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There is quite a bit of confusion within our industry on the topic of independent contractors vs. employees and the resultant liability issues. Some LBM dealers will elect to use sub-contractors exclusively within their respective Installed Sales operations, while others will only use employees to perform labor on installed projects. There are still other dealers who have successfully used a combination of employees and subs.

While I cannot cite a specific incident of a LBM Dealer being fined or audited regarding taxes, my professional recommendation is to be aware of the facts and prepare accordingly. The next several pages outline my observation on this topic, along with some specific insight directly from the I.R.S.

### **Independent Contractors and the I.R.S.**

In a service economy such as ours, the issue of whether an individual is an employee or an independent contractor comes up in many contexts. From babysitters to window trimmers and attorneys to roofers, we all deal with people we believe to be independent contractors every day. Many service professionals assume that they can simply sign a contract designating themselves as an "independent contractor" and that the issue is then settled. This is not necessarily the case.

There are several reasons for wanting to be an independent contractor rather than an employee. One of the most significant involves taxes. An independent contractor is not subject to withholding, FICA or unemployment taxes on the amount he receives for a job. An employee, of course, is subject to all of those taxes. A significant reason that a person hiring an independent contractor would prefer that individual not be an employee is the employer's potential tort liability for that individual's actions that goes along with employee status.

For both tax and liability reasons, then, it is important that the parties get it right in structuring their relationship. The Internal Revenue Service (IRS) and the courts have been more than willing to look beyond the name that the parties themselves have given to a relationship, to determine whether the service provider is an employee or an independent contractor.

The IRS has developed a list of twenty factors to be examined in determining whether a person is an independent contractor. A brief review of them may be helpful in determining what to look out for in structuring your relationships.

1. A worker who is required to comply with another's instructions about when, where, and how s/he is to work is ordinarily an employee.
2. An employee can be fired for failure to follow instructions usually an independent contractor can only be discharged if s/he fails to achieve the contracted-for result.
3. An employee is free to quit at any time without liability.
4. A worker who is required to be trained by another employee is likely to be an employee.
5. Integration of worker's services into business operations usually shows that the worker is an employee.
6. A worker providing tools indicates an independent contractor.
7. Likewise, usually only an independent contractor makes a significant investment in facilities.
8. Where the services must be rendered by the worker personally, and not by someone that s/he hires, the worker is probably an employee.
9. If the person hiring the services also hires, supervises and pays assistants for the worker, the worker is probably an employee.
10. A long-term continuing relationship between the worker and the person needing the services indicates an employment relationship.
11. Likewise, the offer of one's services to the general public indicates an independent contractor.
12. The establishment of set hours of work indicates an employment relationship.
13. If the worker must devote full time to the services, s/he is likely to be an employee.
14. Conversely, an independent contractor frequently works for more than one firm.
15. If the work is performed on the premises of the individual hiring the work, it is probably an employment relationship.
16. If the worker must follow the routing or pattern of work set by the person who hires him or her, s/he is probably an employee.
17. The requirement of regular written reports indicates an employment relationship.

18. Payment by the hour, week or month rather by the job indicates an employee.
19. Payment of business and travel expenses by the person hiring the services indicates an employment relationship.
20. The ability to make a profit or loss on the assignment indicates an independent contractor.

None of these factors are completely determinative, and the IRS and courts feel free to pick and choose from them on a case-by-case basis. It is important to obtain legal advise when setting up your relationship in those situations where the costs of being found not to be an independent contractor would be high, or where more than a few of the above factors indicates an employment relationship.

The following publication is taken directly from the I.R.S. website  
([www.irs.gov/business/small/article/0](http://www.irs.gov/business/small/article/0))

## Independent Contractors vs. Employees

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

- An independent contractor
- A common-law employee
- A statutory employee
- A statutory nonemployee

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In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

It is critical that you, the employer, correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors.

**Caution:** If you incorrectly classify an employee as an independent contractor, you can be held liable for employment taxes for that worker, plus a penalty.

### Who is an Independent Contractor?

A general rule is that you, the payer, have the **right to control or direct only the result of the work** done by an independent contractor, and **not the means and methods of accomplishing the result**.

**Example:** Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at \$16 per hour for 400 hours. She is to receive \$1,280 every 2 weeks for the next 10 weeks. This is not considered payment by the hour. Even if she works more or less than 400 hours to complete the work, Vera Elm will receive \$6,400. She also performs additional electrical installations under contracts with other companies, that she obtained through advertisements. Vera is an **independent contractor**.

### How should I report payments made to independent contractors?

You may be required to file information returns to report certain types of payments made to independent contractors during the year. For example, you must file Form 1099-MISC, Miscellaneous Income, to report payments of \$600 or more to persons not treated as employees (e.g. independent contractors) for services performed for your trade or business. For details about filing Form 1099 and for information about required electronic or magnetic media filing, refer to [information returns](#).

### Who is a Common-Law Employee (Employee)?

Under common-law rules, anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.

To determine whether an individual is an employee or independent contractor under the common law, the

### IRS Resources

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- [Contact My Local Office](#)
- [e-file](#)
- [Forms and Publications](#)
- [Frequently Asked Questions](#)
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relationship of the worker and the business must be examined. All evidence of control and independence must be considered. In an employee-independent contractor determination, all information that provides evidence of the degree of control and degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. Refer to Publication 15-A, [Employer's Supplemental Tax Guide](#) for additional information.

### Who is an Employee?

A general rule is that anyone who performs services for you is your employee **if you can control what will be done and how it will be done.**

**Example:** Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works 6 days a week, and is on duty in Bob's showroom on certain assigned days and times. She appraises trade-ins, but her appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. She has to develop leads and report results to the sales manager. Because of her experience, she requires only minimal assistance in closing and financing sales and in other phases of her work. She is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group-term life insurance for Donna. Donna is an employee of Bob Blue.

### Statutory Employees

If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute (statutory employees) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under **Social security and Medicare taxes**, below.

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
- 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.
- An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
- 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. Refer to the **Salesperson** section located in **Publication 15-A**, Employer's Supplemental Tax Guide for additional information.

### Statutory Nonemployees

There are two categories of statutory nonemployees: **direct sellers** and **licensed real estate agents**. They are treated as self-employed for all Federal tax purposes, including income and employment taxes, 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.

Refer to information on **Direct Sellers** located in [Publication 15-A](#), Employer's Supplemental Tax Guide for additional information.

### Misclassification of Employees

**Consequences of treating an employee as an independent contractor.** If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker. See Internal Revenue Code section 3509 for additional information.

### References/Related Topics

[Worker Classification Webcast](#)

A critical issue for all businesses is properly classifying workers as employees or independent contractors. The IRS's archived Tax Talk Today Webcast, "What's Hot in Employment Taxes: Independent Contractor or Employee?", focuses exclusively on worker classification issues.

- [Tax Topic 762 Basic Information](#)

To determine whether a worker is an independent contractor or an employee, you must examine the relationship between the worker and the business. All evidence of control and independence in this relationship should be considered. The facts that provide this evidence fall into three categories: Behavioral Control, Financial Control, and the Type of Relationship itself.

- [Publication 1976, Section 530 Employment Tax Relief Requirements](#) (PDF)

Section 530 provides businesses with relief from Federal employment tax obligations if certain requirements are met.

- [IRS Internal Training: Employee/Independent Contractor](#) (PDF)

This manual provides you with the tools to make correct determinations of worker classifications. It discusses facts that may indicate the existence of an independent contractor or an employer-employee relationship. This training manual is a guide and is not legally binding. If you would like the IRS to make the determination of worker status, please file IRS Form SS-8.

- [Form SS-8](#) (PDF)

Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

- [Publication 15-A](#)

The Employer's Supplemental Tax Guide has detailed guidance including information for specific industries.

- [Publication 15-B](#)

The Employer's Tax Guide to Fringe Benefits supplements Circular E (Pub. 15), Employer's Tax Guide, and Publication 15-A, Employer's Supplemental Tax Guide. It contains specialized and detailed information on the employment tax treatment of fringe benefits.

- [Businesses with Employees](#)

- [Hiring Employees](#)

- [Online Classroom](#), Lesson 6 - What you need to know about federal taxes when hiring employees/contractors

- [Distinguishing Between Self-Employed Individuals and Independent Contractors](#)

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