

## **Employee or Independent Contractor?**

### I. Why does it matter?

- A. The easiest answer is because it determines the tax liability of both the worker and the payer.
- B. Penalties for misclassification are steep:
  - 1. Total FICA liability (employer plus employee share = 15.3%)
  - 2. 20% of gross payments as federal income tax
  - 3. possibly state and local taxes
  - 4. possibly FUTA, SUTA and workers' compensation
  - 5. penalty of up to **100%** of the above taxes
  - 6. interest

### II. How will they know?

- A. Audit – of either the company/payer OR the worker
- B. Unemployment claim filed by worker
- C. Workers' Compensation claim filed by worker
- D. If a former contractor files a Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding

### III. The IRS has the final authority to classify workers as employees or independent contractors.

- A. Their decision can be appealed, but it is a tedious, expensive process.
- B. Using IRS guidelines can limit the potential for re-classification.
- C. The IRS Common Law Rules that provide evidence of control and independence
  - 1. Behavioral – Does the company control or have the right to control what the worker does and how the worker does his/her job?
  - 2. Financial – Are the business aspects of the worker's job controlled by the payer?
    - a. How is the worker paid?
    - b. Are the worker's expenses reimbursed?
    - c. Who provides the tools/supplies, etc?
  - 3. Type of Relationship – Are there written contracts or employee type benefits (ie: pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?
- D. 20 questions the IRS uses to determine employee/independent contractor classification (any "yes" answer, except for #16, may mean the worker is an employee):

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1. Is the worker required to comply with instructions about when, where, and how the work is done?
  2. Is the worker provided training that would enable him/her to perform a job in a particular method or manner?
  3. Are the services provided by the worker an integral part of the business' operations?
  4. Must the services be rendered personally?
  5. Does the business hire, supervise, or pay assistants to help the worker on the job?
  6. Is there a continuing relationship between the worker and the person for whom the services are rendered?
  7. Does the recipient of the services set the work schedule?
  8. Is the worker required to devote his/her full time to the person he/she performs services for?
  9. Is the work performed at the place of business of the company or at specific places set by the company?
  10. Does the recipient of the services direct the sequence in which the work must be done?
  11. Are regular oral or written reports required to be submitted by the worker?
  12. Is the method of payment hourly, weekly, monthly (as opposed to commission or by the job)?
  13. Are business and/or traveling expenses reimbursed?
  14. Does the company furnish tools and materials used by the worker?
  15. Has the worker failed to invest in equipment or facilities used to provide the services?
  16. Does the arrangement put the person in a position of realizing either a profit or a loss on the work?
  17. Does the worker perform services exclusively for the company rather than working for a number of companies at the same time?
  18. Does the worker in fact make his/her services regularly available to the general public?
  19. Is the worker subject to dismissal for reasons other than non-performance of the contract specifications?
  20. Can the worker terminate his/her relationship without incurring a liability for failure to complete the job?
- E. Not all 20 questions apply to every decision, or carry the same weight.

IV. Requirements when using independent contractors

- A. Payer must file 1099 Miscellaneous forms if payment for the year is equal to or greater than \$600.00
- B. Similar workers must be treated alike (not some as employees, some as contractors)
- C. If a worker appears to be an employee based on the IRS 20 questions, there

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must be a good reason for the contractor status (other than avoiding employer taxes)

1. Precedent: court cases and revenue rulings
2. Practice: long standing in the industry
3. IRS previous audit

V. Statutory and Non-Statutory Employees

- A. The Federal Code lists the following groups as not being employees under the 20 questions, but ARE EMPLOYEES under the Statutory Rules
  1. Agent Drivers or Commission Drivers – must be licensed, paid on commission, and a contract must exist stating the agent will not be an employee for federal tax purposes
  2. Full-Time Life Insurance Salesperson – for one company
  3. Homeworkers – work at home for one employer making clothing, needlecrafts, bedspreads, buttons, quilts, gloves, etc.
  4. Traveling or City Salesperson – sells for one principal employer
- B. The Federal Code considers the following to be independent contractors under Statutory Rules
  1. Qualified Real Estate Agents – must be licensed, paid on commission, and a contract must exist stating that the agent will not be an employee for federal tax purposes.
  2. Direct Seller – sells consumer products outside a permanent retail establishment, is paid on commission, and a contract must exist stating that the salesperson will not be an employee for federal tax purposes

VI. Strategies to use when unsure of employee or independent contractor status

- A. Have the worker sign a written agreement attesting to the fact that he/she is an independent contractor
- B. The worker should bill the business for services performed
- C. The worker should carry his/her own workers' compensation coverage
- D. As much independence as possible should be given in areas such as hours worked, where the job is to be performed, etc.
- E. The worker should provide his/her own tools, supplies, training, transportation, etc.