

### Topic 762 - Independent Contractor vs. Employee

For federal tax purposes the usual common law rules are applicable to determine whether a worker is an independent contractor or an employee. Under the common law, you must examine the relationship between the worker and the business. All evidence of the degree of control and independence in this relationship should be considered. The facts that provide this evidence fall into three categories – Behavioral Control, Financial Control, and the Type of Relationship of the parties.

*Behavioral Control* covers facts that show whether the business has a right to direct and control what work is accomplished and 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. This includes:

- The extent to which the worker has unreimbursed business expenses
- The extent of the worker's investment in the facilities or tools used in performing services
- The extent to which the worker makes his or her services available to the relevant market
- How the business pays the worker, and
- The extent to which the worker can realize a profit or incur a loss

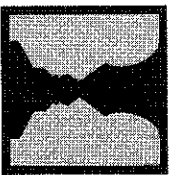
*Type of Relationship* covers facts that show the type of relationship the parties had. This includes:

- Written contracts describing the relationship the parties intended to create
- Whether 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, and
- The extent to which services performed by the worker are a key aspect of the regular business of the company

For more information, refer to [Publication 15-A \(PDF\)](#), *Employer's Supplemental Tax Guide*, or [Publication 1779 \(PDF\)](#), *Independent Contractor or Employee*. If you want the IRS to determine whether a specific individual is an independent contractor or an employee, file [Form SS-8 \(PDF\)](#) *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*.

[More Tax Topic Categories](#)

Page Last Reviewed or Updated: December 22, 2011



# INDEPENDENT CONTRACTOR OR EMPLOYEE

## Which are you?

*For federal tax purposes, this is an important distinction. Worker classification affects how you pay your federal income tax, social security and Medicare taxes, and how you file your tax return. Classification affects your eligibility for employer and social security and Medicare benefits and your tax responsibilities. If you aren't sure of your work status, you should find out now. This brochure can help you.*

The courts have considered many facts in deciding whether a worker is an **independent contractor** or an **employee**. These relevant facts fall into three main categories: *behavioral control*, *financial control*, and *relationship of the parties*. In each case, it is very important to consider all the facts — no single fact provides the answer. Carefully review the following definitions.

### BEHAVIORAL CONTROL

These facts 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. For example:

- **Instructions** — if you receive extensive instructions on how work is to be done, this suggests that you are an employee. Instructions can cover a wide range of topics, for example:
  - how, when, or where to do the work
  - what tools or equipment to use

- what assistants to hire to help with the work
- where to purchase supplies and services

If you receive less extensive instructions about what should be done, but not how it should be done, you may be an **independent contractor**. For instance, instructions about time and place may be less important than directions on how the work is performed.

- **Training** — if the business provides you with training about required procedures and methods, this indicates that the business wants the work done in a certain way, and this suggests that you may be an **employee**.

### FINANCIAL CONTROL

These facts show whether there is a right to direct or control the business part of the work. For example:

- **Significant Investment** — if you have a significant investment in your work, you may be an **independent contractor**. While there is no precise dollar test, the investment must have substance. However, a significant investment is not necessary to be an **independent contractor**.
- **Expenses** — if you are not reimbursed for some or all business expenses, then you may be an **independent contractor**, especially if your unreimbursed business expenses are high.
- **Opportunity for Profit or Loss** — if you can realize a profit or incur a loss, this suggests that you are in business for yourself and that you may be an **independent contractor**.

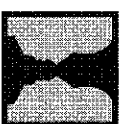
### RELATIONSHIP OF THE PARTIES

These are facts that illustrate how the business and the worker perceive their relationship. For example:

- **Employee Benefits** — if you receive benefits, such as insurance, pension, or paid

leave, this is an indication that you may be an **employee**. If you do not receive benefits, however, you could be either an **employee** or an **independent contractor**.

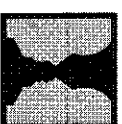
- **Written Contracts** — a written contract may show what both you and the business intend. This may be very significant if it is difficult, if not impossible, to determine status based on other facts.



## When You Are an Employee

- Your employer must withhold income tax and your portion of social security and Medicare taxes. Also, your employer is responsible for paying social security, Medicare, and unemployment (FUTA) taxes on your wages. Your employer must give you a Form W-2, *Wage and Tax Statement*, showing the amount of taxes withheld from your pay.

- You may deduct unreimbursed employee business expenses on Schedule A of your income tax return, but only if you itemize deductions and they total more than two percent of your adjusted gross income.



## When You Are an Independent Contractor

- The business may be required to give you Form 1099-MISC, *Miscellaneous Income*, to report what it has paid to you.

- You are responsible for paying your own income tax and self-employment tax (Self-Employment Contributions Act — SECA). The business does not withhold taxes from your pay. You may need to make estimated tax payments during the year to cover your tax liabilities.

- You may deduct business expenses on Schedule C of your income tax return.



## Independent Contractor (Self-Employed) or Employee?

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It is critical that business owners 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.

### Select the Scenario that Applies to You:

- **I am an independent contractor or in business for myself**  
If you are a business owner or contractor who provides services to other businesses, then you are generally considered self-employed. For more information on your tax obligations if you are self-employed (an independent contractor), see our [Self-Employed Tax Center](#).
- **I hire or contract with individuals to provide services to my business**  
If you are a business owner hiring or contracting with other individuals to provide services, you must determine whether the individuals providing services are employees or independent contractors. Follow the rest of this page to find out more about this topic and what your responsibilities are.

### Determining Whether the Individuals Providing Services are Employees or Independent Contractors

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](#) (PDF) can be filed with the IRS. 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](#) (PDF).

## 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](#)
- [Forms and associated taxes for employees](#)

## Misclassification of Employees

### 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](#) (PDF) 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.

### Voluntary Classification Settlement Program

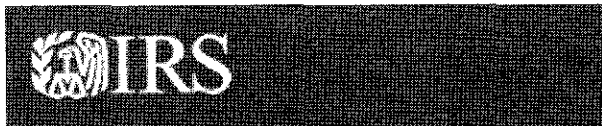
The [Voluntary Classification Settlement Program \(VCSP\)](#) is a new optional program that provides taxpayers with an opportunity to reclassify their workers as employees for future tax periods for employment tax purposes with partial relief from federal employment taxes for eligible taxpayers that agree to prospectively treat their workers (or a class or group of workers) as employees. To participate in this new voluntary program, the taxpayer must meet certain eligibility requirements, apply to participate in the VCSP by filing Form 8952, Application for Voluntary Classification Settlement Program, and enter into a closing agreement with the IRS.

### References/Related Topics

- [Proper Worker Classification Audio](#)
- [Virtual Small Business Tax Workshop - Lesson 6](#)  
The Virtual Small Business Tax Workshop is composed of nine interactive lessons designed to help new small business owners learn their tax rights and responsibilities. See Lesson 6 for information on how to identify an employee versus an independent contractor.
- [IRS Internal Training: Employee/Independent Contractor](#) (PDF)  
This manual provides you with the tools to make correct determinations of worker classifications. It discusses facts that may indicate the existence of an independent contractor or an employer-employee relationship. This training manual is a guide and is not legally binding.
- [Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding](#) (PDF)
- [Publication 15-A, The Employer's Supplemental Tax Guide](#) (PDF) has detailed guidance including information for specific industries.
- [Publication 15-B, The Employer's Tax Guide to Fringe Benefits](#) supplements Circular E (Pub. 15), Employer's Tax Guide, and Publication 15-A, Employer's Supplemental Tax Guide. It contains specialized and detailed information on the employment tax treatment of fringe benefits.
- [Businesses with Employees](#)
- [Hiring Employees](#)
- [Know Who You're Hiring - Independent Contractor \(Self-employed\) vs. Employee](#)

**Note:** This page contains one or more references to the Internal Revenue Code (IRC), Treasury Regulations, court cases, or other official tax guidance. References to these legal authorities are included for the convenience of those who would like to read the technical reference material. To access the applicable IRC sections, Treasury Regulations, or other official tax guidance, visit the [Tax Code, Regulations, and Official Guidance](#) page. To access any Tax Court case opinions issued after September 24, 1995, visit the [Opinions Search](#) page of the United States Tax Court.

Page Last Reviewed or Updated: December 02, 2011



### Employee (Common-Law Employee)

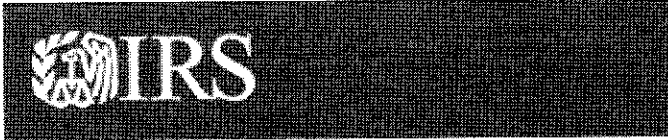
Under common-law rules, anyone who performs services for you is your employee ***if you can control what will be done and how it will be done***. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.

**Example:** Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works 6 days a week, and is on duty in Bob's showroom on certain assigned days and times. She appraises trade-ins, but her appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. She has to develop leads and report results to the sales manager. Because of her experience, she requires only minimal assistance in closing and financing sales and in other phases of her work. She is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group-term life insurance for Donna. Donna is an **employee** of Bob Blue.

### References/Related Topics

- [Independent Contractor \(Self-Employed\) or Employee?](#)

*Page Last Reviewed or Updated: January 06, 2011*



## Statutory Employees

If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute (statutory employees) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under **Social Security and Medicare taxes**, below.

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
- A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for you must be the salesperson's principal business activity.

Refer to the **Salesperson** section located in [Publication 15-A, Employer's Supplemental Tax Guide \(PDF\)](#) for additional information.

## Social Security and Medicare Taxes

Withhold Social Security and Medicare taxes from the wages of statutory employees if all three of the following conditions apply.

- The service contract states or implies that substantially all the services are to be performed personally by them.
- They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
- The services are performed on a continuing basis for the same payer.

## References/Related Topics

- [Independent Contractor \(Self-Employed\) or Employee?](#)

*Page Last Reviewed or Updated: January 06, 2011*



## Statutory Nonemployees

There are generally two categories of statutory nonemployees: direct sellers and licensed real estate agents. They are treated as self-employed for all Federal tax purposes, including income and employment taxes, if:

- Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked, and
- Their services are performed under a written contract providing that they will not be treated as employees for Federal tax purposes.

Refer to information on **Direct Sellers** located in [Publication 15-A, Employer's Supplemental Tax Guide \(PDF\)](#) for additional information.

## References/Related Topics

- [Independent Contractor \(Self-Employed\) or Employee?](#)

*Page Last Reviewed or Updated: January 06, 2011*



## 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.

### References/Related topics

- [Independent Contractor \(Self-Employed\) or Employee?](#)

*Page Last Reviewed or Updated: January 06, 2011*





## 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. However, it is common in some professions, such as law, to pay independent contractors hourly.

### References/Related Topics

- [Independent Contractor \(Self-Employed\) or Employee?](#)

*Page Last Reviewed or Updated: January 06, 2011*



## 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.

### References/Related Topics

- [Independent Contractor \(Self-Employed\) or Employee?](#)

*Page Last Reviewed or Updated: January 06, 2011*