



Employee Misclassification – W2 or 1099 Contractor

While there is not a single question that determines whether or not a Company can legally hire a person as a Contractor for a Management role, two very crucial questions to ask that both the IRS and FLSA agree on are:

1. *Does the Company control, or have the right to control, what the worker does, how the worker does their job, and their working hours?*
2. *Will the worker be responsible for managing Company employees?*
<https://www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/contingent-staffing-can-an-independent-contractor-or-a-consultant-manage-company-employees.aspx>

Although these are only two key determining questions, if the answer to either of these questions is yes, there is a high likelihood that the worker should be classified as a W2 Employee. Over the past ten years, Employee Misclassification has become a legal hotbed issue for State and Federal prosecution. Today, there is much less protection for a Company that might unintentionally misclassify a Contractor.

When hiring a Contractor, the Company must verify and obtain the Contractors COI's and check monthly to ensure the Contractor's policies are still in force.

The following article from SHRM titled "*Employing Independent Contractors*" provides a balanced analysis in helping detail the risks of employing 1099 Contractors and Employee Misclassification: (<https://www.shrm.org/resourcesandtools/tools-and-samples/toolkits/pages/employingindependentcontractors.aspx>).

Workers Comp & Unemployment Insurance

These insurances are required to be carried by law, either by the Company, or the Contractor. In the case of hiring a Contractor, the Company does not - and cannot - provide these insurances. Therefore, the Contractor is required to carry them, but quite often, Contractor's do not. If the Contractor at one time did carry these insurances but lapsed their policy, how would the Company know?

In the situation where a Contractor was not carrying their own Workers Comp insurance, and the Contractor had an accident or got sick while on the job, the Company will more than likely be on the hook for paying the claim and be liable – regardless of whether or not the Company obtained an indemnity agreement from the Contractor (more on indemnity agreements below).

Additionally, if the Contractor is not carrying unemployment insurance and later files an unemployment claim, which surprisingly happens way more often than most people realize, the State will usually go after the Company for unemployment payments. Fines are also often levied, and the Company's insurance rates can be negatively impacted.



Wage and Hour Liability

Even though the Contractor might be placed in an Exempt Manager's role, many cases have later successfully been brought against the hiring Company for unpaid hourly overtime pay. Even though the Company's position was labeled exempt, the Contractor is not necessarily exempt, regardless of what the engagement agreement may say.

1099 Indemnity Agreement

Even if the hiring Company requests and receives an indemnity agreement from the Contractor for any potential losses or liability, a court may decide the Company was negligent in their employment classification and throw out the indemnity agreement, putting the Company at risk.

Income Taxes

If the Company fails to withhold income taxes for an improperly classified Contractor, the Company may become liable for Federal and State taxes.

State Gross Receipts Tax

Regarding Contractors, there is debate regarding who is responsible for paying the State Gross Receipts Tax. But the bottom line is that if the Contractor does not pay the tax, the State can go after the Company for the tax.

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