

Independent Contractor vs. Employee

To determine whether a worker is an independent contractor or an employee, you must examine the relationship between the worker and the business. All evidence of control and independence in this relationship should be considered. The facts that provide this evidence fall into three categories – Behavioral Control, Financial Control, and the Type of Relationship itself.

Behavioral Control covers facts that show whether the business has a right to direct and control how the work is done through instructions, training, or other means.

Financial Control covers facts that show whether the business has a right to control the financial and business aspects of the worker's job. This includes:

- The extent to which the worker has unreimbursed business expenses,
- The extent of the worker's investment in the facilities used in performing services,
- The extent to which the worker makes his or her services available to the relevant market,
- How the business pays the worker, and
- The extent to which the worker can realize a profit or incur a loss.

Type of Relationship includes:

- Written contracts describing the relationship the parties intended to create,
- The extent to which the worker is available to perform services for other, similar businesses,
- Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay,
- The permanency of the relationship, and
- The extent to which services performed by the worker are a key aspect of the regular business of the company.

For more information, refer to Publication 15-A (PDF), *Employer's Supplemental Tax Guide*. If you want the IRS to determine whether a specific individual is an independent contractor or an employee, file Form SS-8 (PDF), *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*.

In order to avoid the requirement to withhold payroll taxes from an employee, there is a tendency for some business owners to declare a worker to be an independent contractor, who properly should be considered an employee. The more control you exercise over the worker, in determining when, where and how he does his job, the more likely it is that the IRS will consider the worker to be an employee, and not an independent contractor.

Employee or Independent Contractor?

Whether someone who works for you is an employee or an independent contractor is an important question. The answer determines your liability to pay and withhold Federal income tax, social security and Medicare taxes, and Federal unemployment tax. In general, someone who performs services for you is your employee if you can control what will be done and how it will be done. The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. These facts fall into three main categories:

- **Behavioral Control** – Facts that show whether the business has a right to direct and control. These include:
 - Instructions - an employee is generally told:
 1. when, where, and how to work
 2. what tools or equipment to use
 3. what workers to hire or to assist with the work
 4. where to purchase supplies and services
 5. what work must be performed by a specified individual
 6. what order or sequence to follow
- Training – an employee may be trained to perform services in a particular manner.
- **Financial Control** – Facts that show whether the business has a right to control the business aspects of the worker's job include:
 - The extent to which the worker has unreimbursed expenses
 - The extent of the worker's investment
 - The extent to which the worker makes services available to the relevant market
 - How the business pays the worker
 - The extent to which the worker can realize a profit or loss
- **Type of Relationship** – Facts that show the type of relationship include:
 - Written contracts describing the relationship the parties intended to create
 - Whether the worker is provided with employee-type benefits
 - The permanency of the relationship
 - How integral the services are to the principal activity

For a worker who is considered your employee, you are responsible for:

- Withholding Federal income tax,

- Withholding and paying the employer social security and Medicare tax,
- Paying Federal unemployment tax (FUTA)
- Issuing Form W-2, Wage and Tax Statement, annually,
- Reporting wages on Form 941, Employer's Quarterly Federal Tax Return.

For a worker who is considered an independent contractor, you may be responsible for issuing Form 1099-MISC, *Miscellaneous Income*, to report compensation paid.

The more control you exercise over the worker, the more likely it is that the IRS will consider him to be an employee, subject to payroll tax withholding, and not an independent contractor, who receives a 1099- MISC form, and pays his/her own taxes. If the employer improperly classifies a worker as being an independent contractor when he should have been considered an employee, the IRS will impose penalties and interest against the employer for failing to withhold payroll taxes.