



## White Papers: IRS 20-Factor Test for Independent Contractors

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### IRS 20 Factor Test – Independent Contractor or Employee?

The IRS test often is termed the “right-to-control test” because each factor is designed to evaluate who controls how work is performed. Under IRS rules and common-law doctrine, independent contractors control the manner and means by which contracted services, products, or results are achieved. The more control a company exercises over how, when, where, and by whom work is performed, the more likely the workers are employees, not independent contractors.

A worker does not have to meet all 20 criteria to qualify as an employee or independent contractor, and no single factor is decisive in determining a worker's status. The individual circumstances of each case determine the weight IRS assigns different factors.

NOTE: Employers uncertain about how to classify a worker can request an IRS determination by filing Form SS-8, “Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding.” However, some tax specialists caution that IRS usually classifies workers as employees whenever their status is not clear-cut. In addition, employers that request an IRS determination lose certain protections against liability for misclassification.

The 20 factors used to evaluate right to control and the validity of independent contractor classifications include:

- **Level of instruction.** If the company directs when, where, and how work is done, this control indicates a possible employment relationship.
- **Amount of training.** Requesting workers to undergo company-provided training suggests an employment relationship since the company is directing the methods by which work is accomplished.
- **Degree of business integration.** Workers whose services are integrated into business operations or significantly affect business success are likely to be considered employees.
- **Extent of personal services.** Companies that insist on a particular person performing the work assert a degree of control that suggests an employment relationship. In contrast, independent contractors typically are free to assign work to anyone.

- **Control of assistants.** If a company hires, supervises, and pays a worker's assistants, this control indicates a possible employment relationship. If the worker retains control over hiring, supervising, and paying helpers, this arrangement suggests an independent contractor relationship.
- **Continuity of relationship.** A continuous relationship between a company and a worker indicates a possible employment relationship. However, an independent contractor arrangement can involve an ongoing relationship for multiple, sequential projects.
- **Flexibility of schedule.** People whose hours or days of work are dictated by a company are apt to qualify as its employees.
- **Demands for full-time work.** Full-time work gives a company control over most of a person's time, which supports a finding of an employment relationship.
- **Need for on-site services.** Requiring someone to work on company premises—particularly if the work can be performed elsewhere—indicates a possible employment relationship.
- **Sequence of work.** If a company requires work to be performed in specific order or sequence, this control suggests an employment relationship.
- **Requirements for reports.** If a worker regularly must provide written or oral reports on the status of a project, this arrangement indicates a possible employment relationship.
- **Method of payment.** Hourly, weekly, or monthly pay schedules are characteristic of employment relationships, unless the payments simply are a convenient way of distributing a lump-sum fee. Payment on commission or project completion is more characteristic of independent contractor relationships.
- **Payment of business or travel expenses.** Independent contractors typically bear the cost of travel or business expenses, and most contractors set their fees high enough to cover these costs. Direct reimbursement of travel and other business costs by a company suggests an employment relationship.
- **Provision of tools and materials.** Workers who perform most of their work using company-provided equipment, tools, and materials are more likely to be considered employees. Work largely done using independently obtained supplies or tools supports an independent contractor finding.
- **Investment in facilities.** Independent contractors typically invest in and maintain their own work facilities. In contrast, most employees rely on their employer to provide work facilities.

- **Realization of profit or loss.** Workers who receive predetermined earnings and have little chance to realize significant profit or loss through their work generally are employees.
- **Work for multiple companies.** People who simultaneously provide services for several unrelated companies are likely to qualify as independent contractors.
- **Availability to public.** If a worker regularly makes services available to the general public, this supports an independent contractor determination.
- **Control over discharge.** A company's unilateral right to discharge a worker suggests an employment relationship. In contrast, a company's ability to terminate independent contractor relationships generally depends on contract terms.
- **Right of termination.** Most employees unilaterally can terminate their work for a company without liability. Independent contractors cannot terminate services without liability, except as allowed under their contracts.

### **Are Independent Contractors Employees?**

Because FLSA applies only to employer-employee relationships, independent contractors are not covered. Court decisions interpreting FLSA coverage rules require that employers use an economic reality test in determining whether an employment relationship exists with respect to a given worker.

Similar to the common law test, the economic reality test focuses on the degree of control exercised by the employer as an essential factor in determining whether an employer-employee relationship exists. While no single factor is controlling or decisive in determining whether an employment relationship exists, the facts and circumstances that courts and federal enforcement officials examine in deciding whether an individual is an employee or an independent contractor are:

- the degree to which the employer controls or directs the manner in which work is performed,
- whether the worker's opportunity for profit or loss depends on his or her managerial skills,
- whether the worker's duties are performed for the employer on an ongoing or permanent basis,
- whether the service performed by the worker is an integral part of the employer's business,
- the extent of the worker's investment in equipment or materials needed to perform the

job, and

- the degree to which the worker is engaged primarily for the benefit of the employer.

The IRS considers a worker to be your employee if you have the right to control not only what work will be done, but also how the worker will do it. If you treat a worker as an independent contractor, but the IRS decides you have sufficient control over the worker to create an employment relationship, the IRS can hit you with a costly bill for the employment taxes you should have been withholding and paying.

When deciding whether you can safely treat a worker as an independent contractor, there are two separate tests you should consider:

*The common law test; and  
The reasonable basis test.*

The common law test: IRS examiners use the 20-factor common law test to measure how much control you have over the worker. These factors are reflected on IRS Form SS-8, (this form can be downloaded at [www.irs.gov](http://www.irs.gov))“Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding.”

You can fill out the SS-8, including the facts of your relationship with the worker, and submit it to the IRS to get a determination of whether the worker is your employee or not. However, many companies simply use the SS-8 as a self-audit to avoid a misclassification trap; they don't actually submit the form to the IRS.

Of course, many workers — the IRS estimates as many as 85% of all Form SS-8 filers — submit the form to the IRS because they want to contest their treatment as independent contractors.

But the issue of who has the right to control is often not clear-cut, and the Tax Code doesn't define “employee.” So, the IRS developed the “20-Factor Test” to arrive at an answer. The IRS later refined this test—it added four new, critical factors and added more weight to some and de-emphasized others in the original 20. You don't need to have all the factors in your favor to be able to treat a worker as an independent, but you are more likely to pass the common law test if the more important factors point to independence.

According to the manual the IRS uses to train its worker classification auditors, the three most important factors are:

**Instructions to workers:** Your worker is probably an employee if you require him or her to follow instructions on when, where, and how work is to be done. This is a very important factor. However, if you tell your electrician you want blue switch plate covers instead of white, you are not exercising control to a degree that would make the person an employee.

**Job training:** If your company provides or arranges for training of any kind for the worker, this is a sign you expect work to be performed in a certain way; therefore, the worker is your employee. Training can be as informal as requiring the worker to attend meetings or work along with someone who's more experienced.

**Worker's ability to make a profit or suffer a loss:** An employee may be rewarded, disciplined, demoted, or fired depending on job performance, but only an independent contractor can realize a profit or incur a financial loss from his or her work. In other words, an employee will always get paid; an independent contractor, however, has a financial stake in his enterprise.

IRS also gives high priority to the following factors:

**W-2 or 1099:** You report payments to independents (if they total \$600 or more in a calendar year) on Form 1099-MISC. Reporting on a Form W-2 indicates that both your company and the worker consider the worker to be your employee.

**Intent of your company and of the worker:** To build a solid case, you and the worker should sign a written agreement stating the worker is an independent contractor who will be paid by the job or project, provide his or her own tools, etc.

**Pay basis:** If you pay a worker on an hourly, weekly, or monthly basis, the IRS will consider it a sign the worker is your employee. An independent is generally paid by the job, project, assignment, etc., or receives a commission or similar fee.

**Benefits:** Providing benefits other than pay are a strong indicator of employee status. Incorporated status: Workers who are incorporated are generally considered to be working for themselves, not as your employee.

**Importance of the worker's services:** If a worker provides services that are integral to the success of your business, the worker is likely your employee.

**Personal performance of services:** An independent contractor should have the freedom to hire assistants or subcontract work to other workers or firms at his or her expense (this is where profit or loss could enter the picture). If you require the worker to perform the work personally, that's a sign of control and therefore indicative of employee status.

**Providing assistants:** There's likely an employer-employee relationship if your company hires, supervises, and pays assistants for the worker.

**Ongoing relationship:** The worker doesn't have to work for you continuously to be considered an employee; it may be enough if the worker gets assignments at frequently recurring, even if irregular, intervals.

**Setting the order or the sequence of the work:** If you determine what gets done when,

it indicates you control how the work is performed. Allow an independent to decide his or her schedule, both day-to-day and for the longer term.

**The reasonable basis test:** While the common law test looks at the nature of the working relationship, the reasonable basis test is based on how the courts and the IRS have classified similar workers in your company or your industry in the past.

The reasonable basis test is considered a “safe harbor.” That is, if you can show you had a reasonable basis for treating a worker as an independent contractor, the IRS is prohibited from reclassifying the worker as your employee either prospectively or retroactively. You have a reasonable basis for treating a worker as an independent if one or more of the following conditions exist:

A court ruling in favor of treating workers in similar circumstances as non-employees;  
A ruling by the IRS (usually a Revenue Ruling) stating that similar workers are not employees subject to employment taxes;

An IRS Technical Advice Memorandum or Private Letter Ruling issued to your company, indicating that the particular worker isn't an employee;

A past IRS payroll audit that didn't find workers in similar positions at your company to be employees; or

A longstanding, widely recognized practice in your industry of treating similar workers as independent contractors.

NOTE: The Treasury Inspector General for Tax Administration has recommended that IRS pursue legislative proposals that would mandate withholding of income taxes on payments made to independent contractors and require monthly estimated tax payments. TIGTA made these recommendations in order to curtail estimated tax payment noncompliance.

The following information was taken from the IRS website in 2006

### **Employee or Independent Contractor?**

Whether someone who works for you is an employee or an independent contractor is an important question. The answer determines your liability to pay and withhold Federal income tax, social security and Medicare taxes, and Federal unemployment tax.

In general, someone who performs services for you is your employee if you can control what will be done and how it will be done.

The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. These facts fall into three main categories:

- **Behavioral Control** – Facts that show whether the business has a right to direct

and control. These include:

- o Instructions - an employee is generally told:

1. when, where, and how to work
2. what tools or equipment to use
3. what workers to hire or to assist with the work
4. where to purchase supplies and services
5. what work must be performed by a specified individual
6. what order or sequence to follow

- o Training – an employee may be trained to perform services in a particular manner.

- **Financial Control** – Facts that show whether the business has a right to control the business aspects of the worker’s job include:

- o The extent to which the worker has unreimbursed expenses
- o The extent of the worker’s investment
- o The extent to which the worker makes services available to the relevant market
- o How the business pays the worker
- o The extent to which the worker can realize a profit or loss

- **Type of Relationship** – Facts that show the type of relationship include:

- o Written contracts describing the relationship the parties intended to create
- o Whether the worker is provided with employee-type benefits
- o The permanency of the relationship
- o How integral the services are to the principal activity

\* See next page for an example of an Independent Contractor Agreement. The Agreement is provided as an example document, A-Plus Benefits, Inc. does not endorse the document nor act as legal counsel for its' clients.

**Example: Independent Contractor Agreement**

AGREEMENT BETWEEN "Name of Organization" (hereinafter "Company") located at [address] and [name of contractor], an Independent Contractor ("Independent Contractor"). The Independent Contractor shall be identified as follows:

Name: Name contractor (hereinafter "Independent Contractor")

Type of Entity:

- Individual
- Sole proprietorship
- Partnership
- Corporation

Address: \_\_\_\_\_

City/State/ZIP: \_\_\_\_\_

Business Telephone: \_\_\_\_\_

Social Security or Employer Identification Number: \_\_\_\_\_

IN CONSIDERATION of the promises and mutual covenants and agreements contained herein, the parties agree as follows:

**Work to Be Performed**

Company desires that the Independent Contractor perform, and the Independent Contractor agrees to perform, the following work:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Term of Agreement**

The services called for under this Agreement shall commence on [date] and terminate on [date].

**Technical Direction**

The Independent Contractor shall receive technical direction only from [name] or his or her designee, as authorized in writing.



## **Terms of Payment**

Company shall pay the Independent Contractor according to the following terms and conditions:

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## **Reimbursement of Expenses**

Company shall not be liable to the Independent Contractor for any expenses paid or incurred by the Independent Contractor unless otherwise agreed to in writing.

## **Federal, State, and Local Payroll Taxes**

Company shall not withhold or pay federal, state, or local income taxes or payroll taxes of any kind on behalf of the Independent Contractor or the employees of the Independent Contractor. Company shall not treat the Independent Contractor as an employee with respect to the services performed hereunder for federal, state, or local tax purposes.

## **Notice to Independent Contractor About Its Tax Duties and Liabilities**

The Independent Contractor understands that he or she is responsible to pay, according to law, the Independent Contractor's federal and state income taxes, and that Company is not withholding or paying any portion of Independent Contractor's taxes. If the Independent Contractor is not a corporation, the Independent Contractor further understands that the Independent Contractor may be liable for self-employment (Social Security) tax, to be paid by the Independent Contractor according to law.

## **Responsibility for Workers' Compensation**

No workers' compensation insurance shall be obtained by Company covering the Independent Contractor or employees of the Independent Contractor. The Independent Contractor shall comply with the workers' compensation law concerning the Independent Contractor and the employees of the Independent Contractor.

## **Termination of Agreement**

This Agreement may be terminated at any time by Company or the Independent Contractor, by written notice to the other party. Notice shall be deemed to have been sufficiently given either when served personally or when sent by first-class mail addressed to the parties at the addresses set forth in this Agreement. Company shall not

be liable for, nor shall the Independent Contractor be liable to perform, any services or expenses incurred after the receipt of notice of termination

### **Independent Contractor Status**

The Independent Contractor expressly represents and warrants to Company that (1) he or she is not and shall not be construed to be an employee of the company and that his or her status shall be that of an independent contractor solely responsible for his or her actions and inactions; (2) the Independent Contractor shall act solely as an Independent Contractor, not as an employee or agent of Company; and (3) the Independent Contractor is not authorized to enter into contracts or agreements on behalf of Company or to otherwise create obligations of Company to third parties.

### **Assignability**

This Agreement shall not be transferred or assigned, in whole or in part, by the Independent Contractor without the prior written consent of Company.

### **Choice of Law**

Any dispute under this Agreement, or related to this Agreement, shall be decided in accordance with the laws of the state of Utah.

### **Agreement**

This Agreement supersedes all prior oral or written agreements, if any, between the parties and constitutes the entire agreement between the parties. The Agreement cannot be changed or modified orally. This Agreement may be supplemented, amended, or revised only in writing by agreement of the parties.

### **Confidential Matters and Proprietary Information**

The Independent Contractor recognizes that during the course of contract performance he or she may acquire knowledge or confidential business information or trade secrets. The Independent Contractor agrees to keep all confidential information in a secure place and further agrees not to publish, communicate, divulge, use, or disclose, directly or indirectly, for his or her own benefit or for the benefit of another, either during or after contract performance, any confidential business information or trade secrets. Upon termination or expiration of this Agreement, Independent Contractor shall deliver all records, data, information, and other computer media or documents produced or acquired during the performance of this Agreement and all copies thereof to Company. Such material shall remain the property of Company. This obligation of confidence shall not apply with respect to information that (1) is available to the Independent Contractor from third parties on an unrestricted basis; or (2) is disclosed by Company to others on an unrestricted basis.

## **Conflicts of Interest**

The Independent Contractor shall not act as an agent for, consultant to, or as an officer, employee, or other representative of any subcontractor or supplier to Company, or serve in any of the foregoing capacities for any of Company's competitors or prospective competitors, without giving prior written notification to Company. The Independent Contractor hereby warrants that there is no conflict of interest between the Independent Contractor's other employment, if any, or other contracts, if any, and the activities to be performed hereunder. The Independent Contractor shall advise Company if a conflict of interest arises in the future.

## **Inventions, Patents, Trademarks**

The terms "work," "trademark," and "invention" include anything created for Company by the Independent Contractor, whether alone or with others, and whether those others be independent contractors, employees, or agents of Company.

1. The term "work" means any and all writings, designs, models, drawings, photographs, physical property, reports, etc., that are protectable under Title 17 of the U.S. Code.
2. The term "trademark" means any name, word, phrase, logo, design, or other graphic depiction generated during the performance of this Agreement that is or can be used to describe either a product or service of Company.
3. The term "invention" means any designs, processes, inventions, or discoveries that may be patentable or otherwise protectable under Title 35 of the U.S. Code.

## **Work Made for Hire**

During the performance of this agreement, the Independent Contractor may create certain works for Company that may be copyrighted under the laws of the United States. To the extent that any such works are created, the Independent Contractor will be considered to have created a work made for hire as defined in 17 U.S.C. § 101, and Company shall have the sole right to the copyright. If any work created by the Independent Contractor does not qualify as a work for hire, the Independent Contractor agrees to assign his or her right in the work to Company, as provided below.

## **Title to Works, Trademarks, and Inventions Produced**

It is understood and agreed that the entire right, title, and interest throughout the world to all works, trademarks, and/or inventions that are conceived of, prepared, procured, generated, or produced, whether or not reduced to practice, by the Independent Contractor, either solely or jointly with others during the course of, in connection with, or

as related to the performance of this Agreement, shall be and hereby are vested and assigned by the Independent Contractor to Company.

The Independent Contractor agrees to execute any and all documents prepared by Company and to do all other lawful acts as may be required by Company to establish, document, and protect such rights.

The Independent Contractor has acquired or shall acquire from each of his or her employees, consultants, and subcontractors, if any, the necessary rights to all such works, trademarks, and inventions produced by such employees, consultants, and subcontractors, within the scope of their employment by the Independent Contractor in performing services under this Agreement. The Independent Contractor shall obtain the cooperation of each such employee to secure to Company or its nominees the rights Company may acquire in accordance with the provisions of this clause.

**Reports**

The Independent Contractor, when directed, shall provide written reports with respect to the services rendered hereunder.

**Security Regulations**

The Independent Contractor shall comply with all applicable security regulations of Company.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of [date].

**INDEPENDENT CONTRACTOR**

By \_\_\_\_\_

Print name \_\_\_\_\_

Title (if applicable) \_\_\_\_\_

**COMPANY**

By \_\_\_\_\_

Print name \_\_\_\_\_

Title (if applicable) \_\_\_\_\_

