

I. Employee versus independent contractor

A. Background

The traditional way to determine whether a worker is an employee or independent contractor is to assess whether the services of the worker are subject to the business owner's control both with respect to what the worker must do and how he or she must do it. In Revenue Ruling 87-41, the IRS discussed the 20 factors listed immediately below that it uses to determine whether a worker is an independent contractor under the common law:

1. Does the principal provide instructions to the worker about when, where, and how he or she is to perform the work?
2. Does the principal provide training to the worker?
3. Are the services provided by the worker integrated into the principal's business operations?
4. Must the services be rendered personally by the worker?
5. Does the principal hire, supervise, and pay assistants to the worker?
6. Is there a continuing relationship between the principal and the worker?
7. Does the principal set the work hours and schedule?
8. Does the worker devote substantially full time to the business of the principal?
9. Is the work performed on the principal's premises?
10. Is the worker required to perform the services in an order or sequence set by the principal?
11. Is the worker required to submit oral or written reports to the principal?
12. Is the worker paid by the hour, week, or month?
13. Does the principal have the right to discharge the worker at will?
14. Can the worker terminate his or her relationship with the principal any time he or she wishes without incurring liability to the principal?
15. Does the principal pay the business or traveling expenses of the worker?
16. Does the worker furnish significant tools, materials, and equipment?
17. Does the worker have a significant investment in facilities?
18. Can the worker realize a profit or loss as a result of his or her services?
19. Does the worker provide services for more than one firm at a time?
20. Does the worker make his or her services available to the general public?

Revenue Ruling 87-41 is a distillation of many years of case law decisions that relate to when a worker is an employee. Revenue Ruling 87-41 is still in effect; although in order to streamline the analysis, the IRS now combines the 20 factors into the three functional categories listed below for Form SS-8 purposes when it determines whether a worker is an employee or an independent contractor:

- Behavioral control;
- Financial control; and
- The relationship of the worker and the firm.

Businesses must weigh all the 20 factors when determining whether a worker is an employee or independent contractor; although in most cases some of the factors are more relevant than others. Some factors may indicate that the worker is an employee, while other factors could indicate that the worker is an independent contractor. There is no set number of factors that make the worker an employee or an independent contractor, and no one factor alone is so important that it can resolve the determination on its own. Factors that are relevant in one worker's situation may not be relevant in another's. The key is to look at the entire relationship between the worker and the business, consider the degree or extent of the right the business has to direct and control the worker, and to document each of the factors used in coming up with the determination.