

The IRS' 20 Questions for Independent Contractors

Are you Really an Independent Contractor?

Independent contractors who don't know about — or who ignore — the relevant aspects of current contractor tax law are endangering their own livelihood and pose a significant threat to companies.

The IRS is currently funding California's Employment Development Department (EDD) to conduct twice as many independent contractor-related corporate tax audits as they did last year. Such audits routinely last 18 months and the resources required to prepare for them frequently put small and even mid-size companies out of business. If you the fight, the penalties (for failure to withhold employment taxes and provide you with benefits, etc.) can amount to 50 percent of the money paid to the subcontractor.

That's right — the Franchise Tax Board and IRS come after you and, at the very least, disallow your related business deductions.

They're complex, arbitrary, and inconsistently applied, but knowing the rules can keep you safe. So here they are, in a nutshell:

Under United States common law, a worker is an employee if the person for whom he or she works has the right to direct and control the way he or she works, both as to the final result and as to the details of when, where, how, and in which sequence the work is to be done. It is the IRS' view that the employer need not actually exercise control. It is sufficient that it has the right to do so.

In the absence of laws that override the safe harbor provisions detailed in Section 530 of the Revenue Act of 1978, IRS has adopted 20 rules to determine whether workers are employees. In brief, these rules are directed at the following questions; the answers most favorable to contractors follow in parentheses.

The 20 Questions

1. Are you required to comply with instructions about when, where, and how the work is to be done? (No.)
2. Does your client provide you with training to enable you to perform a job in a particular method or manner? (No.)

3. Are the services you provide integrated into your client's business operation? (No.)
4. Must the services be rendered by you personally? (No.)
5. Do you have the capability to hire, supervise, or pay assistants to help you in performing the services under contract? (Yes.)
6. Is the relationship between you and the person or company you perform services for a continuing relationship? (No.)
7. Who sets the hours of work? (You do.)
8. Are you required to devote your full time to the person or company you perform services for? (No.)
9. Is the work performed at the place of business of the potential employer? (No.)
10. Who directs the order or sequence in which the work must be done? (You do.)
11. Are you required to provide regular written or oral reports to your client? (No.)
12. What is the method of payment — hourly, commission or by the job? (Contingency or project milestone-based payments are ideal.)
13. Are your business and/or traveling expenses reimbursed? (No.)
14. Who furnishes tools and materials used in providing services? (You do.)
15. Do you have a significant investment in facilities used to perform services? (Yes. The more substantial your investment, the better.)
16. Can you realize both a profit and a loss? (Yes.)
17. Can you work for a number of firms at the same time? (Yes.)
18. Do you make your services available to the general public? (Yes. It's a good idea to have a business listing in the phone book, for example.)
19. Are you subject to dismissal for reasons other than nonperformance of contract specifications? (No. Also, your client should provide at least a week's notice. At will termination makes you look like an employee.)
20. Can you terminate your relationship without incurring a liability for failure to complete a job? (Yes, assuming you're working on a time-and-materials basis. If you're working on a project, or milestone, basis, you are obligated to deliver on your commitments if you wish to be paid for your efforts.)