

TUYSUZOGLU CPA
Free Guide

Employee vs Contractor Classification

Correct classification, the IRS tests, and California's ABC test.

ENGLISH

Why It Matters

Whether you classify a worker as a contractor (1099) or an employee (W-2) directly affects your tax liability, payroll taxes, and legal exposure. Misclassification means IRS and state penalties, back taxes, and interest — one of the most common penalty areas for restaurant and small-business owners.

Core Difference

	Employee (W-2)	Contractor (1099)
Withholding	Employer withholds	Worker pays own
Social Sec./Medicare	Employer pays half	Worker pays all
Control of work	Employer directs	Worker chooses method
Equipment/tools	Usually employer	Usually worker
Duration	Ongoing / set hours	Project / job-based

The IRS Three-Factor Test

- **Behavioral control:** Do you set how, when, and where the work is done?
- **Financial control:** Who covers expenses? Does the worker serve other clients?
- **Relationship type:** Written contract, permanence, benefits (insurance, leave)?

No single factor decides it; the whole picture matters.

California Special: The ABC Test

California (and some states) apply the stricter **ABC test**. A worker is a contractor only if **all three** hold:

- **A:** Free from control and direction in performing the work.

- **B:** The work is outside the company's usual course of business.
- **C:** The worker is engaged in an independently established trade.

***ipucu / Tip: Critical for restaurant owners:** Putting a regular kitchen worker on a 1099 almost always fails condition B.*

Consequences of Misclassification

- Unpaid payroll taxes + interest
- Per-worker penalties
- Retroactive state unemployment and workers' comp liability
- Potential lawsuit exposure

The Right Approach

- When unsure, ask your CPA; if needed, request an official determination via **Form SS-8**.
- Use written contracts with contractors and collect a W-9.
- Issue a 1099-NEC to every contractor paid over \$600 in the year.

This guide is for general information only and is not a substitute for personal tax/financial advice.