



# Tax Researcher

Volume XXVI Issue 10 October 2009

## WHAT MAKES A PERSON PERFORMING SERVICES A *STATUTORY EMPLOYEE* OR A *STATUTORY NON-EMPLOYEE*?

Before one can know how to treat payments made for services performed, it's necessary to determine the business relationship existing between the payer and the person performing the services. Most commonly, the relationship is that of employee or independent contractor, but two other categories also exist and have significant payroll tax requirements.

### **Statutory Employee**

One such relationship is that of *STATUTORY EMPLOYEE*. By statute, an independent contractor under the common law rules, may be treated as an "employee" for certain employment tax purposes if the worker falls within any one of the following four categories:

1. ***Agent or commission drivers*** — a driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is the payer's agent or is paid on commission.
2. ***Life insurance sales agents*** — a full-time sales agent whose principal business activity is selling life insurance and/or annuity contracts, primarily for one company.
3. ***Home workers*** — an individual who works at home on materials or goods that the payer supplies (which are later returned to the supplier or other designated person), under work specifications furnished by the payer.
4. ***Traveling and city salespersons*** — persons working full-time to solicit orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed must be the salesperson's principal business activity.

For workers in these four categories, the payer must withhold social security and Medicare taxes from the wages of the STATUTORY EMPLOYEE if **all three** of the following conditions apply:

- The service contract states or implies that substantially all the services are to be performed personally by the statutory employee.
- The statutory employee does not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
- The services are performed on a continuing basis for the same payer.

For FUTA tax, the term “employee” means the same as it does for social security and Medicare taxes, except that it does not include statutory employees in categories 2 and 3 above. Thus, any individual who is employed under categories 1 or 4 is an employee for FUTA tax purposes and subject to FUTA tax.

Importantly, the payer should not withhold Federal income tax from the wages of STATUTORY EMPLOYEES. However, the payer must furnish a Form W-2, and check “statutory employee” in box 13. Payments to the employee are considered “other compensation” and reported in box 1. Social Security wages should be reported in box 3, Medicare wages in box 5, withheld social security tax in box 4, and withheld Medicare tax in box 6.

## **Statutory Non-employee**

There are three categories of STATUTORY NON-EMPLOYEE workers who are given a different kind of special treatment for payroll tax purposes: ***direct sellers***, ***licensed real estate agents***, and ***certain companion sitters***. They are treated as self-employed for all federal tax purposes, including income and employment taxes, if:

1. Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked, and
2. Their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes.

The category of ***direct sellers***, as used here, needs some clarification. Direct sellers include persons falling within any of the following three groups:

1. Persons engaged in selling (or soliciting the sale of) consumer products in the home or place of business other than in a permanent retail establishment.
2. Persons engaged in selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis prescribed by regulations, for resale in the home or at a place of business other than in a permanent retail establishment.
3. Persons engaged in the trade or business of delivering or distributing newspapers or shopping news (including any services directly related to such delivery or distribution).

Note that the IRS considers direct selling to include the activities of individuals who attempt to increase the direct sales of their direct sellers, and who earn income based on the productivity of their direct sellers. Such activities include providing motivation and encouragement; imparting skills, knowledge, or experience; and recruiting.

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The category of **licensed real estate agents** includes individuals engaged in appraisal activities for real estate sales if they earn income based on sales or other output.

The third category of statutory non-employees is **companion sitters**. These are individuals who furnish personal attendance, companionship, or household care services to children or to elderly or disabled individuals. A person engaged in the trade or business of putting the sitters in touch with individuals who wish to employ them (that is, a companion sitting placement service) will not be treated as the employer of the sitters if that person does not receive or pay the salary or wages of the sitters and is not compensated by the sitters or the persons who employ them on a fee basis. Companion sitters who are not employees of a companion sitting placement service are generally treated as self-employed.

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