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Independent Contractor vs. Employee: Exploring the Categories

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Individuals who do work for you may be classified into one of four categories of service providers:

- Employees
- Independent contractors
- Statutory employees
- Non-statutory employees

You, the hiring company, are the service recipient. That is, you receive the service (or product) and you pay to have that service (or product) provided to you.

Your responsibility for payment of state and federal taxes, social security tax (FICA), unemployment tax, and employee benefits depends on which of the four categories the workers fall under.

Many companies, small and large, would prefer to hire some, or even all, of their workers as independent contractors.

Some of these companies have concluded that it is much less expensive to hire workers as independent contractors rather than as employees.

When an independent contractor provides a service or product, the service recipient does not have to withhold employment taxes, pay social security taxes (FICA), or pay unemployment tax.

Independent contractors are considered self-employed. As such, they are responsible for reporting their income and paying the appropriate state and federal taxes.

The hiring company is not required to pay benefits or worry about minimum wage regulations. All the hiring company must do is file federal income tax form 1099 at the end of the year.

The 1099 is a Federal Tax Form stating the amount paid to independent contractors by the company during that year. In addition to the savings in tax, companies hiring independent contractors save the cost of the bookkeeping associated with those taxes.

The category into which the workers fit, however, is determined by the conditions under which they work and the kind of work that they do. You may not simply select a category and define them as you desire. Choosing the correct categories for the people who do work for you may be critical to the continuation of your business.

However, whether a worker is classified as an independent contractor, an employee, a statutory employee, or a statutory non-employee is not a matter of company or individual choice. The status of these workers depends not on what the workers or the service recipients want, but on what work is provided and under what conditions.

The Internal Revenue Service (IRS), as part of its program to collect the maximum amount of tax owed, has begun to investigate and prosecute cases where individuals are classified as independent contractors.

If, as a result of this investigation, the IRS and/or the courts, determine that the workers are actually employees, the hiring company will owe penalties, back taxes, and interest for as long as they have classified workers as independent contractors.

During the fiscal year ending Sept. 30, 1989, the IRS began an experimental program under which they examined more than 16,000 business tax returns and subsequently reclassified 76,000 workers as employees. As a result, the IRS generated additional tax assessments of \$93.8 million. Ninety percent or more of the companies examined during that 1989 pilot program were found to owe additional taxes.

The 1989 experiment was so successful that the IRS began using a computer program that automatically matches individuals who submit tax Form 1099 with the companies that paid them.

According to some authorities, an individual, non-employee taxpayer who reports more than \$10,000 earned income from a single source is of particular interest to the IRS.

In addition, whenever an individual classified as an independent contractor receives a majority of his/her income from a single source, the "independence" of that worker is called into question and the IRS may investigate the company issuing that 1099.

From the point of view of the IRS, it is easier to collect employment taxes at the source of the wages, the hiring company, than from individual workers. In any payroll audit, the IRS looks for workers classified as independent contractors who, according to the IRS finding, are misclassified and should be employees.

The penalties for misclassifying employees as independent contractors, or consultants, are severe.

The paying company may have to pay back taxes, penalties and interest, unemployment and workers' compensation liabilities and retroactive fringe benefits.

There is no statute of limitations. If the service recipient is a sole proprietorship or partnership, the owners are personally responsible for all amounts due. Bankruptcy does not erase this debt. If the service recipient company decides to defend its position against the IRS, it will also have to pay the costs of litigation.

The IRS guidelines, which are used to help determine whether a worker is an employee or an independent contractor, are somewhat vague. It is almost impossible to make a confident decision. Therefore, most cases are either determined by the IRS or go to court for official determination.

A written contract between the service provider and the service recipient may help to clarify an agreement, but it is not sufficient to make the worker an independent contractor. Situational evidence is of more importance in determining worker classification.

The test for common law employment

Employee or independent contractor

The list that follows gives 20 factors or "tests" used by the IRS when determining whether a person is an employee or an independent contractor.

The question of "who controls the details?" appears to be the primary basis on which the determination is made.

No single factor or small group of factors can be taken as conclusive evidence of the presence or absence of control. To determine a workers' status, all the factors must be evaluated. The weight given to the individual factors is not equal, and some factors may not apply to certain occupations.

No one factor is sufficient to determine status without consideration of the others. Although many of these factors are

open to interpretation as they are written, the language used here is taken exactly from IRS documents. (IRS Publication 937, *Employment Taxes and Information Returns*, p. 4.)

Because final determination is made on a case-by-case basis, often in a court of law, it is very difficult to know in advance how a ruling would be made on any specific employer/contractor.

Following these factors is an examination of the four service provider categories.

- Employees
- Independent contractors
- Statutory non-employees
- Statutory employees

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 control how the work results are achieved.

2. **Training**

An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.

3. **Integration**

An employee's services are usually 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.

4. **Services rendered personally**

An employee renders services personally. This shows that the employer is interested in the methods as well as the results.

5. **Hiring assistants**

An employee works for an employer who hires, supervises and pays workers. An independent contractor can hire, supervise and pay assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.

6. **Continuing relationship**

An employee has a continuing relationship with an employer. A continuing relationship may exist even if work is performed at recurring although irregular intervals.

7. **Set hours of work**

An employee usually has set hours of work established by an employer. An independent contractor generally can set his or her own work hours.

8. **Full-time required**

An employee may be required to work or be available full-time. This indicates control by the employer. An independent contractor can work when and for whom he chooses.

9. **Work done on premises**

An employee usually works on the premises of an employer, or works on a route or at a location designated by an employer.

10. **Order or sequence set**

An employee may be required to perform services in the order or sequence set by an employer. This shows that the employee is subject to direction and control.

11. **Reports**

An employee may be required to submit reports to an employer. This shows that the employer maintains a degree of control.

12. **Payments**

An employee is paid by the hour, week or month. An independent contractor is usually paid by the job or on a straight commission.

13. **Expenses**

An employee's business and travel expenses are generally paid by an employer. This shows that the employee is subject to regulation and control.

14. **Tools and materials**

An employee is normally furnished significant tools, materials and other equipment by an employer.

15. Investment

An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else.

16. Profit or loss

An independent contractor can make a profit or suffer a loss.

17. Works for more than one person or firm

An independent contractor is generally free to provide his or her services to two or more unrelated persons or 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.

19. Right to fire

An employee can be fired by an employer. An independent contractor cannot be fired so long as he or she produces a result that meets the specifications of the contract.

20. Right to quit

An employee can quit his or her job without at any time 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.

In a recent journal article in the *CPA Journal*. April 1992. pp. 48-55.) Alan R. Sumutka, CPA and Associate Professor of Accounting, shared his conclusions that the 20 factors are not weighted equally.

After analyzing a number of court cases, Sumutka concluded that eight of the factors are primary and can provide "very persuasive evidence of employee status" (p. 48).

What is important is whether the service provider or the service recipient has the right to control the details of the work to be performed.

Evidence of employee status is provided if the service recipient has the right to:

- Require compliance with significant instructions (IRS Factor 1).
- Set the hours of work (IRS Factor 7).
- Set the order or sequence of services to be performed (IRS Factor 10).
- Discharge the service provider (IRS Factor 19).
- Hire, pay and supervise assistants as the nature of the work requires (IRS Factor 5).

Or if the service provider:

- Has no ability to realize a profit or loss (IRS Factor 16).
- Has no investment in significant tools, materials and other equipment when such items are necessary to accomplish the task and are usually provided by the service provider (IRS Factor 14).
- Has no significant investment in facilities when they are necessary to accomplish the task and they are customarily provided by the service provider (IRS Factor 15).

If the answer to any of these factors is "yes," the IRS would probably make a case for an employee relationship between the service provider and the service recipient. If the answer to these eight factors is "no," and the answer to any of the remaining IRS factors is "yes," there is still cause for concern.

Worksheet 1, Factor evaluation questionnaire, gives the primary and secondary factors sorted and reworded according to Sumutka's determination of impact.

Worksheet 1

Factor evaluation questionnaire

Primary factors	Yes	No
1. Does the service recipient have the right to require compliance with significant instructions?	<input type="checkbox"/>	<input type="checkbox"/>

2. Does the service recipient have the right to set the hours of work?		
3. Does the service recipient have the right to set the order or sequence of services to be performed?		
4. Does the service recipient have the right to discharge the service provider?		
5. Does the service recipient have the right to hire, pay, and supervise assistants as the nature of the work requires?		
6. Does the service provider have no ability to realize a profit or loss?		
7. Does the service provider have no investment in significant tools, materials, and other equipment when such items are necessary to accomplish the task and are customarily provided by the service provider?		
8. Does the service provider have no significant investment in facilities when they are necessary to accomplish the task and they are customarily provided?		
Secondary factors	Yes	No
9. Does the service recipient train the service provider?		
10. Does the service recipient have the right to require oral or written reports?		
11. Does the service recipient pay by the hour, week or month?		
12. Does the service recipient pay for business and/or travel expenses?		
13. Does the service recipient have the right to require personal service?		
14. Does the service provider usually not work for more than one firm at a time?		
15. Does the service provider maintain a continuing relationship with the service recipient?		
16. Does the service provider maintain a continuing relationship with the service recipient?		
17. Does the service provider devote substantially full time to the service recipient?		
18. Does the service provider have the right to terminate the relationship at any time without incurring liability?		
19. Is the service provider integrated into the service recipient's business?		
20. Does the service provider not make his or her services available to the public on a regular and consistent basis?		

Notes
Yes answers suggest employee status. No answers suggest independent contractor status.

More weight should be given to the first eight questions than the last twelve.

If you answered "yes" to any of these 20 questions, proceed with caution. Consult an accountant or tax lawyer who is familiar with the problems raised by hiring individuals as independent contractors.

Service provider categories

1. Employees (officially referred to as Common Law Employees)

Under common law rules, every individual who performs services subject to the will and control of an employer, as to both what must be done and how it must be done, is an employee.

It does not matter that the employer allows the employee discretion and freedom of action, so long as the employer has the legal right to control both the methods and the result of the services.

Two usual characteristics of an employer/employee relationship are that the employer has the right to discharge the employee and the employer supplies tools and a place to work. If you have an employer/employee relationship, it makes

no difference how it is described. It does not matter if the employee is called an employee, partner, co-adventurer, agent or independent contractor.

It does not matter how the payments are measured, how they are made, or what they are called. Nor does it matter whether the individual is employed full-time or part-time.

For employment tax purposes, no distinction is made between classes of employees. Superintendents, managers and other supervisory personnel are all employees. An officer of a corporation is generally an employee, but a director is not.

An officer who performs no services or performs only minor services, and neither receives nor is entitled to receive any pay, is not considered an employee.

For example, any worker who comes to your apparel manufacturing plant at the times you specify, signs in when he arrives, works at the station you assign, takes a lunch break at a time that you designate, and leaves at a prearranged time, is an employee.

Similarly, a person who comes to your place of business, picks up garment pieces and instructions on how to put them together, takes them home to sew, brings them back by a specified time, and is paid only for the acceptable finished products, is either an employee or a statutory employee. (See employment category 4 below.)

2. Independent contractors (sometimes referred to as Consultants)

People such as lawyers, contractors, subcontractors, public stenographers, auctioneers, and others who follow an independent trade, business or profession in which they offer their services to the general public, are generally not employees.

However, whether such people are employees or independent contractors depends on the facts in each case.

The general rule is that an individual is an independent contractor if the employer has the right to control or direct only the result of the work and not the means and methods of accomplishing that result.

Independent contractors are hired to accomplish a particular job. The relationship between the hiring party and the independent contractor is contractual.

There is a written, verbal or implied contract between the two parties about what will be done and how much that service is worth. The contractor does the job, is paid and moves on to the next job under the next contract.

Independent contractors must give you a correct identification number (an employer identification number or a social security number).

If they do not, you may have to withhold, as income tax, 20 percent of the amount you pay the independent contractor.

For example, plumbers are usually independent contractors. They are in business for themselves.

When a house is being built, the builder specifies the type of plumbing to be installed and the parties agree upon a price.

The plumber does the work and submits a bill, which must be paid if the work is up to standard. If the work is not up to standard, the plumber must do it over without additional compensation.

If the plumber does not complete the work or the work is inadequate, the builder may sue the plumber for damages. The builder cannot, however, direct the step-by-step or day-to-day progress of the job or decide which days and hours the plumber will work.

The builder cannot hire additional people to help the plumber or insist that the plumber do the actual work.

The builder cannot fire the plumber in mid-job. The plumber cannot decide one day that he doesn't want to do this job and simply quit.

Both are bound by a contract that says the work must be done and the plumber must be paid. The builder does not have to hire that plumber ever again, even if the work was perfectly adequate.

If the builder does want to hire the plumber again, they negotiate a new contract for the new job.

At the end of the year, the builder files a Form 1099 with the Internal Revenue Service. This form tells the IRS how much the builder paid the plumber during that year for work that was done.

Meanwhile, the plumber must file quarterly estimated income reports with the IRS and an end-of-the-year tax return.

The plumber must pay self-employment tax on the amount of income earned. The IRS may compare the amount reported by the builder with the amount reported by the plumber.

A person who makes or trims garments in a home-based business and brings them to your consignment store to sell is an independent contractor.

You do not tell that manufacturer what to make or how many or when. You do not determine who will do the actual work. You do not set the selling price or take the risk of loss if the items do not sell. You may contract with the maker so that you both agree about how long the items will remain in your consignment store, what percentage will go to you (the seller), and whether you may mark down the items if they do not sell by a designated time.

3. Statutory employees

Statutory employees are similar to independent contractors, except that they are subject to FICA.

The employer must withhold Social Security Tax on these workers and pay the employer's share, but does not withhold federal or state income tax.

The employer is not responsible for unemployment taxes, nor does he/she provide benefits to a statutory employee.

The statutory employee is responsible for filing quarterly estimated income reports and for paying taxes on income.

Workers in the following four categories may be statutory employees: (IRS Publication 937, *Employment Taxes and Information Returns*.)

- A driver who distributes meat products, vegetable products, fruit products, bakery products or beverages (other than milk), or picks up and delivers laundry or dry cleaning if the driver is your agent or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name (if you also furnish specifications for the work to be done).
- A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods must be merchandise for resale or supplies for use in the buyer's business operation.

Whether an individual worker from one of these categories is actually a statutory employee depends on how he or she stands with regard to the test for common law employment, which is described below.

According to IRS publication 937, "Individuals within any of the above four (statutory employee) categories are employees subject to social security and Medicare taxes if:" (IRS Publication 937, *Employment Taxes and Information Returns*.)

- The service contract states or implies that almost all of the services are to be performed personally by them.

- The service contract is the arrangement under which the work is performed. The contract may be oral or written. Note: To qualify as a statutory employee, the arrangement must be that the employee will personally do the work. As soon as an agreement is reached between the employer and the employee that the work will be shared by someone else, the employee no longer may be classified as a statutory employee.
- The individual has little or no investment in the equipment and property used to perform the services (other than an investment in transportation facilities).

There is no precise definition of "little or no investment in the equipment and property used to perform the services."

The IRS has provided four factors (*Internal Revenue Manual, Part IV — Audit and Investigation, Exhibit 4640-2* (May 6, 1986). Cited in Wright, Kenneth K., "Determining Employee Status." 1991. Unpublished manuscript.) to help determine whether the investment is substantial enough to disqualify the worker from the category of statutory employee:

- What is the value of the worker's investment compared to total investment?
- Are the facilities furnished essential to the work or for the personal convenience of the worker?
- Are the facilities being purchased or leased from the person for whom the services are performed?
- Are the facilities furnished by the worker considerably more extensive than those usually furnished by other workers performing comparable services.

Facilities include such items as office furniture and fixtures, premises, tools and machinery, but they do not include such items as education, training and experience, "nor do they include such tools, instruments, equipment or clothing as are commonly or frequently provided by employees with respect to their employment." (Wright Kenneth K., "Determining Employee Status." 1991. Unpublished manuscript.)

The IRS has also ruled that tools and equipment are not considered a substantial investment "if they may be used for purposes not related to the particular services being performed" on the job. (Wright Kenneth K., "Determining Employee Status." 1991. Unpublished manuscript.)

Therefore a typewriter furnished by a contract typist and a sewing machine furnished by a "merchant tailor" are not considered substantial investments in facilities.

- The services are performed on a continuing basis. A continuing relationship is one that is regular or frequent. Regular, part-time work and recurring seasonal employment are considered continuing.
- A long-term, single-job transaction is not generally considered a continuing relationship.

Workers who do not meet these three requirements are either common law employees (category 1, above) or independent contractors (category 2, above).

4. Statutory non-employees

Workers in two categories are defined as statutory non-employees: Direct sellers and licensed real estate agents. The IRS defines direct sellers as follows: (IRS Publication 911, *Tax Information for Direct Sellers*. 1992.)

Direct sellers sell consumer products to others on a person-to-person basis, usually working out of their own homes.

The products they sell are intended only for personal use, not for resale. They may sell door-to-door, through the sales party plan, or by appointment in someone else's home.

Their customers may be coworkers, friends, relatives or neighbors. They may sell on a regular basis or only occasionally. They may sell as full-time work or as a sideline to a regular job.

A direct seller usually signs up with a particular company to sell its product line.

The company may use one of many titles for its direct sellers, including: consultant, coordinator, dealer, demonstrator,

designer, director, distributor and direct distributor, instructor, manager or supervisor, representative or sales representative.

Direct sellers are treated as self-employed for federal income tax and employment tax purposes if they meet the following two criteria: (IRS Publication 937, *Employment Taxes and Information Returns*.)

- Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked.
- Their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes.

You are a direct seller only if you are in business for yourself. Three kinds of employment-related business taxes may apply to direct sellers: Income tax, self-employment tax and employment taxes.

You must file quarterly estimated income reports and pay estimated tax (IRS Form 1040-ES); and annual income tax (IRS Form 1040, Schedule C).

Self-employment tax is the social security and Medicare tax for those who work for themselves.

If you have employees, you will probably be required to pay employment taxes. These taxes include federal income tax, social security and medicare (FICA) taxes, and federal unemployment tax (FUTA).

For more information about these taxes, see IRS Publication 911 on Tax Information for Direct Sellers, IRS Publication 533 on self-employment tax, and IRS Publications 937 and 15 on employment taxes.

Industrial homeworkers

Many people use the term "homeworker" to describe where they do their work.

They may actually fall under any of the four categories of service providers described above. However, the IRS defines homeworker or Industrial Homeworker as "any employee employed or suffered or permitted to perform industrial homework for an employer."

Therefore, for tax purposes, the term homeworker applies only to people who work at home for someone else.

The Fair Labor Standards Act of 1938, as amended, places many restrictions on the type of work that may be done as homework, who may be hired as a homeworker, and requires strict record keeping, including certification, by both the homeworker and the employer. For more information about restrictions on industrial homeworkers, see IRS Publication 1026.

By definition, industrial homeworkers are automatically either:

- Employees
- Statutory employees.

For both employees and statutory employees, the employer hires an individual and assumes that they personally will be doing the work.

However, if two or more individuals form a partnership, and that partnership is hired to perform a service or make a product, the partners are independent contractors because there can be no presumption that the work will be done solely by one or another member of the partnership.

It is important, however, that the partners do work together as a business. It is not sufficient to say that several people are partners if they contract separately, and work individually.

Reclassification protection

The hiring company faces severe penalties if the IRS and/or the courts determine that service providers being treated as independent contractors should be reclassified as employees.

However, a part of the tax law called the "safe haven" provision of Section 520 of the Revenue Act of 1978 provides some protection against liability for employment taxes, penalties and interest.

To qualify for this protection, three conditions must be met:

- A reasonable basis for classifying an employee as an independent contractor.
- Consistent non-employee treatment for the individual worker and all similar workers.
- The filing of all required information returns.

Final determination

Whether these provisions are met will be determined, of course, by the IRS and/or the courts, which means that no individual company is guaranteed safe even if it appears that they have satisfied the requirements. Further explanations of the three provisions follow.

1. Reasonable basis for classification

Tax law (Section 530 (2)) Section 530 (2) provides several standards that constitute safe havens in determining reasonable basis. These are: (Oden, Debra Hall. "Independent Contractor: A Legitimate Classification with Reclassification Protection." *Taxes*. May 1991. pp. 319-325.)

- **Precedence**
A service recipient has a reasonable basis for non-employee treatment if the classification decision is based on judicial precedent, published rulings, technical advice, or a letter ruling or determination letter to the taxpayer.
- **Prior audit**
If, in a past audit individuals classified as independent contractors are found to be similar in position to the individuals under question, that is considered a reasonable basis for classification.
- **Industry practice**
If long-recognized practice in the industry classifies a worker as an independent contractor, then the employer is considered to have a reasonable basis for treating the worker in the same manner.
- **Other**
The employer may attempt to demonstrate some other reasonable basis for not treating the individual as an employee.

2. Consistent treatment requirement

Tax law (Section 530 (a)(1)(A).) requires that the employer not treat the service provider as an employee for any time period after Dec. 31, 1977.

If, while the company is under investigation, it anticipates a negative ruling from the IRS and withholds employment taxes or files current employment tax returns, by doing so it has treated the Service Provider as an employee and has violated this "consistent treatment" requirement.

In addition, "If all substantially similar workers are treated as independent contractors, then all the workers are covered under the safe-haven protection. If, however, some workers holding substantially similar positions are treated as employees, then none of the workers is covered under the safe-haven provisions." (Oden, Debra Hall. "Independent Contractor: A Legitimate Classification with Reclassification Protection." *Taxes*. May 1991. pp. 319-325.)

3. Return filing requirement

The third requirement for safe haven protection is that the taxpayer must have filed all required federal tax returns and that the employee status used on those returns must have been independent contractor. If the worker has failed to file self-employment tax returns, that failure may disqualify the company from protection under these safe haven provisions of the federal tax law.

In addition, the employer must have filed Form 1099-Misc. to report fees, commissions or other payments made to independent contractors who are either sole proprietors or partnerships, on payment totalling \$600 or more in a calendar year. If the employer has filed a W-2, Wage and Tax Statement for any individual, then that individual has been treated as an employee and the employer would not be able to rely on the safe haven provisions of this section.

Summary

The courts and the IRS have held that "what you call it" does not affect what it really is. Giving a worker the title "independent contractor" makes no difference in the ruling if the worker is in a situation that fits the definition of employee or statutory employee. The same is true for written contracts. If the worker appears to be dependent upon the company, a contract stating that he or she is an independent contractor will not deter the IRS from ruling that that worker is really an employee.

It is important that each service recipient and service provider study the guidelines carefully and/or consult a qualified accountant or tax attorney before deciding that the independent contractor classification is appropriate for your use. The IRS suggests that service recipients and service providers use Form SS-8: Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding (included in this publication).

You may wish to complete this form for your own purposes and/or you may wish to submit it to the IRS for an official ruling. Note that it is not anonymous and becomes a part of IRS records.

Precautions and other considerations

For service recipients

Several suggestions have been offered by various tax accountants and certified public accountants for steps companies can take to strengthen their claims that service providers are independent contractors.

These suggestions are not guaranteed to protect you against an IRS claim that the worker is actually an employee.

The suggestions that follow were adapted from an article by Roth and Biebl. (Roth, Randall W. and Biebl, Andrew R. "How to Avoid Getting Caught in the IRS Crackdown." *Journal of Accountancy*. May 1991. pp. 35-36, 39.)

- Draft a written agreement (a contract) that spells out the relationship and have both parties sign it. The agreement should make it clear the company does not have the right to control the procedures for accomplishing the contracted services.
- Talk to the worker about his/her obligation to pay income and self-employment taxes.
- Avoid setting working hours or number of hours per day or days per week. It is okay, however, to give starting and completion dates.
- If the contractor needs additional help, make it clear that the contractor, not the company, will be hiring and paying for it.
- If the worker needs tools for the job, that worker should provide them.
- The worker should take on other assignments. Avoid being the only service recipient.
- Contract and pay for each job performed rather than for the amount of time spent on the job.
- Advise workers to arrange for their own liability, disability and health insurance coverage.
- Overhead costs (meals, clothing, transportation) should be part of the overall contract price. The service provider

should not bill these charges to the company's account and the company should not pay for them directly.

- Office space should not be provided to the worker on a regular basis.
- Workers should be responsible for their own training.
- The service provider should not be given "fill-in" work between specific jobs.
- Make it clear the service provider is under contract to perform a task. The service provider cannot be "fired" and cannot "quit" without violating the contract.
- Bonuses are not appropriate in most cases.

For service providers

Service providers who wish to be taken seriously as independent contractors may do several things to further their cause. Independent contractors should be independent businesses operating in a professional manner. The IRS will expect evidence of this. Contractors should consider the following:

- Have an office, business cards, stationery, billing forms and contracts with the company business name and address, etc.
- Make your services available to several companies or employers. Advertise in the telephone directory, newspapers and/or journals.
- Individual contractors might take on a partner and contract as one business to another business, so that there is no presumption that one individual, personally, will do the work.
- Own and use the tools and equipment needed for the job. The contractor should not borrow from the service recipient nor allow the service recipient to be the legal owner of tools and equipment that are being purchased.
- Provide the materials for the job. The contractor should not use materials that are provided by the service or product recipient. Investment in materials makes the service/product provider subject to profit or loss. Purchasing the materials from the service recipient is probably not sufficient to show independence.
- Make their business services available for purchase by more than one person or company. A larger customer base frees the service provider from dependence on business from one customer and limits the control a single company could have on the provider.
- File and pay quarterly income and self-employment taxes on income earned.

Glossary

- **Agent**
A sales person who represents a company.
- **Contract**
An agreement between two or more people to do something. It may be formal or informal, written or oral. Violation of a contract may result in a law suit.
- **Control**
The authority or power to make decisions or tell someone else what to do and how to do it.
- **Employment tax**
Income tax. Tax withheld from the wages of employees by the employer. The amount withheld is based on the number of exemptions claimed on the employee's Form W-4. Employment tax is withheld on many benefits in addition to wages paid.
- **FICA — Federal Insurance Contributions Act**
Social Security tax and Medicare tax. Provides for a federal system of old age, survivors, disability and hospital insurance. The employer collects and pays the employee's part of these taxes. As of 1992-93 the rate for social security is 6.2 percent each for the employee and the employer (12.4 percent total). The tax rate for Medicare is 1.45 percent each for employers and employees (2.9 percent total).
- **Form 1099-Misc**
The Federal Income Tax form filed to report payments to independent contractors.
- **FUTA — Federal Unemployment Tax.** Reported on Form 940. Applies to all wages paid to employees, unless an exemption applies.
- **Precedent**

An act, statement, legal decision, etc. that may serve as an example, reason or justification for a later one.

- **Safe haven**

The provision of the tax law (Section 530 of the Revenue Act of 1978) that protects Service Recipients from liability for employment taxes, penalties and interest under certain conditions.

- **Self-employment tax**

The part of income paid to the government by those who are self-employed, such as independent contractors. It may be required that estimated income forms be filed and the tax paid quarterly rather than annually as with employment tax.

- **Service providers**

People who do work for hire. They may be employees, statutory employees, statutory non-employees, or independent contractors. The work may be in the form of a product that is made or a service performed.

- **Service recipients**

People who hire work done for them. They agree to pay the person(s) doing the work and amount based on the amount of time spent on the job or some other agreement.

- **Situational evidence**

The specific conditions that apply in a specific case.

- **Unemployment tax — FUTA**

see above.

- **Workers — Service Providers**

People who do work for hire. Workers may be employees, statutory employees, statutory non-employees, or independent contractors. The work may be in the form of a product that is made or a service performed.

Useful IRS publications

- Publication 937, *Employment Taxes and Information Returns*
- Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding (Available in the printed version of this publication)
- Publication 911, *Tax Information for Direct Sellers*
- Publication 1026, *Regulations, Part 530: Employment of Homeworkers in Certain Industries*
- Publication 587, *Business Use of Your Home*
- Publication 535, *Business Expenses*
- Publication 533, *Self-Employment Tax*
- Publication 522, *Record Keeping for Individuals*
- Publication 583, *Taxpayer's Starting a Business*
- Publication 334, *Tax Guide for Small Business*
- Circular E, Employer's Tax Guide

To obtain these and any other IRS publications, call the IRS at 800-TAX-FORM (800-829-3676).

In Missouri, many booklets and forms are also available from the Department of Economic Development, 800-523-1434.

Resources

- Miller, Miles. The IRS Finds Invisible Employees. *Personnel Journal*, October 1991. pp. 56-60.
- Oden, Debra Hall. Independent Contractor: A Legitimate Classification with Reclassification Protection. In *Taxes*: May 1991. pp. 319-325.
- Roth, Randall W., and Biebl, Andrew R.. How to avoid getting caught in the IRS crackdown. *Journal of Accountancy*, May 1991. pp. 35-39.
- Sumutka, Alan R.. Employee or Independent Contractor? *The CPA Journal*, April 1992. pp. 48-55.
- Wright, Kenneth K. (1988, 1991). Determining Employee Status. Columbia, Mo.: MU.

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