

THE C & D NEWSLETTER



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INDEPENDENT CONTRACTOR OR EMPLOYEE

The Internal Revenue Service and the California Franchise Tax Board are currently conducting a crackdown on employers who improperly classify regular employees as independent contractors. While there are definite advantages to classifying a worker as an independent contractor (such as the elimination of the employer's contribution for social security, tax withholding and workers compensation insurance, and the avoidance of benefits like overtime pay, vacation pay, sick leave, and contributions to pension or profit sharing plans), the misclassification of workers can easily result in tens of thousands of dollars in back taxes and fines. The taxing agencies can audit an employer's books back three years, and can hold the business owners as well as active management personally liable for the amounts due.

The best way to avoid potential liability is to properly classify workers. The Internal Revenue Service uses 20 common law factors to determine whether a worker is an employee or an independent contractor. An Independent Contractor:

1. *Instructions.* Is not required to follow instructions to accomplish a job, but can be provided with job specifications.
2. *Training.* Does not receive training to perform a job, but rather uses his own methods to accomplish his work.
3. *Services can be rendered by others.* Can hire others to do the work for them.
4. *Work hours.* Can set his own work hours.
5. *Work not essential.* Does not render services essential to the success of the company.
6. *Continuing relationship.* Usually does not have a continuing relationship with the company. The relationship may be frequent, but it must be at irregular intervals whenever work is available.
7. *Control of assistants.* Can hire, supervise and pay assistants independent of the company.
8. *Time to pursue other work.* Should have enough time available to pursue other work.
9. *Job location.* Has control of where the work is done. If he works on the company's premises, it is not under the company's direction or supervision.
10. *Order of work.* Controls the sequence of tasks to complete the job.
11. *Progress reports.* Is not required to submit interim or progress reports. He is hired to complete the job.
12. *Payment.* Is paid by the job, not by the time spent doing the job. Payment can be based on the percentage of the job completed, or on the number of hours needed to complete the job.
13. *Work for multiple firms.* Should have time to work for more than one company.
14. *Business expenses.* Pays his own expenses in performing the job.

15. *Tools.* Furnishes his own tools of the trade.

16. *Significant investment.* Should have a significant investment in his business, and should not have to lease the company's equipment, office furniture or facilities.

17. *Services available to general public.* Makes his services available to the other employers by one or more of the following: (a) having an office and assistants, (b) having business signs, (c) having a business license, (d) having a listing in a business directory, or (e) advertising his services.

18. *Possible profit or loss.* Should be able to make a profit or a loss (employees cannot suffer a loss).

19. *Right to discharge.* Cannot be fired as long as he produces the result in the contract.

20. *No compensation for non-completion.* Is not paid for partial completion of the job.

In general, corporate owners performing general services for a corporation are employees. Similarly, corporate officers are usually employees. A corporate director, normally classified as an independent contractor, may also be considered an employee if he or she performs general services for the corporation.

The classification of a worker as an independent contractor or as an employee is somewhat subjective. A written contract tailored to the individual circumstances is an important step in establishing an independent contractor relationship, since it establishes the intent of the parties. However, even the best contract will not be helpful if it does not reflect the actual circumstances. There are other thoughtful steps that may be taken in order to bolster the claimed independent contractor status. These should be reviewed carefully and a determination made as to whether or not a person is an independent contractor. Once the determination is made, the person should be treated as such for tax, employment benefit and withholding, and other employment purposes.

This complimentary newsletter is intended to provide general information. Because of the complexities and constant changes in the law, it is important to seek professional advice before acting on any of the matters covered herein.

