

# Independent Contractors

Many people hire independent contractors for help with their business. Independent contractors are not your employees- by definition they have their own business. Hiring an independent contractor provides a great deal of flexibility (you don't have to withhold payroll taxes or have worker's compensation). However, the IRS is cracking down on misclassification of workers and there is some risk with classifying a worker as an IC. A worker's status as an IC or an employee depends not on what you call them, but on how the government views his or her work.

## When is a worker an independent contractor?

A worker does not become an independent contractor just because you say so. Courts and government agencies will determine the worker's status by applying a legal worker classification test, sometimes called a common law test.

### Common Law Test

The key to determining whether an individual is an employee or independent contractor is **control**. There are several other factors to consider as well, as listed below. You can also see **Appendix A** for *Worker Classification Checklist*.

#### 1. Control

- a. ***An employer has the right to direct and control the way their worker does the job and also has the right to fire them. Employer has power to also set the employees schedule and dictate instructions.***
- b. ***An IC performs agreed upon services, but control is limited to accepting or rejecting the final results. The IC has control of their schedule and freedom to operate as they deem appropriate.***

#### 2. Making a Profit or Loss

- a. Employees are paid for their time and labor and don't have to pay business expenses. They earn the same salary regardless of how work is performed.
- b. An IC can earn a profit or suffer a loss from their work based on their ingenuity, judgment, etc.

#### 3. Working on Site

- a. Employees must work where their employers tell them, usually on the premises
- b. IC's are able to choose where to work (which goes back to control)

#### 4. Offering Services to the General Public

- a. Employees usually offer services solely to the employer
- b. IC's ordinarily make services available to the public.

#### 5. Right to fire

- a. Employer typically can fire the employee at any time

- b. An IC's relationship with the hiring firm can be terminated only according to the terms of their agreement
- 6. Furnishing Tools and Materials
  - a. Employers ordinarily give employees all the tools to do their jobs
  - b. IC's typically furnish their own tools and materials
- 7. Method of Payment
  - a. Employees are usually paid by a unit of time (hour, week, month)
  - b. IC's typically earn a flat rate for a project

## What's the danger of misclassifying an employee as an IC?

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If the IRS determines that you intentionally misclassified a worker as an IC, it will impose a 20 percent income tax assessment, which means you will be required to pay the IRS an amount equal to 20 percent of all the payments you made to the worker.

## Steps When Working with Independent Contractors

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### 1. Interview the prospective IC

When interviewing the IC, do not have them fill out an employment application as this makes them look like an employee. Instead, have them fill out an Independent Contractor Questionnaire. For an example *Independent Contractor Questionnaire*, see **Appendix B**.

### 2. Obtain Documentation on the IC

Before you hire the IC, you should obtain additional documentation that will further support classifying the individual as an IC, as well as verify the legitimacy of the IC. See **Appendix C** for a *Documentation Checklist*.

### 3. Determine whether the Worker Qualifies as an IC

Using the criteria discussed under the Common Law Test and documentation you've gathered, determine whether the worker qualifies as an IC. Create some sort of documentation for your files to justify the classification, such as using the *Worker Classification Checklist* in **Appendix A**.

### 4. Draft and Sign an IC Agreement

Whether it is your own agreement or one created by the IC, you will want to have a real negotiated contract. See **Appendix D** for a general template for an *Independent Contractor Agreement*.

### 5. Have IC fill out form W-9

If you've made the determination that the person you're paying is an independent contractor, you need them to complete the IRS's Form W-9, Request for Taxpayer Identification Number and Certification. This form can be used to request the correct name and Taxpayer Identification Number, or TIN, of the worker. A TIN may be either a Social Security Number (SSN), or an Employer Identification Number (EIN). The W-9 should be kept in

your files for four years for future reference in case of any questions from the worker or the IRS. You do not have to file the W-9 with the IRS. For a PDF of the Form W-9, go to: <http://www.irs.gov/pub/irs-pdf/fw9.pdf>.

## 6. Keep a File for Each IC You Hire

Keep a file for each IC you hire, separate from your personnel files for employees. You will want to keep these files for at least six years. Each file should contain:

- Signed final IC agreement
- IRS W-9 form
- All documentation provided by IC (licenses, proof of insurance, etc.)
- All invoices the IC submits for billing purposes
- Copies of all 1099 forms you file.

## 7. File Form 1099-MISC

The basic rule is that you must file a Form 1099-MISC whenever you pay an unincorporated IC (that is an IC who is a sole proprietor, partnership, or LLC) \$600 or more in a year for work done in the course of your trade or business. You don't need to report payments solely for merchandise or inventory. If your IC is a corporation, you don't need to send them Form 1099. For a PDF of Form 1099-MISC, go to: <http://www.irs.gov/pub/irs-pdf/f1099misc.pdf>

A copy of 1099-MISC must be provided to the independent contractor by January 31 of the year following payment. You must also send a copy of this form to the IRS by February 28 (although the form does not have to be sent to the IRS until March 31 if the business files the 1099s electronically, using the FIRE system).

## Appendix A: Worker Classification Checklist

1. Is the worker a statutory independent contractor?
  - Direct Seller
  - Licensed Real Estate Agent
 If yes, treat worker as IC for federal tax purposes.
  
2. Is the worker a statutory employee?
  - Corporate officer who provides services to the corporation
  - Food or laundry driver
  - Full-time traveling salesperson who sells goods for resale
  - At-home worker supplied with materials and specifications for work
  - Construction industry worker who doesn't hold valid contractor's license
 If yes, treat worker as employee for federal tax purposes.
  
3. Is the Worker an IC under the IRS common law test?
 

Complete the following chart. The more "yes," answers, the more likely the worker is an IC.

IRS FACTORS	Yes (Supports IC Status)	No (Supports Employee Status)
1. <b>Instructions.</b> Will the firm not have the right to give the worker instructions about when, where, and how he or she is to do the job?		<b><i>IF NO, STOP HERE. THE WORKER IS AN EMPLOYEE.</i></b>
2. <b>Training.</b> Will the firm not give the worker training?		
3. <b>Significant Investment.</b> Has the worker invested in facilities (such as an office) used to perform services?		
4. <b>Payment of Expenses.</b> Will the worker be required to pay his or her own business or travel expenses?		
5. <b>Services Available.</b> Does the worker make his or her services available to other businesses?		
6. <b>Method of Payment.</b> Will the worker be paid by commission or by the job rather than by the hour, week, or month?		

7. <b>Realization of Profit or Loss.</b> Will the arrangement enable the worker to realize a profit or suffer a loss?		
8. <b>Written Contract.</b> Will a written contract be executed describing the worker as an independent contractor?		
9. <b>Employee Benefits.</b> Will the worker not receive any employee benefits?		
10. <b>Right to Terminate.</b> Does the firm lack the legal right to terminate the worker at any time without incurring liability?		
11. <b>Regular Business Activity.</b> Is the work to be performed outside of the firm's regular business?		

4. Does the worker qualify for safe harbor protection?

	YES	NO
All 1099s filed		
Consistent treatment		
Reasonable basis for IC classification		

If all three boxes are checked "Yes," treat worker as IC for federal tax purposes.

5. Must the worker be provided with state unemployment insurance coverage?

	YES	NO
Are the worker's pay or hours of work less than the state threshold requirements for UI coverage?		
Does an IC exemption apply—for example: <ul style="list-style-type: none"> <li>• casual labor</li> <li>• spouse, child, or parent</li> <li>• commissioned real estate</li> </ul>		

brokers and salespeople		
Is the worker an IC under state UI laws?		

If you answer "Yes" to any question, you need not provide unemployment insurance coverage.

6. Is the worker and IC for worker's compensation purposes?

	<b>YES</b>	<b>NO</b>
Does employee minimum exclusion apply?		
Does casual labor exclusion apply?		
Does domestic worker exclusion apply?		
Does another exclusion apply?		
Is the worker an IC under state WC laws?		

If you answer "Yes" to any question, you need not provide workers' compensation coverage.

## Appendix B: Independent Contractor Questionnaire

Name: \_\_\_\_\_

Fictitious business name (if any): \_\_\_\_\_

Business address: \_\_\_\_\_

Business phone and fax #: \_\_\_\_\_

Employer Identification number or Social Security number: \_\_\_\_\_

Form of business entity (check one):

Corporation

Partnership

Sole Proprietorship

Limited Liability Company

1. Provide the name, address, and dates of service of all companies for which you have performed services as an independent contractor for the past two years. But please do not provide any information you have a duty to keep confidential.

2. Have you ever hired employees? If yes, please complete the following for each employee:

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Title: \_\_\_\_\_

Salary: \_\_\_\_\_

Dates of employment: \_\_\_\_\_

Workers' compensation carrier and policy number: \_\_\_\_\_

3. Have you paid federal and state payroll taxes for your employees?  Yes  No

4. Do you hold a professional license? If so, please provide a copy.

5. Do you have a business license? If so, please provide a copy.

6. Describe the training you have received in your specialty.

School attended: \_\_\_\_\_

Dates of attendance: \_\_\_\_\_

Degrees received: \_\_\_\_\_

School attended: \_\_\_\_\_

Dates of attendance: \_\_\_\_\_

Degrees received: \_\_\_\_\_

School attended: \_\_\_\_\_

Dates of attendance: \_\_\_\_\_

Degrees received: \_\_\_\_\_

7. Do you advertise your services? [  ] Yes [  ] No  
If so, please provide a copy of these advertisements, including a yellow pages listing.
8. If you don't advertise, how do you market your services? \_\_\_\_\_
9. Do you have a white pages business phone listing? [  ] Yes [  ] No  
If so, please provide a copy.
10. Do you have a website marketing your services? If yes, please provide a copy of the home page and list the URL here: \_\_\_\_\_
11. Describe the business expenses you have paid in the past, including office or workplace rental, materials and equipment expenses, telephone, and other expenses:  
\_\_\_\_\_
12. Describe the business expenses you pay now: \_\_\_\_\_
13. Describe the equipment and facilities you own: \_\_\_\_\_
14. Please describe the tools and materials you will use to perform the services in this job:  
\_\_\_\_\_  
How much do they cost? \_\_\_\_\_
15. Please list your general liability insurance carrier: \_\_\_\_\_  
Policy number: \_\_\_\_\_
16. Please list your auto insurance carrier: \_\_\_\_\_  
Policy number: \_\_\_\_\_
17. Have you ever worked for us before? If so, please complete the following:  
Dates of employment: \_\_\_\_\_  
Services performed: \_\_\_\_\_
18. Do you have an independent contractor agreement? If so, please attach a copy.
19. Do you have your own business cards, stationery, and invoice forms? If so, provide copies.
20. If you're a sole practitioner, have you paid self-employment taxes on your income and filed a Schedule C with your federal tax return? [  ] Yes [  ] No  
If so, will you provide copies of your tax returns for the past two years?  
[  ] Yes [  ] No



## **Appendix C: Documentation Checklist**

Please provide the following documentation:

- copies of your business license and any professional licenses you have
- certificates showing that you have insurance, including general liability insurance and workers' compensation insurance if you have employees
- your business cards and stationery
- copies of any advertising you've done, such as a yellow pages listing
- a copy of your white pages business phone listing, if there is one
- if you're operating under an assumed name, a copy of the fictitious business name statement
- a copy of your invoice form to be used for billing purposes
- a copy of any office lease and proof that you've paid the rent, such as copies of canceled rental checks
- the names and salaries of all assistants that you will use on the job
- the names and salaries of all assistants you have used on previous jobs for the past two years and proof that you paid them, such as copies of canceled checks or copies of payroll tax forms
- a list of all the equipment and materials you will use in performing the services and how much they cost; proof that you have paid for the equipment, such as copies of canceled checks, is very helpful
- the names and addresses of other clients or customers for whom you have performed services during the previous two years; but don't provide any information you have a duty to keep confidential
- if you're a sole proprietor and will agree, copies of your tax returns for the previous two years showing that you have filed a Schedule C, *Profit or Loss From a Business*.

## Appendix D: Independent Contractor Agreement

This Agreement is made between \_\_\_\_\_ (Client), with a principal place of business at \_\_\_\_\_ and \_\_\_\_\_ (Contractor), with a principal place of business at: \_\_\_\_\_.

This Agreement will become effective on \_\_\_\_\_, \_\_\_\_ and will end no later than \_\_\_\_\_, \_\_\_\_.

### Services to be Performed

*[Check and complete applicable provision—select ONE:]*

*[Alternative A]*

Contractor agrees to perform the following services: \_\_\_\_\_ *[Briefly describe services you want performed by IC]*

*[Alternative B]*

Contractor agrees to perform the services described in Exhibit A, which is attached to this Agreement.

*[End alternate provisions]*

### Payment

*[Check and complete applicable provision—select ONE:]*

*[Alternative A]*

In consideration for the services to be performed by Contractor, Client agrees to pay Contractor \$ \_\_\_\_\_ according to the terms set out below.

*[Alternative B]*

In consideration for the services to be performed by Contractor, Client agrees to pay Contractor at the rate of \$ \_\_\_\_\_ per \_\_\_\_\_ according to the terms of payment set out below.

*[Optional: Unless otherwise agreed in writing, Client's maximum liability for all services performed during the term of this Agreement shall not exceed \$ \_\_\_\_\_.]*

*[End alternate provisions]*

### Terms of Payment

*[Check and complete applicable provision—select ONE:]*

*[Alternative A]*

Upon completing Contractor's services under this Agreement, Contractor shall submit an invoice. Client shall pay Contractor the compensation described within a reasonable time after receiving Contractor's invoice.

*[Alternative B]*

Contractor shall be paid \$\_\_\_\_\_ upon signing this Agreement and the rest of the sum described above when the Contractor completes services and submits an invoice.

*[Alternative C]*

Client shall pay Contractor according to the following schedule of payments:

(1) \$\_\_\_\_\_ when an invoice is submitted and the following services are complete:

\_\_\_\_\_

(2) \$\_\_\_\_\_ when an invoice is submitted and the following services are complete:

\_\_\_\_\_

(3) \$\_\_\_\_\_ when an invoice is submitted and the following services are complete:

\_\_\_\_\_

*[Alternative D]*

Contractor shall submit an invoice to Client on the last day of each month for the work performed during that month. The invoice should include: an invoice number, the dates covered by the invoice, the hours expended, and a summary of the work performed. Client shall pay Contractor's fee within a reasonable time after receiving the invoice.

*[End alternate provisions]*

### **Expenses**

Contractor shall be responsible for all expenses incurred while performing services under this Agreement. This includes license fees, memberships, and dues; automobile and other travel expenses; meals and entertainment; insurance premiums; and all salary, expenses, and other compensation paid to employees or contract personnel the Contractor hires to complete the work under this Agreement.

### **Independent Contractor Status**

Contractor is an independent contractor, not Client's employee. Contractor's employees or contract personnel are not Client's employees. Contractor and Client agree to the following rights consistent with an independent contractor relationship.

- Contractor has the right to perform services for others during the term of this Agreement.
- Contractor has the sole right to control and direct the means, manner and method by which the services required by this Agreement will be performed.

- Contractor has the right to perform the services required by this Agreement at any place, location, or time.
- Contractor will furnish all equipment and materials used to provide the services required by this Agreement.
- Contractor has the right to hire assistants as subcontractors, or to use employees to provide the services required by this Agreement.
- The Contractor or Contractor's employees or contract personnel shall perform the services required by this Agreement; Client shall not hire, supervise, or pay any assistants to help Contractor.
- Neither Contractor nor Contractor's employees or contract personnel shall receive any training from Client in the skills necessary to perform the services required by this Agreement.
- Client shall not require Contractor or Contractor's employees or contract personnel to devote full time to performing the services required by this Agreement.

**Business Permits, Certificates, and Licenses**

Contractor has complied with all federal, state, and local laws requiring business permits, certificates, and licenses required to carry out the services to be performed under this Agreement.

**State and Federal Taxes**

Client will not:

- withhold FICA (Social Security and Medicare taxes) from Contractor's payments or make FICA payments on Contractor's behalf
- make state or federal unemployment compensation contributions on Contractor's behalf, or
- withhold state or federal income tax from Contractor's payments.

Contractor shall pay all taxes incurred while performing services under this Agreement--including all applicable income taxes and, if Contractor is not a corporation, self-employment (Social Security) taxes. Upon demand, Contractor shall provide Client with proof that such payments have been made.

**Fringe Benefits**

Contractor understands that neither Contractor nor Contractor's employees or contract personnel are eligible to participate in any employee pension, profit sharing, health, vacation pay, sick pay, or other fringe benefit plan of Client. If Contractor is later classified as Client's employee, Contractor expressly waives Contractor's rights to any benefits to which he or she was, or might have become, entitled.

**Workers' Compensation**

Client shall not obtain workers' compensation insurance on behalf of Contractor or Contractor's employees. If Contractor hires employees to perform any work under this Agreement, Contractor will cover them with workers' compensation insurance and provide Client with a certificate of workers' compensation insurance before the employees begin the work.

*[Optional: If not operating as a corporation, Contractor shall obtain workers' compensation insurance coverage for Contractor. Contractor shall provide Client with proof that such coverage has been obtained before starting work. ]*

### **Unemployment Compensation**

Client shall make no state or federal unemployment compensation payments on behalf of Contractor or Contractor's employees or contract personnel. Contractor will not be entitled to these benefits in connection with work performed under this Agreement.

### **Insurance**

Client shall not provide any insurance coverage of any kind for Contractor or Contractor's employees or contract personnel. Contractor agrees to maintain an insurance policy of at least \$\_\_\_\_\_ to cover any negligent acts committed by Contractor or Contractor's employees or agents while performing services under this Agreement.

Contractor shall indemnify and hold Client harmless from any loss or liability arising from performing services under this Agreement.

### **Terminating the Agreement**

*[Check the applicable provision—select ONE:]*

*[Alternative A]*

With reasonable cause, either Client or Contractor may terminate this Agreement, effective immediately upon giving written notice.

Reasonable cause includes:

- a material violation of this Agreement, or
- any act exposing the other party to liability to others for personal injury or property damage.

*[Alternative B]*

Either party may terminate this Agreement any time by giving thirty days written notice to the other party of the intent to terminate.

*[End alternate provisions]*

### **Exclusive Agreement**

This is the entire Agreement between Contractor and Client.

### **Severability**

If any provision of this Agreement is determined to be invalid, illegal, or unenforceable, the remaining provisions will remain in full force if the essential provisions of this Agreement for Client and Contractor remain valid, binding, and enforceable.

### **Applicable Law**

This Agreement will be governed by the laws of the state of \_\_\_\_\_.

### **Notices**

All notices and other communications in connection with this Agreement shall be in writing and shall be considered given as follows:

- when delivered personally to the recipient's address as stated on this Agreement
- three days after being deposited in the United States mail, with postage prepaid to the recipient's address as stated on this Agreement, or
- when sent by fax or email to the last fax number or email address of the recipient known to the person giving notice. Notice is effective upon receipt provided that a duplicate copy of the notice is promptly given by first class mail, or the recipient delivers a written confirmation of receipt.

### **No Partnership**

This Agreement does not create a partnership relationship. Contractor does not have authority to enter into contracts on Client's behalf.

### **Resolving Disputes**

*[Check and complete applicable provision—select ONE:]*

*[Alternative A]*

[ ] If a dispute arises under this Agreement, the parties agree first to try to resolve the dispute with the help of a mutually agreed-upon mediator in \_\_\_\_\_. Any costs and fees other than attorney fees associated with the mediation shall be shared equally by the parties.

If it proves impossible to arrive at a mutually satisfactory solution through mediation, the parties agree to submit the dispute to a mutually agreed-upon arbitrator in \_\_\_\_\_. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction to do so. Costs of arbitration, including attorney fees, will be allocated by the arbitrator.

*[Alternative B]*

[ ] If a dispute arises under this Agreement, the parties agree first to try to resolve the dispute with the help of a mutually agreed-upon mediator in \_\_\_\_\_. Any costs and fees other than attorney fees associated with the mediation shall be shared equally by the parties.

If the dispute is not resolved within 30 days after it is referred to the mediator, any party may take the matter to court.

*[Alternative C]*

[ ] If a dispute arises under this Agreement, any party may take the matter to court.

*[Optional: If any court action is necessary to enforce this Agreement, the prevailing party shall be entitled to reasonable attorney fees, costs, and expenses in addition to any other relief to which he or she may be entitled.]*

*[End alternate provisions]*

**Signatures**

Client:       *[Name of Client]*      

By: \_\_\_\_\_  
Signature

      *[Typed or printed name]*      

Title: \_\_\_\_\_

Date: \_\_\_\_\_

Contractor:       *[Name of Contractor]*      

By: \_\_\_\_\_  
Signature

      *[Typed or printed name]*      

Title: \_\_\_\_\_

Taxpayer ID Number: \_\_\_\_\_

Date: \_\_\_\_\_

**If Agreement Is Faxed:**



**Small Business Development Center**  
**Clarion University**

*Helping businesses start, grow, and prosper.*

Contractor and Client agree that this Agreement will be considered signed when the signature of a party is delivered by facsimile transmission. Signatures transmitted by facsimile shall have the same effect as original signatures.