

How Should Your Business Prepare for Potential New Rule on Independent Contractors?



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Gene Marks:

Hey everybody, this is Gene Marks and welcome to The Week In Review where I take an item or two from the news and see how it impacts your business and give some thoughts on it. Well, there was a big piece of news that happened recently and it came from the Department of Labor.

They just released a week or two ago a notice of proposed rulemaking to modify their analysis for determining employee or independent contractor classification under the Fair Labor Standards Act. According to the department, they are rescinding the Trump administration's 2021 independent contractor rule and proposing to return to a totality of the circumstances analysis – a move that is likely making it more difficult to support independent contractor status.

And this, everybody, could have a huge impact on your business and mine in the months to come. There will be a 45 day public comment period that has begun when they actually publish it in the Federal Register, which I believe has already been done, so the clock is ticking.

Independent contractor, guys, these are the 1099 workers that you had, and if your business like mine uses them, these new rules that are coming out are likely going to become effective regardless of the feedback. It's going to change how we classify those workers.

Currently, there are a number of factors that you need to consider when determining whether or not a worker is an independent contractor or an employee. I mean, you consider their permanency of the relationship, the nature and the degree of control you have over that worker, and the worker's opportunities for profit and loss as they are an independent contractor.

In an independent contractor relationship, the contractor is not entitled to any benefits of an employee like health insurance and is responsible for paying their own taxes. You and me, as business owners, we pay the contractor directly like they're a vendor, and if there's more than \$600 paid to them during the year, we have to report this payment to the IRS and to them, as well. Right? Okay, fine.

It's all going to change. We know that now that the Department of Labor has announced that they're making these changes, and really this change is going to come down to something called an ABC rule. I want to tell you about this ABC rule because A and C really don't change a whole lot from the past. It's the B part of this rule that's going to have a big impact on our businesses.

"A" means that the worker is free from the control and direction of the hirer in connection with the performance of the work, which should be the case now. When you hire an independent contractor, maybe they're providing services, maybe they're delivering something for you, maybe they're providing some type of marketing work or some type of assistance. That's fine. They're free to do it as they see fit to do. They're an independent business, like you would hire a contractor to, you know, fix your redo your bathrooms. So, "A" I think is okay.

Part "C" I think is okay. In part "C" it says the worker is customarily engaged in an independently established trade, occupation, or business. Well, of course, so when you hire that person, hopefully they're an independent businessperson. They provide you with an employee identification number, an EIN, or a social security number, and you send them a 1099. They're independent. They have other customers and clients. I think that's always been the case, that shouldn't change now.

The "B" part is what you and I need to be careful about. "B" says this: The worker must be performing work that is outside of the usual course of the hiring entity's business – "outside of the usual course". What does that mean?

To me, that means that if you hire an independent contractor and that person is generating revenue for you because you're using that contractor as your course of business, you're billing them out to a client – like I do with some of our contractors – or they're delivering something in the transportation car charges are included in the invoice to the customer. Or they're performing some kind of services and their expenses are included in your entire project fees. Eh, that independent contractor may very well need to be classified as a as an employee.

I mean, take my business, for example. Okay. When needed, I employ a handful of outside developers to perform tasks for clients and then bill my clients for their time. Under this new rule, the ABC rule, I may be required to classify those developers as employees because they're not performing work that is outside of the usual course of my business. They're generating revenue for me, you know. Now, if I have to classify these people as employees, that means I have to withhold taxes, pay employer taxes, potentially offer them participation in my company's benefit plans.

You know, this old shrew, I mean, just think about these contractors – people that are independent drivers, content creators, technicians, trainers, specialists – could all be, that is what the case might be.

So, this is definitely an issue for a lot of small businesses. Now, there are opponents out there which include, by the way, many business organizations and associations that represent freelancers, because they say that these rules inhibit entrepreneurship and their freedom to practice independently. They also argue that the new rules will raise costs for small businesses, right, because it's going to make it easier for employees to unionize.

The supporters, though, say that it gives workers more protections and that, according to, you know, the Department of Labor, you know, employers have to comply with the law. You know, they're at a competitive disadvantage and those who don't comply with this. So, therefore, it kind of levels the playing field. Okay?

The bottom line is you need to get ready that. You need to get ready. So, what do you do to prepare yourself for something like this?

Well, you need to make sure you're prepared to pay more for payroll taxes and benefits, because if you think you've got some of these independent contractors that are going to have to be employees, it's going to be a cost to you. So, you may need to make some adjustments to your contracts in order to cover the cost of these benefits and taxes.

You should also revisit your insurance policies, particularly your workers' compensation coverage, and you might need to have a new calculation as to how much more and premiums are going to have to pay for each additional person who's now classified as an employee.

So, listen, you know, when the new rule is eventually finalized, there's still going to be complications. You know, that's because the rule – it's not likely not going to affect how states determine worker classifications and it's probably not going to change how the IRS determines independent contractors for tax reporting purposes. So, it's going to be kind of a mess and I'm expecting there's going to be a lot of lawsuits that are going to be challenging this new rule. Remember, it's not law. It's just a rule from the Department of Labor.

Bottom line is, though, the Department of Labor is moving forward with these changes to independent contractor rules. So, your takeaway is this if you've got a 1099 worker and they're generating revenue for your business, you need to re-evaluate that worker and readdress their status because they may need to be classified as an employee. Stay tuned and I will try my best and Paychex will do their best to keep you up to date on how these rules continue on.

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