

Bringing On New Staff?

Remember the Independent Contractor versus Employee Analysis

By Paul J. Welk, PT, JD

When a practice “hires” a physical therapist to provide professional services, questions often arise as to whether the individual is an independent contractor or an employee. While such a designation may seem secondary to securing the services of a well-qualified professional, the distinction is important because it directly affects how federal income taxes, Social Security taxes, and Medicare taxes are paid, as well as the individual’s eligibility for certain employer benefits. Specifically, an employer must generally withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages that are paid to an employee. These withholding obligations and tax payment requirements generally are not applicable to independent contractors. Should an employer improperly classify a would-be employee as an independent contractor, the employer may later be held liable by the Internal Revenue Service (IRS) for the payment of certain tax obligations related to that individual. Depending on how long an individual has been improperly classified and the number of individuals involved, the tax obligations may be substantial.¹ Given the potential adverse consequences of improperly classifying an individual, it is important to understand how the IRS distinguishes between an independent contractor and an employee.

When determining whether an individual is an employee or independent contractor, no single factor provides the answer. The general rule is that an individual is an independent contractor if the person for whom the services are performed has the right to control or direct only the result of the work and not the means and methods of accomplishing the results.² To the contrary, under common law rules, an individual who performs services is generally an employee if the employer can control what will be done and how it will be done.³

When examining the specific facts to determine whether someone is properly classified, the IRS concentrates on behavioral control, financial control, and the relationship of the parties.⁴ Behavioral control relates to whether there is a right to direct or control how the worker completes the necessary work. For example, if the individual receives instructions on how the work is to be done and training about required procedures and methods, this suggests that the individual may be an employee. Financial control relates to whether there is a right to direct or control business aspects of the work. For example, if the individual has a significant financial investment in the work, is not reimbursed for business expenses, and has the opportunity to realize a profit or incur a loss, the individual may be an independent contractor. When examining the relationship of the parties, it is important to consider the written contract, which may set forth the parties’ intent.

Whether set forth in a written contract or otherwise, if the relationship between the parties involves the receipt of employee benefits such as insurance or paid vacations, this may indicate that the individual is an employee.⁵

If an employer is uncertain whether an individual should be classified as an independent contractor or employee, the IRS has extensive guidance available at www.irs.gov to assist the employer in this analysis. In addition, an employer may seek input from an outside consultant or may elect to seek a determination of worker status directly from the IRS by completing IRS Form SS-8; however, the employer should realize that it may take a number of months to receive an IRS determination.

Although determining independent contractor or employee status may be a secondary consideration in the staffing process, the IRS does not look favorably on employers attempting to reduce their tax burden by improperly classifying employees as independent contractors. In addition to concerns associated with the IRS, it is important to analyze how staff classification may affect such issues as professional liability insurance coverage and payor credentialing. For these reasons, practices should be certain to adequately consider the issue of independent contractor versus employee when retaining the professional services of additional physical therapists and other staff.

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Paul Welk, PT, JD, is a Private Practice Section member and a physical therapist attorney with Tucker Arensberg, P.C., where he frequently advises physical therapy private practices in the areas of corporate and health care law. Questions or comments can be directed to pwelk@tuckerlaw.com.

¹ As an example, in 2007, the Internal Revenue Service ordered Federal Express to pay back taxes and fines totaling \$319 million for ground employees the firm allegedly misclassified as independent contractors.

² <http://www.irs.gov/businesses/small/article/0,,id=179115,00.html>, accessed December 1, 2008.

³ <http://www.irs.gov/businesses/small/article/0,,id=179112,00.html>, accessed December 1, 2008.

⁴ IRS Publication 1779 (Revised 8-2008).

⁵ Ibid.