

CCH-EXP, TAX RESEARCH CONSULTANT, PLANIND: 9,102 Determining Status as Employee or Independent Contractor

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Determining Status as Employee or Independent Contractor

The IRS has identified 20 factors that can be used to determine whether an individual is an independent contractor or effectively an "employee."¹

The determination of independent contractor versus employee status is based on all of the facts and circumstances surrounding the relationship. These factors seek to determine whether there is behavioral and financial control of the worker. None of the identified factors is determinative. In addition, not all factors are present in all employee or independent contractor relationships.

The factors are listed below, with an explanation of whether they tend to indicate an employer-employee or an independent contractor status.

- *Control of when, where, and how the worker performs services.* Provision of instructions regarding when, where, and how the worker is to work is indicative of an employer-employee relationship. Independent contractors tend to have control of the time, place, and method at and by which the worker performs job obligations.
- *Training.*
Training, requiring services to be performed with other workers, and requiring the worker to attend meetings, are indicative of an employer-employee relationship.
- *Integration into firm operations.*
The integration of a worker's services into the operations of the business indicates the direction and control generally found in an employer-employee relationship.
- *Requirement that services be personally performed.*
Limited identity of the service provider is indicative of an employer-employee relationship. Independent contractors are often not required to personally perform the services. However, there are exceptions and this factor alone is often not determinative.
- *Control over assistants.*
An employer-employee relationship is indicated when the firm has the right to hire, supervise, and pay the worker's assistants.
- *Length of relationship.*
A long-term continuing relationship indicates an employer-employee relationship. However, this factor alone is not enough to determine the degree and extent to which the employer exercises control.
- *Work schedule.*
A worker given a set work schedule indicates the control of an employer in an employer-employee relationship.
- *Number of hours of service required.* The amount of time the worker is required to provide services to the employer is indicative of the worker's status. Full-time employment and firm control over time spent working are indicative of an employer-employee relationship. Provision of services part-time while performing services for others is indicative of a lack of control, suggestive of an independent contractor relationship.
- *Location where services are performed.*
The requirement that services be provided on the firm's premises suggests an employer-employee relationship. However, some types of services or work cannot be performed elsewhere, such as improvements to the firm's facilities. This factor alone is not determinative.

- *Control over technique or sequence.*
Control of the order or sequence in which the worker performs required tasks suggests an employer-employee relationship exists. When the worker determines how and in what order tasks will be performed, it is less indicative of an employer-employee relationship.
- *Reports to firm.* Submission of regular or periodic oral or written reports suggests that there is a degree of control indicative of an employer-employee relationship. However, the requirement that progress reports be made might not be enough by itself to establish an employer-employee relationship.
- *Payment method.*
The interval of payment may be indicative of an employer-employee relationship. Payments by the hour, week, or month suggest that an employer-employee relationship may exist. Payment by the job or based on invoices submitted by the worker are indicative of an independent contractor relationship.
- *Work-related expenses.*
Payment of the worker's business and travel expenses suggests an employer-employee relationship. However, reimbursement of business and travel expenses pursuant to a contract might just be part of the arrangement between an independent contractor and the firm.
- *Tools.* Whether the worker is required to furnish her own tools is an important consideration. Provision of necessary tools and equipment by the firm suggests that there is an employer-employee relationship. However, the fact that a worker supplies or is required to supply her own tools and equipment is not necessarily determinative.
- *Work facilities.*
Investment in and provision of work facilities by the worker, especially if of a type not generally maintained by employees, indicates an independent contractor relationship.
- *Profit and loss potential.*
Workers likely to profit from the success of an enterprise and at risk of experiencing a loss on its failure are usually independent contractors. Workers paid a fixed rate based on time with no possibility of loss are more likely employees.
- *Multiple employers.* The presence of multiple employers, rather than employment by a single firm, is indicative of a worker having an independent contractor status.
- *Restrictions on customers and clients.*
Workers who offer their services to the public on a regular, consistent basis are less likely to be employees than those with a single employer. Workers significantly restricted as to the identity of those for whom they can work are probably employees.
- *Termination of worker.* The firm's ability to terminate its relationship with the worker for any reason without penalty indicates an employer-employee relationship. The availability to the worker of penalties if termination is without cause may indicate more independence, as would be expected of an independent contractor.
- *Termination of relationship by worker.*
The worker's ability to end the relationship at any time without penalty is indicative of an employer-employee relationship. Liability to the worker for terminating the relationship without cause or for reasons not permitted by the agreement may indicate an independent contractor relationship.²

COMMENT

Danshera Cords, J.D., LL.M., Associate Professor of Law, Capital University Law School, Columbus, Ohio: The provision of personal services by a specific individual is often what creates the value of the services. Therefore, in some instances, the fact that the services must be performed by only one individual is not determinative of an employment relationship. Common examples include services that require that worker receive a security clearance or

services that are artistic or personal in nature. In these instances, the performance of work by a substitute might not in fact be the same as performance by the contracted worker.

Another means to determine status as an employee or an independent contractor has been adopted by the Tax Court. The Tax Court considers seven factors, which are:

- The degree of control exerted by the employer over the worker.
- The worker's investment in work facilities.
- The worker's potential to experience profit or loss.
- The ease to the employer of discharging the worker.
- The degree to which the work performed is integral to the principal function of the employer.
- The permanent or temporary nature of the relationship.
- The parties' understanding regarding the nature of the relationship.³

See COMPEN: 3,102, discussing employees versus independent contractors.

Checklist: Independent Contractor Versus Employee

The following checklist may help determine whether an individual's relationship with an employer is a true independent contractor relationship or an "employment-style" arrangement. If a relationship is more like an employment relationship, the employer may be responsible for more obligations to the "employee." Check each statement that is true, remembering that no single issue is dispositive.

- The employer controls the time, place, and manner of the work.
- The employer provides or requires training, or requires attendance at training meetings.
- The employer integrates the worker into regular operations.
- The employer requires that the worker specifically perform the work.
- The employer hires and controls the worker's assistants.
- The employer and the worker have a long-term working relationship.
- The employer requires the worker to work certain hours or a certain schedule.
- The employer requires a certain number of hours.
- The employer requires work at a specific location.
- The employer controls the order of the work or the technique used.

CCH-EXP, TAX RESEARCH CONSULTANT, COMPEN: 3,102 Common-Law Employees Versus Independent Contractors for FICA Purposes

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Common-Law Employees Versus Independent Contractors for FICA Purposes

A person is an employee for FICA and other employment tax purposes if the person is a common-law employee.¹² The common-law employer-employee relationship exists when the person for whom services are performed has the right (whether or not actually exercised) to control and direct the individual who performs the services, not only as to the result to be accomplished but also as to how the result is accomplished. In contrast, if a worker is subject to the direction or control of another merely as to the result to be accomplished by the work and not as to the means and methods by which the result is accomplished, the worker is an independent contractor.¹³ In determining whether the right of direction and control exists, no one factor is necessarily controlling, and the relative importance of any one factor may vary depending on the occupation under consideration.¹⁴ A safe haven rule, known as Section 530 relief, provides that a taxpayer will be relieved from employment tax obligations with regard to workers, even though those workers may be common-law employees, if certain requirements are met. See COMPEN: 3,110 for discussion of Section 530 relief.

INTERACTIVE RESEARCH AIDS

See **Tools: Determining Whether Worker is Employee or Independent Contractor** for an interactive decision tree that will help you determine a worker's status (Interactive Research Aids ¶12,150).

The IRS considers three aspects of control when determining whether a business employs a worker: behavioral control, financial control, and the relationship of the parties.¹⁵ Behavioral control is shown by facts regarding the right to direct or control how the worker performs the specific tasks for which he or she is hired. See COMPEN: 3,102.05 for discussion of behavioral control. Financial control is shown by facts regarding a right to direct or control the financial aspects of the worker's activities. These include whether there is a significant investment by the worker, whether the worker's success depends on entrepreneurial skill, and whether the worker makes his or her services available to the relevant market in addition to the service recipient. See COMPEN: 3,102.10 for discussion of financial control. The relationship of the parties is generally shown by the parties' agreements and actions with respect to each other, paying close attention to those facts which show not only how they perceive their own relationship but also how they represent their relationship to others. Facts which illustrate how the parties perceive their relationship include the intent of the parties, as expressed in written contracts; the provision of, or lack of, employee benefits; the right of the parties to terminate the relationship; the permanency of the relationship; and whether the services performed are part of the service recipient's regular business activities. See COMPEN: 3,102.15 for the nature of the parties' relationship. All three of these factors also come into play when the question is which of two or more entities is the common law employer. See COMPEN: 3,102.20 for discussion of multiple employers.

Prior to consolidating its focus on these three aspects of control, the IRS used a list of twenty factors derived from case law and rulings when determining worker status (though not all factors were necessarily relevant in every case).¹⁶ The IRS still considers these factors to the extent they are relevant in illustrating behavioral controls, financial controls, and the relationship of the parties. The following is the IRS's list of twenty factors:

- (1) A person who is required to comply with instructions about when, where and how to work is ordinarily an employee. The control factor is present if the employer has the right to instruct, whether or not he does so. (However, for a registered representative of a securities broker-dealer, no weight is given to instructions imposed only in compliance with governmental investor protection standards.¹⁷)
- (2) Training by an experienced employee is a factor of control because it is an indication that the employer wants the services performed in a particular method or manner.
- (3) Integration of the person's services in the business operation generally shows that the person is subject to direction and control.

(4) If the services must be rendered personally, it indicates that the employer is interested in methods as well as results.

(5) Hiring, supervising, and paying of assistants by the employer generally shows control over all of the workers on the job. When one worker hires, supervises and pays other workers, under a contract that provides that he will furnish labor and materials and that he will be responsible only for the attainment of a result, the worker is an independent contractor.

(6) The existence of a continuing relationship between an individual and the person for whom he performs services is a factor tending to indicate the existence of an employer-employee relationship.

(7) The establishment of set hours of work by the employer is a factor indicative of control.

COMMENT

This factor is of lesser importance in the modern economy. The IRS training materials give the example of a camera operator who may be an independent contractor even though he must shoot a commercial at the time and place where the actors and director are gathered.¹⁸

(8) If the worker is required to devote full time to the business of the employer, it is implicit that the worker is restricted from doing other gainful work, whereas an independent contractor may choose for whom and when to work.

COMMENT

The IRS training materials state that in light of the wide variety of working arrangements used by both employees and independent contractors in recent years, whether a worker performs services on a full-time or part-time basis is a neutral fact.¹⁹

(9) Doing the work on the employer's premises implies that the employer has control.

COMMENT

The IRS training materials state that the location where work is performed often has no bearing on employment status. Where the selection of the work location is relevant it is relevant because it shows the employer's right to direct and control how the work is performed.²⁰

(10) If the person must perform services in the order or sequence set by the employer, it shows that the worker may be subject to control, although the fact that the employer retains the right to order the work may also show control.

(11) If regular oral or written reports must be submitted to the employer, it indicates control.

(12) An employee is usually paid by the hour, week, or month; payment on a job basis is customary when the worker is an independent contractor. The guarantee of a minimum salary or the granting of a drawing account at stated intervals with no requirement of repayment of the excess over the amount earned tends to indicate an employer-employee relationship.

COMMENT

The IRS training materials suggest that payment on a commission basis is a neutral fact.²¹

(13) Payment by the employer of the worker's business or traveling expenses is a factor indicating control.

COMMENT

The IRS training materials state that reimbursement is a neutral fact; both independent contractors and employees may be reimbursed for business or travel expenses. Significant unreimbursed expenses indicate that the worker is an independent contractor, though there are exceptions. For example, an auto mechanic is typically an employee even though he is not reimbursed for the purchase of his tools.²²

(14) The furnishing of tools, materials, etc., by the employer is indicative of control.

(15) A significant investment by a worker in facilities he uses in performing services for someone else tends to show independent status, while the furnishing of all necessary facilities by the employer tends to indicate employee status.

(16) People who are in a position to realize a profit or suffer a loss as a result of their services are generally independent contractors.

(17) If a person works for a number of employers or firms at the same time it usually indicates an independent status.

(18) Workers who make their services available to the general public are usually independent contractors.

COMMENT

Under the regulations, individuals such as doctors, lawyers, dentists, construction contractors, and others engaged in the pursuit of an independent trade, business, or profession in which they offer their services to the public, are independent contractors and not employees.²³ See COMPEN: 3,200 for discussion of treatment of individuals engaged in specific occupations.

(19) The right to discharge is an important factor indicating that the person possessing the right is an employer.

(20) An employee has the right to end the relationship with an employer at any time the employee wishes without incurring liability, as distinguished from independent contractors, who usually agree to complete a specific job and are responsible for its satisfactory completion or are legally obligated to make good for failure to complete the job.

The IRS will rule on the status of a worker at the request of the worker or the employer. See COMPEN: 3,300.

On audit, taxpayers may request early referral of worker classification issues to the Appeals Office.²⁴ See IRS: 24,106.20 for discussion of the early referral procedures.

There is no private right of action under FICA to sue an employer for failure to withhold and pay FICA taxes when the employer treats the workers as independent contractors and the workers feel they should be treated as employees.²⁵

COMMENT

Workers in this situation can proceed administratively before the Secretary of Health and Human Services to correct their earnings history. However, the employer is not a necessary or proper party to that type of proceeding. Similarly, while the IRS can sue the employer for failure to pay FICA taxes, the workers are not necessary or proper parties to that action.

¹² Code Sec. 3121(d)(2).

¹³ Reg. §31.3121(d)-1(c)(2).

¹⁴ Reg. §31.3121(d)-1(c)(3).

¹⁵ IRS Letter Ruling 200006033, November 10, 1999.

¹⁶ Rev. Rul. 87-41, 1987-1 CB 296; IRS Letter Ruling 9651003, August 26, 1996.

¹⁷ The Taxpayer Relief Act of 1997, P.L. 105-34, Act §921(a) (August 5, 1997).

¹⁸ *Independent Contractor or Employee?*, IRS Training Materials, Training 3320-102 (10-96).

¹⁹ *Independent Contractor or Employee?*, IRS Training Materials, Training 3320-102 (10-96).

²⁰ *Independent Contractor or Employee?*, IRS Training Materials, Training 3320-102 (10-96).

²¹ *Independent Contractor or Employee?*, IRS Training Materials, Training 3320-102 (10-96).

²² *Independent Contractor or Employee?*, IRS Training Materials, Training 3320-102 (10-96).

²³ Reg. §31.3121(d)-1(c)(2).

²⁴ Rev. Proc. 99-28, 1999-2 CB 109.

²⁵ *Salazar v Brown*, DC Mich., 940 FSupp 160.