



StraitRay Corporation

Accounting, Finance, & Tax Consultants

Jeffrey Strait
MSACC
www.StraitRayCorp.com

4475US Hwy 1 S.
Suite 603
St. Augustine, Fl. 32086
StraitRay.Corp@usa.net

904.797.8779
Office
866-578-6046
Fax

Are they an employee or are they a subcontractor?

An independent contractor looks like a no brainer at first because you do not have to withhold taxes, pay benefits and are easier to fire. But if they are reclassified by the IRS or the DOL Wage and Hour Division you can have some crippling retroactive penalties. It is good to have an understanding of the differences.

Employees

Go to work at set hours
Follow orders from you
Receive regular paychecks
Year round workers
Receive oversight on a daily basis
No contract

Subcontractors

Set their own hours
Set their own tasks
Paid by the job
Temporary in nature
Work on their own
Should have a contract

The worst part about a worker status dispute is it can easily balloon into a “class” of workers. Then you have the IRS, DOL, and State Wage and Hours people all circling like vultures waiting for the kill because they are swapping information. The DOL have just issued in 2010 requiring companies to write a classification analysis for all workers including independent contractors. The Fair Playing Field Act of 2010 was defeated despite President Obama’s support. This requires giving to each independent contractor a kind of written Miranda warning that explains why they are not covered by FLSA. Consider writing this into your next subcontract.



What could go wrong?

1. Am I using a mixture of employees and contractors? Look at the tasks of each and if there is overlap you may be in trouble.
2. Contractors who are reclassified as employees are now subject to
 - Back overtime pay which triggers revised payroll tax reporting which triggers penalties and interest. Payroll related penalties are 20% compared to income tax penalties of 5%
 - If the new “employees” cannot prove they paid their withholding, SS, and Medicare taxes, FUTA and SUTA YOU the employer will be responsible for ALL taxes until you collect the employee’s share.
 - You will now be responsible to pay their worker’s compensation premiums, health and welfare benefits, and any employer’s shares of 401K or pension plan.
 - Now your “employees” can ask for unreimbursed travel, meals, and entertainment expenses. It is wise to “draw a line in the sand” in your reclassification agreement as to how far back you can go on this. Most audits I have been involved in go back 1 year from the date of notification.
 - If the IRS determines that you deliberately misclassified the contractors then they can go for a **100 percent penalty on each responsible person.** To avoid this there is legislation, not IRS Code, called Section 530 relief that can protect you from this assessment. Generally, the IRS is not interested in the penalties but are more interested in making sure these workers are treated as employees.

StraitRay Corporation is a public accounting firm specializing in small businesses from a Controller’s and CFO view giving consulting advice from one who has been there for over 30 years.

