

# Independent Contractors vs. Employees

# Topics

- What is the issue
- What is an employee
- Making a classification

# Federal Express Case

- December 2007
- IRS fined Federal Express \$319mm for 2002.
- Misclassified drivers as independent contractors
- Years 2004, 2005 and 2006 still under investigation by IRS
- Potential total fines of over \$1 billion

# What are the Issues?

## IRS

Realizes additional taxes from an employee then an independent contractor

- FICA/Medicare employer matching

## Business

Independent Contractors cost less than employees

- No FICA/Medicare match
- No benefits
- Less paperwork

# What is an employee?

- **IRS definition:** “Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done.”

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- Do not have to exercise the right to control and direct.

# What is an employee?

- IRS: “If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial.”
- Final classification is based on all facts and circumstances of a particular case.

# Making a Classification

- Tools:
  - IRS regulations and definitions
  - “20 Questions”
  - IRS rulings and court cases

# “20 Questions”

- IRS published list of questions used to assist in classification of service provider
- Category of questions:
  - Behavioral control
  - Financial control
  - Relationship
- Copy of questions in handout

# “20 Questions”

- Behavioral Control:
  - Is the worker instructed about when, where and how work is to be completed?
  - Will the worker perform the services personally?
  - Does the worker have set hours of work?

# “20 Questions”

- Financial Control:
  - Does the worker have a significant investment in tools or other types of instruments?
  - Does the worker make his or her services available to the general public?
  - Does the worker perform his or her services for more than one business at one time?

# “20 Questions”

- Relationship:
  - Does the worker have a continued relationship with the business?
  - Can the worker be terminated at the discretion of the business?
  - Can the worker end his or her relationship with the business at any time?

# Making a classification

- “20 Questions”
  - No set formula for making a classification.
- General knowledge of work to be performed by service provider and how that work will be performed (e.g. All facts and circumstances).
- Tax Manager, Accounts Payable & Payroll.

# Federal Express Case - Independent Contractor Factors

- Signed contracts which stated drivers were independent contractors.
- Drivers provide their own truck and paid their own operating and maintenance costs.

# Federal Express Case – Employee Factors

- Truck had to meet FedEx specifications including paint scheme and logos.
- FedEx assigned service area and had right to reconfigure service area.
- FedEx prescribed handling methods to avoid theft, loss and damage to packages.
- Drivers had to prepare FedEx logs, inspection reports, fuel receipts and shipping documents.
- Drivers had to wear FedEx-approved uniforms.

# Federal Express Case –

## Employee Factors cont.

- Drivers had to adhere to FedEx ground manuals and Operations Management Handbook to ensure uniform operation of FedEx terminals.
- FedEx offered drivers deferred compensation or retirement plans, “time-off program” and scholarship program for driver’s children.
- Drivers were paid on a weekly basis at nonnegotiable rates set by FedEx.
- Drivers were to work full-time and exclusively for FedEx.

# Conclusion

- High priority target with the IRS
- Penalties and interest can be very large
- Make classification based on:
  - “20 Questions”
  - All facts and circumstances
  - Tax Manager, Accounts Payable & Payroll as additional resources.

Questions?