

EMPLOYEE VS. INDEPENDENT CONTRACTOR

Under IRS common-law rules, anyone who performs services is your employee if the payer can control what will be done and how it will be done. This is so even if the employee is given freedom of action. The key issue is the right to control the details of how the services are performed. An independent contractor relationship exists if the payer has the right to control or direct only the result of the work and not what will be done or how it will be done.

To determine if a worker is an independent contractor or an employee, look at the main test and the ten secondary factors.

Main Test

Does the principal (you) have the right to direct and control the manner and means in which the worker carries out the job? The right of direction and control, whether or not exercised, is the most important factor in determining an employment relationship. The right to discharge a worker at will and without cause is strong evidence for the right of direction and control. When it is not clear whether you have the right to direct and control the worker, you must look further into the actual working relationship by weighing the ten secondary factors.

Secondary Factors

Depending on the type of relationship and the services performed, each factor varies in importance. Consider each factor independently, then consider them as a whole:

1. Is the worker engaged in a distinct trade or occupation? Does the worker make his or her services available to the general public? Does the worker perform work for more than one firm/company at a time? Does the worker hire, supervise, or pay assistants? Does the worker have a substantial investment in equipment and facilities?
2. Is the work done without supervision? In the geographic area and in the occupation, is the type of work usually done under the direction of a principal without supervision?
3. Is the work highly skilled and specialized? Is the worker trained by the principal? Does the worker personally perform the services?
4. Does the principal furnish/provide the tools, equipment, materials, supplies, and place of work? Does the worker perform the services on the principal's business premises?
5. Are the services provided on a long-term or repetitive basis?
6. Method of payment - Is the worker paid based on time worked or on completion of the project?
7. Are the services an integral part of the principal's business?
8. What type of relationship do the parties believe they are creating?
9. What is the extent of actual control by the principal? Does the worker have the right to terminate the relationship without liability? Does the principal provide instructions on how to do the work? Does the principal establish the work hours or the number of hours to be worked? Does the principal require the work to be done in a particular order or sequence? Does the principal require oral or written reports from the worker?
10. Is the work performed for the benefit of the principal's business?

Guidelines

The following questions are taken from the California Employment Development Department (EDD) and act as a guide in determining the status of an individual you wish to hire.

Questions 1 – 3 are significant questions. If the answer to any of them is "Yes," it is a strong indication that the worker is an employee, and you have a high probability of risk if you classify the worker as an independent contractor.

1. Do you instruct or supervise the person while he or she is working?
Independent contractors are free to do jobs in their own way, using specific methods they choose. A person or firm engages an independent contractor for the job's end result. When a worker is required to follow company procedure manuals and/or is given specific instructions on how to perform the work, the worker is normally an employee.
2. Can the worker quit or be discharged (fired) at any time?
If you have the right to fire the worker without notice, it indicates that you have the right to control the worker. Independent contractors are engaged to do specific jobs and cannot be fired before the job is complete unless they violate the terms of the contract. They are not free to quit and walk away until the job is complete. For example, if a shoe store owner hires an attorney to review his or her lease, the attorney would get paid only after satisfactory completion of the job.
3. Is the work being performed part of your regular business?
Work which is a necessary part of the regular trade or business is normally done by employees. For example, a sales clerk is selling shoes in a shoe store. A shoe store owner could not operate without sales clerks to sell shoes. On the other hand, a plumber engaged to fix the pipes in the bathroom of a store is performing a service on a onetime or occasional basis that is not an essential part of the purpose of the business enterprise. A certified public accountant engaged to prepare tax returns and financial statements for the business would also be an example of an independent contractor.

A "No" answer to questions 4 – 6 indicates that the individual is not in a business for himself or herself and would therefore normally be an employee.

4. Does the worker have a separately established business?
When individuals hold themselves out to the general public as available to perform services similar to those performed for you, it is evidence that the individuals are operating separately established businesses and would normally be independent contractors. Independent contractors are free to hire employees and assign the work to others in any way they choose. Independent contractors have the authority to fire their employees without your knowledge or consent. Independent contractors can normally advertise their services in newspapers and/or publications, yellow page listings, and/or seek new customers through the use of business cards.
5. Is the worker free to make business decisions which affect his or her ability to profit from the work?
An individual is normally an independent contractor when he or she is free to make business decisions which impact his or her ability to profit or suffer a loss. This involves real economic risk, not just the risk of not getting paid. These decisions would normally involve the acquisition, use, and/or disposition of equipment, facilities, and stock in trade which are under his or her control. Further examples of the ability to make economic business decisions include the amount and type of advertising for the business, the priority in which assignments are worked, and selection of the types and amounts of insurance coverage for the business.

6. Does the individual have a substantial investment which would subject him or her to a financial risk of loss?
Independent contractors furnish the tools, equipment, and supplies needed to perform the work. Independent contractors normally have an investment in the items needed to complete their tasks. To the extent necessary for the specific type of business, independent contractors provide their own business facility.

Questions 7 – 13 are additional factors that should be considered. A "Yes" answer to any of the questions is an indication the worker may be an employee, but no one factor by itself is deciding. All factors must be considered and weighed together to determine which type of relationship exists. However, the greater the number of "Yes" answers to questions 7 – 13 the greater the likelihood the worker is performing services as an employee.

7. Do you have employees who do the same type of work?
If the work being done is basically the same as work that is normally done by your employees, it indicates that the worker is an employee. This applies even if the work is being done on a one-time basis. For instance, to handle an extra workload or replace an employee who is on vacation, a worker is hired to fill in on a temporary basis. This worker is a temporary employee, not an independent contractor. (Note: If you contract with a temporary agency to provide you with a worker, the worker is normally an employee but may be an employee of the temporary agency.)
8. Do you furnish the tools, equipment, or supplies used to perform the work?
Independent business people furnish the tools, equipment, and supplies needed to perform the work. Independent contractors normally have an investment in the items needed to complete their tasks.
9. Is the work considered unskilled or semi-skilled labor?
The courts and the California Unemployment Insurance Appeals Board have held that workers who are considered unskilled or semi-skilled are the type of workers the law is meant to protect and are generally employees.
10. Do you provide training for the worker?
In skilled or semi-skilled work, independent contractors usually do not need training. If training is required to do the task, it is an indication that the worker is an employee.
11. Is the worker paid a fixed salary, an hourly wage, or based on a piece rate basis?
Independent contractors agree to do a job and bill for the service performed. Payments to independent contractors for labor or services are made upon the completion of the project or completion of the performance of specific portions of the project.
12. Did the worker previously perform the same or similar services for you as an employee?
If the worker previously performed the same or similar services for you as an employee, it is an indication that the individual is still an employee.
13. Does the worker believe that he or she is an employee?
Although belief of the parties is not controlling, intent of the parties is a factor to consider when making an employment or independent contractor determination. When both the worker and principal believe the worker is an independent contractor, an argument exists to support an independent contractor relationship between the parties.

Interpretations of Answers

Depending on the services being performed and the type of occupation, this questionnaire may produce a variety of results. There may be some factors which lean toward employment and some which lean toward independence. The answers to questions 1 – 6 provide a strong indication of the presence or absence of direction and control. The answers to questions 7 – 13 when joined with other evidence may carry greater weight when indicating the presence or absence of direction and control.

1. If all of the answers to questions 1 – 3 are "No" and all of the answers to questions 4 – 6 are "Yes," there is an indication of independence. When this is the case, there are likely to be a number of "No" answers to questions 7 – 13 which add to the support of the determination.
2. If all of the answers to questions 1 – 3 are "Yes" and all of the answers to questions 4 – 6 are "No," it is a very strong indication that the worker in question is an employee. When this is the case, there are likely to be a number of "Yes" answers to questions 7 – 13 which add to the support of the determination.
3. If the answer to question 1 or 2 is "Yes" or the answer to any one of questions 4 – 6 is "No," there is a likelihood of employment. At the very least, this pattern of answers makes the determination more difficult since the responses to questions 7 – 13 will probably be mixed. In such situations, the business owner would be well advised to complete a DE 1870, giving all of the facts of the working relationship and requesting a ruling from EDD.
4. If the answer to question 3 is "Yes" and the answer to question 4 is "No," there is a likelihood of employment. Given this pattern of answers, it is probable that the answers to questions 5 and 6 will also be "No." When this happens you may also see more "Yes" answers to the last group of questions (7 – 13). This scenario would support an employment determination.

These four scenarios illustrate only a few combinations of answers that could result from the use of this Employment Determination Guide, depending on the working relationship a principal may have with a worker and the type of occupation. The more the pattern of answers vary from the above four situations, the more difficult it is to interpret them. In situations 1 and 2, there is a greater chance that the interpretation will be accurate, and they present the least risk to the business owner of misclassifying the worker.