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Payroll Facts: Employee or Independent Contractor

Who is an employee?

An employee must decide if each worker receiving payments for services performed is an employee or a nonemployee. Payments to employees require employers to withhold taxes (income, social security and Medicare). The employer may be required to withhold taxes (backup withholding) and report (Form 1099-MISC) payments to nonemployees, depending on their status.

Internal Revenue guidelines:

In 1987, the IRS developed a list for its auditors to use to determine if a worker was an employee or an independent contractor. The measure of control an employer has over its workers is the determining factor. If the employer controls the results of the work and not the day to day performance of the task, then the worker is probably an independent contractor. If one answers yes to any of the questions listed, the worker may, in fact, be an employee and not an independent contractor.

The IRS has established a testing procedure to make the classification of workers easier for employers. Testing is accomplished by completing Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding. Employers answer the 20 questions on the SS-8 and submit a copy to the IRS.

While awaiting the IRS' response to the SS-8, the employer must treat the worker as an employee. During this time, the worker must have the appropriate taxes withheld and reported. The taxes will not be refunded to the worker or the employer if the worker is found to be a worker and not an employee.

In addition to the IRS, several other governmental organizations are concerned with the classification of workers. The Wage and Hour Division of the US Department of Labor determines if the worker is being paid minimum wages and overtime appropriately as an employee. State unemployment commissions have jurisdiction when the worker requests unemployment benefits and the worker has not been covered by the employer's taxes or wage reporting.

20 Questions to help determine worker status:

1. Does the employer give specific instructions as to how the job or service is to be completed?
2. Is training required for the worker to complete the job or service in a specified manner?
3. Is the completion of the job or service necessary to ensure the continuation of the business?
4. Is the worker required to perform the job or service personally?
5. Is the worker hired, supervised, and paid by the employer?

6. Is there a continuing relationship between the worker and the employer?
 7. Is the worker required to perform the job or service within specified hours?
 8. Is the worker required to work only for the employer?
 9. Is the worker required to perform the job or service on the employer's premises, even though work could be performed elsewhere?
 10. Is the worker required to adhere to the employer's schedule?
 11. Does the employer require regular written or oral reports?
 12. Is the worker paid by the hour, week, or month instead of by the job or straight commission?
 13. Does the worker pay their own business and travel expenses?
 14. Does the worker furnish his/her own tools and materials?
 15. Does the worker have any investment such as an office or machinery that is required for completing the job or service?
 16. Can the worker realize a profit or loss based on the job or service performed?
 17. Does the worker work for more than one person at a time?
 18. Are the worker services performed for the general public?
 19. Can the worker be fired if they are performing the job or service agreed upon contractually?
 20. Can the worker terminate the job or services without risk or financial loss due to breach of contract litigation?
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This article was furnished by:

Julie Brewer

Business Development Representative

Advantage Payroll Services