Independent Contractor or Employee?

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Q: How do I know whether individuals providing services to our association are employees or independent contractors?

A: Over the years, the Internal Revenue Service has published different tests to assist in determining whether the relationship between a business (here, an association) and a worker is that of employer and employee or independent contractors. The distinction is an important one; worker classification affects employee eligibility for Social Security and Medicare benefits as well as both employer and employee tax responsibilities. The tests, however, have never been easy to apply.

In the past, the IRS used a "Twenty Factor" test to distinguish between employees and independent contractors. As a result of comments from both government and private industry representatives, however, it reorganized the factors a few years ago, consolidating them into three principal categories. Last year, it revised its Publication 1779, which outlines the current tests in a downloadable two-page brochure. Although the IRS still warns that every case must be evaluated on the basis of the facts presented, its attempts at consolidation reflect a desire to simplify the analysis. The following is a summary of the latest categories and tests:

Behavioral Control. According to the IRS, a worker is an employee when the association has a right to direct and control his or her work. In considering whether it has that right, an association should review the type and degree of instruction given to the worker, its evaluation system — if any — and the training it provides.

Specifically, an individual is likely to be classified as an employee if the association provides the individual with extensive instructions regarding how, when or where to work; what equipment to use; what assistants to hire; and where to purchase supplies. Those who receive less

extensive instructions may be classified as independent contractors. Publication 1779 indicates that instructions regarding time and place are generally viewed as less important than those describing how the work is to be performed. Similarly, evaluations that comment on how work is performed point to employer/employee relationships, while evaluations that judge only the end result are indicative of independent contractor relationships. Providing a worker with training as to how to do a job strongly suggests that the worker is an employee.

Financial Control. To make a determination regarding employee versus independent contractor status, the IRS evaluates not only whether the association controls a worker's behavior, but also whether it controls the financial aspects of the worker's job.

For example, the IRS will look at whether the worker has made a significant investment in his or her work through the purchase of tools, equipment or the like. Such an investment tends to be evidence of independent contractor status, but, like all control factors, it is not determinative in and of itself. Workers whose expenses are not reimbursed, who have the opportunity to earn a profit or incur a loss, or who make their services available to multiple parties in the relevant market also are more likely to be characterized as independent contractors than employees. In addition, independent contractors are generally paid a flat fee for a job; by contrast, those guaranteed a regular hourly or weekly salary are more likely to be classified as employees.

Relationship of the Parties. The third category of control addresses the relationship between the worker and the association. For example, individuals who receive insurance, vacation and similar benefits from an association are generally characterized as its employees (although the lack of such benefits is not dispositive evidence of independent contractor status). The duration of the contemplated relationship also is a factor. Thus, when an association hires a worker for an indefinite term, versus a specific project or period, the worker is more likely to be an employee than a contractor.

The IRS has stated that it is not required to align its determination with the terms of agreements that state, for example, that a worker is an independent contractor, responsible for paying his or her own self-employment tax. Instead, the manner in which the parties work together dictates the result. The IRS also has taken the position, however, that a written agreement can provide significant evidence of the parties' intent if it is otherwise difficult or impossible to determine the nature of the relationship based on other facts.

Associations should understand that, where qualification as an independent contractor is not crystal clear, the IRS historically has characterized work relationships as those of employment. And, despite the IRS's attempts to simplify the analysis, the reality is that it is not any easier to make those close calls now than it was several years ago. As such, consulting with legal counsel on these issues is prudent. If a review of the factors still fails to provide a clear answer, an association may request a determination from the IRS by filing Form SS-8. Be aware, however, that the IRS may take as long as six months to issue a determination.

The answers provided here should not be construed as legal advice or a legal opinion. Consult a lawyer concerning your specific situation or legal questions.