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INDEPENDENT CONTRACTORS: IRS'S 20 FACTORS FOR DETERMINING EMPLOYEE STATUS

by

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Because of the continuing controversy surrounding the classification of workers as independent contractors or employees, you might want to review the 20 factors the IRS uses to make the determination.

What's at stake? If a worker is an independent contractor, the employer need not withhold income or payroll taxes, nor pay the employer's portion of FICA taxes. Also, health insurance and other employee benefits generally need not be provided.

In recent years greater numbers of businesses, feeling the crunch of the recession, began treating workers as independent contractors. The IRS has come down hard on the classification issue, targeting the health care, trucking, and construction industries, messenger services and those companies that tend to use professional consultants.

In light of the IRS's crackdown on independent contractors, it is vital that companies considering classifying workers as independent contractors first seek professional advice.

Here are the IRS's 20 factors. These factors are used by the IRS to determine whether a recipient of services has enough control over a worker to be an employer. They are intended only as a guide to help determine whether there is sufficient control to show an employer-employee relationship. Answering "Yes" to the first 16 factors tends to indicate independent contractor status. The IRS says that the importance of each

factor depends on the facts and circumstances of a particular case, and on the industry and type of services being provided.

1. Instructions. Do you have the right (whether or not exercised) to make the worker comply with your instructions on when, where and how he or she must work?
2. Training. Do you train a worker (on your premises or the worker's) by requiring him or her to work with someone experienced, or by having him or her attend meetings, or via correspondence?
3. Integration. Are the worker's duties an integral part of your operation? Is the worker's function necessary to your business?
4. Services rendered in person. Do you require the worker to provide the services personally, or can he or she delegate them to someone else?
5. Hiring/firing. Do you hire, fire and pay the workers' assistants? (If the worker contracts to provide both labor and materials, and is responsible only for the ultimate product, this tends to show independent contractor status.)
6. Relationship. Is there a continuing relationship between the worker and yourself? Are services performed frequently (although irregularly)?
7. Hours. Do you set hours during which the individual must perform the work?
8. Full time. Must the worker devote all of his or her time to your job? (Independent contractors can work when and where they please.)
9. On premises. Must the worker work on your premises, especially if the work could be performed elsewhere? (Or do you have the right to designate travel routes or times or otherwise control the time and place of performance?) The IRS says that the absence of this factor does not necessarily negate an employee relationship.



10. Ordering. Do you have the right to set the order in which services are performed, whether or not you exercise that right?
11. Reports. Do you require the worker to give you written or oral reports?
12. Hourly, weekly or monthly pay. Do you pay the person by the hour, week or month? (A worker might still be an independent contractor and be paid on this basis. Contractors tend to be paid by the job or on straight commission, but could be paid monthly or weekly so as to spread out contract payments.)
13. Expenses. Do you pay the worker's business or travel expenses?
14. Tools and materials. Do you provide the worker with tools or materials?
15. Right to fire. Do you have the right to fire the worker? There can be a tricky distinction between controlling workers via the threat of firing if they do not follow your instructions - which would indicate employee status-and having the right to terminate a contract because the contractor has not performed according to specifications.
16. Worker's right to terminate. Can the worker quit at any time? Remember, answering "Yes" to the rest of the questions tends to show independent contractor status for a worker.
17. Investment. Does the worker have a significant investment in equipment or facilities that are not typically maintained by employees?
18. Profit or loss. Can the worker incur a profit or loss as a result of his or her work (in addition to the profit of payment for the work)? A contractor should bear an economic risk over and above the risk of not being paid.
19. More than one job. Does the worker work for more than one business at a time? (Note, however, that the IRS says that a worker could be an employee of numerous service recipients.)



20. Service available to general public. Does the worker offer services to the general public on a regular basis?

A final note: A provision of federal law may, under certain limited circumstances, provide relief from withholding responsibility in cases where a business has consistently treated workers as independent contractors. That provision is Section 530 of the Revenue Act of 1978. If all of its requirements are met, a worker will not be treated as an employee for withholding purposes - even if the worker would be classified as an employee under the IRS's 20-factor test. (Tax letter, Third Quarter 1993)

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