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FISCAL POLICIES MANUAL

INDEPENDENT CONTRACTOR VS. EMPLOYEE

PREFACE

Agency management has the responsibility of classifying workers properly to ensure that the State of Idaho is not placed in a position of liability due to improper classification of workers. Agency hiring and contracting personnel should be educated concerning the employee versus independent contractor issue and the possible consequences of their choices. Improperly classifying a worker as an independent contractor when that worker is actually an employee can expose you, your agency, and the State of Idaho to a variety of Internal Revenue Service (IRS) penalties. [Click here to view the most current Internal Revenue Code.](#)

DEFINITION

1. The Employment Security Law, [Idaho Code § 72-1316](#) (4) (a) and (b) states:

(4) Services performed by an individual for remuneration shall, for the purposes of the employment security law, be covered employment unless it is shown:

(a) That the worker has been and will continue to be free from control or direction in the performance of his work, both under his contract of service and in fact; and

(b) That the worker is engaged in an independently established trade, occupation, profession, or business.

2. The IRS uses eleven main tests organized into three categories: behavioral control, financial control, and the type of relationship of the parties. These tests are provided in IRS Publication 15-A. [Click here to view IRS Publication 15-A.](#)
3. Chapter 8 of the Social Security Handbook provides guidance to help determine worker status. [Click here to view or download the online Social Security Handbook.](#) The following are two very important sections of that chapter:

800.1 - Who are employees?

For Social Security purposes, you are considered an employee if:

- A. You are an officer of a corporation (see §§824-825);
- B. You meet the “common-law test” (see §§802-823); or
- C. You are in one of the four specific occupations described in §§826-830.

802.1 - What is the common-law test?

Under the common-law test, the person you work for has the right to tell you what to do, how, when, and where to do your job. There are several factors, or elements, which indicate such control over the details of your work. These are discussed in §§803-823.

Refer to the online Social Security Handbook for the most current information in sections 803-823.

POLICY

All state agencies are to comply with all federal and state regulations governing the proper classification of workers performing services.

FISCAL IMPACT

If a worker is classified and paid as an independent contractor and is later determined to be an employee, the State is responsible to immediately place this person on the payroll. As the employer, the State must make all future payments for the employee's services, less the applicable involuntary deductions, through the State's payroll system. The State would then be subject to complying with the Social Security Administration's (SSA) Statute of Limitations, which is the prior four calendar years.

All remuneration plus 100 percent of the applicable FICA taxation (both the employee's share and the employer's share) must be reported and paid by the employer. The Internal Revenue Service's quarterly 941 wage and tax statements would have to be revised and any additional tax developed would have to be remitted. Should additional federal taxation be due, the State could also be assessed late deposit penalties. Late FICA tax deposit penalties may also be assessed.

For improper worker classification, the state could be liable to the worker, to the U.S. Secretary of Labor, to the Department of Justice, to the Internal Revenue Service, and to the Idaho Department of Labor:

- The worker can sue the employer for the recovery of back wages, liquidated damages (an amount equal to the back wages), and the recovery of attorney fees.
- The Department of Justice can criminally prosecute those individuals responsible for willful violations of the Fair Labor Standards Act (FLSA). The penalty for the first offense is a fine of up to \$10,000. For subsequent violations the penalty can include a fine of up to \$10,000 and/or imprisonment for up to six months.
- The Secretary of Labor has the power to initiate investigations to determine whether an employer has violated any provisions of the FLSA. Employees who "blow the whistle" on the employer *cannot* be retaliated against in any way by the employer. Special provisions of FLSA protect the employees.

- The Internal Revenue Code empowers the IRS to assess the employer. [Click here to view current Internal Revenue Code](#). Significant assessments include:
 1. Income tax withholding [IRC Sec. 3509(a)(1), (b)].
 2. Withholding of the worker's share of FICA tax. [IRC Sec. 3509(a)(2), (b)].
 3. Employment taxes [IRC Sec. 6672] and [IRC Sec, 7201].
 4. Filing W-2 with the Social Security Administration [IRC Sec. 6721].
 5. Furnishing correct wage and tax statements (Forms W-2) to employees [IRC Sec. 6674] and [IRC Sec. 7204].
 6. Interest on past-due tax payments.
- The Idaho Department of Labor may assess penalties equaling four percent (4%) of the tax due or twenty dollars \$20.00 , whichever is the larger, for each month or fraction thereof until paid, Idaho Code § 72-1354 (2006). Civil penalties of 100% of the tax due or two hundred fifty (\$250.00), whichever is greater, shall be added to the liability of the employer for each quarter for which the employer willfully filed a false report (Idaho Code § 72-1372 (1) (a) (2007).

REFERENCES

If a worker's status is unclear, the following steps are recommended:

1. Review IRS Form SS-8. [Click here to view or download the IRS Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding](#). The IRS does not issue determination letters for proposed transactions or hypothetical situations, but they may issue an information letter when appropriate. See the IRS Form SS-8 "General Instructions" for details.
2. Review Chapter 8 of the Social Security Handbook. [Click here to view or download the online Social Security Handbook](#). The worker-related sections should provide both the agency and the worker with an understanding of employee vs. independent contractor classification.
3. Additional information can be found on the [Idaho Industrial Commission Web site](#):
 - Idaho Industrial Commission employer information.
 - Idaho Industrial Commission Employee vs. Independent Contractor publication.
4. If you are still unsure of how to classify a worker contact the Idaho Department of Labor Compliance Bureau for further assistance.