

Are you really independent? Independent contractor vs. employee status

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In the past two days, I've spent nearly eight hours talking to three different people about what makes them employees (EEs) rather than the independent contractors (ICs) they thought they were. Each person recently "lost contracts" through non-renewal.

Mind you I was at a golf tournament...which got me thinking. How many other people are in these folks' situation? More than I realized, obviously, since I was being tapped during a tournament.

In listening to these folks I learned that each person was required to work on-site during the company's business hours, use the 'client' company's tools, receive performance reviews, work exclusively for the 'client,' and each had some sort of severance package after their 'contracts' were not renewed.

I was stunned. How could these *employers* not know they had *employees* and not Independent Contractors?

How to determine IC status

To be fair, determining the true status of an IC is tricky. In the current labor and economic markets, trending toward contractors rather than EEs seems - and many times is - a smart move for companies. No employment tax on an IC. No ding against retention/turnover rate post-contract. No increase in insurance, pension, or other EE benefit costs.

Problems arise when ERs start treating ICs like EEs...and many, if not most, ICs do not know when that behavioral line is crossed. Unfortunately, most ERs I have interviewed over the years - and I've been writing on labor issues for 11 years - are equally unfamiliar.

The behavioral line is a critical indicator of status

Just as the amount of control exercised by an ER over an exempt employee determines whether that employee stays exempt from the overtime rules, the right to control work processes determines whether or not an IC retains independent status.

The wrong behavior on the part of the contracting company can create an EE out of an IC.

To figure out if you have an IC relationship, I recommend a wonderful IRS form called an SS-8. It's easy to use and can be downloaded from the IRS.gov site. This form should be filled out by ERs and ICs alike to determine if a true IC relationship has been established. I also recommend both parties download or request IRS Form 1779, which is a brochure updated in 2008 that clearly explains how the ER can get into trouble and what the IC is responsible for - to clients and, of course, to the IRS.

Rather than outlining all the common law factors that determine IC status, IRS Form 1779 clarified and categorized them into three basic sections:

1. Behavioral Control
2. Financial Control
3. Relationship Type

Be thankful, because following are the **20 Common Law Factors**:

1. Instructions
2. Training
3. Integration
4. Service rendered personally
5. Hiring, supervising, and paying assistants
6. Continuing relationship
7. Set hours of work
8. Full-time work required
9. Doing work on business owner's premises
10. Accomplishing work in certain order or sequence
11. Submission of oral or written reports
12. Method of payment
13. Payment of business or traveling expenses
14. Furnishing tools and equipment
15. Significant investment
16. Realization of profit or loss
17. Work for one entity at a time
18. Offer their services to the general public
19. Right to discharge
20. Right to terminate

Simple Example

I need to have my lawn cut once a week. I find a person who cuts lawns, negotiate a price for the season, and negotiate the start date with the end date set as the end of the season or first day of Fall.

- *Since there is an end date, there is no implied or expected contract continuation. If there were, then I would have just created an employment contract for a contingent employee and would then be responsible for all employment taxes. The employee would also be responsible for all my employee benefits, too.*

That's my contract. I need X service for Y amount of time at Z price and at W frequency. I define the work that needs to be done, the time frame in which it needs to be completed, and I negotiate the price I will pay. ***In this respect, I control the 'what' of work.*** (It's the 'what' that I don't want to do, which is why I've contracted someone else).

If the lawn person has quite a few contracts and needs to assign a different crew to do my lawn, I have no control over the people to send or the decision to assign. ***I do not control the 'who' of work.***

- *No one on the crew, by the way, is critical to my project's completion. I any were, I would need to have control over that person, which would make that person an EE.*

The lawn person uses h/her own equipment to take care of my lawn. I do not control access to my equipment, even though I may have the same or similar equipment on my site. I do not supply electricity, gas, oil, electrical cords, lawn bags, rakes, wheelbarrows, fertilizer, seed, weed killer or other supplies and equipment, nor do I pay mileage or other expenses. ***I do not control the 'tools' of work.***

The lawn person decides if it's beneficial to do the back lawn first, then front, or maybe to do all the trim first and then start from front to back. I do not supervise or control the process of work. ***I do not control the 'where' of work.***

The lawn person schedules my lawn cutting to work with h/her schedule and route. ***I do not control the 'when' of the work.***

The lawn person uses h/her own techniques to complete the job and removes debris (or dumps it in my compost, whichever is negotiated). Either way, the essentials of work are taken care of by the lawn person, not me. ***I do not control the 'how' of work.***

The lawn person sends me a bill for service. I do not pay any type of insurance - health, business, workers compensation or otherwise - for the lawn person. There are no bonuses to be earned, nor is there a severance paid after the contract terminates. The lawn person bears a significant financial risk in entering each contract and is responsible for paying crew, repairing tools, training, and covering crew under Workers' Compensation.

The lawn service is available to more than just me. If I contract this person to do only my lawn, then I have myself an EE.

Who is an employee?

The Internal Revenue Service uses these criteria to determine whether an individual is an employee or an independent contractor. The worker is an employee if...

- You or your representative tells the worker where, when, and how to work.
- You train the worker.
- The business performance depends on the worker.
- The worker has a continuing relationship with the company.
- The worker's services must be personally rendered by the him/her.
- You set the worker's work hours.
- The worker works on the employer's premises.
- The worker is paid by the hour, weeks, or month.
- You furnish tools and materials.
- You can fire the worker without violating a contract.
- The worker has a right to quit without incurring a liability.
- The worker does not offer the worker's services to the public at large.
- The worker has no opportunity for profit or loss as a result of the worker's service.
- The worker has no significant investment in the business.
- You require the worker to submit oral or written reports.
- The worker is a key employee or corporate officer.

I hope I've helped you understand the difference between an EE and an IC. If you have any comments or questions, feel free to send them on.

If you'd like me to research another topic, let me know.

Disclaimer *I am not a licensed attorney or certified accountant. My blogs are based on my own experiences and loads of research.*

Diane Faulkner is a freelance writer and speaker whose work is seen in such publications as *Credit Union Management*, *The Federal Credit Union*, *The Conference Board Magazine*, *Human Resource Executive*, *Women's Digest* and *The Business Journal*. A former human resource vice-president and certified substance abuse counselor, Faulkner's expertise in human behavior and labor issues helps people work and play well together in the office without later landing in court.

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