

Independent Contractor or Employee?



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Independent Contractor (Self- Employed) or Employee?

It is critical that you, the business owner, correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. If you are an independent contractor and hire or subcontract work to others, you will want to review the information in this section to determine whether individuals you hire are independent contractors (subcontractors) or employees.

Before you can determine how to treat payments you make for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be -

- An independent contractor
- An employee (common-law employee)
- A statutory employee
- A statutory nonemployee

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

Common Law Rules

Facts that provide evidence of the degree of control and independence fall into three categories:

1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another. The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

Form SS-8

If, after reviewing the three categories of evidence, it is still unclear whether a worker is an employee or an independent contractor, [Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and](#)

[Income Tax Withholding](#) . The form may be filed by either the business or the worker. The IRS will review the facts and circumstances and officially determine the worker's status.

Be aware that it can take at least six months to get a determination, but a business that continually hires the same types of workers to perform particular services may want to consider filing the [Form SS-8](#).

Employment Tax Obligations

Once a determination is made (whether by the business or by the IRS), the next step is filing the appropriate forms and paying the associated taxes.

- **Forms and associated taxes for independent contractors:**
 - a. **Form W-9** - If you've made the determination that the person you're paying is an independent contractor, the first step is to have the contractor complete [Form W-9](#), Request for Taxpayer Identification Number and Certification. This form can be used to request the correct name and [Taxpayer Identification Number](#), or [TIN](#), of the worker. A TIN may be either a Social Security Number (SSN), or an Employer Identification Number (EIN). The [W-9](#) should be kept in your files for four years for future reference in case of any questions from the worker or the IRS.
 - b. **Form 1099-MISC** - [Form 1099-MISC](#) is most commonly used by payers to report payments made in the course of a trade or business to others for services. If you paid someone who is not your employee, such as a subcontractor, attorney or accountant \$600 or more for services provided during the year, a [Form 1099-MISC](#) needs to be completed, and a copy of [1099-](#)

[MISC](#) must be provided to the independent contractor by January 31 of the year following payment. You must also send a copy of this form to the IRS by February 28 (although the form does not have to be sent to the IRS until March 31 if the business files the 1099s electronically, using the [FIRE system](#)).

Also note that independent contractors may have their own employees or may hire other independent contractors (subcontractors). In either case, they should be aware of their tax responsibilities, including filing and reporting requirements, for these workers.

There are certain situations where a 1099 is not required. These exceptions are listed in the [1099 Instructions](#).

- **Forms and associated taxes for employees:**
 - a. **Federal Income Tax and Social Security and Medicare Taxes** - You generally must withhold federal income tax from your employees' wages. You withhold part of Social Security and Medicare taxes from your employees' wages and you pay a matching amount yourself. To figure how much to withhold from each wage payment, use the employee's Form W-4 and the methods described in [Publication 15, Employer's Tax Guide](#) and [Publication 15-A, Employer's Supplemental Tax Guide](#).
 - b. **Federal Unemployment (FUTA) Tax** - You report and pay FUTA tax separately from Federal Income tax, and Social Security and Medicare taxes. You pay FUTA tax only from your own funds. **Employees do not pay this tax or have it withheld from their pay.** Refer to [Publication 15, Employer's Tax](#)

- [Guide](#) and [Publication 15-A, Employer's Supplemental Tax Guide](#) for more information on FUTA tax.
- c. **Reporting Employment Taxes** - In general, employers are responsible to report federal Income Taxes, Social Security, and Medicare taxes on [Form 941, Employer's Quarterly Federal Tax Return](#) and [Instructions](#), or [Form 943, Employer's Annual Federal Tax Return for Agriculture Employees](#) and [Instructions](#) (For use by farm employers).
 - d. **Employers who have an employment tax liability of \$1,000 or less** – Generally employers who have an employment tax liability of \$1,000 or less for the year may file [Form 944, Employer's Annual Federal Tax Return](#) and [Instructions](#), instead of Form 941, Employer's Quarterly Federal Tax Return. Eligible taxpayers will be notified by mail.
 - e. **Report FUTA taxes** - on [Form 940, Employer's Annual Federal Unemployment \(FUTA\) Tax Return](#) and [Instructions](#).
 - f. **Preparing and Filing Form W-2** - At the end of the year, the employer must complete [Form W-2, Wage and Tax Statement](#) to report wages, tips and other compensation paid to an employee. A copy of this form must be given to the employee by January 31st after the end of the year. You must also send a copy of the W-2 to the Social Security Administration (SSA). Employers can prepare and file up to 20 W-2s at a time at the Social Security Administration's Web site. Using [SSA's online W-2 filing](#), employers can also print out all the necessary copies of the W-2 for their employees, state taxing agencies, etc.

Consequences of Treating an Employee as an Independent Contractor

If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker (the relief provisions, discussed below, will not apply). See Internal Revenue Code section 3509 for more information.

Relief Provisions

If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all required federal information returns on a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977. See Publication 1976, Section 530 Employment Tax Relief Requirements for more information.

Misclassified Workers Can File Social Security Tax Form

Workers who believe they have been improperly classified as independent contractors by an employer can use Form 8919, Uncollected Social Security and Medicare Tax on Wages to figure and report the employee's share of uncollected Social Security and Medicare taxes due on their compensation. See the full article [Misclassified Workers to File New Social Security Tax Form](#) for more information.