



Business Law & Taxes

Difference Between Independent Contractor and Employee

Classifying Workers - Why it Matters

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Employee or Independent Contractor?. Westend61/Getty Images

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Why Is It Important to Know if Workers are independent contractors or employees?

The distinction between employees and independent contractors is important. The status of someone who works in your business makes a difference in [how you pay them](#) and in how they pay taxes.

Employees are paid as salaried or hourly and may be subject to overtime. Employees are taxed on their income (they receive a [W-2 form](#) showing their annual income), and you must also withhold federal and state income taxes and [FICA taxes](#) (Social Security and Medicare) from them.

Your business must also make FICA tax payments.

If someone is working for your business as an **independent contractor**, you don't withhold federal or state income taxes and FICA taxes from the amounts you pay them. Your business also isn't required to make payments for FICA taxes. The independent contractor must pay his or her own income taxes (called [self-employment taxes](#)), along with income tax on earnings.

How do I know if a worker is an [Independent Contractor or an Employee](#)?

The IRS distinguishes between an independent contractor and an employee for the purpose of payroll taxes and [withholding taxes](#). Basically, an independent contractor is an independent business person who runs his or her own business but who does work for another business. An employee is hired by a company to perform specific work at the direction of the employer.

How Does the IRS Decide a Worker's Status?

To help distinguish between employees and independent contractors, the IRS has set up [three general criteria](#):

- **Behavioral Control**

If an employer trains and directs work, including hours of work, what tools or equipment to be used, specific tasks to be performed and how the work is to be done, the worker is likely an employee. If the worker can set his or her own hours and works with little or no direction or training, he or she is probably an independent contractor.

- **Financial Control**

This factor includes how the worker is paid, whether the worker may work for others at the same time,



controlling. If the worker is entitled to benefits, this would indicate an employment relationship.
Another factor would be the type of work the person does; if it is directly related to the company's core

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