

Employee or Independent Contractor?

A worker's classification as to being an employee or an independent contractor is important because it determines if an employer must withhold income taxes and pay Social Security, Medicare taxes and unemployment tax on wages paid to an individual.

Generally, an individual is an independent contractor if the payer has the right to control or direct only the result of the work, not what will be done and how it will be done. Small businesses should consider all factors involving the degree of control and independence in the employer/worker relationship.

In classifying a worker, consider these three categories – Behavioral Control, Financial Control and Relationship of the Parties.

Behavioral Control: A worker is an **employee** when the business has the right to direct and control the work performed by the worker, even if that right is not exercised. Behavioral control categories are:

- Type of instructions given -- such as when and where to work, what tools to use or where to purchase supplies and services. Receiving the types of instructions in these examples may indicate a worker is an employee.
- Degree of instruction -- the more detailed instructions may indicate that the worker is an employee. Less detailed instructions reflects less control, indicating that the worker is more likely an independent contractor.
- Evaluation systems -- to measure the details of how the work is done points to an employee. Evaluation systems measuring just the end result point to either an independent contractor or an employee.
- Training a worker on how to do the job -- or periodic or on-going training about procedures and methods -- is strong evidence that the worker is an employee. Independent contractors ordinarily use their own methods.

Financial Control: Does the business have a right to direct or control the financial and business aspects of the worker's job? In looking at this factor consider:

- Significant investment in the equipment the worker uses in working for someone else.
- Unreimbursed expenses, independent contractors are more likely to incur unreimbursed expenses than employees.

- Opportunity for profit or loss is often an indicator of an independent contractor.
- Services available to the market. Independent contractors are generally free to seek out other business opportunities.
- The method of payment on the project. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time even when supplemented by a commission. However, independent contractors are most often paid for a job by a flat fee.

Relationship Between the Parties: The type of relationship depends upon how the worker and business perceive their interaction with one another. This includes:

- Written contracts which describe the relationship the parties intend to create. Although a contract stating the worker is an employee or an independent contractor is not sufficient to determine the worker's status.
- Benefits. Businesses providing employee-type benefits, such as insurance, a pension plan, vacation pay or sick pay have employees. Businesses generally do not grant these benefits to independent contractors.
- The permanency of the relationship is important. An expectation that the relationship will continue indefinitely, rather than for a specific project or period, is generally seen as evidence that the intent was to create an employer-employee relationship.
- The extent to which services performed by the worker are seen as a key aspect of the regular business of the company may determine the classification.

Classifying an employee as an independent contractor with no reasonable basis for doing so makes an employer liable for employment taxes. Certain employers that can provide a reasonable basis for not treating a worker as an employee may have the opportunity to avoid paying employment taxes.