An employer must pay the required amounts of social security and Medicare tax in connection with each employee’s wages. For 2012, the employer must pay social security taxes of 6.2% of the employee’s wages up to a 2012 wage limit of $110,100. The 2011 wage limit was $106,800. In addition, the employer pays Medicare tax at a rate of 1.45%. There is no wage limit on Medicare tax. However, for workers that are properly classified as independent contractors, the employer has no obligation to pay these taxes. The independent contractor is responsible for paying all necessary taxes on their own earnings.

**RIGHT-TO-CONTROL TEST**

A worker is an employee for federal tax purposes if the worker qualifies as an employee under common law. At common law, an employer-employee relationship exists when the firm or person(s) for whom the services are performed has the right to control and direct the worker in how the services are performed. Control over the means and details of the worker’s tasks is the hallmark of an employer-employee relationship. It is not necessary for the employer to actually exercise this control. Merely having the right to control the worker is sufficient to conclude that the worker is an employee and not an independent contractor.

After reviewing several cases and rulings that used this common law approach, the IRS identified 20 factors used to determine whether a worker is an employee or an independent contractor. The IRS notes that these factors are only a guide and that the degree of importance of each factor varies depending on the particular circumstances of each case. These factors look into the degree of control that a firm has over the worker across various aspects of a typical work relationship and are summarized as follows.

1. **Degree of control over worker services.** A larger degree of control over when, where, and how the worker performs work is indicative of an employer-employee relationship. Independent contractors have more control over their work.

2. **Training and meetings.** Providing worker training and requiring the worker to attend meetings indicates the existence of an employer-employee relationship.

3. **Integration of work performed into firm operations.** Strong integration of the worker’s services into other firm operations is indicative of an employer-employee relationship.

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2. Ibid.
3. Ibid.
4. Ibid.
4. **Personal performance of services.** Employees must personally perform services. The same requirement might not be made of an independent contractor, although there are exceptions. This factor alone is frequently not determinative.

5. **Personnel control.** A firm’s control over the hiring, supervision, and payment of the worker’s assistants is suggestive of an employer-employee relationship. Independent contractors typically maintain and control their own staff.

6. **Length of working relationship.** A continual, long-term work relationship is indicative of an employer-employee relationship. Such a long-term relationship may also exist with an independent contractor. Therefore, this factor taken alone is not determinative.

7. **Work schedule.** An established work schedule for the worker indicates that an employer-employee relationship exists. Independent contractors generally retain more freedom with scheduling the performance of their services to a firm.

8. **Hours of service required.** Requiring a lengthy period of time from the worker in the performance of services to the firm is indicative of full-time employment within an employer-employee relationship. Conversely, part-time hours worked for one firm while the worker also provides work hours for other firms indicates that the worker may be an independent contractor.

9. **Location of services.** Requiring the worker to perform services at the firm’s own location tends to suggest an employer-employee relationship. However, because some types of work can only be performed at the firm’s work site, this factor alone is not determinative.

10. **Control over work technique.** Control by the firm over the worker’s technique or order of tasks indicates that an employer-employee relationship exists. A worker that has control over the technique or task order in the performance of services indicates that the worker may be an independent contractor.

11. **Periodic reporting.** Requiring regular, periodic written or verbal reports from the worker to other firm personnel is indicative of an employer-employee relationship. However, requiring progress reports by an independent contractor is also common. Therefore, this factor alone is not determinative.

12. **Payment method.** Payment at regular intervals (hourly, weekly, or monthly) suggests an employer-employee relationship. Alternatively, payment to the worker based on the particular job or project, or based on invoices issued by the worker, is indicative of an independent contractor relationship.

13. **Work-related expenses.** Payment of the worker’s business and travel expenses suggests an employer-employee relationship. However, this type of arrangement may also exist between a firm and an independent contractor.

14. **Provision of tools.** Tools furnished by the worker indicate that the worker is an independent contractor. A firm that provides the worker with tools suggests the existence of an employer-employee relationship.

15. **Work facilities.** A worker that invests in and provides work facilities is likely to be an independent contractor, particularly if the facilities are of a type not generally maintained by employees.

16. **Profit potential and risk of loss.** Workers that profit from the success of a business and bear the risk of loss from failure are more likely to be independent contractors than employees. Employees are typically paid a fixed amount without regard to profits or losses.

17. **Providing services to multiple firms.** An employee tends to provide services to a single firm. However, an independent contractor frequently provides services to a number of firms.

18. **Restrictions on customers.** Workers who regularly and consistently offer their services to the public are more likely to be independent contractors.
19. **Firm’s right of termination.** A firm’s ability to terminate the worker for any reason and without penalty suggests an employer-employee relationship. The presence of penalties to the firm upon termination without cause may be indicative of a higher degree of worker independence more characteristic of an independent contractor relationship.

20. **Worker’s right of termination.** A worker having the ability to terminate the relationship with the firm at any time without penalty is indicative of an employer-employee relationship.

**TAX COURT TEST**

To determine whether a worker is an employee or independent contractor, the Tax Court considers the following **seven factors:**

1. The degree of the firm’s control over the worker
2. The worker’s investment in work facilities
3. Profit or loss potential for the worker
4. The degree of ease with which the firm can discharge the worker
5. The degree of integration of the worker’s services to the firm’s principal function
6. The temporary or permanent nature of the relationship
7. The parties’ understanding of the nature of their relationship

The following example is based on the facts of *Peno Trucking, Inc. v. Comm’r.*

**Example 1.** PT Trucking owns 15 trucks and leases them to OTC Transport. PT provides OTC with hauling services using these trucks. PT agrees to provide drivers and to ensure that their work is in accordance with the leases. PT obtains drivers to fulfill its obligations to OTC. PT hires, fires, disciplines, and supervises the drivers. PT also determines the days the drivers can work, and requires them to maintain commercial driving licenses, driving logs, and other documents. PT negotiates the rate of pay with each driver, and the contract with each driver indicates that it is not possible for the driver to become indebted to PT in any way. PT provides the necessary equipment for the drivers, although drivers are free to provide extra equipment at their own cost. PT pays for all fuel, tolls, and truck maintenance and repairs.

To provide the hauling services required by the OTC agreement, PT offers drivers the opportunity to accept hauls each day. A driver is free to decline any haul that is offered. However, if the driver accepts, PT provides directions to the driver regarding pick-up and delivery locations as well as times. PT provides drivers with beepers to keep in contact with them on the road. In each driver’s contract, PT designates each driver as an independent contractor and issues each driver a Form 1099-MISC in connection with annual pay. PT does not withhold federal taxes, social security, or Medicare taxes.

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