



Meg Eynon, Vice President 610.644.4569 • Meg@prfusa.com
www.thepayrollfactory.com

So you've hired a worker, but what happens next?

Congratulations! You have hired a worker. Or maybe, you have workers and have for a while. It is a great feeling to have that extra support and it is a great responsibility knowing that others are depending on you to make a living and support their families. So what does this have to do with being financially savvy? It is all about knowing the rules.

In most businesses the cost of labor is the first or second largest expense that a company has. A lot of companies try to control the cost of this labor by paying their workers as subcontractors. And here is where you need to put on the brakes!

There are very specific rules for how you pay a worker. The rules outline how you are to classify a worker either as an employee or as a subcontractor. There are also very substantial ramifications if you misclassify an employee as a subcontractor. And this is important for every employer to know because in this instance, size doesn't matter! You may have one worker or a hundred workers, the rules are the same.

So first, how do you know how to classify a worker? The Internal Revenue Service (IRS) has a great tool on their website that allows you to go through their list of worker classification questions to ask yourself and then to determine your worker status. <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>. The IRS governs whether or not your worker is an employee or a subcontractor based on what they call the "Common Law Rules".

****Don't miss out....Special Offer on page 3****

- 1 -

The Common law rules basically ask you, who has the direction and control over the worker? Some sample questions are:

- Is worker required to comply with instructions?
- Does worker need to be trained?
- Are worker's tasks integrated into normal business operations?
- Does the worker have a continuing relationship with the hiring firm?
- Are worker's hours set by the hiring firm?
- Is work performed on the hiring firm's premises?
- Is the worker required to submit regular oral or written reports?
- Is the worker's payment based on time spent instead of by the job?
- Does the hiring firm furnish tools, materials and other equipment?

If you answered yes to a majority of these questions then you have a "Common Law Employee" according to the IRS. Typically if your classification of a subcontractor is challenged the court will look at who has the right to control the worker. If you tell your worker what to do, when to do it, how to do it and they use your equipment or facilities to do it then under the rules of direction and control, you have an employee not a subcontractor.

When a worker is misclassified as a subcontractor when they should be an employee there can be substantial ramifications. The first of which is the audit process. There are several agencies that can audit you for employee classification: The IRS, your State revenue department, your State unemployment agency, your Worker's Compensation Company to name a few.

And right at this point I know some are thinking, "not me, they would never audit me, I am under their radar"....but you are not. Audits get triggered in several ways but the most common is by one of your workers. If a misclassified subcontractor gets hurt, they may look for Worker's Compensation. This would trigger an audit. If you fire a misclassified subcontractor, they may try to collect unemployment. This would trigger an audit. There are more ways audits get triggered, but this appears to be the most common.

So what happens next? You would have to go through an audit process. This means that you are going to pay out of pocket to have a CPA or your attorney represent you through an audit. If all goes well, the only expense you incur is their billable time. However, if it is discovered that you have misclassified a worker as a subcontractor, the financial ramifications can be substantial.

When the IRS deems that a company has misclassified a worker as a subcontractor they do not go back to the employee and ask them to pay the tax; they go back to the company that misclassified the employee in the first place. So in an IRS audit if your worker is found to be misclassified you will pay the employees' taxes, the

****Don't miss out....Special Offer on page 3****

- 2 -

employer overhead taxes and penalty and interest for those payments not being made in a timely manner.

The easiest ways to avoid this situation is to go through the IRS Common Law Rules and to go through and answer the questions honestly. After that is done you need to call your accountant and ask them what the standard is for your industry. Your accountant will be able to advise you what the proper classification of your workers should be.

Even though labor can be one of the biggest costs of being in business, this is not an area where you can save money by paying workers as subcontractors if it is not your industry standard. Don't get fooled into thinking that you can break these rules or that you are under the radar on this. Size is not an issue for tax agencies to ignore misclassified employees.

Talk to your accountant, trusted advisor or attorney and find alternate ways to save money on your labor costs. Some examples of this would be from having employees telecommute to paying staff on a production basis scale of pay. There are many appropriate ways to control these costs, keep your workers happy and comply with the rules.

About the author

Meg Eynon is the Vice President of The Payroll Factory and has over sixteen years of experience working with businesses to help them come up with simple ways to make their employees' lives easier through the process of producing payroll.

Meg loves to read and business books are on the top of her piles to be read. This month Meg recommends the book The One Minute Entrepreneur, by Ken Blanchard, Don Hutson and Ethan Willis. "This book is a great inspiration. It tells the story of one man's challenge in creating his own business and follows his journey of balancing work, family life and community while staying true to his core values. A must read," says Meg.

Special Offer:

Winter is drawing to an end and it is time to get back in the swing of things. When was the last time you had your payroll analyzed to see where you could be saving money and time?

Contact me to find out about cost cutting techniques to save you money on your biggest expense – labor. If I can save you time and money sign up for my services with a 25% discount. This offer is good until April 6, 2011. Call now! 610-644-4569.

Meg can be contacted at Meg@PRFUSA.com

****Don't miss out....Special Offer on page 3****

- 3 -