

The following is an excerpt from IRS Publication 15A - Employer's Supplemental Tax Guide.

The complete document is available online at: [www.irs.gov/pub/irs-pdf/p15a.pdf](http://www.irs.gov/pub/irs-pdf/p15a.pdf)

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## 2. Employee or Independent Contractor?

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

### Common-Law Rules

To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. These facts are discussed next.

**Behavioral control.** Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of:

***Instructions that the business gives to the worker.***

An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right

to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

***Training that the business gives to the worker.*** An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

**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 unreimbursed business expenses.*** Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their employer.

***The extent of the worker's investment.*** An independent contractor often has a significant investment in the facilities or tools he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.

***The extent to which the worker makes his or her services available to the relevant market.*** An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

***How the business pays the worker.*** An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is often paid a flat fee or on a time and materials basis for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

***The extent to which the worker can realize a profit or loss.*** An independent contractor can make a profit or loss.

**Type of relationship.** Facts that show the parties' type of relationship include:

- ***Written contracts describing the relationship the parties intended to create.***
- ***Whether or not 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 you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that

your 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 your regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

**IRS help.** If you want the IRS to determine whether or not a worker is an employee, file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

## Industry Examples

The following examples may help you properly classify your workers.

### Building and Construction Industry

**Example 1.** 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 that he engaged 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. Jerry Jones and his assistants are employees of Wilma White.

**Example 2.** Milton Manning, an experienced tile setter, 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 3.** 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 equipment. He performs personal services as a carpenter and mechanic for an hourly wage. He also acts as superintendent and foreman 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 that 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 4.** 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.

**Example 5.** Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at \$16 per hour for 400 hours. She is to receive \$1,280 every 2 weeks for the next 10 weeks. This is not considered payment by the hour. Even if she works more or less than 400 hours to complete the work, Vera Elm will receive \$6,400. She also performs additional electrical installations under contracts with other companies, that she obtained through advertisements. Vera is an independent contractor.

### Trucking Industry

**Example.** Rose Trucking contracts to deliver material for Forest, 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.

### Computer Industry

**Example.** Steve Smith, a computer programmer, is laid off when Megabyte, Inc., downsizes. Megabyte agrees to pay Steve a flat amount to complete a one-time project to create a certain product. It is not clear how long that it will take to complete the project, and Steve is not guaranteed any minimum payment for the hours spent on the program. Megabyte provides Steve with no instructions beyond the specifications for the product itself. Steve and Megabyte have a written contract, which provides that Steve is considered to be an independent contractor, is required to pay federal and state taxes, and receives no benefits from Megabyte. Megabyte will file Form 1099-MISC, Miscellaneous Income, to report the amount

paid to Steve. Steve works at home and is not expected or allowed to attend meetings of the software development group. Steve is an independent contractor.

## Automobile Industry

**Example 1.** Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works six 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 is required 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. Bob also pays the cost of health insurance and group-term life insurance for Donna. 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 Bach 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 of 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 an independent contractor and the helpers are her employees.

## Attorney

**Example.** Donna Yuma is a sole practitioner who rents office space and pays for the following items: telephone, computer, on-line legal research linkup, fax machine, and photocopier. Donna buys office supplies and pays bar dues and membership dues for three other professional organizations. Donna has a part-time receptionist who also does the bookkeeping. She pays the receptionist, withholds and pays federal and state employment taxes, and files a Form W-2 each year. For the past 2 years, Donna has had only three clients, corporations with which there have been long-standing relationships. Donna charges the corporations an hourly rate for her services, sending monthly bills detailing the work performed for the prior month. The bills include charges for long distance calls, on-line research time, fax charges, photocopies,

postage, and travel, costs for which the corporations have agreed to reimburse her. Donna is an independent contractor.

## Taxicab Driver

**Example.** Tom Spruce rents a cab from Taft Cab Co. for \$150 per day. He pays the costs of maintaining and operating the cab. Tom Spruce keeps all fares that he receives from customers. Although he receives the benefit of Taft's two-way radio communication equipment, dispatcher, and advertising, these items benefit both Taft and Tom Spruce. 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 in this section, you do not have to withhold federal income tax from his or her pay (see [Statutory Employees](#) in section 1). However, even if a salesperson is not an employee under the usual common-law rules for income tax withholding, his or her pay may still be subject to social security, Medicare, and FUTA taxes as a statutory employee.

To determine whether a salesperson is an employee for social security, Medicare, and FUTA tax purposes, the salesperson must meet **all eight** elements of the statutory employee test. A salesperson is a statutory 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 sideline 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 establishments,
4. Sells merchandise for resale, or supplies for use in the customer's business,
5. Agrees to do substantially all of this work personally,
6. Has no substantial investment in the facilities used to do the work, other than in facilities for transportation,
7. Maintains a continuing relationship with the person or company for which he or she works, and
8. Is **not** an employee under common-law rules.