

# Employee vs. Independent Contractor

(Adapted from *IRS Summertime Tax Tip 2010-20*, <http://www.irs.gov/newsroom/article/0,,id=173423,00.html>)

The IRS provides guidance that can help you determine how to classify the people your parish employs. This will affect how much the parish pays in taxes, whether taxes need to be withheld from employees' paychecks and what tax documents you need to file.

Here are several considerations that will help you distinguish independent contractors versus employees.

1. The IRS uses three characteristics to determine the relationship between businesses and workers:
  - Behavioral Control covers facts that show whether the business has a right to direct or control how the work is done through instructions, training or other means.
  - Financial Control covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker's job.
  - Type of Relationship factor relates to how the workers and the business owner perceive their relationship.
2. If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees.
3. If you can direct or control only the result of the work done -- and not the means and methods of accomplishing the result -- then your workers are probably independent contractors.
4. Employers who misclassify workers as independent contractors can end up with substantial tax bills. Additionally, they can face penalties for failing to pay employment taxes and for failing to file required tax forms.
5. Workers can avoid higher tax bills and lost benefits if they know their proper status.

**Contact the Archdiocese of Chicago  
Human Resources Office at (312) 534-5360 for additional information  
on employee classification**

# Financial Control

Financial control refers to facts that show whether or not the business has the right to control the economic aspects of the worker's job.

The financial control factors fall into the categories of:

- Significant investment
- Unreimbursed expenses
- Opportunity for profit or loss
- Services available to the market
- Method of payment

## **Significant investment**

An independent contractor often has a significant investment in the equipment he or she uses in working for someone else. However, in many occupations, such as construction, workers spend thousands of dollars on the tools and equipment they use and are still considered to be employees.

There are no precise dollar limits that must be met in order to have a significant investment.

Furthermore, a significant investment is not necessary for independent contractor status as some types of work simply do not require large expenditures.

## **Unreimbursed expenses**

Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their business.

## **Opportunity for profit or loss**

The opportunity to make a profit or loss is another important factor. If a worker has a significant investment in the tools and equipment used and if the worker has unreimbursed expenses, the worker has a greater opportunity to lose money (i.e., their expenses will exceed their income from the work). Having the possibility of incurring a loss indicates that the worker is an independent contractor.

## **Services available to the market**

An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

## **Method of payment**

An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job.

# Behavioral Control

Behavioral control refers to facts that show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done – as long as the employer has the right to direct and control the work.

The behavioral control factors fall into the categories of:

- Type of instructions given
- Degree of instruction
- Evaluation systems
- Training

## Types of Instructions Given

An employee is generally subject to the business's instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow when performing the work.

## Degree of Instruction

Degree of Instruction means that the more detailed the instructions, the more control the business exercises over the worker. More detailed instructions indicate that the worker is an employee. Less detailed instructions reflect less control, indicating that the worker is more likely an independent contractor.

**Note:** The amount of instruction needed varies among different jobs. 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. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

## Evaluation System

If an evaluation system measures the details of how the work is performed, then these factors would point to an employee. If the evaluation system measures just the end result, then this can point to either an **independent contractor or an employee.**

## Training

If the business provides the worker with training on how to do the job, this indicates that the business wants the job done in a particular way. This is strong evidence that the worker is an employee. Periodic or on-going training about procedures and methods is even stronger evidence of an employer-employee relationship. However, independent contractors ordinarily use their own methods.

# Type of Relationship

Type of relationship refers to facts that show how the worker and business perceive their relationship to each other.

The factors, for the type of relationship between two parties, generally fall into the categories of:

- Written contracts
- Employee benefits
- Permanency of the relationship
- Services provided as key activity of the business

## **Written Contracts**

Although a contract may state that the worker is an employee or an independent contractor, this is not sufficient to determine the worker's status. The IRS is not required to follow a contract stating that the worker is an independent contractor, responsible for paying his or her own self employment tax. How the parties work together determines whether the worker is an employee or an independent contractor.

## **Employee Benefits**

Employee benefits include things like insurance, pension plans, paid vacation, sick days, and disability insurance. Businesses generally do not grant these benefits to independent contractors. However, the lack of these types of benefits does not necessarily mean the worker is an independent contractor.

## **Permanency of the Relationship**

If you hire a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.

## **Services Provided as Key Activity of the Business**

If a worker provides services that are a key aspect of the business, it is more likely that the business will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.