

## **Internal Revenue Service chimes in on Worker Classification: Employee or Contractor**

On December 16, 2021, the IRS Office of Federal, State, and Local Government hosted a webinar addressing which workers are considered employees versus contractors for purposes of Code Sec. 3121(d)(2). The answer is based upon an application of common law standards and factoring the circumstances surrounding the work performed.

Under common law rules, whether an individual is an employee or an independent contractor is determined by the relationship of the worker and the business, and if the business can direct or control how the worker performs a task.

The IRS considers several aspects of the relationship between parties that can inform how a worker is classified, such as:

- The substance of the relationship, rather than its label;
- Whether a worker receives benefits (insurance, pension plan, vacation/sick pay);
- The permanency of the relationship; and
- The extent to which a worker's services are a key aspect of the regular business of the company.

A business has "behavioral control" of an employee if it can place restrictions on what equipment can be used, where supplied can be purchased, or which protocol should be followed. Whether or not there was formal training and the extent thereof is also a factor as to whether a worker is an employee.

As a general rule, an independent contractor can make a profit or loss and is paid a flat fee or a contract price, while employees do not incur such risk and are paid a regular wage.

Independent contractors are, generally (as there is no formal definition), self-employed individuals who have been contracted to perform services for a taxpayer. This includes, for example, doctors, veterinarians, and auctioneers working in an independent trade, business, or profession in which services are offered to the public. Because independent contractors control the means and methods of how to accomplish an assigned task or project, they are not classified as employees.

Statutory non-employees are also excluded from the employee designation. There are three categories of statutory non-employees:

- Direct sellers—individuals engaged in selling consumer products in the home or place of business other than in a permanent retail establishment (including newspaper or shopping news distributors);
- Qualified real estate agents—individuals engaged in appraisal activities for real estate sales, with at least 90% of earned income coming from commissions on sales or other outputs; and
- Specified companion sitters—individuals who furnish personal attendants, companionship, household care services to children, elderly, and/or disabled persons.

Statutory employees falling under one of the following categories are considered employees:

- Agent drivers who distribute beverages other than milk, meat, vegetables, fruit, or bakery products, or who pick up and deliver laundry or dry cleaning.
- Full-time life insurance sales agents whose principal business activity is selling insurance or annuity contracts, or both.
- Individuals that work at home on materials or goods that must be returned to a customer.
- Full-time traveling sales agents who work on someone's behalf and turns in orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments.

Officers of a corporation are employees unless both of the following situations apply:

- The officer does not perform any services or performs only minor services.

- The officer is not entitled to receive—directly or indirectly—any remuneration. Services are minor or nominal depending on the character of the service, the frequency and duration of performance, and the how important such services are to the conduct of the corporation's business.

A Form SS-8 can be filed with the IRS by either the worker or the entity for which the worker performs services for an official, binding response as to whether the worker is an employee. The Voluntary Classification Settlement Program (VCSP) allows taxpayers that treat its workers as independent contractors or other non-employees to instead reclassify them as employees. An eligible taxpayer must have filed Forms-1099 for each applicable worker it has treated as a non-employee for the previous three years. To apply, a taxpayer must submit a Form 8952 and enter into a closing agreement with the IRS.

Note: Regardless of how a worker is classified for federal tax purposes, many states have laws that are more strict. Those states may classify workers that qualify as contractors under federal law but are nevertheless classified as employees under State law.