IRS Common Law Rules - Independent Contractor or Employee?

The IRS uses the 20 factors to determine if a worker is an employee or an independent contractor. However, it is their interpretation (although it could be challenged). Not all factors apply in each case or carry the same weight.

The key factor which determines whether a worker is an independent contractor is who has the right to control the worker as to how work is accomplished?

According to the IRS, workers are employees if they must comply with the employer's instructions about their work, receive training or direction from the employer, provide services that integrate into the employer's business, render their services personally (can't subcontract), have a continuing working relationship with the employer, must follow set hours of work, work full-time for the employer, perform the work at the employer's site, regularly report to the employer, are paid regularly (e.g. weekly), are paid for business expenses, use the employer's tools, materials, etc. lack a major investment in facilities used to perform services, cannot make a profit or suffer a loss from their services, work for one employer at a time, do not offer services to the public, can be fired, may quit work at any time and not incur a liability. Thus, to qualify as an independent contractor, the opposite of all of these would be true. But remember, the IRS selects the questions and grades the answers.

The following are a list of 20 questions the IRS uses to determine if a worker is an independent contractor or employee. The answer of yes to any one of the questions (except #16) may mean the worker is an employee.

1. **Is the worker required to comply with instructions about when, where and how the work is done?** Independent contractors are not required to follow, nor are they furnished with, instructions to accomplish a job.

2. **Is the worker provided training that would enable him/her to perform a job in a particular method or manner?** Independent contractors typically do not receive training by the hiring firm. They use their own methods to accomplish the work.

3. **Are the services provided by the worker an integral part of the business' operations?** Independent contractor's work not essential. A company's success or continuation should not depend on the service of outside independent contractors. An example violating this would be a law firm which called their lawyers independent contractors.

4. **Must the services be rendered personally?** Others can be hired. Independent contractors are hired to provide a result and usually have the right to hire others to do the actual work.

5. **Does the business hire, supervise, or pay assistants to help the worker on the job?** Independent contractors control their own workers. Independent contractors shouldn't hire, supervise, or pay assistants at the direction of the hiring company. If assistants are hired, it should be at the independent contractor's sole discretion.
6. Is there a continuing relationship between the worker and the person for whom the services are performed? Usually independent contractors don't have a continuing relationship with a hiring company. The relationship can be frequent, but it must be at irregular intervals, on call, or whenever work is available.

7. Does the recipient of the services set the work schedule? No time clock. Independent contractors set their own work hours

8. Is the worker required to devote his/her full time to the person he/she performs services for? Independent contractors should have enough time available to pursue other gainful work.

9. Is the work performed at the place of business of the company or at specific places set by the company? Independent contractors control where they work. If they work on the premises of the hiring company, it is not under that company's direction or supervision.

10. Does the recipient of the services direct the sequence in which the work must be done? Independent contractors determine the order and sequence in which they will perform their work.

11. Are regular oral or written reports required to be submitted by the worker? Independent contractors are hired for the final result only. They should not be asked for progress or interim reports.

12. Is the method of payment hourly, weekly, monthly (as opposed to commission or by the job?) Independent contractors are paid by the job, not by time. Payment by the job can include periodic payments based on a percentage of job completed. Payment can be based on the number of hours needed to do the job times a fixed hourly rate. Payment method should be determined before the job commences.

13. Are business and/or traveling expenses reimbursed? Independent contractors are generally responsible for their own business expenses.

14. Does the company furnish tools and materials used by the worker? Independent contractors usually furnish their own tools. Some hiring firms have leased equipment to their independent contractors so that they could show the independent contractor had their own tools and an investment in their business. This strategy won't work if the lease is for a nominal amount or can be voided by the hiring firm at will. The lease must be equivalent to what an independent business person could have obtained in the open market.

15. Has the worker failed to invest in equipment or facilities used to provide the services? Independent contractors should be able to perform their services without the hiring company's facilities (equipment, office furniture, machinery, etc.). The independent contractor's investment in his trade must be real, essential, and adequate.
16. Does the arrangement put the person in a position or realizing either a profit or loss on the work? Independent contractors should be able to make a profit or a loss. Employees can’t suffer a loss. Five circumstances show that a profit or loss is possible:

- the independent contractor hires, directs, and pays assistants;
- the independent contractor has his own office, equipment, materials, or facilities;
- the independent contractor has continuing and recurring liabilities;
- the independent contractor has agreed to perform specific jobs for prices agreed upon in advance; and
- the independent contractor’s services affect his own business reputation.

17. Does the worker perform services exclusively for the company rather than working for a number of companies at the same time? Independent contractors often work for more than one firm at a time.

18. Does the worker in fact make his/her services regularly available to the general public? Independent contractors make their services available to the general public by one or more of the following:

- having an office and assistants;
- having business signs;
- having a business license;
- listing their services in a business directory; or
- advertising their services.

19. Is the worker subject to dismissal for reasons other than non-performance of the contract specifications? Independent contractors can’t be fired so long as they produce a result which meets the contract specifications.

20. Can the worker terminate his/her relationship without incurring a liability for failure to complete the job? No compensation if the job isn’t done. Independent contractors are responsible for the satisfactory completion of a job or they may be legally obligated to compensate the hiring firm for failure to complete.

If a worker clearly is an independent contractor, a complete agreement to that effect is useful and recommended; however, any agreement, no matter how well drafted and explained to each party and signed, will not change the results if a person is held to be an employee under the facts and circumstances.

The laws surrounding the employee versus independent contractor issues are extremely complex and you should consult with a tax attorney on these issues.