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Hiring an Associate: W-2 or 1099, and What Getting It Wrong Costs

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The short answer

Whether someone is an employee or a contractor is decided by how much control the practice has over the work, not by what the agreement is called and not by what the associate prefers. If you set the schedule, the fees, the location and the materials, you have an employee, whatever the paperwork says. Clinical support staff are employees in nearly every case. Getting it wrong is expensive, because the practice owes the payroll taxes that were never withheld, plus penalties and interest, and several states apply a stricter test than the IRS does.

What the IRS actually looks at

The common law test groups the evidence into three categories. No single factor decides it, and the agreement itself is only one piece of evidence among many.

Category	Points toward employee
Behavioral control	You set the hours, assign the patients, direct how the work is done, require training or protocols
Financial control	You set the fees, supply the equipment and materials, pay regardless of collections, cover the overhead
Type of relationship	Open-ended arrangement, benefits provided, the work is the core service the practice sells

That last point does a lot of work in a clinical setting. An associate dentist treating patients in your chairs, on your schedule, with your assistants and your supplies, billing under your practice, is performing the central service of the business. Dressing that up as a contractor relationship rarely survives scrutiny.

Where the line usually falls

Role	Usual treatment
Hygienists, assistants, front desk, office manager	Employee, essentially always
Associate on your schedule, in your space, using your staff and supplies	Employee in most cases
Locum or substitute covering occasional days, own malpractice, multiple practices, own terms	Contractor is often defensible
Specialist who rents space, keeps their own patients, sets their own fees and bills separately	Contractor, and often a tenant relationship as well
Billing company, IT, cleaning, marketing agency	Contractor

> A written independent contractor agreement does not create a contractor. It is useful evidence only when the facts already support the conclusion.

What a reclassification costs

- The employer share of Social Security and Medicare tax on everything paid
- The income tax and employee payroll tax that should have been withheld, reduced under a special rule if the misclassification was not intentional
- Federal and state unemployment tax
- Penalties and interest on all of it
- Potential retirement plan problems, because an excluded worker may have been eligible, and a plan correction is its own expense
- State consequences, including workers compensation coverage and wage law exposure

If the failure to withhold is found to be willful, a 100 percent penalty can be assessed personally against the people responsible for the money. That one does not stay inside the entity.

States can be stricter

Several states apply an ABC test for state purposes, under which a worker is an employee unless the practice can prove all three: the worker is free from control, the work is outside the usual course of the practice business, and the worker is independently established in that occupation. The middle prong is close to impossible for a clinical provider in a clinical practice.

You can therefore be defensible federally and still wrong at the state level. Where your associate is licensed and where the work is performed both matter, and so does your state corporate practice of medicine or dentistry rule, which may limit who can own or employ providers in the first place.

How the choice touches your own tax plan

Associates on payroll add W-2 wages to the practice. For an owner whose income is above the threshold where the 20 percent pass-through deduction is limited by wages, those wages can help, though medical and dental practices are specified service businesses whose deduction phases out entirely at higher income, so the benefit depends on where you sit.

Payroll also changes the reasonable compensation conversation inside an S corporation, gives you a cleaner basis for a retirement plan with meaningful owner contributions, and makes the practice easier to sell, because a buyer can see a staffed, transferable business rather than one person with 1099s.

If you have been treating an associate as a contractor and want to change it, do it at the start of a year, price the change properly, and get specific advice on the prior periods before you file anything that highlights them.

Frequently asked questions

Can an associate dentist be a 1099 contractor?

Sometimes, but not in the usual arrangement. If the practice sets the schedule and fees, supplies the space, staff and materials, and bills under the practice, the associate is an employee regardless of the contract.

Can a hygienist be a contractor?

Almost never. Clinical support staff work under the practice's direction, in its space, with its equipment, which is the definition of an employee.

What happens if the IRS reclassifies our contractors?

The practice owes the employer payroll taxes, the amounts that should have been withheld, unemployment tax, and penalties and interest. Willful failures can bring a 100 percent personal penalty against the responsible individuals.

Does a signed contractor agreement protect us?

Only as supporting evidence where the facts already fit. It cannot overcome day-to-day control over how, when and where the work is done.

Do state rules differ?

Yes, and several states are stricter than the IRS. Under an ABC test, work that is part of the practice's ordinary business generally cannot be contractor work at all.

General information based on federal law for tax year 2026, not tax advice for your situation. State rules vary.

Want this applied to your situation? Book a free 30-minute call with Akanchya Acharya, CPA at acharyacpa.com/contact or email akansha@acharyacpa.com.

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