

Notes

**Independent Contractor
versus
Employee**

**OFM-IRS Training
April 11, 2013**

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Objectives

- Determination of worker status
- Identify other types of employment situations

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Internal Revenue Code 3121(d)

- (1) Corporate officer
- (2) Common-law employee
- (3) Statutory employees
- (4) Section 218 employees

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Notes

Common Law Employee

“Control” Standard:

The right to direct and control the means and details of the work performed by the service-provider

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Revenue Ruling 87-41, 1987-1 C.B. 296

“The 20 Common Law Factors Test”

- Analytical tool
- Irrelevant or out-dated factors
- Examine all facts surrounding the relationship

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Weighing the Evidence

Evaluate the extent of the right to direct and control:

1. Within the context of the service-provider's specific industry
2. Using industry's standards and common practices

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Notes

Categories of Evidence

- Publication 1779
- Three main categories of evidence
- Updates and supplements Revenue Ruling 87-41 (20 common-law factor test)


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Categories of Evidence

- **BEHAVIORAL CONTROL**
- **FINANCIAL CONTROL**
- **RELATIONSHIP OF PARTIES**

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Behavioral Control




RIGHT TO DIRECT AND CONTROL
HOW
WORKER PERFORMS TASK

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Notes

Behavioral Control

- **Elements**
 1. Instructions
 2. Training



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Behavioral Control

- **Instructions**
 - How, when, where to do job
 - Tools and equipment to use
 - Required to follow established routines or policies

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Behavioral Control

- **Instructions (continued)**
 - Prior approval (Examples)
 - Degree of instruction (Examples)

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Notes

Behavioral Control

- Training

- Periodic or required
 - Paid while attending training
- versus
- Orientation
 - Unpaid attendance



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Financial Control



RIGHT TO DIRECT AND CONTROL
ECONOMIC ASPECTS
OF WORKER ACTIVITIES

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Financial Control

1. Significant Investment
2. Unreimbursed Expenses
3. Services Available to Public
4. Method of Payment
5. Opportunity for Profit or Loss



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Notes

Financial Control

1. Significant Investment

- The amount of capital (money) already expended on business assets
- Must have substance
- Presence indicates independent contractor status (Example 5)

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Financial Control

2. Unreimbursed Business Expenses

- Reimbursements common for employees and independent contractors
- Fixed costs apart from job-related costs
- Out-of-pocket business expenses

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Financial Control

3. Services Available to the Relevant Market

- Actively pursuing business opportunities
- Maintaining a legal presence (licensed, bonded, etc.)
- Absence of factor equates to neutral factor (Example 6)

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Notes

Financial Control

4. Methods of Payment

Salaried or hourly wages:
indicative of employee status

Flat fee:
indicative of independent contractors

Commissions:
may have equal application

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Financial Control


5. Realization of profit or loss

- Strongest evidence factor if worker controls the financial aspects of the business
- Authority to incur and pay the business expenses

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Relationship of the Parties

**WHAT IS THE INTENT
OF THE PARTIES**



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Notes

Relationship of the Parties

1. Intent of parties/written contracts
2. Incorporation
3. Employee benefits
4. Discharge/termination of worker
5. Length of relationship
6. Regular business activity

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Relationship of the Parties

1. Intent of parties/written contracts

Written agreements are strong indicator
of independent contractor status
Contractual designation without
substance is insufficient
Compliance with contract conditions

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Relationship of the Parties

2. Incorporation

- Recognized under state and federal statutes if
 1. Corporate formalities are followed; and
 2. One non-tax business purpose exists

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Notes

Relationship of the Parties

3. Employee Benefits

- Participation in employee welfare benefit plans is indicative of employee status
- Mandatory exclusion from benefit plans indicative of independent contractor status
- Independent contractors are eligible to receive limited fringe benefits

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Relationship of the Parties

4. Discharge/termination - Traditional

- Ability of both parties to end the work relationship at-will - indicative of employee status
- Termination of employment contract by either party governed by contract terms - indicative of independent contractor status

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Relationship of the Parties

4. Discharge/termination (Current)

- Limits on ability to discharge worker
- Limits on ability of worker to quit
- Termination of contracts

Summary:

Limited usefulness

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Notes

Relationship of the Parties

5. Length of the Relationship

- Permanency of relationship - indicative of employee status
- Indefinite relationship - indicative of employee status
- Long-term relationship - indicative of either status
- Temporary relationship - indicative of either status

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Relationship of the Parties

6. Regular Business Activity

- Integration of worker's activities in key aspects of the agency's operations

- Out-sourcing of essential business functions is common business practice

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Factors of Lesser Importance

- Part-time or full time work

- Place of work

- Hours of work

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Notes

Weighing the Evidence

- Apply each element to the facts and circumstances surrounding the relationship
 - Some facts support both parties
- Evaluate the relative impact of each element
 - Control and autonomy is exercised by both parties
- Determine if autonomy or control predominates (Example 7)

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Employment Relationships

Two-party:

- Direct exchange of pay for services

Three-party:

- Interceding party makes payment

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Third Party Relationships

- “Deemed” employer – legal control over payment and reporting
- Employer’s Agent – contractual control over the payment and reporting
- Leasing employer – contractual control over payment and services

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Notes

**CONSEQUENCES OF
INCORRECT TREATMENT**

- **TAX LIABILITY** (May go back up to 3 years or more), plus:
- **PENALTIES**
- **INTEREST**
- **EMPLOYEE BENEFITS**

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**CONSEQUENCES OF
INCORRECT TREATMENT**

Federal employment taxes:
Employer FICA; plus
20% of employee's FICA (if Form 1099 filed); or
40% of employee's FICA (if Form 1099 is NOT filed)

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**Voluntary Classification Settlement
Program (VCSP)**

- IRS Announcements 2011-64 & 2012-45
- Form 8952, Application for VSCP
- For past three years:
Consistent treatment of workers; and
Consistent filing of Forms 1099s
- Not subject to employment tax audit by
IRS, US DOL, or state agency

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Notes

Voluntary Classification Settlement Program (VCSP)

- Prospective treatment of workers as employees
- Pay ten percent (10%) of worker-employee compensation under reduced IRC 3509 rates
- Not liable for penalties and interest
- Not subject to audit of reclassified workers for prior years

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IRS Determination of Status

Form SS-8

Determination of Employee Work Status for Purpose of Federal Employment Taxes and Income Tax Withholding



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ELECTED AND APPOINTED OFFICIALS

- Officers, employees, elected officials
- Employees for FITW
 - Must use Common Law to determine status for FICA

- Elected Officials
- Generally considered employees

- Appointed Officials
- May be either IC or Employee

- Board/Commission Members
- May be either IC or Employee

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Notes

Summary

1. Understand the business operations, worker's industry, and the worker's relationship to the business
2. Apply the Categories of Evidence
 - a. Behavioral control
 - b. Financial control
 - c. Relationship of the parties
3. Determine control or autonomy

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CASE STUDY

- Breakout Groups
- Each member read instructions
- Each GROUP has an assigned case
- Each Group selects a leader/scribe
- 10 minutes to read and discuss
- Groups share their conclusions

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Internal Revenue Service

Resources

Publication 1779, Independent Contractor versus Employee (sign up for delivery)

Publication 15-A, Employer's Supplemental Tax Guide (sign up for delivery)

Form SS-8, Determination of Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding

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Notes

Email Contacts:

Martinsburg Computing Center:
1-866-455-7438 or
www.mccirp@irs.gov
Internal Revenue Service Publications
<http://www.irs.gov/formspubs/>

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