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Contractor or Employee?

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Extra help is often needed around the farm. It can be easy to get someone to come help out when needed and pay them at the end of the day for the job completed. What gets difficult is knowing the difference between contract labor and an employee. A lot of the time, this distinction between contractor or employee may not come up until the end of the year, when it is time to issue W-2's and 1099's. However, the correct treatment should be determined before payment has ever been made.

What is a contractor?

According to IRS Publication 1779, there are three main categories that are used to determine if you are an independent contractor. Those categories are behavioral control, financial control, and relationship to the parties. It is important to note, that when determining if you are an independent contractor, you must review all of the facts. Typically, just one piece of information will not be enough to make the determination.

When considering behavior control, the question you are trying to answer is who is in control. Does the person paying you control your behavior, or how and when you complete the job? If someone else trains you and specifically instructs you on how to complete the job, you may be an employee, not a contractor.

Financial control considers who has an investment in the project and who is bearing the financial risk of the job. An independent contractor typically has an investment in the business (tools, equipment, education), pays for expenses to complete the job, and has the opportunity to make or lose money based on the successful, satisfactory completion of the job.

The relationship of the parties refers to if the worker is compensated with employee benefits, such as insurance and retirement. If the employer pays these benefits, you are most likely an employee, not a contractor. A formal contract may also be used to determine the status of an independent

contractor. A contract to complete a given job at a specified price could help distinguish the relationship as an independent contractor.

What is an Employee?

An employee is typically hired by an employer to perform jobs as requested by the employer. Typically, employees are not paid by the job, but at an hourly or piece rate. The employer trains employees and the employer provides the instructions, tools, and equipment to perform the assigned task. Employees do not bear any financial risk associated with the job or project. Employees may receive certain benefits such as insurance, retirement, and time off that are paid by the employer.

Why does the Distinction Matter?

If you are an employee, an employer is responsible for withholding and paying Social Security and Medicare benefits on your salary, as well as withholding federal and sometimes state and local taxes. Wage and tax information for employees is reported on a Form W-2 at the end of the year. If an employer neglects to withhold these taxes from your payment, they are then responsible for paying them or offering backup withholding on future payments to make up the difference of what should have been withheld.

A payment to an independent contractor is not subject to withholding by the employer. Independent Contractors that are paid more than \$600 are issued a Form 1099 at the end of the year for the total amount of compensation paid during the year. The independent contractor is then subject to pay the Social Security and Medicare tax (otherwise known as Self-Employment Tax) on their tax return when filed.

Correct characterization of the payment when paid to employees or independent contractors helps to limit confusion and extra tax payments at the end of the year as well as avoid penalties and interest. While it may be easiest to report all workers as independent contractors, it is not always correct. The IRS can and will issue fines and penalties for the improper reporting of paid labor. If you have further questions about how to treat your paid labor, you can consult several IRS publications, or talk with your tax professional.

IRS Publication 1779: <https://www.irs.gov/pub/irs-pdf/p1779.pdf>

IRS Publication 15: Employers Tax Guide: <https://www.irs.gov/publications/p15>

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