

# 40 SQUARE CONSORTIUM

## COMMON LAW EMPLOYEE TOOL

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**Note: This is a tool. It is not legal or tax advice.** The information provided is based largely upon <https://www.irs.gov/businesses/small-businesses-self-employed/employee-common-law-employee> (as visited May 31, 2017), IRS Small Business Week Tax Tip 2017-02, and other IRS publications listed below. If you have questions regarding whether you have common law employees, you should contact your tax professional, accountant, or tax attorney.

### Why am I receiving this information?

In order to participate in the 40 Square Consortium Health Plan, an employer must have at least one **common law employee**. This is a good time to review the status of your paid help.

### What is a “common law employee”?

In general, when someone performs services for a business and that business (1) controls **what** the person does, and (2) **how** the person does it, that person is a common law employee. Whether an individual that performs work is a common law employee is determined based on the particular facts and circumstances of the situation. All information that evidences the nature of the relationship between the worker and the business should be factored into determining whether a worker is a common law employee or an independent contractor. Court cases and IRS guidance provide a framework for analyzing a situation, including factors to consider. In general, no one factor is determinative. And, the label used by the worker and the business is not determinative. For example, if a worker is called an independent contractor, the facts and circumstances of the relationship between the worker and the business need to support the label. **The label does not control.**

### What factors should be considered in identifying a common law employee?

As mentioned above, the courts and IRS guidance provide factors for consideration. In general, the factors fall into three clusters: behavioral control, financial control, and the nature of the relationship.

**Behavioral Control:** When a business (1) controls **what** work is being completed, and (2) controls **how** the work is completed, the worker is a common law employee. Examples of behavioral control include:

- Employer instructs worker when and where to do the work
- Employer instructs worker what tools or equipment to use
- Employer instructs worker who will assist the worker in performing the work
- Employer instructs worker where to purchase supplies and services
- Employer determines which worker performs which task
- Employer instructs worker what order or sequence to follow when performing job duties
- Employer trains the worker to perform services in a specific way

**Caution:** Even where no instructions are actually given to a worker, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved.

**Financial Control:** If the business directs or controls financial and certain other relevant aspects of the worker's job, then the business may be exercising sufficient financial control such that the worker is a common law employee. Examples of financial control include:

- The extent of the worker's financial investment in tools and facilities used to perform the job
- The extent the worker also makes his/her services available to others in the relevant market
- The way the business pays the work (e.g., flat fee, time plus materials versus amount per hour, week, month, etc.)
- The extent to which the worker realizes a gain or loss based upon completion of the work

**Relationship:** The relationship between the worker and the business may also impact whether the employee is a common law employee. Examples of factors suggesting an employer to common law employee relationship exists include:

- Written contract(s) between the business and the worker describing the relationship they intend to create

- Whether the business provides the worker with employee-type benefits such as insurance, pension benefits, sick pay, vacation, etc.
- The permanency of the business/worker relationship
- The extent to which the worker has unreimbursed business expenses, including fixed costs the worker would have incurred regardless of the work performed for the business
- To the extent to which the services performed are part of the business' regular business activities

**Note:** For assistance, the IRS can help employers determine the status of their workers using IRS Form SS-8, available at <https://www.irs.gov/pub/irs-pdf/fss8.pdf>.

## Examples

The following examples come from IRS Publication 15-A available at <https://www.irs.gov/pub/irs-pdf/p15a.pdf>:

### Common law employee

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 isn't 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 that he has spent, including the payroll. The company gives him a check for that amount from which he pays the assistants, although he isn't personally liable for their wages. Wallace Black and his assistants are employees of the Sawdust Co.

### Not a common law employee

Bill Plum contracted with Elm Corporation to complete the roofing on a housing complex. A signed contract established a flat amount for the services rendered by Bill Plum. Bill is a licensed roofer and carries workers' compensation and liability insurance under the business name, Plum Roofing. He hires his own roofers who are treated as employees for federal employment tax purposes. If there is a problem with the roofing work, Plum Roofing is responsible for paying for any repairs. Bill Plum, doing business as Plum Roofing, is an independent contractor.

### What happens if a worker is misclassified?

Businesses typically have federal tax withholding obligations and specific employment obligations with respect to common law employees that they do not have with respect to independent contractors.

Common law employees should receive a Form W-2 from their employers. However, sometimes employees are not classified correctly. They are treated as independent contractors, and receive a Form 1099, or are paid less than \$600 and receive no IRS form.

**Important:** The tax form that an employer provides to a worker does *not* determine whether an employee is a common law employee. The facts and circumstances determine whether a worker is a common law employee. If the worker is a common law employee, the worker should receive a Form W-2.

For employees who have been misclassified as independent contractors (i.e., not common law employees), the IRS has a developed Form 8919 for employer's to determine the uncollected social security and Medicare taxes due on the employee's compensation. Form 8919 is available at <https://www.irs.gov/pub/irs-pdf/f8919.pdf>.

### Where can I find more information?

Also see the following publications:

- Determination of Worker Status for Purposes of Federal Employment Taxes and Income Withholding (IRS Publication 15-A) available at <https://www.irs.gov/pub/irs-pdf/p15a.pdf>.
- Independent Contractor or Employee (IRS Publication 1779) available at <https://www.irs.gov/pub/irs-pdf/p1779.pdf>.