

HB

468

FISCAL NOTE

1

STATE OF ALASKA
1992 LEGISLATIVE SESSION

BILL Bill Version: HB 468
(H) Publish Date: 2-26-92

Revision Date: _____
Title: "An Act relating to unfair trade
practices by construction contractors."
Sponsor: House Judiciary Committee
Requestor: House Labor & Commerce

Department Affected: Labor
BRU: Workers' Compensation
Component: Workers' Compensation
COMPONENT SERIAL NO. 344

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
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REVENUE FUND SOURCE:						
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Linda Rexwinkel, Director Phone: 264-2452
Division: Workers' Compensation Date: 2/24/92
Approved by Commissioner: John Abshire, Acting Commissioner
Agency: Department of Labor Date: 2/24/92

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OME, & Impacted Agency(ies).

COMMITTEE COPY

BILL NO: House Bill No. 468

DATE: March 2, 1992

TITLE: "An Act relating to unfair trade practices by construction contractors."

CONTACT: Arbe Williams
465-2700

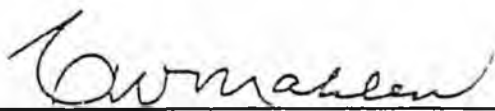
House Bill No. 468 provides that a person who suffers damages as a result of a competitive bid for a construction contract losing to a bid of a person who knowingly violates an employee provision by treating an employee as an independent contractor may bring action for damages or injunctive relief against the person who was awarded the contract. An employee provision as used in this subsection provides for an employer's obligation to pay unemployment insurance contributions, an employer's liability for workers' compensation payments to employees or an employer's obligations under the Federal Insurance Contributions Act.

The bill also provides that the attorney general may bring action in superior court against a person who knowingly violates an employee provision and provides for specific penalties in addition to any other penalty allowed by law.

House Bill No. 468 establishes a civil liability against a contractor or subcontractor who knowingly violates an employee's right to unemployment compensation, workers' compensation coverage or provisions of the Federal Insurance Contributions Act.

The Department of Labor supports this legislation.

APPROVED:

 3/2/92

C. W. Mahlen, Commissioner
Department of Labor

POSITION ~~APER~~/Department of Labor

Independent Contractor Status

Under FICA and FUTA

For federal tax purposes (FICA and FUTA) the determination of whether an individual is an employee or an independent contractor is derived from three tests.

Test I--Corporate Officers

For purposes of FICA and FUTA corporate officers are generally considered to be employees of the corporation, even if they are equity holders. There are some exceptions, however. Corporate officers who perform little or no services for the corporation and receive little or no remuneration (either directly or indirectly) may not be considered as employees.

Test II--The Common Law Rules For Determining Employee or Independent Contractor Status.

The common law rules of the IRS are used to determine employee or independent contractor status for purposes of FICA and FUTA. Generally, an individual is an employee if the person for whom he or she works has the right to direct and control that individual as to the way the individual works in terms of the final results and the details of when, where and how the work gets done. It should be noted that the employer need not actually exercise control for an employer-employee relationship to exist. The fact that the employer has the right to do so usually results in a determination of employee status. The IRS uses 20 common law factors to determine the extent of control exercised and therefore the status of the worker. Workers are generally considered to be employees if they:

- *Must comply with the employer's instructions about the work in terms of when, where and how the work is to be performed. These instructions may be oral or in the form of written procedures such as a personnel manual.

- *Receive training from or at the direction of the employer. Training by the employer or an experienced employee of the employer denotes a certain amount of control. This training can take several forms, including attendance at meetings, use of company policy and procedure manuals, and written correspondence.

- *Provide services that are integrated into the business. In those cases where the success or continuation of the business is dependent upon the provision of certain kinds of services by an individual then it is assumed that the business owner exerts some control over the provision of these services.

- *Provide services that are rendered personally. If an individual who is providing a service to a business has the right to hire a substitute without the permission of the business owner, it suggests a lack of control on the part of the owner. A service that must be rendered personally, however, indicates that the business owner has interest in the methods of delivering the

service as well as the end result.

*Hire, supervise, and pay assistants for the employer. An individual who performs these services for an employer is generally considered to be under the control of the employer, unless this is done under a contract that specifies that the individual is responsible for labor, materials and the end result of the work--not the methods of attainment.

*Have a continuing working relationship with the employer. The existence of such a relationship over a period of time indicates an employer-employee relationship, even if the work is part-time or seasonal.

*Must follow set hours of work. An individual who cannot control his own time is almost always an employee--not an independent contractor.

*Work full-time for an employer. Full-time work by an individual is considered indicative of control by the employer, since the individual is not free to offer his services to other parties. If, for example, an employer requires a certain volume of work that consumes all of the individual's working time, it is generally considered an employer-employee relationship. By contrast, an independent contractor is free to work whenever he chooses for whomever he chooses.

*Do their work on the employer's premises. This circumstance implies employer control especially if the work could be done off the premises. The use of office space, desk space, office equipment and services provided by the employer generally places the individual under the direction of the employer unless the worker has the option to use other space and facilities. Working off the employer's premises, on the other hand, does not imply independent contractor status if the work must be performed off the premises (construction work, for example).

*Must do their work in a sequence set by the employer. If the employer determines, or has the right to determine, the order of the work to be performed control may be implied.

*Must submit regular reports to the employer. Any type of oral or written reports indicates that the worker must account for his actions to the employer and this may imply control and direction.

*Receive payments of regular amounts at set intervals. Whenever payments to a worker are made on an hourly, weekly or monthly basis it is likely that an employee-employer relationship exists. Independent contractors are usually paid on a job basis or by commission. A guarantee by the employer of a minimum salary may give rise to an employer-employee relationship. The establishment of a drawing account by the employer for the benefit of the worker+ may imply an employment relationship if the worker is allowed to draw from the account at stated intervals and is not required to reimburse for any amount exceeding earnings.

*Receive payments for business and/or travel expenses. Payment of such expenses is indicative of control by the employer.

*Rely on the employer to furnish tools and materials. Independent contractors usually supply their own tools and materials. The furnishing of such items by the employer implies control.

*Lack a major investment in facilities used to perform the service. If the worker has a major investment in the work premises or equipment used to perform the work it is indicative of independent status. Employers routinely supply employees with items such as tools, manuals, instruction books, clothing, etc. and these are not considered facilities.

*Cannot make a profit or suffer a loss from their services. The possibility that the worker may profit or suffer a loss as a result of services performed is indicative of independent contractor status. An independent contractor has recurring liabilities and obligations and profit or loss is dependent on the relation between his receipts and expenditures.

*Work for one employer at a time. An individual who works for a number of employers at one time is usually thought to be free from the control of any employer thereby achieving independent status.

*Do not offer their services to the general public. Offering services to the general public usually connotes independent contractor status, especially if the individual has a place of business, advertises his services, and generally seeks to attract customers.

*Can be fired by the employer. An individual who can be fired from his or her employment position by the employer is an employee. Independent contractors cannot be fired, except to the extent that they do not adhere to some contractual obligation or specification.

*May quit work at any time without incurring liability. If a worker has the right to leave the employment at any time without incurring liability, then an employer-employee relationship exists. An independent contractor usually agrees to do a specific job for a specified commission, and if the contractor does not fulfill that obligation he can be held liable.

Test III--Statutory Employees

Four occupations that could not meet the employee-status test under the IRS common-law rules have been designated employees by congressional statute (agent-drivers or commission-drivers, full-time life insurance salespeople, homeworkers, and full-time traveling or city salespeople).

In order for an individual to be designated as a Test III statutory he or she must meet the specifications for one of the four designated occupations, as well as the following conditions:

*The worker must perform substantially all of the work personally;

*The worker must have no substantial investment in the facilities used to perform the work; and

*The work must be performed in a continuing relationship.

Statutory Nonemployees

In the Revenue Act of 1978 the Congress created a "safe haven" for taxpayers who had previously classified certain workers as independent contractors, but who might not actually meet the IRS test. This safe haven would extended by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). These actions were taken to minimize employers' confusion about employment status while the Congress continued to seek a more definitive method of determining classifications.

Another provision of the TEFRA legislation designated qualified real estate agents and direct sellers as statutory nonemployees, thereby granting self-employed status to these individuals.

277.ATT
21-JAN-92

REPRESENTATIVE DAVE DONLEY

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CHAIRMAN
JUDICIARY COMMITTEE

VICE CHAIRMAN
REGULATION REVIEW COMMITTEE

MEMBER
RULES COMMITTEE
LABOR AND COMMERCE COMMITTEE

MEMORANDUM

TO: All House Members

FROM: Representative Dave Donley ^{DB}

RE: Questions and Answers regarding HB468, an act relating to unfair trade practices by construction contractors

DATE: March 11, 1992

1. What is the problem HB 468 will redress?

HB 468 tries to address a growing problem in Alaska and in many other states where there is a high probability contractors are misclassifying employees as independent contractors in order to escape payment of unemployment compensation, workers' compensation insurance, and social security taxes. The problem is so pervasive that in 1990 the Internal Revenue Service estimated that 38% of all employers misclassify employees as contractors. With declining revenues it is nearly impossible for Alaska to effectively monitor employee misclassification. In turn, HB 468 provides an additional solution to this problem by allowing industry participants to bring a private cause of action and police misclassification by their peers.

2. How does HB468 address the problem?

HB468 provides a private cause of action to contractors, workers, or unions that suffers damages by loss of a bid. In their action the person who suffers damages must show that the winning bidder knowingly misclassified employees as independent contractors. If they meet this burden, the plaintiff may collect damages for the loss they suffered and may enjoin award of the bid to the bidder in



violation of these statutes. The plaintiff may not succeed in this action if, in their bid, they also knowingly misclassified employees as independent contractors.

HB 468 also gives the attorney general authority to bring an action for penalties and for injunctive relief against a person who knowingly violates the employee provisions addressed in this bill.

3. What types of construction contracts does this address?

HB 468 would primarily affect public sector construction projects. This legislation applies to all construction contracts that were let out for competitive bid. For this reason the act would apply to projects put out for bid by the state, its political subdivisions, and public corporations, including the Alaska Railroad. If a construction project in the private sector was let out for competitive bid the legislation would conceivably apply.

4. Is there similar legislation in other states?

Connecticut and Oregon have both enacted legislation similar to HB 468. Illinois and California are addressing similar legislation at this time. In addition, there is a bill in the United States Congress to provide for a private cause of action on federal construction projects.

The real impetus for this legislation in other states is parallel to the reason for this legislation in Alaska. The number of contractors failing to secure workers' compensation, failing to make unemployment contributions, and failing to pay social security taxes is too great, and in the face a grave fiscal constraints, the states do not have the budget to address this problem on their own. For example, Connecticut, the first state to enact legislation on this issue, did so in large part because they lacked the state funds to monitor compliance on their own.

Here in Alaska the fiscal constraints are identical. Just as one example, in FY 92 the Workers' Compensation Division laid off the one investigator they had who pursued companies that failed to obtain workers' compensation coverage. While the Wages and Hours Division of the Department of Labor has taken on some of these responsibilities, the amount of effort they can expend on this issue is minimal at best.

REPRESENTATIVE DAVE DONLEY

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CHAIRMAN
JUDICIARY COMMITTEE

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REGULATION REVIEW COMMITTEE

MEMBER
RULES COMMITTEE
LABOR AND COMMERCE COMMITTEE

MEMORANDUM

To: Senator Drue Pearce
Chair, Labor and Commerce Committee

From: Representative Dave Donley^B
Chair, House Judiciary Committee

Re: HB 468, An act relating to unfair trade practices by
construction contractors

Date: March 30, 1992

MAR 30 1992

I am writing to request that you please schedule for hearing HB 468, an act relating to unfair trade practices by noncomplying contractors. This legislation addresses concerns both contractors and the labor community have about unfair bidding practices of contractors who are attempting to reduce their bids by misclassifying employees as independent contractors. Misclassification allows the bidder to escape payment of FICA taxes, workers' compensation, and unemployment contributions and resultingly reduce their bid.

The bill has two main provisions.

1. It provides a private cause of action to contractors workers, and unions that suffer damages by loss of a bid to sue winning bidders who reduced their bid by knowingly misclassifying employees as independent contractors. One exception to this provision is that a person who brings an action against a winning bidder may not collect damages if the defendant to the case establishes that the plaintiff also knowingly violated employment law by misclassifying an employee as an independent contractor in their bid for the same contract.



2. It gives the attorney general authority to bring an action for civil penalties and injunctive relief against a person who knowingly violates the workers' compensation, unemployment contributions, and FICA withholdings by misclassifying an employee as an independent contractor.

While the State presently has the authority to address this misclassification in the bids it receives, many are concerned that the State is too overburdened to discover every case. For example, the IRS has recently estimated that 38% of employers misclassify workers as contractors. Therefore, HB 468 provides this private cause of action. It is similar to a bill presently introduced at the federal level to address this same concern.

HB 468 has the support of the Labor community and is not opposed by the Associated General Contractors.

DD/jmn

FISCAL NOTE

STATE OF ALASKA
1992 LEGISLATIVE SESSION

BILL NO : CSHB 468 (Jud) am

Revision Date: _____
 Title: "An Act relating to unfair trade
 practices by construction contractors."
 Sponsor: House Judiciary Committee
 Requestor: Senate Labor & Commerce

Department Affected: Labor
 BRU: Workers' Comp/Employment Security
 Component: Workers' Compensation/
 Unemployment Insurance
 COMPONENT SERIAL NO. 344/329

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
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REVENUE FUND SOURCE:						
---------------------------------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of cost year impact: None

(Attach a separate page if necessary)

Prepared by: Arbe Williams, Special Assistant Phone: 465-2700
 Division: Commissioner's Office Date: 4/20/92
 Approved by Commissioner: C. W. Mahlen
 Agency: Department of Labor Date: 4/20/92

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

DEPARTMENT OF LABOR

CSHB 468(Jud)am

Enforcement procedures for violating employment security or workers' compensation laws:

The Employment Security Division

audits an employer's records for proper payment of unemployment insurance contributions. Failure to pay the required contributions will result in the assessment of penalties and a lien on the employer's assets.

The Division of Workers' Compensation

responds to a direct complaint that an employer does not have workers' compensation coverage or to information from the Department's Wage and Hour investigations that an employer cannot produce proof of workers' compensation coverage. An investigation is initiated and upon determination that the employer does not have the required coverage, the matter is referred to the Workers' Compensation Board. If the Board determines that the employer is in violation of the requirement for coverage, the Board can issue a stop order prohibiting the employer from hiring employees. The case is referred to the Attorney General's Office for prosecution in the event an employer does not comply with the requirement to provide workers' compensation insurance which can result in the assessment of a \$10,000 fine.

HB 468 ACTION AGAINST NONCOMPLYING CONTRACTORS

"An Act relating to unfair trade practices by construction contractors."

SPONSOR(S): JUDICIARY

HB 468 Bill History

Jrn-Date	Page	Action
02/12/92	2236	(H) READ THE FIRST TIME - REFERRAL(S)
02/12/92	2236	(H) L&C, JUD
02/26/92	2425	(H) L&C RPT 2DP 2NR
02/26/92	2425	(H) (DP: BRUCKMAN,DONLEY) (NR: IVAN,PARNELL)
02/26/92	2425	(H) -ZERO FISCAL NOTE (LABOR) 2/26/92
03/06/92	2537	(H) JUD RPT CS(JUD) 4DP 2NR
03/06/92	2537	(H) (DP: DONLEY,GRUENBERG,ELLIS,PARNELL)
03/06/92	2537	(H) (NR: HANLEY,MARTIN)
03/06/92	2537	(H) -PREV ZERO FN (LABOR) 2/26/92
03/06/92	2537	(H) REFERRED TO RULES

ALASKA STATE LEGISLATURE
HOUSE BILL NO. 468

HISTORY IN THE HOUSE

1992
2/12 Read first time and referred to:
LEC, JUD.

3/6 JUD RPT CS(JUD) New Title
4 DP ~~DNP~~ 2 NR ~~AM~~
FN 1 OFN Previous FN

RPT CS() New Title
DP DNP NR AM
FN OFN Previous FN

RPT CS() New Title
DP DNP NR AM
FN OFN Previous FN

3/11 Read second time
CS(Jud) Adopted

3/13 Amended
in 1

3/11 Advanced

3/11 Read third time

3/11 Held in 3rd to next calendar

3/13 Return to second for specific amendment Am 31 - adopted

3/13 PASSED EFD Same ___ or
Yeas 30 Yeas
Nays 3 Nays
Excused 5 Excused
Absent 2 Absent

Intent adopted

3/13 Reconsideration by Lemans
3/14 Reconsideration not taken up

PASSED ON RECON. EFD Same ___ or
Yeas Yeas
Nays Nays
Excused Excused
Absent Absent

Intent adopted

3/16 Reported correctly engrossed
Signed by Speaker, to the Senate
Justin Green
Chief Clerk of the House

HISTORY IN THE SENATE

1992
3/18 Read first time and referred to:
STA L+C

3/19 add JUD: STA R+C JUD

3/23 STA wanted to R+C JUD

3/23 STA RPT() CS DP NR DNP AM
New Title Same Title Previous FN
FN OFN wanted to To L+C

RPT() CS DP NR DNP AM
New Title Same Title Previous FN
FN OFN To

RPT() CS DP NR DNP AM
New Title Same Title Previous FN
FN OFN To

Rules Calendar() CS AM Other
New Title Same Title Previous FN
FN OFN

Read second time
CS Adopted () New Title
Amended Advanced

Read third time
Letter of Intent adopted
Return to second for specific amendment

PASSED EFD Same ___ or
Yeas Yeas
Nays Nays
Excused Excused
Absent Absent

Reconsideration
Reconsideration not taken up

PASSED EFD Same ___ or
Yeas Yeas
Nays Nays
Excused Excused
Absent Absent

Reported correctly engrossed
Signed by President, to the House
Secretary of the Senate



Department of the Treasury
Internal Revenue Service
Catalog Number 63126N

Publication 937

Business Reporting

- Employment Taxes
- Information Returns

For use in preparing
1990 Returns

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Important Changes for 1990

New tax rates and wage maximums for social security taxes. In 1990, the tax rate for social security taxes is 7.65% for both the employee and the employer (a total of 15.3%) on wages up to \$51,300. The 7.65% tax is a total of 6.2% for social security (old-age, survivors, and disability insurance), and 1.45% for Medicare (hospital insurance).

In 1991, the tax will remain at 7.65% but the maximum wages subject to the social security portion (6.2%) increase to \$53,400, while the maximum wages subject to the Medicare portion (1.45%) increase to \$125,000.

Group legal service plans. The cost of group legal service plans is not subject to social security and federal unemployment taxes, or income tax withholding, if the cost is paid before January 1, 1992. See *Withholding and Reporting Payments Other than Wages under Income Tax Withholding*.

Educational assistance plans. The cost of educational assistance plans is not subject to social security and federal unemployment taxes, or income tax withholding, if the cost is paid before January 1, 1992. See *Withholding and Reporting Payments Other than Wages under Income Tax Withholding*.

Farmers and crew leaders must withhold income tax. For wages paid after 1989, farmers and crew leaders must withhold federal income tax from farm workers who are subject to social security taxes.

Now federal tax deposit penalties. After 1989, the penalty for a late tax deposit is based on the length of time the deposit is late. See *Penalties under Deposits*, later.

New \$100,000 deposit rule. After July 31, 1990, undeposited taxes that reach \$100,000 or more in any eighth-monthly deposit period must be deposited on the next banking day. However, you are still required to make deposits within 3 banking days when undeposited taxes reach at least \$3,000 at the end of an eighth-monthly deposit period. See *Deposits under Paying Social Security and Withheld Income Taxes*.

Federal unemployment (FUTA) tax rate. The gross FUTA tax rate remains at 6.2% through 1991.

Introduction

This publication is mainly designed for small businesses. This includes self-employed persons such as sole proprietors, independent contractors, and members of a partnership.

Free publications and forms. If you need information on a subject not covered in this publication, please check our other free publications. To order publications and forms, call our toll-free telephone number: 1-800-TAX-FORM (1-800-825-3576). You may also write to the IRS Forms Distribution Center for your area as shown in the income tax package.

Employment Taxes

If you have any employees, you will probably be required to withhold federal income tax from their wages. You may also have to withhold and pay social security (FICA) taxes. If you do not withhold these taxes, or withhold the taxes but do not deposit them, you may be subject to a penalty equal to the amount of the tax. See *Penalties under Deposits*, later.

This publication discusses an employer's responsibility for these taxes. It also discusses income tax withholding on payments other than wages, the federal unemployment (FUTA) tax, the rules for advance payment of the earned income credit, and the rules for tip reporting and allocation. Information useful for 1991 is also included.

If you need information on railroad taxes, see the instructions for Form CT-1, *Employer's Annual Railroad Retirement and Unemployment Repayment Tax Return*, and Form CT-2, *Employee Representative's Quarterly Railroad Tax Return*. Railroad retirement and railroad unemployment repayment taxes are explained in the *Instructions for Form CT-1*.

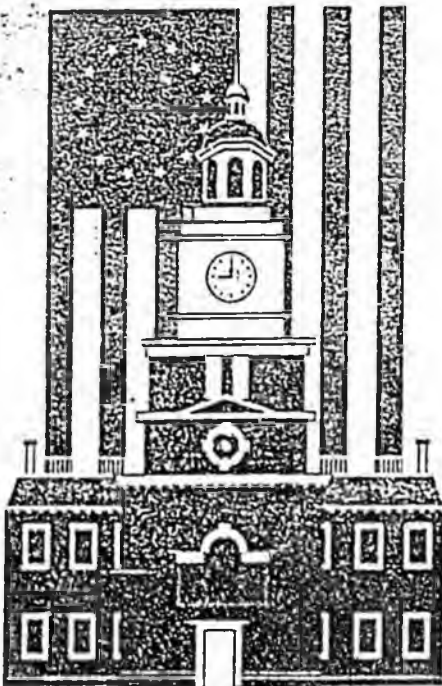
Note. After your employees file their 1990 income tax returns, you can help them correct any mistakes they may have made in figuring their income tax withholding for 1990 by making new 1991 Forms W-4 available. You should encourage them to check their income tax withholding situation if they owed a large amount of tax or received a large refund for 1990, and to give you a new Form W-4 for 1991 if necessary. An employee is most likely to have too little tax withheld if both the employee and his or her spouse work. See *Form W-4 Withholding Allowances*, under *Income Tax Withholding*, later.

After you receive completed Forms W-4 from your employees, you can help them determine whether they are having the right amount of income tax withheld in 1991 by giving them Publication 919, *Is My Withholding Correct for 1991?* This publication will help your employees compare the amount of tax they expect to show on their 1991 tax returns with the amount of tax to be withheld from their pay during 1991.

Who Are Employees?

Before you can know how to treat payments you make for services rendered to you, you must first know the business relationship that exists between you and the person performing those services. The person performing the services may be:

- 1) An independent contractor;
- 2) A common-law employee;
- 3) A statutory employee, or



4) A statutory nonemployee.

This discussion explains these four categories. A later discussion, *Employee or Independent Contractor?*, points out the differences between an independent contractor and an employee and gives examples from various types of occupations.

Independent Contractors

People such as lawyers, contractors, subcontractors, public stenographers, auctioneers, etc., who follow an independent trade, business, or profession in which they offer their services to the general public, are generally not employees. However, whether such people are employees or independent contractors depends on the facts in each case. The general rule is that an individual is an independent contractor if you, the employer, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result.

You do not have to withhold or pay taxes on payments you make to independent contractors.

Common-law Employees

Under common-law rules, every individual who performs services subject to the will and control of an employer, as to both *what* must be done and *how* it must be done, is an employee. It does not matter that the employer allows the employee discretion and freedom of action, so long as the employer has the *legal right* to control both the method and the result of the services. For a discussion of the factors that indicate whether sufficient control is present to establish an employer-employee relationship, see *Employee or Independent Contractor?*, later.

Two usual characteristics of an employer-employee relationship are that the employer has the right to discharge the employee and the employer supplies the employee with tools and a place to work.

If you have an employer-employee relationship, it makes no difference how it is described. It does not matter if the employee is called an employee, or a partner, co-adventurer, agent, or independent contractor. It does not matter how the payments are measured, how they are made, or what they are called. Nor does it matter whether the individual is employed full time or part time.

No distinction is made between classes of employees. Superintendents, managers, and other supervisory personnel are all employees. An *officer of a corporation* is generally an employee, but a director is not. An officer who performs no services or only minor services, and neither receives nor is entitled to receive any pay, is not considered an employee.

You may have to withhold and pay taxes on wages you pay to common-law employees.

Statutory Employees

If an individual who works for you is not an employee under the common-law rules (see *Employee or Independent Contractor?*, later), you do not have to withhold federal income tax from that individual's pay. However, for social security taxes, the term *employee* includes any individual who works for you for pay in one of the following four categories:

- 1) A driver who distributes meat products, vegetable products, fruit products, bakery products, or beverages (other than milk) or picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
- 2) A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- 3) An individual who works at home on materials or goods which you supply and which must be returned to you or to a person you name, if you also furnish specifications for the work to be done.

4) A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for you must be the salesperson's principal business activity.

Social security tax. For social security tax, individuals within any of these categories are employees if:

- The service contract states or implies that almost all of the services are to be performed personally by them;
- The individual has little or no investment in the equipment and property used to perform the services (other than an investment in transportation facilities); and
- The services are performed on a continuing basis.

Federal unemployment tax. For federal unemployment tax, the term *employee* means the same as it does for social security tax, except that it does not include categories (2) and (3), above. Thus, any individual who is an employee under categories (1) or (4) is also an employee for federal unemployment tax purposes.

Reporting payments to statutory employees. Furnish a Form W-2 to a statutory employee, and check *Statutory employee* in box 6. Show your payments to the employee as other compensation in box 10. Also, show social security tax withheld in box 11, and social security wages in box 12. The statutory employee can deduct his or her expenses from the payments shown on Form W-2 and, after 1989, will report earnings as a statutory employee on line 1 of Schedule C. (A statutory employee's business expenses are not subject to the reduction by 2% of his or her adjusted gross income that applies to common-law employees.)

Statutory Nonemployees

Two categories of statutory nonemployees have been established: *direct sellers* and *licensed real estate agents*. They are treated as self-employed for federal income tax and employment tax purposes if:

- 1) Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked; and
- 2) Their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes.

Direct sellers. Direct sellers are persons:

- 1) Engaged in selling (or soliciting the sale of) consumer products in the home or at a place of business other than in a permanent retail establishment; or
- 2) Engaged in selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis prescribed by regulations, for resale in the home or at a place of business other than in a permanent retail establishment.

Direct selling includes activities of individuals who attempt to increase direct sales activities of their direct sellers and who earn income based on the productivity of their direct sellers. Such activities include providing motivation and encouragement, imparting skills, knowledge, or experience, and recruiting.

For more information on direct sellers, get Publication 911, *Tax Information for Direct Sellers*.

Licensed real estate agents. This category includes individuals engaged in appraisal activities for real estate sales if they earn income based on sales or other output.

General Rules for Withholding

You may find it helpful to remember the following general rules for withholding:

- 1) **Independent contractors.** You do not have to withhold income tax or social security tax from amounts you pay an independent contractor. But, if you pay an independent contractor \$600 or more during the year in the course of your trade or business, you must file a Form 1099-MISC, *Statement for Recipient of Miscellaneous Income*.
- 2) **Common-law employees.** You may have to withhold income tax and social security tax from the wages you pay common-law employees. You may also have to pay federal unemployment tax and your share of social security taxes on these wages.
- 3) **Statutory employees.** You do not withhold income tax from the wages of statutory employees. But you must withhold and pay social security taxes. Unless they are full-time life insurance sales agents or work at home, you must also pay federal unemployment tax on their wages.
- 4) **Statutory nonemployees.** You do not withhold or pay taxes on payments to statutory nonemployees.

Taxes due if worker not treated as an employee. If you treat a worker other than as an employee (for example, as an independent contractor) and you have no reasonable basis for doing so, you will have to pay employment taxes for that worker.

Relief provisions. If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all required federal tax returns, including information returns, on a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977. For further information, see Revenue Procedure 85-18, in Internal Revenue Cumulative Bulletin 1985-1, page 518.

Technical service specialists. This relief provision does not apply to a worker who provides services for a client as a technical specialist under an arrangement between a taxpayer, such as a technical services firm, and the client. A technical service specialist is an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work. (A taxpayer who directly contracts with a technical service specialist to provide services for itself rather than for a third party may still be entitled to the relief provision.) This rule does not automatically convert technical service specialists to employees for employment tax purposes. The common-law standards control whether the specialist is treated as an employee or an independent contractor. See *Employee or Independent Contractor?*, below.

Leased employees. Under certain circumstances, a corporation furnishing workers to various professional people and firms is the employer of those workers for employment tax purposes. For example, a professional service corporation may provide the services of secretaries, nurses, and other similarly trained workers to its subscribers. The service corporation enters into contracts with the subscribers under which the subscribers specify the services to be provided and the fee to be paid to the service corporation for each individual furnished. The contracts provide that the service corporation has the right to control and direct the worker's services for the subscriber including the right to discharge or reassign the worker. The service corporation hires the workers, pays their wages, provides them with unemployment insurance and other benefits, and

is the employer for employment tax purposes. For information on employee leasing as it relates to pension plan qualification requirements, see *Employee Leasing* in Publication 560, *Self-Employed Retirement Plans*.

Nonbusiness (personal) services by employees. Noncash payments by an employer for personal services by employees, not in the course of the employer's business, are not subject to employment taxes.

Cash payments by an employer, however, for personal services by employees not in the course of the employer's business, such as making repairs on the employer's home, are subject to the following rules:

- 1) For income tax withholding and federal unemployment taxes, the payments are taxable if the employee earns \$50 or more in cash in a calendar quarter performing personal services for the employer, and works 24 or more days in that quarter or in the preceding quarter in the employer's business.
- 2) For social security taxes, the payments are taxable if the employee receives \$100 or more in cash in a calendar year from the employer for personal services.

These rules do not apply to corporate employees. They also do not apply to household and farm workers.

Additional Information. For more information about what wages are taxable, the treatment of special types of employment, the treatment of special types of payments, and similar subjects, get a free copy of Publication 15 (Circular E), *Employer's Tax Guide*, or Publication 51 (Circular A), *Agricultural Employer's Tax Guide*, from the Internal Revenue Service.

Employee or Independent Contractor?

An employer must generally withhold income taxes, withhold and pay social security taxes, and pay unemployment taxes on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to independent contractors.

Common law rules. To help you determine whether an individual is an employee under the common law rules, 20 factors have been identified that indicate whether sufficient control is present to establish an employer-employee relationship. The degree of importance of each factor varies depending on the occupation and the context in which the services are performed. It does not matter that the employer allows the employee freedom of action, so long as the employer has the right to control both the method and the result of the services. If an employer treats an employee as an independent contractor and the relief provisions discussed earlier do not apply, the person responsible for the collection and payment of withholding taxes may be held personally liable for an amount equal to the employee's income and social security taxes that should have been withheld.

The 20 factors indicating whether an individual is an employee or an independent contractor are:

- 1) **Instructions.** An employee must comply with instructions about when, where, and how to work. Even if no instructions are given, the control factor is present if the employer has the right to give instructions.
- 2) **Training.** An employee is trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
- 3) **Integration.** An employee's services are integrated into the business operations because

the services are important to the success or continuation of the business. This shows that the employee is subject to direction and control.

- 4) **Services rendered personally.** An employee renders services personally. This shows that the employer is interested in the methods as well as the results.
- 5) **Hiring assistants.** An employee works for an employer who hires, supervises, and pays assistants. An independent contractor hires, supervises, and pays assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.
- 6) **Continuing relationship.** An employee has a continuing relationship with an employer. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.
- 7) **Set hours of work.** An employee has set hours of work established by an employer. An independent contractor is the master of his or her own time.
- 8) **Full-time work.** An employee normally works full time for an employer. An independent contractor can work when and for whom he or she chooses.
- 9) **Work done on premises.** An employee works on the premises of an employer, or works on a route or at a location designated by an employer.
- 10) **Order or sequence set.** An employee must perform services in the order or sequence set by an employer. This shows that the employee is subject to direction and control.
- 11) **Reports.** An employee submits reports to an employer. This shows that the employee must account to the employer for his or her actions.
- 12) **Payments.** An employee is paid by the hour, week, or month. An independent contractor is paid by the job or on a straight commission.
- 13) **Expenses.** An employee's business and travel expenses are paid by an employer. This shows that the employee is subject to regulation and control.
- 14) **Tools and materials.** An employee is furnished significant tools, materials, and other equipment by an employer.
- 15) **Investment.** An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else.
- 16) **Profit or loss.** An independent contractor can make a profit or suffer a loss.
- 17) **Works for more than one person or firm.** An independent contractor gives his or her services to two or more unrelated persons or firms at the same time.
- 18) **Offers services to general public.** An independent contractor makes his or her services available to the general public.
- 19) **Right to fire.** An employee can be fired by an employer. An independent contractor cannot be fired so long as he or she produces a result that meets the specifications of the contract.
- 20) **Right to quit.** An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it.

Form SS-8. In doubtful cases, the facts will determine whether or not there is an actual employer-employee relationship. If you want the IRS to determine whether a worker is an employee, file Form SS-8, *Determination of Employee Work Status for Purposes of Federal*

Employment Taxes and Income Tax Withholding, with the District Director.

If you classify an employee as an independent contractor and you had no reasonable basis for doing so, you will have to pay employment taxes for that worker (the relief provisions, discussed earlier, will not apply). Further, if you do not withhold income and social security taxes from his or her wages, you may be held personally liable for a penalty of 100% of the tax if you are the person responsible for the collection and payment of withholding taxes. See *Penalties*, under *Deposits*, later.

The following examples may help you to properly classify your workers:

Building and Construction Industry

Example 1. John Brown has an oral agreement with Ace Building Co. to do carpentry work on any house designated by the Ace Building Co. He supplies his own hand tools. The Ace Building Co. supplies the material for each job. He has to do the work himself and he works on a full-time basis for the company. For some work he is paid on a piecework basis and for some on an hourly basis. He has no assistants, does not have an office, and does not advertise in newspapers or otherwise hold himself out to the public as being in the carpentry business. The Ace Building Co. can discharge him any time before he finishes a job without contractual liability. John is an employee of the Ace Building Co.

Example 2. Ron Smith, a mason, has an oral agreement with Jifty, Inc., a contractor, to face a building with brick. Jifty supplies all material for the job. He supplies only his hand tools. He has to do the work himself and is paid on an hourly basis. Jifty employs two other masons on the job, who are supervised by Ron. Detailed supervision over him is neither necessary nor warranted because of his skill in the work. He can quit the job at any time, or Jifty can discharge him at any time. He has no investment or proprietary interest in a business that offers the general public services similar to those he does for Jifty. Ron is an employee of Jifty, Inc.

Example 3. Tom Green is a painting subcontractor who has contracted to paint 264 houses. He hired 40 painters to do the work for him, although only about 15 are on the job at any one time. He supplies all the paint, brushes, and ladders. He designates the house to be painted, and either pays the painters per house or by the hour. Detailed instructions about the work are not necessary because of the painters' skill in their trade. He inspects the work and requires them to repaint any unsatisfactory work. The painters cannot engage helpers without his consent. He can discharge them for any reason, and they are free to resign at any time. The painters are under no legal obligation to complete the painting of the houses. They assume no business risks and have no capital investment. None of them has an established business. The painters are employees of Tom Green.

Example 4. Jerry Jones has an agreement with Wilma White to supervise the remodeling of her house. She did not advance funds to help him carry on the work. She makes direct payments to the suppliers for all necessary materials. She carries liability and worker's compensation insurance covering Jerry and others he engaged to assist him. She pays them an hourly rate, and exercises almost constant supervision over the work. Jerry is not free to transfer his assistants to other jobs. He may not work on other jobs while working for Wilma. He assumes no responsibility to complete the work and will incur no contractual liability if he fails to do so. He and his assistants perform personal services for hourly wages. They are employees of Wilma White.

Example 5. Milton Manning, an experienced tilesetter, orally agreed with a corporation to perform full-time services at construction sites. He

uses his own tools and performs services in the order designated by the corporation and according to its specifications. The corporation supplies all materials, makes frequent inspections of his work, pays him on a piecework basis, and carries worker's compensation insurance on him. He does not have a place of business or hold himself out to perform similar services for others. Either party can end the services at any time. Milton Manning is an employee of the corporation.

Example 6. Wallace Black agreed with the Sawdust Co. to supply the construction labor for a group of houses. The company agreed to pay all construction costs. However, he supplies all the tools and equipment. He performs personal services as a carpenter and mechanic for an hourly wage. He also acts as superintendent and foreman, and engages other individuals to assist him. The company has the right to select, approve, or discharge any helper. A company representative makes frequent inspections of the construction site. When a house is finished, Wallace is paid a certain percentage of its costs. He is not responsible for faults, defects of construction, or wasteful operation. At the end of each week, he presents the company with a statement of the amount he has spent, including the payroll. The company gives him a check for that amount from which he pays the assistants, although he is not personally liable for their wages. Wallace Black and his assistants are employees of the Sawdust Co.

Example 7. A local plumbers' union and a contractors' association agreed to set up an apprenticeship program. The program is financed by the contractors and is administered by a joint apprenticeship committee. Trainees are enrolled first in a preapprenticeship program, in which they attend vocational school full time 5 days a week for 6 to 8 weeks. During this period, they are paid an hourly rate and are furnished with all materials and supplies used in school.

After completion of the preapprenticeship program, the trainees are assigned to work for local contractors as apprentice plumbers. The apprentices must attend training classes related to the trade one day a week for 2 years. The apprenticeship program pays them for the time spent in attending classes at the same hourly rate they earn working for their contractor-employers.

While in the preapprenticeship program, the trainees are not employees. Their payments from the program are not subject to income tax withholding or social security taxes. The contractors and the administrators of the preapprenticeship program are not liable for federal unemployment tax. However, the apprentices assigned to contractors as apprentice plumbers are considered employees; even when attending classes under the apprenticeship program. Their payments from the program are subject to income tax withholding, social security taxes, and federal unemployment tax.

Trucking Business

Example 1. Drivers for Rover Trucking Co. often engage laborers to unload their trucks with the express consent of the company. The drivers pay the unloaders from funds provided by the company. The unloaders are company employees. This also would be true if the drivers had only the implied consent of the company.

Example 2. A company engages Phil Blue to haul products to its customers. The company has legal ownership and control of the trucking equipment. Phil can be required, on an hour's notice, to make deliveries at times and places specified by the company. Refusal can jeopardize his relationship with the company. He has to operate and maintain the equipment and provide the necessary operators and helpers. He is not allowed to use the company's equipment to haul for others. He is paid on a tonnage basis and is not guaranteed a minimum amount of compensation. He has

to pay the operators and helpers out of his tonnage receipts as well as pay for all insurance coverage required by the company. Phil and any operators or helpers engaged to assist him are employees of the company.

Fishing Industry

Example 1. Harry Rose is the captain of one of the Pan Fishing Company's schooners. He engages a crew of 15 to operate the schooner. He offers to pay each crew member on the *lay* (sharing of the profit) basis. He and the crew members (except the engineer, who is paid a straight fee) are jointly liable for any losses resulting from a voyage.

The schooner is an American vessel of more than 10 net tons. He and the Pan Fishing Company entered into a contract of service within the United States.

After the voyage, Captain Rose sells the catch through a fish exchange, which deducts its fees from the proceeds. After deducting certain specified expenses (such as fuel, oil, etc.), he turns one-fourth of the proceeds over to Pan Fishing Co., less 5%, which he keeps as his commission. From the remaining three-fourths, the expenses of food, bait, etc., are deducted. The remainder is then equally divided among the members of the crew, including himself.

The members of a crew engaged under these circumstances are employees of either the captain (if he is not an agent of the vessel owner) or of the vessel owner. Their lays are in the nature of wages, and the agreements under which the crews are engaged in these circumstances are contracts of hire.

In this example, Captain Rose is acting as an agent of Pan Fishing Co. Therefore, the company is the employer. As an employer of a crew working on an American vessel under a contract entered into in the U.S., the company must withhold income tax and social security taxes from the entire crew's wages, including the wages of Captain Rose and the engineer. The company must also pay the employer's portion of social security taxes.

Because the schooner is a vessel of more than 10 net tons with a crew of more than nine members, the company must also pay federal unemployment tax on these wages.

The value of *meals and lodging furnished to the crew* is not subject to income tax withholding, social security taxes, and federal unemployment tax because the company must furnish meals and lodging on board the vessel so that the crew can do their work.

Federal unemployment tax. The work of catching fish is exempt from federal unemployment tax *except* for:

- 1) Work related to catching salmon or halibut for commercial purposes; or
- 2) Work performed on a vessel of more than 10 net tons.

However, work falling under items (1) and (2) above is also exempt if the four conditions mentioned, below, under *Certain crew members considered self-employed* are met.

Certain crew members considered self-employed. Wages paid to the members of a crew on a fishing boat are not subject to federal income tax withholding, social security taxes, and the federal unemployment tax if all the following conditions are met:

- 1) The members neither get nor are entitled to any money for their work (other than as provided in condition (2), below);
- 2) The members get shares of the catch or of the proceeds from the sale of the catch;
- 3) Each member's share depends on the size of the catch; and
- 4) The operating crew of the boat (or each boat from which a member gets a share for a

fishing operation involving more than one boat) normally numbers less than 10.

Each member of the crew who meets these conditions is considered self-employed. The earnings of these crew members are considered trade or business income and therefore subject to self-employment tax. See Publication 533, *Self-Employment Tax*.

Example 2. Mike Jones, an owner of a fishing boat of more than 10 net tons, employs a captain and eight others to work as crew members. The proceeds from the sale of the catch offset boat operating expenses, such as fuel, bait, and ice. The balance is divided 60% among the captain and the crew members and 40% between Mike and the captain. Between voyages the crew members do not receive any additional compensation, but they must do certain work, such as repairing nets, splicing cable, and transporting the catch. However, the mate, the engineer, and the cook receive an additional payment of \$100 each. This payment does not depend on the boat's catch. Since the mate, the engineer, and the cook receive payment other than a share of the catch, they are not considered self-employed. The \$100 payment and their share of the proceeds from the catch are subject to federal income tax withholding, social security taxes, and the federal unemployment tax.

The other six crew members, including the captain, are considered self-employed because they do not receive any additional pay and are members of an operating crew of fewer than 10 members. Mike does not have to withhold federal income tax or social security taxes from their pay. They must pay self-employment tax on their earnings. Also, because the boat has a crew of less than 10 members and meets the four conditions mentioned above under *Certain crew members considered self-employed*, Mike does not have to pay the federal unemployment tax for the other six crew members.

Example 3. Assume the same facts as in Example 2, except that, in addition to receiving a share of the catch, the captain and the other crew members are entitled to receive \$3 per hour for repairing nets, constructing new nets, splicing cable, and other incidental work while in port. Since the crew members are entitled to receive payment other than a share of the catch, they are not considered self-employed. The \$3 per hour payment and their share of the proceeds from the catch are subject to federal income tax withholding, social security taxes, and the federal unemployment tax.

Reporting requirements. The operator of a boat must file with the IRS a completed Form 1099-MISC, *Statement for Recipients of Miscellaneous Income*, if any of the crew members work as self-employed individuals. It must be filed with the IRS by February 28 of the year following the calendar year in which the crew member was paid. All amounts must be reported. The \$600 or more rule does not apply.

Statement to crewmen. Each operator who is required to file Form 1099-MISC must also furnish a statement to each crew member. You may use Copy B of Form 1099-MISC for this purpose. This statement must be furnished to all crew members by January 31 of the year following the calendar year in which the crew member was paid.

Federal unemployment tax. Self-employed crew members do not pay federal unemployment tax on their earnings. However, the operator of the boat may be subject to federal unemployment tax on the earnings of crew members who perform services that come under the exceptions stated earlier under *Federal unemployment tax*, and who do not meet the four conditions mentioned above under *Certain crew members considered self-employed*.