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## **EMPLOYEE VS. INDEPENDENT CONTRACTOR**

### **DETERMINING A WORKER'S EMPLOYMENT STATUS**

As an employer and hirer of various independent services, the University is legally obligated to correctly identify workers as employees or independent contractors.

The University uses the same method of determining employment status as the Internal Revenue Service. The Internal Revenue Code, Section 3121d, defines an employee for Social Security employment purposes as follows:

1. any officer of a corporation; or
2. any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee;..."

Definition 1 considers any officer of the University as an employee. However, definition 2 refers to what is known as the common law rules, which can best be described as a list of factors that gauge the control of an employer (someone who employs the services of others) over an employee (someone who renders services).

The following section discusses the employer-employee relationship and summarizes the various factors of the Common Law Test.

### **Common Law Test**

#### **Central Focus: Employer's Right to Control**

The central focus of the common law test is determining who has the right to control two basic elements:

1. What must be done -- i.e., the results of the work, and
2. How it must be done -- i.e., the method by which the work or services are performed. Under this test, a worker is considered an employee subject to payroll tax withholding if the employer has the right to control both the result to be accomplished and the method or means by which the result is achieved. If the employer has the right to control or direct only the result of the work -- and not the method or means used to accomplish the result -- the individual may qualify as an independent contractor. Proper application of the test requires an employer to consider a number of factors or characteristics. No one factor or set of factors is automatically controlling. All the facts and circumstances of a particular situation must be taken into account in determining whether an individual worker should be treated as an employee or as an independent contractor.

#### **Factors Used by IRS in Determining Employee Status**

- Risk of profit or loss -- Independent contractors typically can invest significant amounts of time or capital in their work without any guarantee of success -- i.e., they realize a profit or sustain a loss based on their success in performing the work or service. When workers are insulated from loss or are restricted in the amount of profit they can gain, they usually are classified as employees.
- A continuing relationship -- Employees usually are hired for a continuing, indefinite period. This generally applies even to work or services performed on an irregular but recurring basis, as well as

- to part-time, temporary, and seasonal work. The relationship between an independent contractor and employer, on the other hand, usually ends when the job is finished.
- Compliance with instructions -- An individual who must comply with another person's instructions about when, where, or how to work generally is considered an employee. This applies even if the other person simply has the right to require compliance, but does not exercise that right.
  - Training -- Requiring that an individual be trained through such methods as working with an experienced employee, attending instructional sessions or training courses, or corresponding with the employer is indicative of employee status because it shows that the employer wants to control the way the work is done or the method that is used. Independent contractors, on the other hand, normally are not trained by the purchaser of their services.
  - Personal services required -- Employee status is suggested if an individual is required to personally render the services in question because such an arrangement indicates that the employer is interested in controlling the methods used to accomplish the results. By contrast, an individual's right to substitute another's services without the employer's knowledge suggests the existence of a contractor relationship.
  - Integration into the business -- The fact that an individual's services are so integrated into an employer's operations that the success or continuation of the business depends on the performance of the services generally indicates that the individual is subject to a certain amount of control by the owner of the business.
  - Control over the hiring, supervising, and paying of assistants -- An employer that hires, supervises, and pays an individual's assistants usually is viewed as controlling the work (and the individual performing the services) in question. On the other hand, individuals who hire, supervise, and pay other workers in accordance with an arrangement in which they have agreed to provide the labor needed to attain a certain result generally are treated as independent contractors.
  - Set hours of work -- A requirement that individuals adhere to certain work hours established by the employer generally is viewed as a factor indicating employer control.
  - A full-time work requirement -- Employee status is suggested if an individual must work on a substantially full-time basis for the employer since this indicates that the employer controls the amount of time the individual spends working and thus essentially restricts the worker's ability to perform for someone else. By contrast, independent contractors typically are free to work when and for whom they choose.
  - Working on the employer's premises -- Performance of the work on the employer's premises may be viewed as evidence of employer control, especially if the work could be done elsewhere. Employer control is suggested when the employer has the right to "compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places."
  - A required work order or sequence -- A requirement that an individual perform work in a certain order or sequence may be viewed as a factor showing that the employer controls or retains the right to control the worker.
  - Required reports -- A degree of control is suggested where an individual is required to submit regular oral or written reports to the employer.
  - Payment by the hour, week, or month -- Employees generally are paid by the hour, day, or month, while independent contractors typically are paid by the job or on a lump-sum or straight commission basis.
  - Payment of business or travel expenses -- Employer payment of an individual's business or work-related travel expenses generally indicates employee status.
  - Furnishing of tools and materials -- An employer-employee relationship is indicated where an employer supplies a worker with significant amount of tools, materials, or other equipment.
  - Investment in facilities -- Individuals are likely to be treated as independent contractors if they have a significant investment in facilities they use in the course of performing services (e.g., an office rented at fair market value from a third party).
  - Working for more than one firm -- Individuals who perform services for a number of businesses or people at the same time usually are considered independent contractors.
  - Worker's availability to the general public -- Individuals who make their services available to the public on a "regular and consistent" basis generally are treated as independent contractors.
  - Employer's discharge rights -- If an employer has the right to discharge an individual, that worker is viewed as an employee. Independent contractors, on the other hand, cannot be fired as long as they perform in accordance with their contract specifications.
  - Worker's termination rights -- Employees typically can end their employment relationship at any time without incurring liability, whereas independent contractors might be liable for a breach of contract if they leave without completing their work.

## **University Employees Who Cannot Be Paid As Independent Contractors**

In most circumstances, University employees are not allowed to receive independent contractor type payments.

Benedictine University employees (professors, adjunct professors, administrative staff, hourly support staff, temporary staff, student workers, research assistants, teaching assistants, etc.) performing services for the University cannot be considered independent contractors, regardless of the source of payment (departmental accounts, government grants, foundation funds). With the exception of employee/authors who receive royalty payments, the University can not treat a worker as both an employee and an independent contractor.

Based on the Common Law Test, the following categories of workers will not be considered independent contractors while performing services for the University:

- Anyone currently employed by the University who performs additional services outside his/her regular job description.
- Any individual working as tutors, regardless of whether or not they are currently on the university payroll.
- Instructors, employed by any department of the University, conducting workshops, classes, or seminars on University premises for any University department.
- Any individual who provides any TEACHING services will not be paid as an Independent Contractor. Income classified under teaching (tutoring or instructing) represents compensation to people who are regular employees of the University.
- Benedictine University professors working for a consulting firm, selling their services back to the University.

Whenever in doubt, check with the Payroll Department about proper classification before any services are contracted. The final decision concerning whether an individual should be classified as an employee or an independent contractor will be made by the Payroll Department, in conjunction with Personnel Resources.

## **Special Payments that University Employees Can Receive through the Accounts Payable System**

In certain cases, University employees can receive payments handled through the Accounts Payable System. The general rule of thumb is that an individual is an independent contractor if the University has the legal right to control or direct only the result of the work and not the means and methods of accomplishing the result. Generally, independent contractors hold themselves out in their own names as self-employed and make their services available to the public. These cases are listed below:

1. Special interest payments: so-called payments for "hobby services" - an activity which could be considered a hobby/recreational avocation which is not related to regular duties performed by the employee at the University. For example, a department might submit a Check Requisition to pay a university employee for musical services (conducting, playing, performing, etc.) provided that the 'musician' performs as a side-line interest and is employed in any of university departments except the Music Department. The request will be honored and the musician may receive payment through this method. However, Check Requisitions to pay any employee in the Music department for musical services will be refused; the employee must be paid through the Payroll system. To count as a 'hobby' payment, the services rendered must be unrelated to the person's regular employment at the university.
2. Human subject fees: usually a fee paid to a student or university employee for participation in hospital or Biological Sciences Division research project or study.
3. Royalties or Permission Fees: a payment which represents compensation for the sale or use of a copyrighted or patented work of an author, composer, or inventor. (See next section)

## Other IRS Reportable Payments Processed Through the Accounts Payable System

The following categories of payments, although not considered independent contractor payments, are processed through the Accounts Payable System:

1. **Honorarium:** a payment which is primarily intended to confer distinction on or to symbolize respect, esteem or admiration for the recipient. It is paid to the recipient at the discretion of the payer, and is not a fee charged by the person being paid. Some departments err by requesting "honorarium" payments for an individual who has rendered services to the university (e.g. "speaker's honorarium"). Such an "honorarium" - no matter how small - is still considered a compensation for services. If such an honorarium is requested for a University employee, it must be processed through Payroll as extra service pay.
2. **One-time lecture fee:** a payment which represents compensation for services for which a discourse, or lecture, is given before a class or an audience. Lectures and seminar speakers treated as independent contractors are paid for "independent personal services", not "teaching". Income classified under teaching represents compensation paid to people who are regular employees of the university. Generally, Guest Speakers or guest lecturers brought to the University for very short durations because of their expertise. Anyone receiving more than a single "one-time" lecture fee in any given calendar year may be subject to treatment as an employee.
3. **Human subject fee:** a payment which represents compensation to individuals participating as subjects in a scientific research project.
4. **Royalties:** a payment made to an author or composer for each copy of his work sold, or to an inventor for each article sold under a patent.
5. **Permission fees:** a percentage paid to an author or inventor for the use of all, or a portion of, their copyrighted or patented material--for example, fees paid for Xeroxing copyrighted material for use in a class.
6. **Rents:** a payment made to a renter for overnight stays at a bed and breakfast, apartment rental, rental of a room in a private residence, office space rental, and equipment rental---for example, tents, linens, tables, chairs etc.
7. **Professional Services:** individuals providing professional services, such as attorneys, accountants and other consultants.

## General Tax Consequences

Classification of an individual as an employee or an independent contractor has significant tax consequences for the University, the individual, and the government.

### a. Employee

If an individual is classified as an employee, the University is required to withhold income and Social Security (FICA) taxes on the wages paid to the employee. The University is required to pay a matching FICA tax. In addition, classification as an employee may require that the employee be included in pension plans and other fringe benefit programs, which would not be applicable if classified as an independent contractor. The University must file an IRS Form 941 on a quarterly basis to report and remit taxes withheld on wages paid, and must prepare and file an IRS Form W-2 for each employee at the end of each calendar year. Since the burden is on the employee to file an income tax return and obtain refunds, compliance problems for the government are accordingly diminished.

### b. Independent Contractor

If an individual is classified as an independent contractor, payments made for services are not subject to income tax withholding, FICA, or Federal Unemployment Tax (FUTA). Instead, the independent contractor is liable for estimated tax payments and for self-employment tax (SECA). The University is responsible for preparing and filing an IRS Form 1099 for payments made to each independent contractor at the end of each calendar year whenever the cumulative amount of

payments to the independent contractor is \$600 or more. Since there is no withholding requirement for payments to independent contractors, compliance problems for the government are increased dramatically.

c. Liabilities for Misclassification of an Employee as an Independent Contractor

If the University classifies an individual as an independent contractor instead of an employee, and cannot demonstrate a reasonable basis for the classification, the IRS can hold the University (or specific persons) liable for several different fines or penalties-ranging in severity.