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Hire a Contractor or an Employee?

Independent contractors and employees are not the same, and it's important to understand the difference. Knowing this distinction will help you determine what your first hiring move will be and how you withhold a variety of taxes and avoid costly legal consequences.

What's the Difference?

An Independent Contractor:

- Operates under a business name
- Has his/her own employees
- Maintains a separate business checking account
- Advertises his/her business' services
- Invoices for work completed
- Has more than one client
- Has own tools and sets own hours
- Keeps business records
- Registered with the state
- Maintains county/city business licenses

An Employee:

- Performs duties as directed or **controlled** by the employer
- Is given training for work to be done
- Works for only one employer

Many small businesses rely on independent contractors for their staffing needs. There are many benefits to using contractors over hiring employees:

- Savings in payroll taxes, workmen's compensation and benefits
- Reduced liability
- Flexibility in hiring and firing

Why Does It Matter?

Misclassification of an individual as an independent contractor will have a number of costly legal consequences. If your independent contractor is discovered to meet the legal definition of an employee, you may be required to:

- Reimburse them for wages you were required to pay them under the [Fair Labor Standards Act](#), including overtime and minimum wage
- Pay back taxes and severe penalties for federal and state income taxes, Social Security, Medicare and unemployment
- Pay any misclassified injured employee's workers' compensation benefits
- Provide employee benefits, including health insurance and retirement.

Tax Requirements

Visit the IRS ***Independent Contractor or Employee*** guide to learn about the tax implications of misclassification, download and fill out a form to have the IRS officially determine your workers' status, and find other related resources.

Employment Information

There is no single test for determining if an individual is an independent contractor or an employee under the Fair Labor Standards Act. However, the following guidelines should be taken into account:

1. The extent to which the services rendered are an integral part of the principal's business
2. The permanency of the relationship
3. The amount of the alleged contractor's investment in facilities and equipment
4. The nature and degree of control by the principal
5. The alleged contractor's opportunities for profit and loss
6. The amount of initiative, judgment, or foresight in open market competition with others that is required for the success of the claimed independent contractor
7. The degree of independent business organization and operation

Whether a person is an independent contractor or an employee generally depends on the amount of control exercised by the employer over the work being done. Read [Equal Employment Opportunity Laws - Who's Covered?](#) for more information on how to determine whether a person is an independent contractor or an employee, and which are covered under federal laws.

Below is the IRS' **20 Factor Test For Employee or Independent Contractor Status**.