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Independent Contractor vs. Employee: Walking a Fine Line

BY [BOB NIEMAN](#) | May 13, 2009

Is that attendant who handles your coin laundry's wash-dry-fold service an employee? Or is she an independent contractor?

What about the guy who comes in to clean up your store at the end of the day? Employee? Or independent contractor?

It's a fact that there are tangible benefits – as well as pitfalls – for self-service laundry owners who take advantage of the services of independent contractors during the normal course of operating their businesses. The benefits include lower operating expenses, fewer taxes to pay and reduced responsibility for worker performance.

However, the pitfalls include the fact that Internal Revenue Service must recognize the workers status as independent contractors, and not classify them as employees. The latter decision could entail substantial additional expense for the store owner.

Clearly, one of the thorniest issues employers handle is accurately making the distinction between independent contractors and employees. While the difference may be clear in your own mind, the IRS applies complex criteria to the question, so you should be certain that your independent contractors meet the IRS's test before treating them as contractors. Above all, seek outside legal advice when making the initial decision and throughout the employment/contractor relationship when circumstances change.

What's the Difference?

There is often a thin line between who is as an employee and who is an independent contractor. This distinction can be significant for employers because companies are normally required to provide employees' federal and local withholding taxes, withhold and pay Social Security and Medicare taxes, provide all tax documentation and pay workers' compensation. Companies are exempt from providing these for workers determined to be independent contractors. When a company is determined to have not provided withholding and documentation for workers that the IRS deems to be employees, penalties can be charged.

How Do You Know?

The distinction between employee and independent contractor usually is determined by the amount of control the company has over the way in which the individual works and by the support given to an individual.

For instance, when a person works at the company's facility, is supplied with required equipment, is not required to pay for the facility's phone and utility bills, and has specific, required hours of work, the person would normally be considered an employee.

When a person works outside the company's facility, pays for and uses his or her own equipment, pays his or her own insurance, phone and utility bills and is not required to work specific hours (even though deadlines for

completion of work may exist), the person would normally be considered an independent contractor.

The determinations that make this person an employee are the length of employment, the way in which the person is supervised (whether supervisors and peers are all salaried employees of the company, for example) and the degree to which the company determines the person's work schedule.

Also significant in a determination would be whether the individual can turn down work offered by the company (if no, the person is likely an employee), whether the company provides training that is required (if yes, the person is likely an employee), and whether the individual is performing the same type of work for other companies while working at a location outside the company's facility (if yes, the person is likely an independent contractor). Also of key importance is whether the worker contracts out to more than one company at a time.

Many independent contractors work for a number of companies simultaneously, bill each company for hours or work completed and pay their own insurance, utilities and other working costs. Most independent contractors file either a Schedule C for their 1040 Form when paying federal taxes (Profit or Loss From Business – Sole Proprietorship) or a Form 1065 (Return of Partnership Income) if they are in a partnership.

Any worker who is directly involved in the profit and loss of a company, whether working from home or at the company's facility, would be deemed to be an employee of the company.

20 Factors to Settle the Debate

In Revenue Ruling 87-41, 1987-1 CB 296, the IRS has developed 20 factors used to determine whether a worker is an independent contractor under the common law. They are:

1. Is the worker subject to the employer's instructions?

A worker who is required to comply with the employer's instructions as to when, where and how work is to be done is most likely an employee. It is only required that an employer have the right to control the worker, whether or not the control is implemented is irrelevant.

2. Does the employer provide training?

Any form of employer-provided training suggests an employee-employer relationship since training implies that the work needs to be performed in a particular manner. The IRS defines training in very broad terms.

3. What is the degree of integration of the services into the business?

If the success of the services performed by the individual is crucial to the success of the business as a whole, control over the services is presumed to exist. The greater the degree of integration of the work into the business, the greater the likelihood that an employer-employee relationship exists.

4. Are the services rendered personally by the worker?

Services required to be performed in person by the worker tend to indicate control, especially when the employer has an interest in how the results are achieved.

5. Who is responsible for hiring, supervising and paying assistants?

Hiring, directing, or paying assistants, when done by the employer, shows an employee-employer arrangement. Independent contractors hire, direct and pay their own people.

6. Does a continuing relationship exist?

Continuing work by the individual, even if not regular, points toward an employer-employee relationship.

7. Does the employer set hours of work?

Designating hours of work demonstrates control over the worker.

8. Is full-time work required?

Utilizing a worker on a full-time basis precludes the worker from pursuing other work and is an indication of control.

9. Is the person doing work on the employer's premises?

Performing work away from the employer's offices reduces the thread of control. While some independent contractors do work on the employer's premises, this tends to indicate greater control by the employer.

10. Is the work order or sequences set by the employer?

Following routines or work patterns established by the employer is indicative of employee status.

11. Are oral or written reports required?

The requiring of regular progress reports demonstrates control.

12. Is payment by the hour, week or month?

Payment on a fixed periodic basis, rather than upon completion of the work, is an indicator of employee status.

13. Does the employer make payment of business and/or traveling expenses?

The payment of these expenses by the employer points to regulation of business activities and thus indicates employee status.

14. Is the employer responsible for the furnishing of tools and materials?

Independent contractors normally provide their own tools and materials.

15. Is the worker required to make a significant investment to perform the work?

The making of a substantial investment by the worker, e.g. rental of a facility, tends to support the existence of independence.

16. Does performance result in realization of profit or loss?

The ability to realize either a profit or a loss in performing the work is a characteristic of an independent contractor.

17. Is the individual working for more than one firm at a time?

The performance of services for several customers simultaneously is typical of an independent contractor.

18. Is the individual engaged in making service available to the general public?

Marketing one's services to the general public indicates independence.

19. Does the employer have a unilateral right to discharge the worker?

The right to discharge at will indicates an employer-employee relationship. Independent contractors typically can only be discharged for failure to meet contract requirements.

20. Does the worker have a unilateral right to terminate his services?

An employee may resign at will, but an independent contractor may be contractually obligated to perform.

"A general rule is that you, the payer, have the right to control or direct only the result of the work done by an independent contractor, and not the means and methods of accomplishing the result," states the IRS Web site. "A general rule is that anyone who performs services for you is your employee if you can control what will be done and how it will be done."

The site provides numerous examples to clarify the distinctions between employee status and independent contractor status.

"To determine whether an individual is an employee or independent contractor under the common law, the relationship of the worker and the business must be examined. All evidence of control and independence must be considered. In an employee-independent contractor determination, all information that provides evidence of the degree of control and degree of independence must be considered."

Obviously, designating your store's workers as independent contractors rather than as employees could save you money. However, be sure that you know the facts before diving into such an arrangement.

This article is intended to call attention to the need for maintaining clear distinction in relationships between employers, employees and independent contractors who provide materials and services. It is not intended as an authoritative source, and laundry owners concerned with their professional relationships should consult with their accountants, tax advisors and attorneys.

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