

Independent Contractor (Self-Employed) or Employee?

(from <http://www.irs.gov>)

It is critical that you, the business owner, correctly determine whether the individuals providing services are **employees** or **independent contractors**. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. If you are an independent contractor and hire or subcontract work to others, you will want to review the information in this section to determine whether individuals you hire are independent contractors (subcontractors) or employees.

Before you can determine how to treat payments you make for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be -

- An independent contractor
- An employee (common-law employee)
- A statutory employee
- A statutory nonemployee

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

Common Law Rules

Facts that provide evidence of the degree of control and independence fall into three categories:

1. **Behavioral:** Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. **Financial:** Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. **Type of Relationship:** Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that

“makes” the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another.

The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

Form SS-8

If, after reviewing the three categories of evidence, it is still unclear whether a worker is an employee or an independent contractor, Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding can be filed with the IRS. The form may be filed by either the business or the worker. The IRS will review the facts and circumstances and officially determine the worker’s status.

Be aware that it can take at least six months to get a determination, but a business that continually hires the same types of workers to perform particular services may want to consider filing the Form SS-8.

Employment Tax Obligations

Once a determination is made (whether by the business or by the IRS), the next step is filing the appropriate forms and paying the associated taxes.

Misclassification of Employees

Consequences of Treating an Employee as an Independent Contractor

If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker (the relief provisions, discussed below, will not apply). See Internal Revenue Code section 3509 for more information.

Relief Provisions

If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all required federal information returns on a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977. See Publication 1976, Section 530 Employment Tax Relief Requirements for more information.

Misclassified Workers Can File Social Security Tax Form

Workers who believe they have been improperly classified as independent contractors by an employer can use Form 8919, Uncollected Social Security

and Medicare Tax on Wages to figure and report the employee's share of uncollected Social Security and Medicare taxes due on their compensation.

Independent Contractor

People such as lawyers, contractors, subcontractors and auctioneers who follow an independent trade, business, or profession in which they offer their services to the public, are generally not employees. However, whether such people are employees or independent contractors depends on the facts in each case.

The general rule is that an individual is an independent contractor if you, the person for whom the services are performed, have the ***right to control or direct only the result of the work and not the means and methods of accomplishing the result.***

Example: Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at \$16 per hour for 400 hours. She is to receive \$1,280 every 2 weeks for the next 10 weeks. This is not considered payment by the hour. Even if she works more or less than 400 hours to complete the work, Vera Elm will receive \$6,400. She also performs additional electrical installations under contracts with other companies that she obtained through advertisements. Vera is an ***independent contractor.***

Employee (Common-Law Employee)

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.*** This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.

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.