

Independent Contractors

Whether an individual hired to perform services by the University is classified an employee or an independent contractor has major consequences. The University is required to withhold income and Social Security taxes from payments to employees. Independent contractors are responsible for the payment of their own income and self-employment taxes. If an individual hired as an independent contractor is subsequently determined by the Internal Revenue Service to be an employee, the University may be held liable for all income and Social Security taxes that should have been withheld, as well as for interest and penalties. Furthermore, workers' compensation, unemployment insurance, malpractice or other employment-related claims may be assessed the University if an employment relationship is established by State labor agencies.

The Internal Revenue Service has developed twenty factors based on common law principles to help determine whether an individual is an independent contractor or an employee. [Revenue Ruling 87-41] Not all factors apply to every situation and some factors may be more heavily weighted than others. The more important factors are in bold in the text.

1. **Instructions**. "An employee must comply with instructions about when, where and how to work. Even if no instructions are given, the control factor is present if the employer has the right to give instructions." [Revenue Rulings 68-598 and 66-381]

Does the University have the right to give instructions to the worker, other than the setting of general project parameters?

2. Training. "An employee is trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchaser of their services. Training includes being required to attend meetings, rehearsals, motivational sessions, etc." [Revenue Ruling 70-369]

Will the worker receive training?

3. Integration. "An employee's services are integrated into the business operations because the services are important to the success or continuation of the business. This shows that the employee is subject to direction and control." Integration is present when

several people must perform services to accomplish the end result, and when one worker must finish his or her part of the task before turning over the product to another worker. [U.S. v. Silk, 331 U.S. 704 (1947)]

Does the success of the project rest on the performance of the worker?

4. **Services rendered personally.** "An employee renders services personally. This shows that the employer is interested in the methods as well as the results." If the services may be performed by only one individual, it indicates a control factor over both the method of production and the end result of the product. [Revenue Ruling 55-695]

Must the worker perform the services personally?

5. **Hiring assistants.** "An employee works for an employer who hires, supervises and pays assistants. An independent contractor hires, supervises and pays assistants under a contract that requires the contractor to provide materials and labor and to be responsible only for the result." The question is whether the University is contracting with a business entity or hiring an individual. [Revenue Rulings 63-115 and 55-593]

If assistants are needed, is the worker free to hire them?

6. **Continuing relationship.** "An employee has a continuing relationship with an employer. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals." A self-employed individual may be an employee of some clients and an independent contractor of others. This factor relates closely to factors 9, 14 and 15.

Does the worker have a continuing relationship with the University?

7. **Set hours of work.** "An employee has set hours of work established by an employer. An independent contractor is the master of his or her own time." This would also apply to flexible scheduling where only the minimum number of hours is specified but the actual times are left open. [Revenue Ruling 73-591]

Is the worker free to establish his or her own working hours?

8. Full-time work. "An employee normally works full-time for an employer. An independent contractor can work when and for whom he or she chooses." If full-time work is required it implies control since it would restrict the worker from accepting other jobs. [Revenue Ruling 56-694]

Does this agreement prevent the worker from doing other gainful work during the period of the agreement?

9. Work done on premises. "An employee works on the premises of an employer, or works on a route or at a location designated by an employer." This is not a hard and fast rule, as all facts and circumstances must be considered. For example, an independent contractor may work on a client's premises for convenience (auditing books, repairing typewriters or copiers). Another important factor is whether the payor has employees on the premises who perform essentially the same work or services as the individual who claims to be independent. [Revenue Ruling 56-694]

Will a significant portion of the work be done in University facilities?

10. Order or sequence set. "An employee must perform services in the order or sequence set by an employer. This shows that the employee is subject to direction and control." Again, the crucial thing is not whether the payor actually sets the order or sequence, but that he or she has the right to do so. [Revenue Ruling 56-694]

Does the University have the right to determine the order or sequence of the tasks to be completed?

11. Reports. "An employee submits reports to an employer. This shows that the employee must account to the employer for his or her actions." Progress reports tend to indicate control or supervision as to how the work is being performed. [Revenue Rulings 70-309 and 68-248] Is a progress report or timesheet required for performance evaluation?

12. Payments. "An employee is paid by the hour, week or month. An independent contractor is paid by the job or

on a straight commission." Professionals can bill at an hourly rate without jeopardizing their independent contractor status if they do not know in advance how much time a job will require. In effect, even though they are billing on the basis of time and materials, they are billing for the completed task. [Revenue Ruling 74-389]

Will the worker be paid on an hourly, weekly or monthly basis?

13. Expenses. "An employee's business and travel expenses are paid by an employer. This shows that the employee is subject to regulation and control." This is another generality with many exceptions. Reimbursement for travel expenses incurred by independent contractors is quite common. [Revenue Ruling 55-144]

If expenses are incurred, will the University reimburse the worker for them?

14. Tools and materials. "An employee is furnished significant tools, materials and other equipment by an employer." [Revenue Ruling 71-524]

Will the University furnish tools other than specialized equipment?

15. Investment. "An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else." If the worker has to rely on the payor for facilities or equipment to perform the services this would indicate dependence and an employer-employee relationship. [Revenue Ruling 71-524]

Has the worker made a significant investment in facilities and/or equipment in order to perform the services?

16. Profit or loss. "An independent contractor can make a profit or suffer a loss." An independent contractor is at risk to the extent that he or she may underestimate the costs involved in the job. Two key questions to ask: Is the worker bonded or insured? If so, by whom and for whose benefit? Whose reputation is at risk if something goes wrong and the task is not completed on time, satisfactorily, or to specifications? [Revenue Ruling 70-309]

Can the worker realize an economic loss for non-performance other than the loss of payment for personal services?

17. Works for more than one person or firm. "An independent contractor gives his or her services to two or more unrelated persons or firms at the same time." Working for a number of unrelated firms indicates independence. [Revenue Ruling 70-572]

Does the worker perform services for a number of firms at the same time?

18. Offers services to the general public. "An independent contractor makes his or her services available to the general public." This is a critical factor. In many cases, a worker will be determined to be an independent contractor if he or she is listed in the yellow pages as a private entrepreneur. Additional support comes from having a separate business checking account, a business license, company stationery, business cards, advertising, etc. [Revenue Ruling 56-660]

Are the worker's services regularly available to the general public?

19. Right to fire. "An employee can be fired by an employer. And independent contractor cannot be fired so long as he or she produces a result that meets specifications of the contract." The threat of dismissal indicates control of the worker by making him or her follow ongoing instructions. [Revenue Ruling 70-309]

Can the worker be discharged for convenience as opposed to having his or her contract terminated in accordance with contract terms?

20. Right to quit. "An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it." Employees get paid until the time they leave the premises. Independent contractors generally are risking the entire compensation from the job and also are risking liability for breach of contract. [Revenue Ruling 70-309]

Can the worker unilaterally terminate the contract prior to completion?

Until Congress enacts legislation on the classification of workers as independent contractors or employees, an employer can continue treating workers as independent contractors without incurring liability if:

- a "reasonable basis" exists for not classifying the individual as an employee;
- the employer did not or does not treat a similar individual as an employee; and
- the employer files all tax returns required to be filed (including information returns) on the basis that an individual is not an employee.

An employer may rely on one of the following types of authority to meet the "reasonable basis" test above:

- judicial precedent, published rulings, or a technical advice memorandum ruling or letter ruling issued to the employer;
- a past IRS audit of the employer in which the IRS did not assess employment tax deficiencies for amounts paid to individuals holding positions substantially similar to a job held by an individual;
- a long-standing recognized practice of a significant segment of the industry in which an individual is engaged.

These three tests are not the exclusive means of satisfying the reasonable basis requirement. An employer may also meet the test by general evidence that the individual functions as an independent contractor rather than as an employee (the "20 rule test").