

Bookkeeping Tips

Knowing When That New Worker is an Employee v. Independent Contractor (IC)

Even if you use an outside payroll service, deciding if a new hire is an employee or an independent contractor (IC) may end up being your decision. You ask the boss, but most bosses don't know, don't care or want you to decide. That is why we offer practical ways to classify workers in our free technical briefing for our 30,000 members, *The General Ledger* (www.aipb.org/general_ledger.html).

How can you know when a new worker is an employee or an IC?

There are two answers. **a.** Focus on the three guidelines that the IRS uses for classifying workers, which may involve some risk when you have to make a close call; or **b.** Use the guaranteed classification method which takes more time, but may be worth it when you face a difficult decision.

a. Three guidelines on classifying that new hire. The IRS examines three areas: behavioral control, financial control and relationship of the parties.

1. Behavioral control is the right to direct or control performance of specific tasks such as whether you give training or instruction on how to perform them.
2. Financial control is the right to direct or control financial aspects of the worker's activities. The business has less financial control when the worker makes a significant investment, incurs unreimbursed expenses and makes services available to other employers in the relevant market. Other factors are method of payment and the opportunity for the worker to make a profit or incur a loss.
3. The relationship of the parties is shown in agreements and actions toward each other. Actions show how they perceive the relationship and represent the relationship to others, whether the worker gets employee benefits, permanency of the relationship, the right of the parties to terminate the relationship, and whether the services performed are part of the business's regular activities.

The case: A federal agency contracted with an individual to be instructor, role player and training developer, gave him specific training and instruction and had a supervisor give daily assignments, including the methods he was to use. All work was performed at the agency on a full-time schedule set by the agency that included evening and weekend work. He had to attend two briefings a day and was counseled if meetings were missed. He provided all services personally.

The agency provided all the supplies, equipment, materials, and property he needed. He incurred no expenses in performing the services, was required to submit daily performance reports and was responsible for damaged or lost equipment when performing the services. He was paid an hourly wage, was not eligible for paid vacation and was represented to the public as a contract employee who did not perform similar services for others. Both parties stated that the firm could terminate the relationship at any time, but the worker had to provide at least 2 weeks' notice and could be responsible for contract completion.

(continued)

The ruling: The IRS held that the worker was subject to the direction and control of the agency and would be treated as an employee, not as an independent contractor. [Private Letter Ruling 200504009]

b. The guaranteed classification. Request a definitive ruling from the IRS by filing Form SS-8. Procedures for filing an SS-8 are usually published in the first Revenue Procedure of each year. The IRS has ruled as follows:

- ✓ There is no time limit by which an SS-8 determination must be requested.
- ✓ If you don't agree with the result or believe the IRS did not consider all the facts, you can request reconsideration; and
- ✓ There is no time limit on requesting reconsideration.

[Internal Legal Memorandum 200607018]

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