



Tax Researcher

Volume XXVI Issue 9 September 2009

EMPLOYEE vs. INDEPENDENT CONTRACTOR

When a worker performs services and receives some form of remuneration, an important question is whether the remuneration is subject to employment taxes. The answer depends on whether the worker is an employee or an independent contractor. This determination of the worker's status depends on the facts...facts which define the business and the relationship of the parties, at the time the services are rendered.

Generally, a common law EMPLOYEE works for and performs services under the control of the party which pays for the services. On the other hand, an INDEPENDENT CONTRACTOR is an individual in business for himself or herself, and performs the services free of control from the party which pays for the services.

Employment taxes apply solely to the remuneration paid to workers classified as EMPLOYEES. The employer's obligation is to deduct Federal income tax withholding (FITW), to deduct as well as "match" Social Security and Medicare taxes (FICA), and to pay Federal unemployment tax (FUTA). Also, there may be state income tax to be withheld and the employer or employee may have to pay state unemployment compensation contributions and state disability insurance. A business normally is not required to withhold taxes from payments made to independent contractors.

In addition, certain Federal and state laws governing benefit-plan participation, wage payment, working conditions and workers' compensation, apply ONLY to employees and not to independent contractors. For example, only employees may participate in a Section 401(k) pension plan, and only employees are protected by minimum wage and overtime pay laws.

I.R.S. Guidance

When determining under common law whether an individual is an employee or an independent contractor, the IRS stresses that ALL evidence of the degree of control and degree of independence must be considered. Formerly, the IRS used a list of 20 factors (the "20-Factors Test") to evaluate a specific worker's situation. The current IRS official guidance, however, in Publication 15-A, *Employer's Supplemental Tax Guide (Supplement to Publication 15 (Circular E), Employer's Tax Guide)*, indicates that facts which provide evidence of the degree of control and independence fall into three major categories: behavioral control, financial control, and the type of relationship between the parties, as follows:

- A. BEHAVIORAL CONTROL** – Facts that show whether the business has the right to direct and control how the worker does the task for which the worker is hired, include the type and degree of:
- **Instructions the business gives the worker** – An employee is generally subject to the business' instructions about when, where and how to work. Even if no instructions are given, sufficient behavioral control may exist if the employer has the RIGHT to control how the work is done.
 - **Training the business gives to the worker** – An employee may be trained to perform services in a particular manner. Independent contractors, however, ordinarily use their own methods.
- B. 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 un-reimbursed business expenses** – Independent contractors are more likely to have unreimbursed expenses than employees.
 - **The extent of the worker's investment** – An independent contractor often has a significant investment in the “facilities” used to perform services for someone else, but this is not mandatory.
 - **The extent to which the worker makes services available to the relevant market** – Employees tend to work for a single business.
 - **How the business pays the worker** – An employee generally is paid by the hour, week or month. An independent contractor usually is paid by the job. However, it is common in some professions, such as law, to pay independent contractors at an hourly rate.
 - **The extent to which the worker can realize a profit or incur a loss** – An independent contractor can make a profit or loss.
- C. TYPE OF RELATIONSHIP** – Facts that show the type of relationship between the parties, include:
- **Written contracts describing the type of relationship the parties intended to create**
 - **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** – If one engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence the intent was to create an employer-employee relationship.
 - **The extent to which services performed by the worker are a key aspect of the regular business of the company** – If a worker provides services that are a key aspect of the company's business activity, it is more likely that the company will have the right to direct and control his or her activities. This would indicate an employer-employee relationship.

Upon request, the IRS will determine whether a worker is an employee. File Form SS-8 (*Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*). Note that some state unemployment compensation programs define “independent contractor” more narrowly than the IRS.

TAX RESEARCHER is distributed with the understanding that the publisher is not rendering legal, accounting or other professional services. If such advice or assistance is required, an attorney or accountant should be consulted. This newsletter is published monthly by Statutory Research, a department of the Employer Services Division. Address comments to: ADP, Inc., Statutory Research Department, One ADP Boulevard (M/S 364), Roseland, New Jersey 07068. Copyright 2009 ADP, Inc.

For more information, contact your local ADP representative

Go to www.adp.com or call 1 800 CALL ADP (1.800.225.5237)

The ADP Logo is a registered trademark of ADP, Inc.
All other trademarks and service marks are the property of their respective owners.

12-MONTH INDEX (October 2008 through September 2009)

<u>TOPIC</u>	<u>MONTHLY ISSUE</u>
Advance Payment of Earned Income Credit (<u>SEE</u> Earned Income Credit, advance payment of)	
Auto Mileage Rates (IRS) effective July 1, 2008	Aug-08
effective January 1, 2009	Jan-09
Bonus, Withholding Tax Alternatives (<u>SEE</u> Supplemental Wage Payment)	
“Catch-Up” Contributions (<u>SEE</u> Pension Plan Contribution Limits)	
Corporation	July-08
De Minimum Fringe Benefits	June-09
Deferred Compensation Plans (<u>SEE</u> Pension Plan Contribution Limits)	
Earned Income Credit, advance payment of	Feb-09
Earned Income Credit, Ten Things You May Not Know	May-09
Economic Stimulus Plan	Apr-09
Employee vs. Independent Contractor	Sept-09
Federal Annual Amounts and Limits	Nov-08
Federal Mileage Rates (<u>SEE</u> Auto Mileage Rates (IRS))	
Garnishment Orders	June-09
Independent Contractor, Employee vs	Sept-09
Internet, Helpful Links	Jan-09
IRS Citations	Mar-09
Medicare Taxable Wages	Nov-08
Mergers	Oct-08
Minimum Wage Rate Changes (including maximum tip credit, if applicable)	
Federal—effective 7/24/09	July-09
Arizona—effective 1/1/09	Dec-08
Colorado—effective 1/1/09	Dec-08
Florida—effective 1/1/09, 7/24/09	Dec-08
Kansas—effective 1/1/10	June-09
Missouri—effective 1/1/09	Dec-08
Montana—effective 1/1/09, 7/24/09	Dec 08
Nevada—effective 7/1/09	June-09
Ohio—effective 1/1/09, 7/24/09	Dec-08
Oregon—effective 1/1/09	Dec-08
Vermont—effective 1/1/09	Dec-08
Washington—effective 1/1/09	Dec-08
Wisconsin—effective 7/24/09	June-09
Minimum Wage—When Federal and State Do Not Agree	July-09
Pension Plan Contribution Limits 2008 and 2009	Nov-08
Predecessor Employer	Oct-08
Retirement Planning, Five Key Issues In	Aug-09
Social Security Taxable Wages	Nov-08
State Disability Insurance	Feb-09
State Unemployment Insurance	
Taxable wage limits table for 2008 and 2009	Jan-09
SUI (<u>SEE</u> State Unemployment Insurance)	
Successor Employer	Oct-08
Tip Credit Defined	July-09
Tip Credits (<u>SEE</u> Maximum Wage Rate Changes)	