

Worker Classification

Dear Client:

A business generally must withhold and pay income, social security, and Medicare taxes, and pay federal unemployment taxes, on wages it pays to common-law employees. This letter is in response to your request for general information on determining whether a worker is a common law employee (rather than an independent contractor) for these purposes.

UPDATE: This year California passed AB5 which is a California law which limits the use of classifying workers as independent contractors rather than employees by companies in the state

This bill could have reaching and costly effects, including expensive class action lawsuits, state EDD and department of industry reclassification audits and other potential legal issues.

This bill must be addressed before the end of the year.

The text of the bill can be found here:

https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB5

Generally, the term "employee" includes any individual who, under the common law rules for determining the employer/employee relationship, has the status of an employee. Under common law, a worker is an employee when the person for whom the services are performed has the right to control and direct the individual who performs the services. An employee must be subject to the will and control of the employer not only as to what work is to be done, but also how the work is to be done.

Over time, the IRS and Social Security Administration compiled a list of factors used in court decisions to determine worker status. The IRS has grouped those factors into three "categories of evidence": (1) behavioral control, (2) financial control, and (3) relationship of the parties.

The behavioral control category of evidence consists of evidence that substantiates the right to direct or control the details and means by which the worker performs the required services. Factors in this category include instructions the business gives to the worker, evaluation systems, and training the business gives to the worker.

The financial control category of evidence consists of evidence of the economic aspects of the relationship between the parties, which are an indication of who has financial control of the activities undertaken. Factors taken into account include the extent of the worker's investment in the facilities or tools he or she uses in performing services; the

extent of the worker's unreimbursed expenses; the extent to which the worker makes his or her services available to the relevant market; how the business pays the worker; and the extent to which the worker can realize a profit or loss from his or her work.

The relationship-of-the-parties category consists of evidence that reflects the parties' intent concerning control. Factors in this category include any written contracts between the parties; whether Form W-2, Wage and Tax Statement, have been filed for the worker; whether the worker receives benefits traditionally associated with employee status; and the permanency of the relationship between the worker and the business.

You can request the IRS to determine whether or not a worker is an employee by filing Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

Please call me at your convenience so that we can examine in greater detail the status of your workers as common employees or independent contractors.

Sincerely,

Michael David Daniels

<http://www.michaeldaniels.com>