EMPLOYEE OR INDEPENDENT CONTRACTOR

An employer must generally withhold income taxes, withhold and pay social security and Medicare taxes, any pay unemployment taxes on wages paid to an employee. An employer does not generally have to withhold or pay taxes on payments to independent contractors.

Common-law rules - To help you determine whether an individual is an employee under the common-law rules, the IRS has identified 20 factors that are used as guidelines to determine whether sufficient control is present to establish an employer-employee relationship.

These factors should be considered guidelines. Not every factor is applicable in every situation, and the degree of importance of each factor varies depending on the type of work and individual circumstances. However, all relevant factors are considered in making a determination, and no one factor is decisive.

It does not matter that a written agreement may take a position with regard to any factors or state that certain factors do not apply, if the facts indicate otherwise (for example, calling someone an independent contractor in an employment contract does NOT make them one). If an employer treats an employee as an independent contractor and the relief provisions discussed earlier do not apply, the person responsible for the collection and payment of withholding taxes may be held personally liable for an amount equal to the taxes that should have been withheld.

The 20 factors indicating whether an individual is an employee or an independent contractor follow.

1) Instructions. An employee must comply with instructions about when, where, and how to work. Even if no instructions are given, the control factor is present if the employer has the right to control how the work results are achieved.

2) Training. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchaser of their services.

3) Integration. An employee's services are usually integrated into the business operations because the services are important to the success or

continuation of the business. This shows that the employee is subject to direction and control.

4) Services rendered personally. An employee renders services personally, where an independent contractor often hires others to actually perform the services. This shows that the employer is interested in the methods as well as the results.

5) Hiring assistants. An employee works for an employer who hires, supervises, and pays workers. An independent contractor can hire, supervise, and pay assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.

6) Continuing relationship. An employee generally has a continuing relationship with an employer. A continuing relationship may exist even if work is performed at recurring although irregular intervals.

7) Set hours of work. An employee usually has set hours of work established by an employer. An independent contractor generally can set his or her own work hours.

8) Full-time required. An employee may be required to work or be available full-time. This indicates control by the employer. An independent contractor can work when and for whom he or she chooses.

9) Work done on premises. An employee usually works on the premises of an employer, or works on a route or at a location designated by an employer.

10) Order or sequence set. An employee may be required to perform services in the order or sequence set by an employer. This shows that the employee is subject to direction or control.

11) Reports. An employee may be required to submit reports to an employer. This shows that the employer maintains a degree of control.

12) Payments. An employee is generally paid by the hour, week, or month. An independent contractor is usually paid by the job or on a straight commission.

13) Expenses. An employee's business and travel expenses are generally paid by an employer. This shows that the employee is subject to regulation and control.

14) Tools and materials. An employee is normally furnished significant tools, materials, and other equipment by an employer, where an independent contractor supplies their own.

15) Investment. An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else.

16) Profit or less. An independent contractor can make a profit or suffer a loss.

17) Works for more than one person or firm. An independent contractor is generally free to provide his or her services to two or more unrelated persons or firms at the same time.

18) Offers services to general public. An independent contractor makes his or her services available to the general public.

19) Right to fire. An employee can be fired by an employer. An independent contractor cannot be fired so long as he or she produces a result that meets the specifications of the contract.

20) Right to quit. An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it.

IRS help. In doubtful cases, the facts will determine whether or not there is an actual employer-employee relationship. If you want the IRS to determine whether a worker is an employee, file **Form SS-8**, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with your District Director.

Sample Situations Illustrating the Employee vs. Independent Contractor Criteria

The following examples may help you properly classify your workers.

Building and Construction Industry

Example 1. John Brown has an oral agreement with Ace Building Co. to do carpentry work on any house designated by the company. He supplies his own hand tools. The Ace Building Co. supplies the material for each job. He has to do the work himself and he works on a full time basis for the company. For some work he is paid on a piecework basis and for some on an hourly basis. He has no assistants, does not have an office, and does not advertise in newspapers or otherwise hold himself out to the public as being in the carpentry business. The Ace Building Co. can fire him any time before he finishes a job without contractual liability. John is an employee of the Ace Building Co.

Example 2. Ron Smith, a mason, has an oral agreement with Jiffy, Inc., a contractor, to face a building with brick. Jiffy supplies all material for the job. Ron supplies only his handouts. He has to do the work himself and is paid on an hourly basis. Jiffy employs two other masons on the job, who are supervised by Ron. Detailed supervision over him is neither necessary nor warranted because of the skill of his work. He can quit his job at any time. He has no investment or proprietary interest in a business that offers the general public services similar to those he does for Jiffy. Ron is an employee of Jiffy, Inc.

Example 3. Sarah Green is a painting subcontractor who has contracted to paint 264 houses. She hired 40 painters to do the work for her, although only about 15 are on the job at any one time. She supplies all the paint, brushes, and ladders. She designates the house to be painted and either pays the painters per house or by the hour. Detailed instructions about the work are not necessary because of the painters' skill in their trade. Sarah inspects the work and requires them to repaint any unsatisfactory work. The painters cannot engage helpers without her consent. She can discharge them for any reason, and they are free to resign at any time. The painters are under no legal obligation to complete the painting of the houses. They assume no business risks and have no capital investment. None of them has an established business. The painters are employees of Sarah Green.

Example 4. Jerry Jones has an agreement with Wilma White to supervise the remodeling of her house. She did not advance funds to help him carry on the work. She makes direct payments to the suppliers for all necessary materials. She carries liability and workers' compensation insurance covering Jerry and others he engages to assist him. She pays them an hourly rate, and exercises almost constant supervision over the work. Jerry

is not free to transfer his assistants to other jobs. He may not work on other jobs while working for Wilma. He assumes no responsibility to complete the work and will incur no contractual liability if he fails to do so. He and his assistants perform personal services for hourly wages. They are employees of Wilma White.

Example 5. Milton Manning, an experienced tilesetter, orally agreed with a corporation to perform full-time services at construction sites. He uses his own tools and performs services in the order designated by the corporation and according to its specifications. The corporation supplies all materials, makes frequent inspections of his work, pays him on a piecework basis, and carries workers' compensation insurance on him. He does not have a place of business or hold himself out to perform similar services for others. Either party can end the services at any time. Milton Manning is an employee of the corporation.

Example 6. Wallace Black agreed with the Sawdust Co. to supply the construction labor for a group of houses. The company agreed to pay all construction costs. However, he supplies all the tools and the equipment. He performs personal services as a carpenter and mechanic for an hourly wage. He also acts as superintendent and foeman, and engages other individuals to assist him. The company has the right to select, approve, or discharge any helper. A company representative makes frequent inspections of the construction site. When a house is finished, Wallace is paid a certain percentage of its costs. He is not responsible for faults, defects of construction, or wasteful operation. At the end of each week, he presents the company with a statement of the amount he has spent, including the payroll. The company gives him a check for that amount from which he pays the assistants, although he is not personally liable for their wages. Wallace Black and his assistants are employees of the Sawdust co.

Example 7. A local plumbers' union and a contractors' association agreed to set up an apprenticeship program. The program is financed by the contractors and is administered by a joint apprenticeship committee. Trainees are enrolled first in a pre-apprenticeship program, in which they attend vocational school full time 5 days a week for 6 to 8 weeks. During this period, they are paid an hourly rate and are furnished with all materials and supplies used in school.

After completion of the pre-apprenticeship program, the trainees are assigned to work for local contractors as apprentice plumbers. The

apprentices must attend training classes related to the trade 1 day a week for 2 years. The apprenticeship program pays them for the time spent in attending classes at the same hourly rate they earn working for their contractors-employers.

While in the pre-apprenticeship program, the trainees are not employees. Their payments from the program are not subject to Federal income tax withholding or social security and Medicare taxes. The contractors and the administrators of the pre-apprenticeship program are not liable for Federal unemployment tax. However, the apprentices assigned to contractors as apprentice plumbers are considered employees, even when attending classes under the apprenticeship program. Their payments from the program are subject to income tax withholding, social security and Medicare taxes, and Federal unemployment tax.

Example 8. Bill Plum contracted with Elm corporation to complete the roofing on a housing complex. A signed contract established a flat amount for the services rendered by Bill Plum. Bill is a licensed roofer and carries workers' compensation and liability insurance under the business name Plum Roofing. He hires his own roofers who are treated as employees for Federal employment tax purposes. If there is a problem with the roofing work, Plum Roofing is responsible for paying for any repairs. Bill Plum, doing business as Plum Roofing, is an independent contractor.

Trucking Industry

Example 1. Drivers for Rover Trucking Co. often engage laborers to unload their trucks with the express consent of the company. The drivers pay the unloaders from funds provided by the company. The unloaders are company employees. This also would be true if the delivery drivers had only the implied consent of the company.

Example 2. A company engages Phil Blue to haul products to its customers. The company has legal ownership and control of the trucking equipment. Phil can be required, on an hour's notice, to make deliveries at times and places specified by the company. Refusal can jeopardize his relationship with the company. He has to operate and maintain the equipment and provide the necessary operations and helpers. He is not allowed to use the company's equipment to haul for others. He is paid on a tonnage basis and is not guaranteed a minimum amount of compensation. He has to pay the operators and helpers out of his tonnage receipts as well

as pay for all insurance coverage required by the company. Phil and any operators or helpers engaged to assist him are employees of the company.

Example 3. Rose Trucking contracts to deliver material for Fores Inc. at $140 per ton. Rose Trucking is not paid for any articles that are not delivered. At times, Jan Rose, who operates as Rose Trucking, may also lease another truck and engage a driver to complete the contract. All operating expenses, including insurance coverage, are paid by Jan Rose. All equipment is owned or rented by Jan and she is responsible for all maintenance. None of the drivers are provided by Forest Inc. Jan Rose, operating as Rose Trucking, is an independent contractor.

Fishing Industry

Members of a crew on a fishing boat are considered self-employed (independent contractors) if all the following conditions are met.

1) The members neither get nor are entitled to any money for their work (other than as provided in condition 2 below).

2) The members get shares of the catch or of the proceeds from the sale of the catch.

3) Each member's share depends on the size of the catch.

4) The operating crew of the boat (or each boat from which a member gets a share for a fishing operation involving more than one boat) is normally fewer than 10 persons.

If any of these four conditions are not met by a crew member, that crew member is an employee of either the captain (if he is not an agent of the vessel owner) or of the vessel owner. See Pub. 595, tax Guide for Commercial Fishermen, for more information.

Automobile Industry

Example 1. 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. Donna is an employee of Bob Blue.

Example 2. Sam sparks performs auto repair services in the repair department of an auto sales company. He works regular hours and is paid on a percentage basis. He has no investment in the repair department. The sales company supplies all facilities, repair parts, and supplies; issues instructions on the amounts to be charged, parts to be used, and the time for completion of each job; and checks all estimates and repair orders. Sam is an employee of the sales company.

Example 3. An auto sales agency furnishes space for Helen Smith to perform auto repair services. She provides her own tools, equipment, and supplies. She seeks out business from insurance adjusters and other individuals and does all the body and paint work that comes to the agency. She hires and discharges her own helpers, determines her own and her helpers' working hours, quotes prices for repair work, makes all necessary adjustments, assumes all losses from uncollectible accounts, and receives, as compensation for her services, a large percentage of the gross collections from the auto repair shop. Helen is self-employed and the helpers are her employees.

Attorney

Example. Donna Yuma is an attorney who is engaged in the private practice of law. She received a $10,000 annual retainer from Wilson Corporation starting in 1994. In return for the fee, Donna must defend the corporation against any suit brought against it. In 1994, Donna must defend the corporation against any suit brought against it. In 1994, Donna represented the corporation in two suits. In 1995, she was not called upon to perform any services for the retainer she received for 1995. During 1994, Wilson Corporation provided Donna with an office on its premises in order to efficiently prosecute the suits. Donna Yuma is engaged in her own trade or business and is an independent contractor with regard to the services she performs for Wilson Corporation.

Taxicab Driver

Example. Tom Spruce rents a cab from Taft Cab co. for $150 per day. He pays for all maintenance and gas for the cab. Tom keeps all fares.

Although he has use of the two-way radio communication, dispatcher, and advertising media provided by Taft Cab Co., these items are equally important to the interests of both Taft Cab Co. and Tom Spruce. They enhance their profits by promoting more cab rental business and efficiency. Tom Spruce is an independent contractor.

Salesperson

To determine whether salespersons are employees under the usual common-law rules, you must evaluate each individual case. If a salesperson who works for you does not meet the tests for a common-law employee, discussed earlier, you do not have to withhold income tax from his or her pay (see s**tatutory employees** earlier). However, even if a salesperson is not an employee under the usual common-law rules, his or her pay may still be subject to social security, Medicare, and FUTA taxes. To determine whether a salesperson is an employee for social security, Medicare, and FUTA tax purposes, you must apply the statutory employee tests. A salesperson is an employee for social security, Medicare, and FUTA tax purposes if he or she:

1) Works full time for one person or company except, possibly, for sidelines sales activities on behalf of some other person,

2) Sells on behalf of, and turns his or her orders over to, the person or company for which he or she works,

3) Sells to wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishment,

4) Sells merchandise for resale, or supplies for use in the customer's business,

5) Agrees to do most of this work personally,

6) Has no substantial investment in the facilities used to do the work, other than in facilities for transportation, and

7) Maintains a continuing relationship with the person or company for which he or she works.