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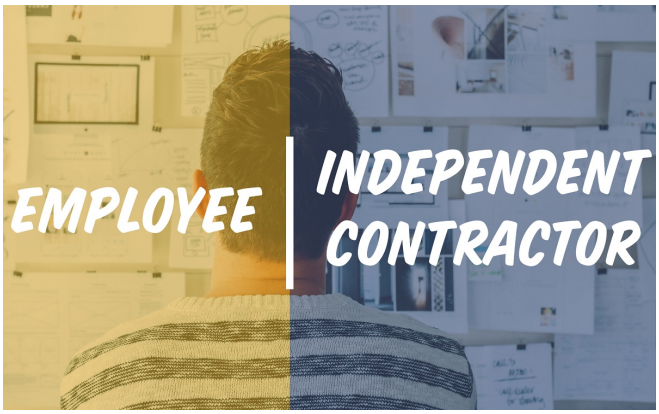
Tax Law Doesn't Alter Definitions of Independent Contractor

By Finance New Mexico



The new tax law passed by Congress in December 2017 aims to lower taxes for everyone, but proponents cite its overwhelming benefits to businesses. Under the new law, companies — including sole proprietors and workers in the gig economy — can deduct 20 percent of their revenue from taxable income.

This provision alone could disrupt formal relationships between employers and workers, increasing the number of people who define themselves as independent contractors. But employees who wish to serve their former employers as independent contractors should know that even though tax laws have changed, the rules governing working relationships have not: Independent contractors still must meet the criteria that distinguish them from employees.

Pitfalls of Misclassification

Employees who become contractors lose many benefits of a traditional job, among them access to workers' compensation insurance for work-related injuries and unemployment benefits. Rather than sharing the cost of Social Security and Medicare taxes with an employer, independent contractors pay these self-employment taxes alone.

Contractors who do business in New Mexico also have to collect and pay gross receipts tax on the revenue they receive. And while the Affordable Care Act is no longer a federal mandate, contractors shoulder the costs of their health insurance and retirement plan contributions.

Employees also lose the job security provided by companies that retain workers when revenue dips: Contractors are usually the first to feel the effects of economic downturns because they are the easiest to terminate — and to replace when the economy starts moving again.

Companies that knowingly misclassify — or have no reasonable basis for treating a worker as a contractor — can be liable for retroactive employment taxes and overtime pay if the worker exceeded the maximum number of hours allowed by law.

How To Know

According to the Internal Revenue Service website, the general rule is that "an individual is an independent contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done."

But the U.S. Department of Labor Wage and Hour Division, which protects workers' rights under the Fair Labor Standards Act, cites additional factors that govern the relationship, and only one involves degree of control. Other factors include whether the worker's managerial skills affect his or her profit and loss, the extent to which the work is integral to the employer's business, the worker's skill and initiative, the investments made and risks shared by each, and the permanency of the relationship. No one factor outweighs the rest, and the Labor Department urges a qualitative rather than quantitative analysis.

Workers who apply their skills to multiple entities and can increase their contractual relationships can probably be considered sole-proprietor independent contractors. But workers with a single contract should review the criteria to determine if they are properly classified. Businesses should conduct periodic reviews of their worker relationships to ensure that circumstances haven't changed and they haven't inadvertently moved workers into a different category.

For more information, visit https://www.dol.gov/whd/regs/compliance/whdfs13.htm or https://www.irs.gov/businesses.

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