



When to Hire Independent Contractors vs. Employees

As a small business owner, it's critically important that each of the people performing work on behalf of your company are properly categorized as either Employees or Independent Contractors. It's tempting to categorize workers as independent contractors to minimize tax payments and avoid complying with state and federal regulations governing employer/employee relationships (e.g., minimum wage laws, paid time off, health insurance requirements).

However, improperly categorizing employees as independent contractors can lead to significant financial penalties including (but not limited to) the payment of back taxes and interest.

The IRS and state agencies weigh many factors to determine if a worker is an Independent Contractor or Employee. For example **the IRS and most states say that an Independent Contractor must be:**

- **Free to determine “How” the work is accomplished.** The company hiring the Independent Contractor may specify the “Outcome” or finished product but the contractor must have the legal right to determine the details of how they accomplish that outcome.
- **Self-employed.** In other words, they have the freedom to provide their services to other companies besides yours or to consumers directly.
- **Bound by an Independent Contractor Agreement.** The contract should make it clear that the worker is an independent business owner and responsible for paying his or her own taxes, insurance (if applicable) and determining how the work is performed.

Alternatively, there are additional **factors that can lead the IRS or your state authorities to conclude that a worker is in fact an Employee:**

- **If the work being performed is “central” to your business** the workers could be categorized as employees. For example, the drivers making deliveries on behalf of a furniture store might be considered employees if the store is scheduling the deliveries and requiring the delivery people to adhere to certain processes & standards.

- **If the employer provides the worker with typical employee benefits**, a required uniform, and/or materials or tools to conduct the work, the workers could be categorized as employees. Independent contractors typically have their own “tools of the trade”.

Unfortunately, there is no fool-proof method of making the Independent Contractor vs. Employee determination and the IRS and different states may come to different conclusions based on the same set of facts. Therefore, you should speak to an employment attorney to help you make a wise decision.

Here’s some information from the IRS on making a determination:

- <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>

Here are links with information about how to locate and work with an employment lawyer:

- <https://nysba.org/new-york-state-bar-association-lawyer-referral-service/>
- <https://www.nycbar.org/get-legal-help/>
- [Legal Shield](#)

Note – this document is meant to be accompanied by oral commentary from a Harvard Business School alumni coach.