

INDEPENDENT CONTRACTORS AND YOU



Sometimes employers aren't as careful as they should be when they hire an independent contractor. Misjudging a worker's status can impact workers' compensation, taxes, and other liability issues. And, misclassifying an employee as an independent contractor can carry significant IRS and state-legislated fines.

THE ISSUE

Basically, someone who provides services to another for payment can be either an employee or an independent contractor. The name one or both parties applies to the relationship is not determinative. What is determinative is the actual characteristics of the relationship, based on an analysis of several factors.

Let's look at the IRS factors that will help determine whether someone is an employee or an independent contractor in terms of three categories: Behavioral Control, Financial Control, and the Type of Relationship.

BEHAVIORAL CONTROL

Behavioral control relates who controls how the work is done. For example:

- Did the employer or the worker supply the instruments, tools, and place of work for the worker? Independent contractors usually furnish their own tools. Some employers have leased equipment to their independent contractors so that the contractor could show

that he or she had his or her own tools and an investment in his or her own business. This is a risky practice if the lease is not equivalent to what an independent business would pay in the open market.

- Did the employer direct how the work was done, or was the worker acting like a specialist without supervision? Independent contractors are not required to follow, nor are they furnished with, instructions to accomplish a job. They typically do not receive training by the hiring firm. They use their own methods to accomplish the work. Independent contractors are hired to provide a result and usually have the right to hire others to do the actual work. They set their own work hours and determine the order in which the work is done.
- Can the employer fire the independent contractor as an at-will employee or are there contract provisions that govern termination? Independent contractors can't be fired as long as they produce a result which meets the contract specifications, while most employees are at-will and can be fired anytime, with or without cause or notice, as long as the reason for firing is not a discriminatory one.
- Does the contractor provide workers' compensation insurance for him or herself as well as any of the contractor's employees? Independent contractors are not covered by the employer's workers' compensation insurance. This means an employer using an independent contractor who has its own employees should ask for and review evidence of the contractor's workers' compensation insurance. Be aware that in some states and in some cases, both the employer and the contractor may have workers' compensation liability for some of the involved parties.

FINANCIAL CONTROL

Financial control relates to whether the employer has a right to control the financial and business aspects of the worker's job.

- Does the worker have unreimbursed business expenses? Independent contractors are generally responsible for their own business expenses.
- How does the employer pay the worker? Independent contractors are paid by the job, not by time. The method should be set before the job begins. Payment by the job can include periodic payments based on a percentage of job completed. Payment can be based on *the number of hours needed to do the job times a fixed hourly rate*.
- Does the worker have an investment in the facilities used in performing the work? Independent contractors control where they work. If they work on the premises of the hiring company, it is not under that company's direction or supervision. Independent contractors should be able to perform their services without the hiring company's facilities (equipment, office furniture, machinery, etc.). The independent contractor's investment in his or her trade must be necessary and adequate.
- To what extent can the worker realize a profit or incur a loss? Employees can't suffer a loss, but an independent contractor should be able to make a profit or a loss. Check these five circumstances to show that a profit or loss is possible:
 1. The independent contractor hires, directs, and pays assistants.
 2. The independent contractor has his or her own office, equipment, materials, or facilities.
 3. The independent contractor has continuing and recurring liabilities.
 4. The independent contractor has agreed to perform specific jobs for prices agreed upon in advance.
 5. The independent contractor's services affect his or her own business reputation.

TYPE OF RELATIONSHIP

The type of relationship category relates to what the parties intend and the written contract(s) describing it.

- Is the worker free to perform services for other, similar businesses? Independent contractors should have enough time available to pursue other jobs for other businesses.
- Does the employer provide the worker with benefits such as health insurance or vacation pay?
- Do the parties consider it an ongoing relationship? Usually independent contractors don't have a continuing relationship with a hiring company. The relationship can be frequent, but must be at irregular intervals - like when work is available.
- Does the worker perform services that are key to the regular business of the employer? A company's success should not depend wholly on the services of outside independent contractors.

BOTTOM LINE:

If you are still not sure whether you have an employee or independent contractor, the IRS will provide an employer with a written determination as to whether a worker is an employee or an independent contractor for tax withholding purposes. Contact your local IRS for a copy of Form SS-8 to be filled out by an employer requesting a determination for federal tax purposes.

