one year in prison.

One of the ways in which construction companies get accused for unintentionally or intentionally misclassifying workers is through their competitors, Lundy noted. For example, if company A lost a project to company B because company B keeps its costs down by misclassifying workers, company A might call the IRS to tip them off.

Other times, a worker who believes he's been misclassified files a complaint with the IRS, or files for unemployment benefits, thinking he's an employee. Companies can also be exposed during IRS audits. Companies that come forward and admit that they misclassified a worker are often granted some leniency, Lundy said.