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# W-2 EMPLOYEE VS. 1099 INDEPENDENT CONTRACTOR: UNDER THE LAW, THERE IS A HUGE DIFFERENCE

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# INTRODUCTION



# INTRODUCTION

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- Under the law, there is a huge difference between a W-2 employee and a 1099 independent contractor.
- There is no such thing as a "1099 employee," and there is no such thing as a "W-2 independent contractor."
- Only a human being can be an employee; an "it" cannot be an employee. In other words, while John Smith (a human being) can be an employee, John Smith Marketing Group, LLC (an "it") cannot be an employee. John Smith is either a W-2 employee or a 1099 independent contractor but not both.

# CHARACTERISTICS OF AN INDEPENDENT CONTRACTOR

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- General Rule - An individual is an Independent Contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done.
- In other words, services where someone else is telling you what to do and how to do it generally means you are not an independent contractor.

# CHARACTERISTICS OF AN EMPLOYEE

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- Under common-law rules, anyone who performs services for you is your employee ***if you can control what will be done and how it will be done.***
  - True even when you give the employee freedom of action.
  - Bottom line is who has the right to control the details of how the services are performed.

# CHARACTERISTICS OF AN EMPLOYEE

## ■ IRS Example

- Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works 6 days a week, and is on duty in Bob's showroom on certain assigned days and times. She appraises trade-ins, but her appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. She has to develop leads and report results to the sales manager. Because of her experience, she requires only minimal assistance in closing and financing sales and in other phases of her work. She is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group term life insurance for Donna. Donna is an **employee** of Bob Blue.

# CHARACTERISTICS OF AN EMPLOYEE

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- Facts that provide evidence of the degree of control and independence fall into three categories
  - Behavioral
  - Financial
  - Type of Relationship

# CHARACTERISTICS OF AN EMPLOYEE

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- Behavioral Control falls into the following categories
  - Type of Instructions
    - An employee is generally subject to the business's instructions about when, where, and how to work.
    - All of the following are examples of types of instructions about how to do work.
      - When and where to do the work.
      - What tools or equipment to use.
      - What workers to hire or to assist with the work.
      - Where to purchase supplies and services.
      - What work must be performed by a specified individual.
      - What order or sequence to follow when performing the work



# CHARACTERISTICS OF AN EMPLOYEE

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- Degree of Instructions

- The more detailed, the more control.
- Less detailed instructions often means less control, so the person may be an independent contractor.
- Because the amount of instruction needed varies with different jobs; so, even if no instructions are given, there may still be sufficient behavioral control for an employee.
- Key consideration is whether the business has retained the right to control the details of a worker's performance or has given up that right.

# CHARACTERISTICS OF AN EMPLOYEE

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## ■ Evaluation Systems

- Is there an evaluation system to measure the details of how the work is performed?
  - Yes - most likely an employee
  - No - most likely an independent contractor

## ■ Training

- Is there training on how the job should be performed?
- Periodic or on-going training about procedures and methods is strong evidence of an employer-employee relationship.

# CHARACTERISTICS OF AN EMPLOYEE

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- Financial Control
  - Who controls the business aspects such as:
    - How the worker is paid
    - Whether expenses are reimbursed
    - Provides tools and supplies

# CHARACTERISTICS OF AN EMPLOYEE

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- Financial Controls fall in the following categories
  - Significant Investment
    - An independent contractor will often have a significant investment in the equipment being utilized in providing the services
    - No specific dollar limit that constitutes a significant investment
    - Some types of work simply do not require large expenditures

# CHARACTERISTICS OF AN EMPLOYEE

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- Unreimbursed Expenses
  - More likely for Independent Contractors
  - Fixed ongoing Cost that reoccur regardless of work are important considerations

# CHARACTERISTICS OF AN EMPLOYEE

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- Financial Controls fall in the following categories
  - Opportunity for Profit or Loss - If the worker has a significant investment in tools and equipment or unreimbursed expenses, then the worker has a greater opportunity to lose money. This type of person looks more like an Independent Contractor
  - Services available to the market - Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

# CHARACTERISTICS OF AN EMPLOYEE

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- Method of payment
  - An employee is generally guaranteed a regular wage for an hourly, weekly, or other time period.
  - An Independent Contractor is usually paid a flat fee.

# CHARACTERISTICS OF AN EMPLOYEE

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- Type of relationship
  - Factors for the type of relationship between the two parties generally fall into the following categories:
    - Written Contracts
      - IRS is not bound by determinations by the parties
      - The IRS will look at how the parties interact
    - Employee Benefits
      - Includes things like insurance, pension plans, paid vacation, sick days, and disability insurance
      - Not generally granted to independent contractors
      - Lack of benefits doesn't necessarily mean independent contractor



# CHARACTERISTICS OF EMPLOYEES

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- Type of Relationship
  - Permanency of the Relationship
    - specific project or
    - long term relationship
  - Services Provided as Key Activity of the Business
    - Key Activity of the Business means more likely to be able to control the activities

# CHARACTERISTICS OF EMPLOYEES

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- No magic line that once crossed changes someone from an employee to and independent contractor
- Key is to look at the entire relationship
  - Consider the degree or extent of the right to direct and control
  - Document the factors used in coming up with the determination
- <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>



# FEDERAL LAW



# KICKBACK STATUTE

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- The Medicare anti-kickback statute prohibits offering, paying, soliciting, or receiving any remuneration in exchange for referring (or arranging for the referral of) a patient to a person or entity for any Medicare-covered item or service or in exchange for purchasing, leasing, ordering, or arranging for or recommending purchasing, leasing, or ordering any Medicare-covered item or service.

# KICKBACK STATUTE

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- There are both an exception and a safe harbor to the anti-kickback statute that say that it is permissible for a health care provider to pay commissions to a bona fide full-time or part-time W-2 employee.
- The reasoning behind this exception is because the provider has the obligation to supervise and control its employee, and the provider is liable for the acts of its employee.

# KICKBACK STATUTE

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- On the other hand, a provider has no duty to supervise and control a 1099 independent contractor, and the provider is not liable for the acts of a 1099 independent contractor.
- So while it is permissible for a provider to pay commissions to a bona fide employee who generates business to the provider (in which the payer is a government program), it is a violation of the kickback statute if the provider pays commissions to a 1099 independent contractor who generates business to the provider (in which the payer is a government program).

# KICKBACK STATUTE

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- The anti-kickback statute cuts both ways
  - the payer of the money (the provider) and the recipient of the money (the 1099 independent contractor) are both liable under the statute, which is a criminal statute.

# DHHS STATEMENT

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- A 1989 statement by the Department of Health and Human Services is illuminating:
  - "We are aware of many examples of abusive practices by sales personnel who are paid as independent contractors and who are not under appropriate supervision. We believe that if individuals and entities desire to pay a salesperson on the basis of the amount of business they generate, then to be exempt from civil or criminal prosecution, they should make these salespersons employees where they can and should exert appropriate supervision for the individual's acts."



# OIG ADVISORY OPINION

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- Also instructive is an OIG Advisory Opinion that addressed a proposed arrangement in which a sales representative for a medical supply manufacturer would be paid a monthly commission based on a percentage of amounts invoiced for products sold pursuant to the sales representative's efforts.

# OIG ADVISORY OPINION

- According to the OIG
  - "Sales agents are in the business of recommending or arranging for the purchase of the items or services they offer for sale on behalf of their principals, typically manufacturers, or other sellers (collectively, 'Sellers'). Accordingly, any compensation arrangement between a Seller and an independent sales agent for the purpose of selling health care items or services that are directly or indirectly reimbursable by a Federal health care program potentially implicates the ant-kickback statute, irrespective of the methodology used to compensate the agent. Moreover, because such agents are independent contractors, they are less accountable to the Seller than an employee ... . For these reasons, this Office has a longstanding concern with independent sales agency arrangements."

# OIG ADVISORY OPINION

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- However, the AO did state that in some circumstances these type of arrangements may be permissible if the sales rep's contact is structured to fit the Personal Services and Management Contracts safe harbor to the anti-kickback statute.

# SAFE HARBOR

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- Although a 1099 independent contractor relationship may be established under the Personal Services and Management Contracts safe harbor, such an arrangement must comply with the specific elements of the safe harbor, including the following:
  - (i) payments to the 1099 independent contractor must be pursuant to a written agreement with a term of at least one year, and
  - (ii) the aggregate compensation paid to an independent contractor must be set in advance, consistent with fair market value, and not determined in a manner that takes into account the volume or value of any referrals or business generated.

# PROHIBITED CARVE OUT

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- The OIG has taken the position that if a 1099 independent contractor paid on a production basis is generating both commercial and federally funded health care program referrals, any arrangement where the independent contractor is paid commissions only for the referrals of commercial patients and is paid nothing for the patients covered by a government program, nevertheless, violates the anti-kickback statute.

# PROHIBITED CARVE OUT

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- The reasoning is that the commissions for the commercial patients, in reality, also serve as compensation for the patients covered by a government program.

# PROHIBITED CARVE OUT

- As stated by the OIG:
  - "[A]s a threshold matter, we must address whether the "carve out" of Federal business is dispositive of the question of whether the Existing Arrangement implicates the anti-kickback statute. It is not. The OIG has a long-standing concern about arrangements pursuant to which parties "carve out" Federal health care program beneficiaries or business generated by Federal health care programs from otherwise questionable financial arrangements. Such arrangements implicate and may violate the anti-kickback statute by disguising remuneration for Federal business through the payment of amounts purportedly related to non-Federal business."



# “TAKE AWAYS”





# “TAKE AWAYS”

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- It is permissible to pay commissions to bona fide W-2 part-time or full-time employees who generate patients to the provider in which the payer is a government program.

# “TAKE AWAYS”

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- The employment arrangement must be "bona fide," not a "sham."
- The smell test applies.
  - Let's say that the provider and the sales rep sign a written employment agreement;
  - Let's say that the provider withholds taxes from the rep's paycheck;
  - Let's say that the provider gives a W-2 to the rep;
  - But, let's say that the provider, in reality, exercises no supervision and control over the rep.

# “TAKE AWAYS”

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- It is likely that this "employment" arrangement will be considered to be a "sham" arrangement, meaning that the government will likely take the position that the rep is, in fact, a 1099 independent contractor of the provider. This, in turn, will result in a violation of the anti-kickback statute.

# “TAKE AWAYS”

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- A sales rep (who generates patients covered by a government health care program) can be a 1099 independent contractor if the arrangement complies with the Personal Services and Management Contracts safe harbor.
- However, a fixed annual fee arrangement (no commissions) with a sales rep is normally unrealistic.

# “TAKE AWAYS”

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- If a 1099 independent contractor sales rep generates both commercial patients and patients covered by a government health care program, the parties cannot avoid violating the anti-kickback statute by the provider paying commissions only for the commercial patients and paying nothing for the patients covered by a government health care program.

# “TAKE AWAYS”

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- Lastly, let's say that the rep is a 1099 independent contractor, is paid commissions, and only generates commercial patients for the provider.
- In this scenario, the Medicare anti-kickback statute will not apply.
- However, the parties will need to review the state's anti-kickback statute.

# “TAKE AWAYS”

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- All states have anti-kickback statutes that are similar to the Medicare anti-kickback statute.
- Some state anti-kickback statutes only come into play when the payer is the state's Medicaid program.
- Other state statutes come into play regardless of the payment source.



# QUESTIONS?







# THANK YOU

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