

Employee or Independent Contractor?

UW Campus Tax Training



Outline

- What is an Employee, What is an Independent contractor.
- Why should we care about the difference?
- Classification Rules
- 20 factor test
- UW Policy
- Case Studies



Employee

- Anyone who performs services for a business where UW controls what will be done and how it will be done.
- Must pay benefits such as vacation, health, etc.
- Must remove (i.e. withhold) taxes from paycheck and provide W-2

Independent Contractor

- When the person for whom services are provided has the right to control or direct only the result of the work and not the means or the methods of the work
- IC has flexibility to purchase and structure own benefit plans
- Provide form 1099, as opposed to W-2
- No withholdings

Why do we care?

- Because the IRS cares – A LOT!
- Because we want to be compliant with the law
- Because penalties can be steep

Classification Rules

- Look at control:
 - Behavioral control
 - Financial control
- Look at Relationships

Behavioral Control

- Do we have the *right* to direct or control the worker?
- Indicators of behavioral control
 - When to do the work
 - Where to do the work
 - How they do their work
 - What tools are used
 - What order or sequence to follow
 - Is prior approval required?

Financial Control

Indicators of a independent contractor:

- Significant investment in equipment
- Unreimbursed expenses
- Have fixed costs
- Services available to the market
- Paid a flat fee

Type of Relationship

- Written contracts
 - But substance, not label rules
- Employee benefits
- Permanency of the relationship
- Services provided as key activity of the business

Factors to consider

- Specific factors that are used by the IRS in determining whether an individual is an employee or an independent contractor. The listing is commonly referred to as the "20 factors" test.
- No one factor is determinative. Need to weigh all the facts and circumstance.
- The twenty factors are not all inclusive and other factors might come into play.

20 factors Test

Note: "Yes" answers are indicative of employee status per IRS

1. Worker is required to comply with instructions about when, where, and how work is done.
2. Worker needs to be trained.
3. Worker's tasks are integrated into normal business operations.
4. Worker's services must be personally rendered.
5. Worker is not responsible for hiring, paying, or supervising assistants.



20 factors Test

6. Worker has continuing relationship with "employer".
7. Working hours are set by "employer".
8. Worker is required to devote full-time efforts to "employer's" business.
9. Worker must perform or execute duties on "employer's" premises.
10. Worker's services must conform to order or sequence set by "employer".



20 factors Test

11. Worker is required to submit regular oral or written reports.
12. Worker's payment is based on time spent instead of by the job.
13. Worker is reimbursed for travel and other expenses.
14. Worker is furnished tools, materials, and other equipment by "employer".
15. Worker has no significant investment in facilities (such as an office).



20 factors Test

16. Worker has no risk of real economic loss.
17. Worker is not working for more than one "employer" at a time.
18. Worker does not make services available to the general public.
19. Worker is subject to discharge without "employer" penalty -- even if job specifications are met.
20. Worker can terminate relationship with "employer" without worker liability.



Who is an Employee - Recap

- UW has the right to control the work
- UW provides all supplies and equipment
- UW pays individual on an hourly, weekly, monthly basis
- UW provides benefits – health insurance, vacation time, sick leave
- Performing a core function of the UW



Forms and taxes for employees

- Federal income tax withholding
- Social Security and Medicare taxes (FICA)
 - UW matches the amount
- Federal unemployment tax
- W-2 reporting of income and withholding

Who is an Independent Contractor - Recap

- UW has the right to control or direct *only* the result of the work
- IC gets fixed payment regardless of hours worked
- IC performs same services for other organizations
- IC supplies own equipment

Taxes and forms for independent contractors

- IC is responsible for paying estimated taxes on income
- IC is responsible for paying self-employment tax
- UW reports income on Form 1099 MISC

How do I make the determination?

- Look at all facts and circumstances
- Use twenty factor test as guideline – Form 1631/1632
- Make the determination ***before*** a contract is signed with the individual
 - May have to go back and pay them as an employee. Is there a breach of contract?

Tricky situations

- Contract with person's corporation, not individual, ok if:
 - Corporate formalities are followed
 - At least one non-tax business reason exists for contracting with company
 - LLC? May not be a corporation!

Independent Contractor Policy (APS 32.3)

- Revised November 2012
- Current UW employee cannot be paid as a contractor at the same time, regardless of differences in work provided
- Doesn't matter if different department
- Pay as FEE or URD earn types through Payroll



Independent Contractor Classification

Consequences	Ind. Contractor	UW
Taxes	Individual responsible for self-paying all taxes	Does not withhold any taxes. Reports income on 1099
Benefits	Not entitled to UW benefits	Provides to benefits to ICs
Workers Comp.	Individual required to obtain own coverage	Does not cover ICs

- Consequences of misclassification
 - Back taxes, penalties, and interest (can be steep!)
 - Falls on UW and individual

Case Studies

- UW professor of psychology
- Business school asks him to give a lecture on Psychology of Wall Street traders and will pay him \$200 for the lecture.
- Pay Prof as EE or IC?

Case Studies

- Jane was laid off in June due to budget cuts. Her former department wants to hire her as an independent contractor for 40 hours in August to finish up the project she was working on because they have found some temporary funding. What should the department do?

Case Studies

- Law school hires Ima Lawyer, in November, as an independent contractor to advise the tax clinic on low income taxpayer IRS options. They like her so much they want to hire her as a permanent staff. Can they?

Case Studies

- Art department wants to hire the company, Studio Bonzai, to do some design work
- Studio Bonzai is owned and operated by current UW employee
- Is this okay?

Case Studies

- Mark leaves UW Fisheries department in December, 2010 to work on The Deadliest Catch TV show. The show goes off the air in January and Fisheries wants to hire Mark to give a lecture on how to get on a TV fishing show. They want to hire him in March 2011 as an independent contractor. Can they?

Questions? & Resources

- <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>
- IRS Publication 1779 @ IRS.gov
- Tax Office Website:
<http://f2.washington.edu/fm/tax/fed-taxes/employee-independent-contractor>
- APS:
<http://www.washington.edu/admin/rules/policies/APS/32.03.html>
- Tax Office: taxofc@uw.edu