



It's 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

If you are a business owner or an independent contractor who provides services to other businesses, then you are generally considered self-employed. For more information on your tax obligations, visit the Self-Employed Tax Center at [irs.gov](https://www.irs.gov).

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.

Making a Determination

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 could be one of the following:

- An independent contractor
- An employee (common-law employee)
- A statutory employee
- A statutory nonemployee
- A government worker

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:

- **Behavioral.** Does the company control or have the right to control what the worker does and how the worker does his or her job?
- **Financial.** Are the business aspects of the worker's job controlled by the payer? These include things like how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.
- **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 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 that are relevant in one situation may not be relevant in another.

The key is to look at the entire relationship, consider the degree or extent of the right

to direct and control, and document each of the factors used in coming up with the determination.

Form SS-8

If, after reviewing the three categories of evidence, it's 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*, 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.

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, such as forms W-9 and 1099-MISC for independent contractors, and forms 940, 941, W-2 and W-3 for employees.

Note: There are specific employment tax guidelines that must be followed for certain van operators in the moving industry and workers within the limousine industry.

Misclassification of Employees

There are tax consequences of treating an employee as an independent contractor.



However, if you have reasonable basis for treating a worker as an independent contractor instead of 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 IRS Publication 1976, *Section 530 Employment Tax Relief Requirements*, for more information.

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 §3509 for more information.

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.

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 who 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.

Conclusion

Determining whether a worker is an employee or independent contractor isn't always black and white. Please consult your tax professional for additional guidance.

This brochure contains general tax information for taxpayers. As each tax situation may be different, do not rely upon this information as your sole source of authority. Please seek professional advice for all tax situations.

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Employee vs. Independent Contractor

