

# Independent Contractor or Employee?

BY ROB AND CAROL TROW

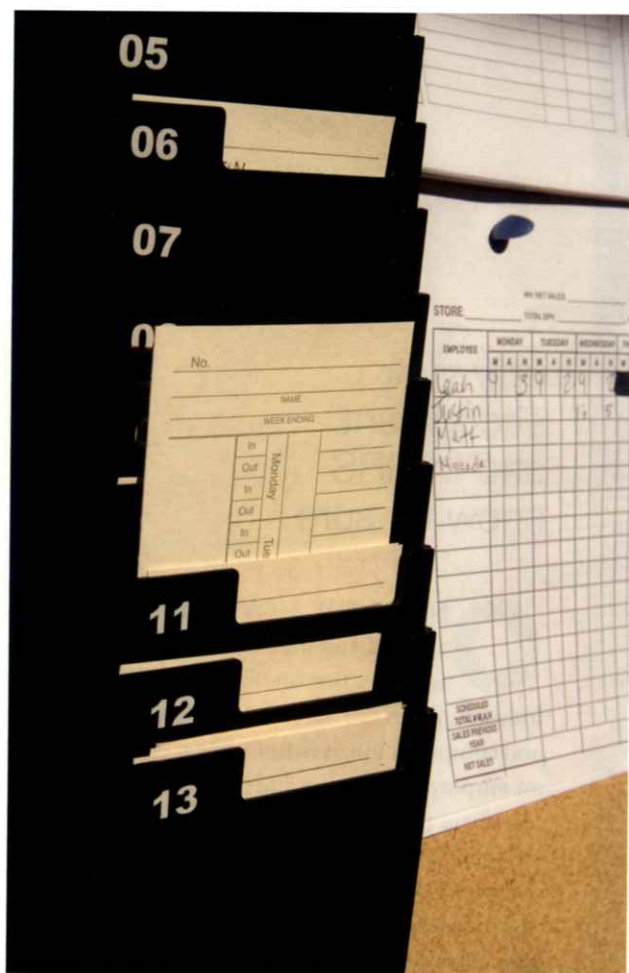
only your  
accountant  
and the IRS  
know for sure

ONE OF THE MORE PERPLEXING and difficult human resource personnel issues that one faces in the esthetics industry, given the nature of staffing, finances and compensation, is defining what constitutes an employee versus an independent contractor. If you think you know, chances are you are wrong. The distinction is more complicated and complex than most of us think. The answers to many questions will be determining factors in how to properly classify someone who performs a service for your company. In addition, the definitions that the federal government's Internal Revenue Service (IRS) applies may, in fact, be at odds with those of your state.

Note that this article does not intend to provide legal advice. Rather, it raises a number of issues that you should address with your accountant and/or attorney. It is vitally important to periodically review the status of any independent contractor to insure that they are correctly classified.

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## Twenty factor checklist: contractor or employee?



Set hours of work—the establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control.

AS AN AID IN DETERMINING WHETHER AN INDIVIDUAL is an employee under the common law rules, 20 factors or elements have been identified by the Internal Revenue Service as indicating whether sufficient control is present to establish an employer-employee relationship. The 20 factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. They are designed only as guides for determining whether an individual is an employee. Special scrutiny is required in applying the factors to ensure that the aspects of an arrangement do not obscure the substance of the arrangement. That is, if the person or persons for whom the services are performed exercise sufficient control over the individual to be classified as an employee. The 20 factors are described below:

\_\_\_\_ **1. Instructions.** A worker who is required to comply with other persons' instructions about when, where and how he or she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the right to require compliance with instructions.

\_\_\_\_ **2. Training.** Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner.

\_\_\_\_ **3. Integration.** Integration of the worker's services into the business operation generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business.

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## Defining status

If a worker is determined to be an employee, the company must withhold federal income taxes. The company must also pay the employer's share of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act and applicable fringe benefits available to other employees of the same status. There are also state specific obligations as well. If the person is an independent contractor, the employer is required to send out a 1099-MISC form for the year showing what was paid to the worker if it exceeded \$600.

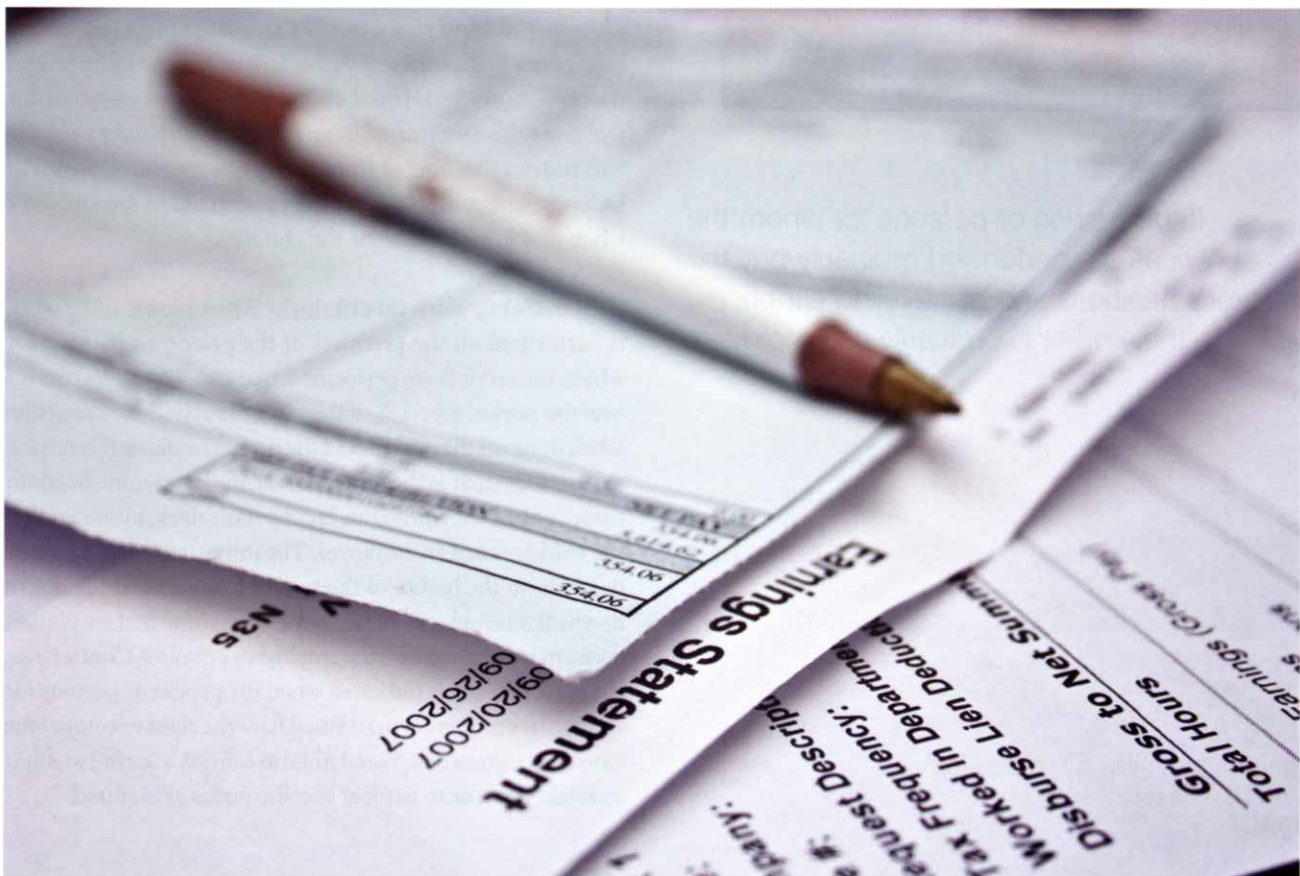
To determine a worker's status there are a number of questions that need to be asked, which may—yes, *may* (we said this was not going to be simple)—define whether a person is an employee in the eyes of the taxing authorities. There are several places to look to help define status: IRS regulations, state tax rules, common law practices, the Fair Labor Standards Act and court decisions. Definitions termed “common law” have been determined not by the IRS or state tax codes but by court decisions.

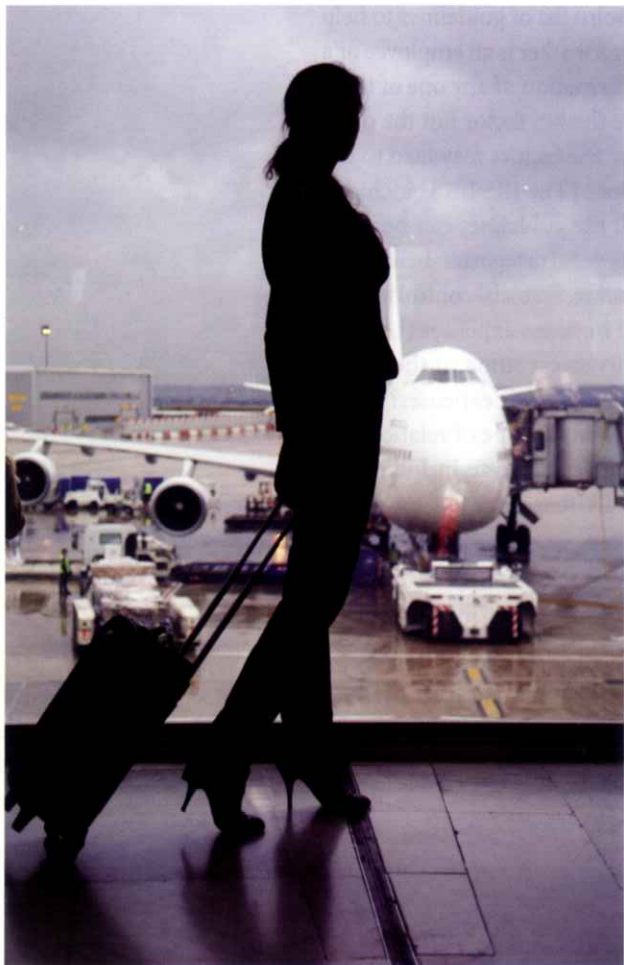
It is critical to understand that the test to determine if one is an employee or not includes answering a myriad of questions. There is not

just one question that needs to be answered but many. There is no uniform definition of the term employee. If you are not confused yet, just wait. The IRS has a 20 point list of guidelines to help determine whether a worker is an employee or a contractor. The affirmation of any one of these factors may not be the key factor but the overall picture of all of the factors may lead to the proper classification. (The IRS list is included in this article.) All the guidelines can be summarized by three general categories: behavioral control over the worker, financial control including unreimbursed business expenses (i.e. does the worker have to invest some of their own funds to cover some of their expenses?), how the worker is paid and the type of relationship that each party intended to create, including but not limited to any written contracts, employee benefits and sick pay.

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The receipt of a steady paycheck for a set amount or hourly rate may mean you are an employee in the eyes of the IRS.





If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee.

\_\_\_\_ **4. Services rendered personally.** If the services must be rendered personally, the person or persons for whom the services are performed are presumably interested in the methods used to accomplish the work as well as in the result.

\_\_\_\_ **5. Hiring, supervising and paying assistants.** If the person or persons for whom the services are performed hire, supervise and pay assistants, that factor generally shows control over the workers on the job. However, if one of the hired workers supervises and pays the other assistant pursuant to a contract, under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status.

\_\_\_\_ **6. Continuing relationship.** A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.

\_\_\_\_ **7. Set hours of work.** The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control.

\_\_\_\_ **8. Full time required.** If the worker must devote full time hours to the business of the person or persons for whom the services are performed, that person or persons have control over the amount of time the worker spends working and restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses.

\_\_\_\_ **9. Doing work on employer's premises.** If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Work done off the premises of the person or persons receiving the services, such as the office worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route to canvass a territory within a certain time, or to work at specific places as required.



\_\_\_\_\_ **10. Order or sequence set.** If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow his own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are being performed do not set the order of the services, or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so.

\_\_\_\_\_ **11. Oral or written reports.** A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control.

\_\_\_\_\_ **12. Payment by hour, week, month.** Payment by the hour, week or month generally points to an employer-employee relationship, provided that this payment method is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor.

\_\_\_\_\_ **13. Business payments and/or traveling expenses.** If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities.

\_\_\_\_\_ **14. Furnishing of tools and materials.** The fact that the person or persons for whom the services are performed furnish significant tools, materials and other equipment tends to show the existence of an employer-employee relationship.

\_\_\_\_\_ **15. Significant investment.** If the worker invests in facilities that they use to perform services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. Special scrutiny is required with respect to certain types of facilities, such as home offices.

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If a worker performs more than de minimis [minimal] services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor.



An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications.



\_\_\_\_ **16. Realization of profit or loss.** A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

\_\_\_\_ **17. Working for more than one firm at a time.** If a worker performs more than de minimis [minimal] services for multiple unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. However, a worker who performs services for more than one person may be an employee of each person, especially where such persons are part of the same service arrangement.

\_\_\_\_ **18. Making service available to the general public.** The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.

\_\_\_\_ **19. Right to discharge.** The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications.

\_\_\_\_ **20. Right to terminate.** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship.



If an employer pays social security taxes and benefits, that person is usually an employee.

### Control and authority

One of the main factors that can be used to determine whether you are an employee or an independent contractor centers on the degree of control an employer has over a service or product. If you are directed daily in how, when and where to show up and are given specific instructions on how to do your job, you are an employee.

Can you determine if you want to work, accept an assignment or establish your own daily schedule? If you have a high degree of autonomy about how you go about your business, you fit one of the definitions of an independent contractor. A worker's control over hours of employment needs to be addressed. If the decision maker is the worker, they meet one of the characteristics to be considered an independent contractor. One way to address this issue is to consider whether the employer has direct authority on how a worker accomplishes his or her work or instead requests a series of tasks to be carried out or outlines desired results.

The receipt of a steady paycheck for a set amount or hourly rate may well mean you are an employee in the eyes of the IRS. Independent contractors often receive variable pay based on such factors as commission based compensation. If all of the tools, supplies and equipment needed to do your job are provided by the company, you may be an employee.

### So many questions

Can you work for others or are you mandated to work for only one company? If you are required to just have one employer, it could mean you are an employee. If an individual can perform work for other companies, that person may be an independent contractor. Essentially, some courts have ruled that if a person must be solely aligned with one organization, that qualifies them as employees.

Another factor is the intent of those involved when they mutually agree to an employment relationship. If an employer pays social security taxes and benefits, that person is usually an employee.

Remember—there is no one perfect test or question to answer. There is no single factor that must or must not be met, nor are all of these factors applied in an exact manner. You should consult with your attorney or accountant for the answers. There are no easy answers to the issue so do your homework and get a professional opinion. ■



**Rob and Carol Trow**, his wife, own *DermaConcepts USA*, the eastern U.S. (excluding metro NYC) distributors for *Environ® Skin Care*. Rob's background includes two decades in higher education as a faculty member, administrator and business consultant. He has been in the skin care field for over ten years. Prior to her involvement with *Environ® Skin Care*, Carol served as an RN, director of marketing for *Professional Service Business Development* and operated her own consulting firm focusing on practice development. Rob is an authority in the business of skin care and has authored articles for professional publications. He speaks frequently on current and emerging topics of interest to medical spas, estheticians and physicians.

