



Employee vs. Subcontractor

The IRS has developed a list of 20 factors it uses to test employee or subcontractor status. The Department of Labor and state boards will normally follow these as well. Here are the twenty factors you should be aware of before deciding to call an employee an independent contractor.

1. Does the business require the worker to follow their instructions on how work is to be performed? If yes, this indicates employee status. An independent contractor will generally decide how the project should be completed and use his own methodology.
2. Does the business provide training to the worker? If you're hiring a person for a job they are not trained for and providing them with the training to carry it out, that person is probably an employee. There can be exceptions based on the facts and circumstances, but if you fail this test, you might lose no matter how many of the others you pass.
3. Are the worker's services a substantial or integral part of the business? This indicates employee status because it indicates the business maintains direction and control over the worker.
4. Does the business require the worker to perform all services personally? Independent contractors may have their own employees or at least should have the option of hiring other contractors to perform their work. Agreements for personal services indicate employee status.
5. Does the business hire, supervise and pay the worker's assistants? If so, this is a strong indication of employee status. Let the independent contractor pay his or her own assistants.
6. Does the business have an ongoing relationship with the worker? This one is a stretch since many businesses maintain lifelong relationships with contractors whose work they like. But the IRS views this as an indication of employee status.
7. Does the business set the worker's schedule and hours? Independent contractors generally set their own work schedules. If the contractor must work certain hours because of required interrelationships with your employees or to take advantage of down time for computer-related work, document these facts.
8. Does the business require the worker full-time? This is an indication of employee status because the business controls their availability and prevents them from working on other clients.
9. Does the business provide the workspace? Contractors who work off-site are more likely to be classified an independent contractor.
10. Does the business determine the order or sequence in which work is completed? Indicates employee status. If specific schedules are required, document them in the contract with the reasoning for doing so.
11. Does the business require oral or written reports? The IRS believes regular written or oral reports detailing the work completed indicates employee status. In reality, this is, and should be, expected from independent contractors as well.

12. Does the business pay by the hour, week or month? This indicates employee status. See our comments at the end of this article on this issue.
13. Does the business pay expenses? This is an indication that the business is directing the Independent contractor's business activities. Make sure the independent contractor pays the expenses and bills you for reimbursement.
14. Does the business provide tools and equipment for the worker? Independent contractors would normally provide their own tools and equipment.
15. Does the worker have a significant investment in their own facilities? If the contractor maintains his own office space, computer equipment, tools, etc., this is a good indication that they are an independent contractor.
16. Does the worker have profits and losses independent of the business? This is an indication that the contractor is running his own bona fide business and is an independent contractor.
17. Does the worker have multiple clients? Working with multiple clients generally indicates independent contractor status.
18. Does the worker market their services to the general public? Employees do not generally market their services to the general public.
19. Does the business have the right to discharge the worker at any time? This suggests employee status. An independent contractor would only be discharged for failure to meet contract specifications.
20. Does the worker have the right to quit at any time? An independent contractor is under contract and cannot quit until the project is completed.

The purpose of these factors is to attempt to determine whether the employer has the right to control the worker, how, when and where the work is performed, and the amount of investment the worker has in his own business. The higher degree of control the employer has over the worker, the more likely the IRS will classify the worker as an employee. As you can see, there is a high degree of subjectivity in these tests. Some consultants will tell you that you're in danger if your worker falls into the employee category on more than 7 to 9 of these guidelines. I can tell you from experience that you may be in trouble if you fail on only **three or four!** The test **is** highly subjective and an IRS agent may feel strongly that the requisite control is evidenced even if you pass most of the guidelines with flying colors.

The entire point of looking at these guidelines and applying them to your particular facts and circumstances is to determine if classification as an independent contractor is worth the risk and, if you decide that it is, to determine how to shore up your position before the work begins. At a minimum you should do each of the following to make sure your case is as strong as it can be.

1. Put your agreement with the independent contractor in writing. Include a description of the project, the expected duration, the amount to be paid and how it is to be paid, a paragraph specifically acknowledging that the worker is an independent contractor, and as many other details as can be agreed on. Specify that the worker must supply his own insurances. Ask for the insurance certificates and keep them on file.
2. Get a completed I-9 form from the worker and be prepared to issue a 1099 at year's end.
3. Save any promotional materials, proposals, etc. that the contractor has given you. Also save the promotional materials, proposals, etc. that you got from other contractors competing for your work. Document why you selected this contractor.

4. Pay only on invoices submitted to you by the contractor. Even if the contract is for an hourly rate, let the contractor maintain the records of hours worked and bill you for them. You may, of course, keep your own records to verify his.
5. If at all possible, do not pay on an hourly basis. You may have to, but if possible break down the amounts to be paid based on deliverables throughout the life of the project. You may pay periodic draws to aid the contractor's cash flow, but make sure the contractor accounts for them on his bills as draws against his billing for the deliverables.
6. If the project runs over the original budget and the original contract terms, address this issue in writing. If you're prepared to pay the extra fees, add a contract addendum to cover it. If the project scope changes and you require additional work, add a contract addendum for that as well.

Even with the above documentation there is no guarantee that you will prevail if the IRS comes knocking. But without such documentation, you may be risking your business!

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