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Subcontractors

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1. Is there a difference between an employee and a subcontractor?

If a worker is an employee you are responsible for withholding and paying the employment-related taxes. If your worker is a subcontractor, he is responsible for keeping his or her own records and paying his or her own income and self-employment taxes. Therefore, it is very important to determine whether your worker is an employee or a subcontractor.

2. If the worker is a subcontractor, what forms do I complete and file to report his earnings?

You use [Form 1099-MISC](#), Miscellaneous Income for payments of \$600 or more to your subcontractors.

3. How do I determine whether my worker is an employee or subcontractor?

The courts have considered many factors in deciding whether a worker is a subcontractor or an employee. They can be divided into three categories:

- *Behavioral control* evaluates whether you have the right to direct and control *how* the work is done (training and instructions),
- *Financial control* considers whether you have the right to direct and control the *economic* aspects of the work (significant investment, expenses, opportunity for profit or loss), and
- *Relationship of the parties* looks at how you and the worker view your relationship (employee benefits and written contracts).

All facts and circumstances of your situation must be examined to determine whether a worker is an employee or subcontractor. No single factor provides the answer.

4. How do instructions and training affect the employment status of a worker?

Instructions and training provided to a worker are important factors to be considered. If you give the worker detailed instructions on how work is to be done or train the worker to perform tasks in a certain way, the worker may be an employee. A subcontractor does not need or receive detailed instructions or training on how the work should be done.

5. What types of instructions might be given to a worker who is an employee?

Examples of instructions can cover a wide range of topics, for example:

- how, when or where to do the work,
- what tools or equipment to use,
- what assistants to hire to help with the work, and
- where to purchase materials and services.

6. Does my worker's status change if he provides his own tools or hires his own workers?

Yes, a subcontractor generally provides his own tools and materials and can hire employees or subcontractors himself.

See [Example](#)

7. If my worker invests in his own equipment does it change his status?

Yes, if the worker owns or rents costly equipment to do the work, he may be a subcontractor.

8. If I reimburse my worker for his job related out of pocket expenses, does it affect his status?

Yes, a worker that has high, non-reimbursed expenses on a regular basis may be a subcontractor.

See [Example](#).

9. If I provide employee benefits to my workers, does it affect their status?

If you provide benefits such as paid vacation, sick days, health insurance, or a pension, the worker may be an employee. However, many workers who are employees do not receive employee benefits. Consequently, the absence of employee benefits may not be important in deciding the worker's status.

10. If the written contract with my worker states he is a subcontractor, will this outweigh the other factors?

While a contractual designation, in and of itself, is not sufficient evidence for determining worker status, a written contract describing the worker as a subcontractor may be viewed as evidence that you and the worker intended the relationship to be independent. If the parties are not acting in accordance with the terms of the contract, however,

the contract may be ignored. The actual facts in each situation are more important than a contract, but the contract *may* be a deciding factor, all other things being equal.

11. Will the IRS help me determine my worker's status?

If you want to get an IRS opinion on your situation, a [**Form SS-8**](#) can be filled out by either the employer or the worker and sent to your local Internal Revenue Service office for a decision.

12. What happens if there is an employment tax audit?

Many IRS audits of employment tax issues end with all parties reaching a mutual decision. If, however, it appears that your workers should be classified as employees, the first step the auditor will take is to see if the relief provisions (under section 530 of the Revenue Act of 1978) will limit your liability for the employment tax.

If the requirements of Section 530 are met, you may be entitled to relief from federal employment tax obligations. Section 530 terminates the business's but not the worker's employment tax liability, including any interest or penalties attributable to the liability for employment taxes. Under Section 530 there are two tests that must be met:

- Consistency Test
- Reasonable Basis Test

To meet the consistency test, you must:

- File all required [**Forms 1099**](#) with the IRS on time, reporting the amounts paid to the workers, and
- Have treated all workers in similar jobs in the same manner as the workers in question. That is, if you pay two of your painters as employees and four as subcontractors, you won't meet this test.

To meet the reasonable basis test, you must have treated the worker as a subcontractor because you reasonably relied on:

- A court case or ruling to support your position,
- A prior IRS audit,
- A long standing practice in your industry, or
- Any other reasonable basis for treating worker as subcontractor

If an IRS audit finds that your workers are employees *but* you meet the consistency and reasonable basis tests, you

will not have to pay employment taxes on the workers. The workers, however, remain liable for paying their share of the FICA tax on the wages received. If the workers have paid self-employment tax on their income, they may be entitled to a refund of the tax paid. See [Revevue Procedure 85-18](#) for further information.

13. I want to see more examples to help me properly classify my workers.

See Industry [Example](#)s {example 1,2,3,4,5 on page 6 of Pub 15-A}

See text [Example](#)

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