

### **What Is an Independent Contractor?**

Independent contractors work for themselves — they are treated as if they are running their own business. Thus, you are not the employer of an independent contractor, and you aren't liable for payroll taxes or benefits for them, nor are they protected by workers' compensation or most labor laws.

Independent contractors control the performance of the work based on their experience, special license, or special education or training required for the job. In most cases, you tell them the outlines of the project that needs to be done and the due date, and they determine how to accomplish it, on their own schedule. The independent contractor provides the knowledge, experience, and labor to perform the job or provides other individuals to perform the job contracted. Independent contractors are usually paid based on their results (i.e., a flat rate per job, or a per-unit-completed rate) rather than the time they put in.

**Independent contractor under the Internal Revenue Code.** The IRS frowns on the use of independent contractors, in part because such workers are responsible for paying their own payroll taxes and it's much more difficult to make sure they're doing so.

Generally speaking, [for tax purposes](#) the key question is the degree of control you can exercise over the worker. The worker will be treated as an employee if the company has the right to determine not just what the employee does, but when, where, or how he or she does it. The IRS has a 20-factor test that it uses to determine whether an employee is an independent contractor or an employee in disguise. The factors can carry different weights, depending on the factual situation. Generally speaking, if the worker would be considered an employee under at least 10 of the factors, you should treat him or her as an employee.

If in doubt, look at IRS Form SS-8, which is the form used by the IRS to determine individual status for purposes of income and employment taxes.

**Independent contractors under the Fair Labor Standards Act (FLSA).** The FLSA is another important federal law governing your treatment of workers. Unfortunately, it has its own definition of independent contractor that is slightly different from the IRS's definition. In order to be truly sure that you're safe in treating workers as independent, you must meet *both* definitions.

Under the FLSA, independent contractors are not "employees" under the federal FLSA and are, therefore, not entitled to minimum wage and overtime protections. There are six factors for determining whether a worker is an "employee" under the FLSA, as opposed to an independent contractor:

- the degree of the alleged employer's right to control the manner in which the work is performed
- the alleged employee's opportunity for profit or loss depending upon

- managerial skill
- the alleged employee's investment in equipment or materials required for the work
- whether the service rendered requires special skills
- the degree of permanence of the working relationship
- whether the service rendered by the worker is an integral part of the alleged employer's business

No single factor is more important than the others in determining independent contractor status. When the issue comes up in courts, the judge must consider whether, as a matter of economic reality, a worker is dependent on the business to which a service is rendered for continued work. The greater the dependence, the more likely the worker will be found to be an employee.

It's very important to realize that having a worker sign an independent contractor agreement will not automatically create such status if the worker does not meet the requirements of the tests described above.

Workers employed by an independent contractor are not employees of the organization which the contractor is serving — they are employees of the contractor.

## Independent Contractors vs. 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
- A 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.

It is critical that you, the employer, 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.

**Caution:** If you incorrectly classify an employee as an independent contractor, you can be held liable for employment taxes for that worker, plus a penalty.

### Who is an Independent Contractor?

A general rule is that you, the payer, have the *right to control or direct only the result of the work* done by an independent contractor, 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**.

### How should I report payments made to independent

## **contractors?**

You may be required to file information returns to report certain types of payments made to independent contractors during the year. For example, you must file Form 1099-MISC, Miscellaneous Income, to report payments of \$600 or more to persons not treated as employees (e.g. independent contractors) for services performed for your trade or business. For details about filing Form 1099 and for information about required electronic or magnetic media filing, refer to [information returns](#).

## **Who is a Common-Law Employee (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.

To determine whether an individual is an employee or independent contractor under the common law, the relationship of the worker and the business must be examined. All evidence of control and independence must be considered. In an employee-independent contractor determination, all information that provides evidence of the degree of control and degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. Refer to Publication 15-A, [Employer's Supplemental Tax Guide](#) for additional information.

## **Who is an Employee?**

A general rule is that anyone who performs services for you is your employee *if you can control what will be done and how it will be done*.

**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.

### **Statutory Employees**

If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute ( statutory employees ) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under **Social security and Medicare taxes** , below.

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
- A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer s business operation. The work performed for you must be the salesperson s principal business activity. Refer to the **Salesperson** section located in **Publication 15-A**, Employer s Supplemental Tax Guide for additional information.

### **Statutory Nonemployees**

There are two categories of statutory nonemployees: *direct sellers* and *licensed real estate agents*. They are treated as self-employed for all Federal tax purposes, including income and employment taxes, if:

1. Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked and
2. Their services are performed under a written contract providing that they will not be treated as employees for Federal tax purposes.

Refer to information on **Direct Sellers** located in [Publication 15-A](#), Employer s Supplemental Tax Guide for additional information.

### **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. See Internal Revenue Code section 3509 for additional information.

## Resources

- [Tax Topic 762 Basic Information](#)  
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.
- [Publication 1976, Section 530 Employment Tax Relief Requirements](#) (PDF)  
Section 530 provides businesses with relief from Federal employment tax obligations if certain requirements are met.
- [IRS Internal Training: Employee/Independent Contractor](#) (PDF)  
This manual provides you with the tools to make correct determinations of worker classifications. It discusses facts that may indicate the existence of an independent contractor or an employer-employee relationship. This training manual is a guide and is not legally binding. If you would like the IRS to make the determination of worker status, please file IRS Form SS-8.
- [Form SS-8](#) (PDF)  
Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
- [Publication 15-A](#)  
The Employer's Supplemental Tax Guide has detailed guidance including information for specific industries.
- [Publication 15-B](#)  
The Employer's Tax Guide to Fringe Benefits supplements Circular E (Pub. 15), Employer's Tax Guide, and Publication 15-A, Employer's Supplemental Tax Guide. It contains specialized and detailed information on the employment tax treatment of fringe benefits.

## **THE IRS'S 20 FACTORS USED TO DETERMINE EMPLOYMENT STATUS**

The traditional tests to determine whether a worker is an employee or independent contractor involve the concept of control: Are the services of the worker subject to the Taxpayer's will and control over what must be done and how it must be done? In *Revenue Ruling 87-41, 1987-1 CB 296*, the IRS developed 20 factors used to determine whether a worker is an independent contractor under the common law. Remember: the burden of proof is on the taxpayer; therefore, in general, at least 11 of these factors must show independent contractor status under the common law tests.

**For the following questions, a "yes" answer means the worker is an employee.**

1. Does the principal provide instructions to the worker about when, where, and how he or she is to perform the work?
2. Does the principal provide training to the worker?
3. Are the services provided by the worker integrated into the principal's business operations?
4. Must the services be rendered personally by the worker?
5. Does the principal hire, supervise and pay assistants to the worker?
6. Is there a continuing relationship between the principal and the worker?
7. Does the principal set the work hours and schedule?
8. Does the worker devote substantially full time to the business of the principal?
9. Is the work performed on the principal's premises?
10. Is the worker required to perform the services in an order or sequence set by the principal?
11. Is the worker required to submit oral or written reports to the principal?
12. Is the worker paid by the hour, week, or month?
13. Does the principal have the right to discharge the worker at will?
14. Can the worker terminate his or her relationship with the principal any time he or she wishes without incurring liability to the principal?
15. Does the principal pay the business or traveling expenses of the worker?

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**For the following questions, a "yes" answer means  
the worker is an independent contractor.**

16. Does the worker furnish significant tools, materials and equipment?
17. Does the worker have a significant investment in facilities?
18. Can the worker realize a profit or loss as a result of his or her services?
19. Does the worker provide services for more than one firm at a time?
20. Does the worker make his or her services available to the general public?

## Topic 762 - Independent Contractor vs. Employee

To determine whether a worker is an independent contractor or an employee under common law, 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*.