Independent Contractor Guidelines

The issues relating to Independent Contractor status is a highly contested area between taxpayers and the Internal Revenue Service. This area of employment law has had a long history of contentious litigation and administrative struggle between the parties involved. This specific area of law continues to have many problematic issues arising both at the administrative level, and in the courts.

Among the basic issues of contention is the question of who bears the burden of the payroll taxes, the employer, or the independent contractor. Should the Internal Revenue Service position prevail wherein it is determined by them that an employment relationship exists rather than employer contractor relationship, the burden of paying the payroll taxes as payments for services are made falls to the employer. In this situation the Internal Revenue Service receives the funds for the payroll taxes as the payment for services takes place whereas in the situation that an employer contractor relationship is deemed to exist the Self Employment Taxes that are paid by the contractor in lieu of the payroll taxes. The self-employment taxes are paid by the contractor on a quarterly basis.

There exists another series of problems for the Internal Revenue Service and local taxing authorities such as the Employment Development Department in California if an employer contractor relationship exists. In the situation that an employer employee relationship exists the payroll taxes as well as the income taxes required to be withheld by the employer is calculated upon the gross wage therefore creating a higher tax receipt for the government. When an employer contractor relationship exists the contractor theoretically has the right of offsetting the gross earnings with expenses incurred for the production of income thereby reducing the tax revenues of the government. Additionally the Internal Revenue Service now has multiple sources of collection rather than the singular employer thereby increasing the administrative costs of collection of the taxes.

There are many benefits to the employer to exclude potential
employees from the payroll not the least of which is the reduction of costs relating to the administrative issues of insurance and pension costs along with the escaped payroll tax liability. The bookkeeping costs to keep in compliance with the Internal Revenue Service and local taxing authorities are also avoided. These issues alone can be overly burdensome. In some instances these costs can be a substantial increase to operating overhead and can impair competitive positions in the marketplace.

The entire area of classification of independent contractor versus employee status is extensive and should be evaluated on a case by case basis. Various issues including immigration and labor laws come into play in the evaluation. We strongly suggest that any questions that relate to this area of employment be reviewed by us in relationship to your specific situation. The long term as well as the short-term implications can be substantial.

Some guidelines that both the employer should consider and the Internal Revenue uses as criteria in determining the relationship between an employer and an independent contractor are as follows. This listing is not entirely definitive, as there are various factors in each individual situation to be analyzed:

1) **Instruction** – Is the individual(s) in question given instruction by management and required to comply with those instructions? Should issues such as when, where, and how the work is to be performed are exercised by management then there exists the strong probability that the Internal Revenue Service will classify as employees the individual(s) in question.

2) **Training** – Requiring a worker to attend meetings, work with more experienced personnel, or otherwise perform work in a particular manner or method indicates employee status.

3) **Integration** – The degree to which a business depends upon worker’s services tends to indicate employee status.

4) **Services** – Services rendered personally indicates employee status.

5) **Hiring, Supervision, Payment of Assistants** – If services can be delegated or subcontracted at the worker’s election with the worker paying from his own funds for such help, independent contractor status is indicated.

6) **Continuing Relationship** – Should a continuing relationship exist, even on an irregular interval, employee
status is indicated.

7) **Set Hours of Work** – The establishment of set hours of work by the person for whom the work is performed indicates control by the employer, therefore indicating an employee status.

8) **Full Time Requirement** – Should a worker be required to devote substantially full time to the business and there are implicit or explicit restrictions on doing other gainful work, employee status is indicated.

9) **Employer’s Premises** – Should the work be performed on the premises of the person for whom the services are performed for, this suggests control over the worker, especially if the work could be performed elsewhere, employee status is indicated.

10) **Order of Sequence** – Should the worker perform work in a set order of sequence for the benefit of whom the work is to be performed, employee status is indicated.

11) **Oral or Written Reports** – A requirement that the worker submit regular reports to the person or entity for which the services are performed indicates employee status.

12) **Payment Method** – An employee is normally paid by the hour, week, month, or on some regular method. An independent contractor is generally paid at the end of a job, task, or by contractual arrangement. The method of payment will indicate the relationship of employment or contractor status.

13) **Payment of Business Expenses** – The payment of a worker’s business and travel expenses indicates employee status.

14) **Furnishing of Tools and Materials** – The furnishing of significant tools, materials, or other equipment by the owner or entity for the use of the worker indicates employee status.

15) **Significant Investment** – The lack of existence of significant investment in the entity on the part of the worker indicates employee status.

16) **Realization of Profit or Loss** – A worker who can realize a profit or suffer a loss as a result of services performed generally would be classified as an independent contractor.

17) **Services Available to Others** – An independent
contractor generally provides services to many unrelated entities whereas an employee generally provides services exclusively to one employer.

18) **Right to Discharge** – The right to discharge a worker indicates employee status whereas the independent contractor’s termination is predicated on a contractual agreement and the terms indicated therein.

19) **Working for More than One Entity** – Should a worker perform minimal services for a number of entities or persons the presumption is that an independent contractor relationship may exist.

20) **Right To Terminate** – Should a worker have the right to end his/her relationship at anytime, this indicates an employee relationship. Should the situation exist that the worker must comply with contractual agreements and is bound to complete assignments, this would indicate an independent contractual relationship.

21) **Existence of a Written Contract** – While not conclusive in itself, the existence of a written contract indicating realistic terms, conditions, objectives, etc. is substantive evidence that a contractual arrangement exists. Lacking a written contract leaves far too much interpretation available to third parties including the Internal Revenue Service.

The foregoing is not intended to be all inclusive as to the issues relating to the ongoing controversies between the taxing authorities and employers on this issue, but merely a guideline for some of the more salient points considered in each and every case that is brought into review by the Internal Revenue Service and other taxing agencies. No one point or grouping of points is conclusive evidence as to the ultimate determination of the nature of the relationship between an employer and the worker(s) in question.

Any evaluation must be made in concert with the overall situation, industry in which the business operates, norms and practices within the given industry, and the true nature of the employer worker relationship. Each situation is different. Case and administrative law is extensive in the area of employer worker relationships and each situation require evaluation based upon the facts involved.

Planning issues also abound, and as stated above, costs in regards to employees are substantial. A review by our firm of any given situation that you may have regarding these issues is strongly suggested. Both current and downstream financial
implications are extensive. After the fact planning is never productive, and generally involves defense of possibly unsolvable situation(s) after a taxing authority assessment has been made. Assessments generally are overwhelming in this area of tax law. Added to any assessment are penalties and interest and as these types of assessments generally cover many years, the overall liabilities asserted by the Internal Revenue Service and other authorities tend to be enormous.

After the fact defense is costly, the assessments can be more than what can be dealt with reasonably, and more expensive than what proper advance planning would have ever cost. Again, we are available for discussion on this matter.