

Independent Contractor or Employee?

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Withholding Fact Sheet 8

Fact Sheet

This fact sheet explains Minnesota income tax withholding responsibilities as they relate to classification of independent contractors. If you need more information, call the phone number at the bottom of this page.

When workers perform services for a business, they may be classified as independent contractors or employees. It is critical that they be classified correctly. If the worker is an employee, generally the employer must withhold and deposit income taxes, Social Security taxes, and Medicare taxes. In addition to these taxes, the employer must pay unemployment taxes and carry worker's compensation insurance. This is generally not required for independent contractors.

How to classify a worker

To determine if an individual is an employee or an independent contractor, the business relationship between you and the individual performing the services must be examined. All evidence of control and independence must be considered.

Many factors are considered when deciding if a worker is an employee or an independent contractor. These factors fall into three main categories:

- behavioral control
- financial control
- relationship of the parties

If you are generally in control of (or have the right to control) these factors, the worker is most likely your employee. Not all of the following factors need to be present to make a determination of worker status; however, all factors must be considered.

Behavioral control

If you have the right to direct or control the manner and means in which services are performed, you have behavioral control over the worker. You do not have to actually direct or control the way work is done, as long as you have the right to do so.

The following behavioral control factors indicate the worker is an employee:

- you direct how, when, or where the work will be done,
- you specify which tools or equipment will be used,
- you specify the sequence in which services will be performed,
- you determine who will be hired to assist with the work,
- you decide where supplies and services will be purchased,

- you establish work hours,
- you require reports to be submitted, or
- you provide training regarding procedures and methods.

Financial control

If you have the right to direct or control the administrative aspects of the work, you have financial control over the worker. The following financial aspects indicate the worker is an employee:

- you reimburse or pay travel and business expenses,
- you pay at regular intervals (hourly, weekly, etc.), or
- you provide tools, materials, and other equipment.

The following financial aspects indicate the worker is an independent contractor:

- the worker has an opportunity for profit or risk of loss,
- the worker has a significant investment in the work,
- the worker offers services to the general public, or
- the services provided are not an integral part of the business (e.g., a bank hiring a plumber).

Relationship of the parties

The following factors illustrate how you and your worker perceive your relationship and indicate your worker is an employee:

- the worker has the right to quit without incurring liability,
- you have the right to fire the worker,
- the worker has the right to receive employee benefits,
- there is a continuing relationship between you and the worker, or
- services performed by the worker are a key aspect of the regular business activities.

Written contracts are taken into consideration when determining worker classifications. However, the mere existence of a contract does not make a worker an employee or an independent contractor. The actual relationship between the parties must be examined.

Examples

- Maria, a computer science student, gets a part-time job as a customer service representative at a computer-software company. Maria works designated hours at the business location, is paid hourly, has no investment and is trained on how to help customers. Maria is an employee.

Continued

Withholding Tax Division, Mail Station 6501, St. Paul, MN 55146-6501
Phone: 651-282-9999 or 1-800-657-3594
Minnesota Relay 711 (TTY)
E-mail: withholding.tax@state.mn.us

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This fact sheet is intended to help you become more familiar with Minnesota tax laws and your rights and responsibilities under the laws. Nothing in this fact sheet supersedes, alters, or otherwise changes any provisions of the tax law, administrative rules, court decisions or revenue notices. Alternative formats available upon request.

- Jack's Construction is building a house that must be completed in six months. Jack's Construction is not licensed to do the electrical work. Carrie's Electric is subcontracted to do the work. Carrie bids the job and will be paid upon completion. The work is done without the supervision of Jack's Construction. Carrie advertises her business in the telephone book and newspaper. She uses her own tools and equipment and works with many construction companies. Carrie is an independent contractor.
- Kristine is the President of ABC Company, an S corporation. She works approximately 20 hours a week and pays herself \$2,000 per month. Kristine is an employee of ABC Company. (For more information on corporate officers, read Withholding Fact Sheet 6, *Corporate Officers*).
- Joseph drives a truck for Amber's Leasing, a company that leases tractor-trailer rigs with drivers to contract carriers. Amber's Leasing retains the right to direct and control Joseph to the extent necessary to protect its investment. Joseph is an employee.
- Rachel drives cars to a distant auction for Nick's Used Car Sales. Nick determines the minimum selling price. Nick reimburses all of her expenses. She is paid on a commission basis. Rachel is an employee of Nick's Used Car Sales.

Employees

If the worker is an employee, you must register, file and pay all required federal and state taxes. For more information, read Withholding Fact Sheet 10, *New Employer Guide*.

Independent contractors

If the worker is an independent contractor, you must have him or her complete federal Form W-9, *Request for Taxpayer Identification Number and Certification*, to obtain a taxpayer ID number (TIN). If the independent contractor does not provide you with a TIN, you must withhold income tax from the independent contractor's pay. This is called backup withholding. Backup withholding is 28 percent for the IRS and 7.85 percent for the Minnesota Department of Revenue. Additional information on backup withholding for the IRS can be found in federal Publication 1679, *A Guide to Backup Withholding*.

The business may be required to file federal Form 1099-Misc, *Miscellaneous Income*, to report payments made to independent contractors. To obtain federal forms, instructions, and publications, go to the IRS website at www.irs.gov or call 1-800-829-4933.

Classifying workers incorrectly

The IRS, Minnesota Department of Revenue, Minnesota Department of Employment and Economic Development, and the Minnesota Department of Labor and Industry have the authority to make worker classification determinations. If it is discovered that employees are being incorrectly treated as independent contractors, an employer could be liable for all back taxes plus any applicable penalties and interest. It can be very costly for businesses to classify workers incorrectly.

Information and assistance

The following agencies will help you correctly classify workers as independent contractors or employees. Call the following numbers for more information.

IRS	1-800-829-4933
Minnesota Department of Employment and Economic Development	651-296-6141
Minnesota Department of Revenue	651-282-9999
	1-800-657-3594
Minnesota Department of Labor and Industry	651-284-5005

To obtain free IRS publications, go to the IRS website at www.irs.gov or call 1-800-829-3676. Publications you might find helpful are:

- Pub. 15, Circular E, *Employer's Tax Guide*
- Pub. 15-A, *Employer's Supplemental Tax Guide*
- Pub. 51, Circular A, *Agricultural Employer's Tax Guide*
- Pub. 910, *Guide to Free Tax Services*
- Pub. 926, *Household Employer's Tax Guide*

The Minnesota Department of Revenue offers the following fact sheets that may pertain to your business. Fact sheets are available on our website at www.taxes.state.mn.us or by calling our office at 651-282-9999 or 1-800-657-3594.

- Fact Sheet 3, *Agricultural Workers*
- Fact Sheet 4, *Fairs and Special Events*
- Fact Sheet 6, *Corporate Officers*
- Fact Sheet 7, *Household Employees*
- Fact Sheet 9, *Definition of Wages*
- Fact Sheet 10, *New Employer Guide*
- Fact Sheet 11, *Nonresident Entertainer Tax*
- Fact Sheet 12, *Surety Deposits for Out-of-State Contractors*
- Fact Sheet 13, *Construction Contracts with State or Local Government Agencies*
- Fact Sheet 14, *A Step-by-Step Guide to Filing and Paying Electronically*
- Fact Sheet 15, *A Step-by-Step Guide to Paying Electronically*
- Fact Sheet 16, *A Step-by-Step Guide to Filing and Paying Electronically for Annual Filers*

The Minnesota withholding instruction booklet and tax tables contain crucial information about your withholding filing and payment responsibilities. To obtain the booklet and/or tax tables, go to our website at www.taxes.state.mn.us or call 651-282-9999 or 1-800-657-3594.