



Tax Researcher

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EMPLOYEE vs. INDEPENDENT CONTRACTOR

When a worker performs services and receives some form of remuneration, an important question is whether the remuneration is subject to employment taxes. The answer depends on whether the worker is an employee or an independent contractor. The determination of the worker's status depends on the facts in each case. These facts define the business relationship of the parties at the time the services are rendered.

Generally, a common law EMPLOYEE works for and performs services under the control of the party which pays for the services. On the other hand, an INDEPENDENT CONTRACTOR is an individual in business for himself or herself, and performs the services free of control from the party which pays for the services.

Employment taxes apply solely to the remuneration paid to workers classified as EMPLOYEES. The employer's obligation is to deduct federal income tax withholding (FITW), to deduct as well as "match" social security (for 2011 the employee rate is 4.2%, the employer rate is 6.2%) and Medicare taxes (FICA), and to pay federal unemployment tax (FUTA). Also, there may be state income tax to be withheld and the employer and/or employee may have to pay state unemployment compensation contributions and state disability insurance. A business normally is not required to withhold taxes from payments made to independent contractors.

In addition, certain federal and state laws governing benefit plan participation, wage payment, working conditions and workers' compensation, apply ONLY to employees and not to independent contractors. For example, only employees may participate in a Section 401(k) pension plan, and only employees are protected by minimum wage and overtime pay laws.

I.R.S. Guidance

When determining under common law whether an individual is an employee or an independent contractor, the IRS stresses that ALL evidence of the degree of control and degree of independence must be considered. The IRS no longer uses a list of 20 factors (the "20-Factors Test") to evaluate a specific worker's situation. IRS' official guidance can be found in Publication 15-A, Employer's Supplemental Tax Guide (Supplement to Publication 15 (Circular E), Employer's Tax Guide). This information outlines the facts that provide the evidence of the degree of control and independence which fall into three major categories: behavioral control, financial control, and the type of relationship between the parties:

A. BEHAVIORAL CONTROL

Facts that show whether the business has the right to direct and control how the worker does the task for which the worker is hired, include the type and degree of:

- **Instructions the business gives the worker** – An employee is generally subject to the business' instructions about when, where and how to work. Even if no instructions are given, sufficient behavioral control may exist if the employer has the RIGHT to control how the work results are achieved.
- **Training the business gives to the worker** – An employee may be trained to perform services in a particular manner. Independent contractors, however, ordinarily use their own methods.

B. FINANCIAL CONTROL

Facts that show whether the business has a right to control the business aspects of the worker's job include:

- **The extent to which the worker has unreimbursed business expenses** – Independent contractors are more likely to have unreimbursed expenses than employees.
- **The extent of the worker's investment** – An independent contractor often has a significant investment in the facilities or tools used to perform services for someone else, but this is not mandatory.
- **The extent to which the worker makes services available to the relevant market** – Employees tend to work for a single business.
- **How the business pays the worker** – An employee generally is paid by the hour, week or month. An independent contractor usually is paid by the job. However, it is common in some professions, such as law, to pay independent contractors at an hourly rate.
- **The extent to which the worker can realize a profit or incur a loss** – An independent contractor can make a profit or loss.

C. TYPE OF RELATIONSHIP

Facts that show the type of relationship between the parties, include:

- **Written contracts describing the type of relationship the parties intended to create**
- **Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay**
- **The permanency of the relationship** – If one engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence the intent was to create an employer-employee relationship.
- **The extent to which services performed by the worker are a key aspect of the regular business of the company** – If a worker provides services that are a key aspect of the company's business activity, it is more likely that the company will have the right to direct and control his or her activities. This would indicate an employer-employee relationship.

Upon request, the IRS will determine whether a worker is an employee. File Form SS-8 (*Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*). Note that some state unemployment compensation programs define "independent contractor" more narrowly than the IRS.

NEW YORK ENACTED MARRIAGE EQUALITY ACT EFFECTIVE 7/24/11

New York's Marriage Equality Act, which took effect on 7/24/11, provides that all marriages, whether between same-sex couples or different-sex couples, will be treated equally under state law. The state will recognize all legally performed marriages, whether or not the marriage took place in NY.

The NY Department of Taxation & Finance is informing employers that they are not to withhold NY tax on certain benefits provided to a same-sex married employee. Employers don't need to withhold tax for New York State, New York City, or Yonkers income tax purposes on the value of certain benefits (e.g. domestic partner health benefit), even though they remain subject to federal withholding. This applies if the employee's federal taxable wages subject to withholding include the value of the benefits, and the value of these benefits wouldn't be included in taxable wages if provided to a different-sex married spouse.

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