

worksome

COMPLIANCE PLAYBOOK

THE STRATEGIC GUIDE TO

US Worker Classification in 2026

A compliance playbook for HR, Procurement, Finance, and Operations
leaders building the modern US workforce.

PUBLISHED BY

worksome

FOR

HEADS OF HR, TALENT, PROCUREMENT, FINANCE & OPERATIONS

EDITION

2026

The End of the “Grey Area”

In 2026, the luxury of ambiguous worker classification has vanished. Federal agencies and aggressive state regulators have synchronized enforcement, using AI-driven audit tools to identify misclassified “shadow workforces” with surgical precision.

This guide moves beyond 101 definitions. It provides the legal context, historical precedent, and 2026 regulatory specifics required to build a compliant, scalable external workforce — and a clear path to operationalizing compliance at scale.

— THE 2026 LANDSCAPE AT A GLANCE

- 1 Binary reality**
There is no “middle category.” A worker is either an Independent Contractor (1099) or an Employee (W-2).
- 2 The cost of failure**
Settlements routinely exceed \$10M for mid-market firms. C-suite executives face personal liability for unpaid payroll taxes.
- 3 The solution**
Compliance must be a system of record — not a manual checklist.

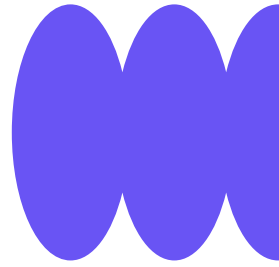
\$10M+
Typical mid-market misclassification settlement

50
US states where Worksome provides EOR and Payroll services

6 yrs
Record retention required in NY & CA

This guide is for informational purposes and does not constitute legal advice. Classification rules are complex, jurisdiction-specific, and subject to change. Employers should consult qualified employment counsel before making classification decisions.

Contents



Six sections. Two of context. Three your team can do on Monday.

01	The regulatory landscape	05
	Federal agencies, state patchwork, and the 2026 AI-audit regime.	
02	Classification in practice	09
	The decision tree, 1099 vs. W-2 side-by-side, and the documentation mandate.	
03	Red flags & the cost of getting it wrong	12
	Six warning signs, and the seven parallel liabilities a single determination triggers.	
04	The compliance action plan	15
	Three operational checklists: evaluate, onboard, and manage ongoing.	
05	The Worksome solution	19
	Compliance as a system of record for classification, contracts, and payments.	
06	Customer stories	21
	\$9.6M in annual savings. An HMRC audit cleared in under five months.	

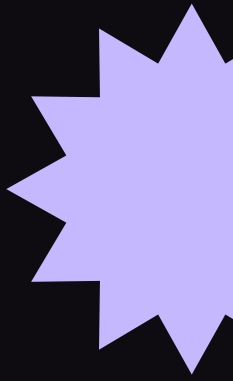


How to use this guide

Sections 1–3 cover legal and risk context. Section 4 gives HR, Legal, Finance, and Procurement a practical action plan. Section 5-6 shows how Worksome operationalizes it.

— SECTION 01

01



The Regulatory Landscape

Federal agencies, state regulators, and courts now apply distinct and sometimes-conflicting tests for classification. Understanding the architecture is step one.

— FEDERAL ARCHITECTURE

One Worker, Three Judges

There is no universal classification test. Three federal bodies apply distinct standards — and a single engagement can be a contractor under one and an employee under another.

DOL · FLSA

1

Economic Reality Test

The DOL's 2026 test centers on **opportunity for profit or loss**. If your worker can't actually lose money, they likely aren't a contractor.

IRS

2

Common Law Test

Applied across **behavioral control, financial control, and type of relationship**. If you provide the laptop, software, and methodology — the IRS sees an employer.

NLRB

3

Joint-Employer Liability

In 2026, the NLRB is focused on joint-employer liability. Exercise “indirect control” over a staffing agency's workers — and you share legal responsibility.

2026 WATCHLIST

AI-driven audits.

State agencies now use predictive modeling to flag companies whose 1099 spend grows faster than their W-2 headcount. Expect cross-referenced data pulls from IRS filings, state UI records, and workers' comp carriers.

— WHAT THIS MEANS IN PRACTICE

Compliance floor

Federal law sets the minimum worker protections. States are free to build a higher ceiling — and many have.

Whichever is stricter

When tests disagree, apply the stricter standard. A worker who passes the IRS test may still fail California's ABC test.

Document the rationale

The burden of proof sits with you. Decisions without contemporaneous documentation are presumed invalid.

— STATE CEILING

The Federal Floor vs the State Ceiling

Federal law is the minimum. States build higher — sometimes radically. A compliant engagement in Texas can be a misclassification in California.

STRICTEST

CA

California

THE ABC TEST · AB 5

Presumes employee status unless **all three** prongs are met:

A Absence of control

Free from direction in contract and practice.

B Outside core business

Services not central to company's usual business.

C Independent business

Established trade with other clients or entity.

Impact: A software company cannot hire a 1099 developer. Prong B fails on its face.

MANDATED CONTRACTS

NY

New York

FREELANCE ISN'T FREE · STATEWIDE

As of 2026, **"Freelance Isn't Free"** is now a statewide mandate — not just NYC.

- ✓ Any engagement over **\$800** requires a written contract.
- ✓ Payment must clear within **30 days** of invoice — strictly enforced.
- ✓ Common-law multi-factor analysis, with industry overlays (construction uses ABC-like).

Impact: Even compliant 1099s can create liability via payment delays — late payments alone now trigger statutory damages.

MA

IL

NJ

The "contagion" effect.

MA, IL, and NJ have adopted versions of the ABC test — creating a high-risk corridor. Assume stricter standards in any blue state until proven otherwise.

— PATCHWORK

Not Every State Is California

Some states remain genuinely business-friendly. Others hover somewhere in between. Your classification program needs to account for all of them.

BUSINESS-FRIENDLY

TX

Texas

COMMON LAW ALIGNMENT

Uses the common-law test, aligned with IRS standards. No ABC presumption. But employers must still prove independence — **a 1099 form alone is not enough.**

Arrangements that pass in Texas may fail in California. If you hire nationally, design for the stricter test.

PATCHWORK

48 others

Everywhere else

1 in 3

states use some form of the ABC test, often for UI or workers' comp only.

FL/VA

most Southern states follow the IRS-style common law test.

ME

some use hybrid statutory tests (Maine's combined criteria).

By role

Occupation-based exemptions common (lawyers, accountants, real estate).

— PRACTICAL EXAMPLE

The Same Writer, Two Outcomes

A content writer working remotely may qualify as a contractor under IRS rules or Texas law. But in **California** — if writing is central to the company's business and the worker has no other clients — **prong B fails**, and they must be classified as an employee.

— KEY TAKEAWAY

When tests disagree, apply the stricter one.

Multi-state employers should build their classification program to the strictest standard — or use Worksome to classify state-by-state automatically.

Beyond classification tests, state-specific rules add steps. California requires Form DE 542 filings with the state EDD. NYC's "Freelance Isn't Free Act" mandates written contracts and 30-day payment terms.

SECTION 02

02

Classification in Practice

Turning the legal tests into a workable decision-making framework. A step-by-step tree, a side-by-side comparison, and the documentation every engagement needs.



— DECISION TREE

Is This Worker a 1099 or a W-2?



Run every prospective engagement through these three gates. If you can't answer yes to all three, you have a W-2.

1

GATE 1 · CORE BUSINESS

Is the work “core” to your business?

A software company hiring a developer. A law firm hiring a paralegal. A marketing agency hiring a writer.



 **YES** → Must be W-2.  **NO** → Continue.

2

GATE 2 · BEHAVIORAL CONTROL

Do you dictate the how, when, and where?

Company laptop, mandated hours, mandatory internal meetings.



 **YES** → Must be W-2.  **NO** → Continue.

3

GATE 3 · ECONOMIC INDEPENDENCE

Is the worker a legitimate business entity?

LLC, multiple clients, business insurance, separate marketing.

 **YES** → Compliant 1099.  **NO** → High-risk. High risk in CA, NY, MA.

W

How Worksome does this

Worksome Classify runs this logic on every hire, automatically. It applies federal, state, and city-level rules based on the worker's location — then produces a documented, timestamped classification decision before the engagement starts. No manual judgment calls. No inconsistency between hiring managers.

— 1099 VS W-2

The Real Differences

The decision is binary — but the operational, financial, and legal implications are not. This is what actually changes.

	1099 · CONTRACTOR	W-2 · EMPLOYEE (via Worksome EOR)
Control	High autonomy. Worker sets methods, hours, and tools.	Directed by hiring manager. Schedule and methods set by employer.
Audit risk	EXTREME AI-flagged in 2026.	LOW Worksome assumes liability.
Executive risk	Personal liability for unpaid payroll taxes.	Indemnified via Worksome.
Benefits	None. Providing any creates ERISA exposure.	Full health, 401(k), PTO, state-mandated leave.
Tax reporting	W-9 collected. 1099-NEC for \$600+.	Payroll taxes withheld. W-2 by Jan 31.
Record retention	6 years (NY/CA). Maintained manually.	Automated via Worksome Vault.
Penalty	Back wages + double damages + up to \$25K/violation .	Not applicable.

Worksome operates as the **Employer of Record (EOR)** for W-2 workers and the **Agent of Record (AOR)** for 1099 contractors — meaning both pathways sit inside a single compliant system rather than stitched-together workflows across payroll, legal, and procurement.

— CREATING A DOCUMENT VAULT

The Document Vault Is Your Only Defense

In a 2026 audit, the burden of proof is on you. If you can't produce documentation, the agency defaults to W-2 — and back-assesses from there.

1

Contemporaneous rationale

Every 1099 needs a signed document dated **at the time of hire** explaining which test they passed.

Post-hoc reconstruction won't survive an audit.

2

SOW, not JD

1099s need a **Statement of Work** with deliverables and milestones — not a job description.

Framing matters as much as substance.

3

The 6-year rule

In NY and CA, retain all records for **6 years post-engagement**. Federal is 3–4 years; stricter rule governs.

Destroy early at your peril.

— SOW VS JD

Small Word Choices, Large Legal Consequences

✓ SOW (GOOD)	× JD (RISKY)
Deliver X by Y	"Work 40 hrs/wk"
Fixed project fee	"Hourly, bi-weekly"
Methodology at discretion	"Follows team process"
Deliverable triggers payment	"Performance review at month 3"

⚠ JOINT-EMPLOYER TRAP

Staffing agencies don't shield you.

If your managers handle day-to-day discipline, scheduling, or performance feedback for vendor workers, you are a **joint employer** under NLRB rules.

Worksome's workflows preserve the necessary legal distance: all employment actions route through Worksome, while clients direct deliverables.

— SECTION 03

03

The Red Flags & the Cost of Getting It Wrong

Recognizing the warning signs early. Understanding the multi-million dollar consequences when you miss them.



— SIX RED FLAGS

When a Contractor Is Actually an Employee

Six warning signs that an engagement is at risk. If any apply, reassess immediately — labels in a contract don't override the actual working relationship.

 FLAG 01

High control or integration

Sets daily hours, supervises tasks, requires adherence to staff policies. Contractors should operate with meaningful autonomy.

 FLAG 02


Exclusive or long-term engagement

Worker has no other clients and is Retained for extended, open-ended roles. True contractors typically serve multiple clients.

 FLAG 03

Low-skill or short-term roles

Temporary clerical work with training and supervision is almost always an employment relationship, not a contractor one.

 FLAG 04
STRONGEST SIGNAL

Former employees rehired

Ex-employees returning to do **identical work** as contractors is the single strongest signal for auditors. Always involve Legal.

 FLAG 05

No independent business presence

No LLC, no business insurance, no marketing, no other clients. Auditors read this as economic dependence — i.e. employment.

 FLAG 06

Treated like staff

Company email, badge, listed in the org chart, attends employee-only events. The more embedded, the more they look like staff.

“

Labels in a contract don't override reality. What matters is the actual working relationship — and auditors are trained to see through the paperwork.

”

— COST OF GETTING IT WRONG

When Classification Goes Wrong

Misclassification penalties compound across wage, tax, benefits, and regulatory regimes. A single determination can trigger seven parallel liabilities.

1

IRS BACK TAXES

Unpaid FICA (7.65%), FUTA, plus penalties and interest, back to start.

2

STATE TAXES

Back state income tax withholding and SUI contributions + state penalties.

3

WAGE & HOUR

Unpaid overtime, off-the-clock, and meal break violations. Often doubled.

4

BENEFITS (ERISA)

Health, 401(k), and PTO claims — the “Microsoft Perma-temp” precedent.

5

WORKERS' COMP

Missed premiums. Uninsured on-site injury = direct liability to company.

6

UNEMPLOYMENT

A single UI claim from an ex-contractor triggers a state audit of every 1099.

7

CLASS ACTIONS

One complaint can become a class. Settlements for mid-market firms exceed \$10M.

!

PERSONAL

Executive liability. 100% Trust Fund Recovery Penalty under IRC §6672 — personally.

Case study · FedEx Ground, 2015

Drivers were classified as 1099 contractors. After a decade of litigation, FedEx settled for **\$228M**. The same playbook applies to modern “gig” models in 2026.

\$228M

SECTION 04

04



The Compliance Action Plan

Three checklists your HR, Legal, Procurement, and Finance teams can operationalize today — from the moment you evaluate a contractor to the moment you close the engagement.

— CHECKLIST 1 OF 3

Evaluate Your Current Workforce **01**

Before onboarding anything new, audit what you have. This is the diagnostic that tells you where your exposure sits today.

Inventory all 1099s	Pull a complete list from AP. Scope: every contractor paid in the last 24 months. Cross-reference with HRIS.
Run the decision tree	Put every active 1099 through the 3-gate test (page 9). Flag any with two or more red flags (page 13).
Map by state	CA, MA, IL, NJ, and NY require immediate review. Any role in CA that's central to your business fails ABC on prong B.
Risk-score the list	Rank: Red (convert immediately), Amber (review quarterly), Green (compliant, document annually).
Quantify exposure	Estimate back-tax liability: 15.3% FICA/FUTA × total pay × 3 years + state SUI + penalties. This is your minimum number.
Brief the C-suite	Executives face personal IRC §6672 liability. They need to know the number before any audit, not after.

COMMON FINDING

12–20% of "contractors" will be reclassified.

Based on Worksome audits of mid-market tech, media, and professional-services firms. Plan accordingly.

DEADLINE PRESSURE

Section 530 relief has a shelf life.

Self-correction under Section 530 is only available if you act before an audit letter arrives. The window is narrowing.

— CHECKLIST 2 OF 3

Onboard Every New Engagement

02

Every new hire — contractor or employee — runs through this pipeline. No exceptions, no backdoors, no “just this once.”

Classify first	Before writing any paperwork, run the 3-gate test. Document the decision and the rationale the same day.
Collect W-9 / I-9	W-9 for 1099s. I-9 and state tax forms for W-2. Missing forms = defaulted to employee in an audit.
Write an SOW (not a JD)	For 1099s: deliverables, milestones, fixed fee, methodology at worker's discretion. Never a JD.
Contract by state	NY needs FIFA-compliant terms. CA needs AB5 analysis. NYC enforces 30-day payment. One template does not fit all.
IP & confidentiality	Work-for-hire clauses. NDAs. Assignment of rights. Standard for all engagements regardless of classification.
Verify insurance (1099s)	Request proof of general liability and professional indemnity. Workers without business insurance are harder to defend.
Set up payment terms	30-day payment in NY (enforced). Milestone-based, not hourly, for 1099s wherever possible.
File it, timestamped	Every document, dated, in a system of record. A timestamped decision at hire is your single best audit defense.

— CHECKLIST 3 OF 3

Manage the Engagement

03

A compliant hire can become non-compliant over time. These are the management practices that keep classification defensible across the engagement lifecycle.

Keep managers clean	No performance reviews. No internal training. No mandatory meetings. Direct by deliverable, not by direction.
Watch the clock	12+ months of continuous 1099 engagement with the same worker is an audit trigger. Plan for renewal or conversion.
No internal-employee perks	No branded email. No internal directory. No all-hands invitations. No swag. These look like employment in an audit.
Review quarterly	Re-run the decision tree on any “Amber” contractors. Look for scope creep that converts a 1099 into a W-2.
Pay on milestones	Milestone-based payment reinforces independent-contractor status. Hourly + timesheets reinforces employment.
File 1099-NECs correctly	By January 31. Any 1099 paid \$600+ in the calendar year. Missed filings trigger \$280+ per form, per year.
Retain for 6 years	NY and CA require 6 years post-engagement. Federal is 3–4. The stricter rule governs all engagements.

The quarterly review habit

Mature organizations run a light quarterly review on Amber contractors and a deep annual audit on every 1099. Worksome automates both.

Qx4

SECTION 05

05

Compliance as a System of Record

Worksome replaces manual classification checklists with an automated, auditable, and defensible compliance infrastructure — embedded directly in your hiring workflow.



— THE PLATFORM

Three Modules. One System of Record.

Classification decisions, contracts, and payments — governed by a single compliance infrastructure covering 150+ countries.

CLASSIFY

Automated classification

Runs the 3-gate test on every prospective engagement against federal, state, and city-level rules. Produces timestamped decisions.

- Per-state ABC / Common Law
- FIFA + AB5 pre-checks
- Signed audit trail

CONTRACTS

Jurisdiction-aware contracts

SOWs, not JDs. Auto-populated by state, role, and engagement type. IP and confidentiality baked in.

- 50-state templates
- E-signature + versioning
- 6-year retention built-in

PAYMENTS

Global payments & taxreporting

NY 30-day rule enforced. 1099-NEC filed by Jan 31. W-2 payroll via Worksome's own EOR entities.

- EOR in 150+ countries
- AOR for 1099s
- Indemnified classification

— THE ASSURANCE

We take the classification risk.

Worksome indemnifies every classification decision it issues — the liability sits with us, not you.

Real EOR, not brokered.

Worksome operates its own legal entities in 150+ countries. No daisy-chained third parties.

Audit-ready in minutes.

Every decision, contract, and payment is exportable in a DOL / IRS-formatted audit bundle on demand.

— SOLUTION SPOTLIGHT

Compliance That Pays for Itself.

Two real outcomes from Worksome customers — a mid-market global brand and a UK-headquartered enterprise.

GLOBAL BRAND **MID-MARKET**

\$9.6M

annual savings

A global consumer brand consolidated its US contractor program on Worksome — collapsing five staffing vendors into a single system of record and cutting classification overhead by 73%.

“

We went from manual quarterly audits to continuous compliance with a fraction of the headcount.

VP, TOTAL REWARDS

UK · HQ **ENTERPRISE**

< 5 mo

HMRC audit · cleared

When HMRC opened an IR35 investigation covering 300+ contractors, Worksome produced the complete audit file in 48 hours. The case closed in under five months — with zero reclassifications and zero penalties.

“

The audit pack was one export. Our auditors said it was the cleanest contractor documentation they'd ever seen.

DIRECTOR OF PROCUREMENT

VENDORS CONSOLIDATED

5 → 1

CLASSIFICATION OVERHEAD

-73%

TIME TO AUDIT RESPONSE

48 hrs

— YOUR NEXT 90 DAYS

A 90-Day Plan to Safe Harbor.

You don't need to solve everything at once. A phased rollout including diagnose, pilot, expand, gets most organizations to compliant-by-default in a quarter.

1

WEEKS 1-2

Diagnose

Run the inventory + risk-score against your current 1099 population.

Worksome provides the compliance and risk assessment free of charge.

2

WEEKS 3-6

Pilot

Route new engagements through Worksome in one business unit or one state.
Typical pilot: 20-40 hires.

3

WEEKS 7-12

Expand & remediate

Roll out platform-wide.
Convert "Red" contractors onto Worksome's W-2 EOR.
Close the audit gap.

— TALK TO US

Book a 30-minute classification review.

Bring us your current 1099 list. We'll tell you, state by state, where you stand and what a migration path looks like.

[worksome.com](https://www.worksome.com)OR EMAIL: HELLO@WORKSOME.COM

WHAT COMES NEXT

Build Your Future Workforce — Not Your Future Liability

See how Worksome classifies, contracts, pays, and indemnifies your entire external workforce from one system of record.

[Book a compliance audit](#) →

[Explore EOR](#)

[Explore AOR](#)