

# Employee vs. Subcontractor

## The Problem

New business owners have a tendency to shy away from calling a person an employee until they know their business is successful. They may only need help periodically or only part time. They do not see that person as an employee or do not want to go through all the payroll requirements. So what they do is pay the person a gross check without any deductions or give them cash. They consider the person a subcontractor and give them a 1099 form at the end of the year or they do not even bother giving the person a 1099 form. This is a mistake that I have seen come back to haunt a business and in some situations result in the business termination. It is not unusual for someone who starts calling people subcontractors to just make it a standard business practice. If a person is working strictly for you, they should most likely be called an employee. Eventually, you let someone go or they are injured on the job. The person files for unemployment or disability. The state does not show them as covered. They send out an auditor. The auditor determines this person should have been an employee. They charge you taxes on this employee, plus all the others you are calling subcontractors, they go retroactive for five years, and they add non-reporting and

non-filing penalties plus interest. You don't have the money. The business you worked so hard for does not survive.

If you control a person's time or you retain ultimate responsibility for the work and how it is performed, you should consider your workers are employees. You cannot get in trouble calling them employees. You can get in all kinds of trouble treating employees as subcontractors. If a general contractor is building a house and hires a plumber to handle the plumbing, the plumber is a true subcontractor. The general contractor does not have a plumber's license. The plumber will normally be in business, work for other general contractors, have his own tools, and assume responsibility for the plumbing portion of the project. This plumber is a true subcontractor. If that plumber has individuals working with him as assistants, controls their time, retains ultimate responsibility for the work, and directs how it is performed, the workers should be considered employees and not subcontractors. You can find more detailed examples by going to [www.irs.gov](http://www.irs.gov). Click on Forms and Pubs, then Lists of current forms, then type Publ 15-A in find.

## **Subcontractor Reporting**

If you engage a subcontractor to perform services for you and they are not a corporation, you need to have them complete a W-9 form. You can find this form at [www.irs.gov](http://www.irs.gov). Click on Forms and Pubs, then List of current forms, and then type W-9 in find. On the form the individual provides you their name, address, and identification number. This person is not covered by your insurance. You need to get a certificate of his insurance coverage for your file. In addition, you should make sure that the individual provides you a timely copy of all renewals. You need to track all payments to each subcontractor. At the end of the year you need to complete a 1099

form and 1096 transmittal form. You can find these at [www.irs.gov](http://www.irs.gov). Click on Forms and Pubs, then List of current forms, then type 1099 in find, then 1096 in find. The subcontractor uses this form to report income on his personal tax return.

For more resources visit [www.rjclark.com](http://www.rjclark.com).