



YOUR ULTIMATE GUIDE TO

# Hiring A New Contractor





# Hey, it's Grace!

Want to learn more about what you need to do before you hire your first contractor? You're in the right spot!

Contractors can be a great option if you need some help taking tasks off your plate or tackling a specialized project. However, there are several things you need to consider to make sure you don't end up facing consequences like back pay or even criminal charges!

Different agencies have different rules regarding contractor and employee classification. In this guide, we'll be focusing on the U.S. Department of Labor's standards. Please consult with an HR or tax professional for your specific situation.

# Why can't every new worker be classified as a contractor?

The consequences of incorrectly classifying an employee as a contractor can result in back wages and interest, criminal charges, and penalties. But, why exactly does the government care *so much* about whether you're calling a worker a contractor or an employee?

Employees are entitled to certain protections under the Fair Labor Standards Act (FLSA) like minimum wage and overtime pay. Incorrectly classifying an employee as a contractor removes those legal protections. Check out the next page for the Department of Labor's Economic Reality Test Factors to help with contractor classification.

Employees and contractors are also treated differently from a tax perspective. Generally, a business does not need to withhold any taxes from a contractor's pay. Taxes become the contractor's responsibility.

# Economic Reality Test Factors

- Opportunity for profit or loss depending on managerial skill
- Investments by the workers and the employer
- Degree of permanence of the work relationships
- Nature and degree of control
- The extent to which the work performed is an integral part of the employer's business
- Skill and initiative

\* *Information sourced from DOL.gov*

# Employee vs. Contractor

Works for another business

Generally can only earn more by working more hours

Works for one employer or may be prohibited from working for others

Continuing or indefinite relationships with employer

Employer decides how/when work will be performed

Employer assigns work

In business for themselves

Can earn more money through business decisions

Provides own tools, materials, and equipment

Can work with multiple clients

Temporary relationship

Decide which projects they will take on

Determines own schedule

## **GENERAL RULE OF THUMB**

The more you have control over your worker, the more likely it is they should be classified as an employee.

## CLEARING UP MISCONCEPTIONS

# 5 Things That Don't \*Actually\* Determine Whether A Worker Is A Contractor

- Whether you (or they) call them a contractor
- Whether you issue them a 1099
- How often you pay them or your payment method
- Whether you have a written contractor agreement
- Whether they are able to work offsite or have flexible working hours

# Why do I need a signed Form W-9 from a new contractor?

Before you ever issue a payment to a contractor, it's important that you have their signed Form W-9 on file. This form provides important tax information like your contractor's SSN or EIN, business name, federal tax classification, exemptions, and mailing address.

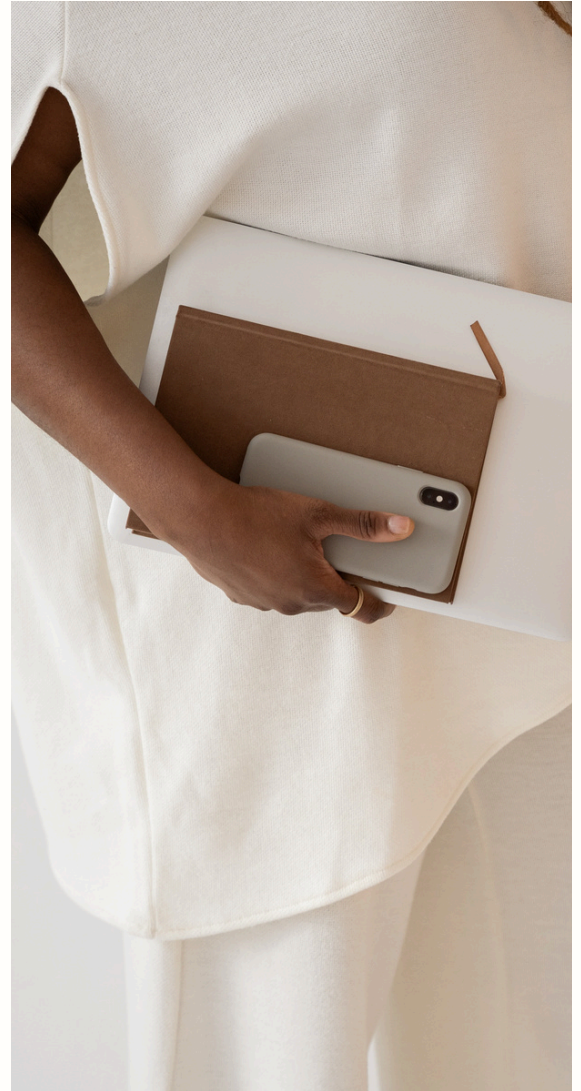
Without this information, you won't know whether you should or shouldn't issue a 1099 to your contractor, whether you should be withholding backup taxes, or which tax ID number to use when issuing a 1099.

Failing to collect this information can lead to penalties for both you and your contractor. If a contractor refuses to provide a W-9, you should document the written refusal and consider whether you still want to move forward with your business relationship.

# How To Pay Your Contractors

When paying your contractors, avoid personal payment apps (Venmo, CashApp, Zelle, etc).

These apps don't typically have formal protection for business payments or required tax reporting for businesses. For some apps, sending business payments can even be a violation of their terms and conditions.



## Recommended Payment Methods

- ACH or Business Bank Account Transfer
- Professional Payment Platforms (like Bill.com, Melio, Quickbooks, or Gusto)
- Business Checks
- Business Credit Card Payments



# New Contractor Onboarding Checklist

- Draft and have both parties sign a written contractor agreement
- Collect a signed Form W-9
- Define payment terms and collect their payment information
- Verify that the contractor is correctly classified (not an employee)
- Review any insurance requirements and proof of liability
- Ensure all tax and legal documentation is in the contractor's company file
- Make all necessary team and client introductions

# What You Need To Know About 1099-NECs

## **NON-EMPLOYEE COMPENSATION**

If you paid \$600 or more of non-employee compensation to a contractor during the calendar year, you may need to issue them a 1099-NEC.

## **NON-CORPORATE ENTITIES**

Generally, you only need to issue 1099-NECs to sole proprietorships, partnerships, and LLCs that aren't taxed as corporations. However, some payments to C corporations and S corporations may require a 1099 based on the type of payment or nature of the contractor's business.

## **NOT PAID BY PAYMENT PROCESSOR**

Payments made to contractors via credit card or third-party payment processors should be reported by the processor via 1099-K.



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