4. Completing Form SS-8

The Form SS-8 is divided into the following five parts:

- Part I — General Information;
- Part II — Behavioral Control;
- Part III — Financial Control;
- Part IV — Relationship of Worker to Firm; and
- Part V — For Service Providers or Salespersons

Each part is designed to elicit information relevant to a certain aspect of the worker classification issue. The questions have been carefully developed by the IRS. While the questions are designed to be objective, firms must remember that the IRS determines a worker to be an employee in more than 70% of the cases. Firms responding to these questions must carefully consider the implications of their responses in light of the many factors that affect worker classification determinations. The firm must be mindful of how its responses for a specific worker will affect all its classifications for all categories of its workers.

The person completing Form SS-8 must sign a declaration under penalties of perjury stating that the facts presented are true, correct, and complete. The declaration that the form is ''complete'' requires taxpayers to exercise due diligence in ensuring that all relevant information has been provided.

4.1. Part I — General Information

Part I sets the stage for the IRS to make its determination.

Line 1

Line 1 asks who is completing the Form SS-8. In most cases, the worker and the firm will each complete a Form SS-8 for the same worker. Line 1 also asks for the period during which the services were performed. Only the period for which a determination is being requested should be included. For example, if a worker initially provided services as an independent contractor and was later hired as an employee and the request relates to his or her status as an independent contractor, include only the period he or she was an independent contractor.

Line 2

Line 2 asks the reason(s) for filing the Form. Many firms receive a Form SS-8 because a worker who was classified as an independent contractor is contending that he or she was an employee for the periods stated on Line 1. A common fact patter involves a worker who knew that he or she was classified as an independent contractor and later contends that he or she was an employee for the purpose of (i) collecting unemployment compensation, (ii) collecting worker's compensation benefits, or (iii) avoiding taxes or penalties for failing to pay income and self-employment taxes. If the IRS sends a Form SS-8 to a firm, the firm's response to Line 2 is that it is responding to a request from the IRS to complete the Form.

Line 3

Line 3 asks for the total number of workers who are performing the same or similar services. Firms are required to classify workers performing the same or similar services the same way; that is, either an employee or an independent contractor. If a firm has employees performing the same or similar services as an independent contractor, the IRS will, in almost all cases, classify that worker as an employee. Thus, it is important to be very specific about the tasks each worker performs so that as many distinctions can be made to distinguish one worker, who may be classified by the firm as an employee, from another worker, who may be classified by the firm as an independent contractor.

As is discussed elsewhere in more detail, § 3509 reduces a firm's liability for failing to withhold income tax and the employee's share of FICA tax. (The employer's share of FICA tax is not reduced.) It also does not apply to certain statutory employees. Consistency in how a firm treats workers is important in determining whether the relief provided by § 3509 is available. First, § 3509 does not apply if the firm deducts income tax but not FICA tax. Second, § 3509 does not apply if a firm intentionally disregards the requirement to deduct and withhold employment taxes. If a firm treats some workers as employees and others who perform the same tasks as independent contractors, the inconsistency suggests that the failure to deduct and withhold may be an intentional disregard of the requirement with respect to the workers treated as independent contractors.

Line 4

Line 4 asks how the worker obtained the job. Four boxes are provided: application, bid, employment agency, or other. A worker who obtains work by application or through an employment agency is more likely to be viewed as an employee. Even short-time workers can be employees. A worker who obtains work through a competitive bid is more likely to be viewed as an independent contractor.

Line 5

Line 5 contains four requests. First, it asks for copies of ''all supporting documentation (contracts, invoices, memos, Forms W-2 or Forms 1099-MISC issued or received, IRS closing agreements, IRS rulings, etc.).'' This is a very broad request, and includes any documentation that relates to the status of the worker as an employee or independent contractor. Because the worker and the firm will each be completing the Form SS-8, each party must consider the documents that the other party may have and include those in the response.

While each party (also referred to as ''taxpayer'') will be inclined to include those documents that support its position and exclude those that do not support its position, it is important to provide any relevant documentation. The IRS has broad discovery powers, and can compel a taxpayer to produce all documents other than those protected by the attorney-client privilege, the work-product doctrine, or the confidentiality privilege under § 752 relating to communications between a taxpayer and a tax advisor. If a taxpayer does not disclose a relevant document in the Form SS-8 response, the IRS may discover the document either because the other party included it in its response to the Form SS-8 or the taxpayer is later examined by the IRS. In either case, the taxpayer may find itself in the uncomfortable position of explaining why it did not include a relevant document in its response. If a taxpayer decides not to include a document that is arguably relevant in

its response, the taxpayer should retain in its records an explanation justifying why the document was not provide.

Second, Line 5 asks the taxpayer to inform the IRS of any current or past litigation concerning the worker's status. Litigation is not defined for this purpose, and it is unclear what type of disputes should be reported. For example, are disputes regarding the worker's status for unemployment compensation, worker's compensation benefits, or eligibility for overtime pay for which an administrative process has begun considered litigation?[19] The prudent approach would be to treat as litigation any dispute regarding a worker's status that results in an inquiry or challenge brought pursuant to a process established by a governmental authority.

Third, Line 5 asks for the amount of income earned for the year(s) at issue if no income reporting forms (Form 1099-MISC or Form W-2) were furnished to the worker. Generally, a firm should issue a Form 1099-MISC to any independent contractor to whom it pays at least $600. This question does not ask for the amount of payments made to a worker, but *the amount of income earned*. Generally, a firm will not know the expenses incurred by an independent contractor. In answering this question, a firm should state the amount it paid the worker, but that it does not know what portion, if any, of that amount is taxable income to the worker. Depending on the arrangement between the firm and the worker regarding the reimbursement of expenses, reimbursements may or may not be included in the amount earned. Generally, if the arrangement is a flat fee arrangement without regard to the expenses the firm pays the worker, the full amount paid the worker (unreduced by the worker's costs) is the amount of income earned. If the arrangement provides that the worker will account to the firm for expenses and that the firm will reimburse the worker for the expenses, the amount of income earned may exclude the reimbursed expenses.

Finally, Line 5 asks for an explanation if a worker received both a Form W-2 and a Form 1099-MISC. The IRS is very suspect of situations in which an employee terminates employment and then is retained by the firm as an independent contractor. An initial concern on the part of the IRS will be whether the employee was terminated so that the employer no longer has to provide employee benefits to that individual. Have the services performed by the worker changed sufficiently to cause him or her to qualify as an independent contractor? The reverse is less suspect; that is, an independent contractor who is then hired as an employee.

Line 6

Line 6 asks the firm to describe its business. In providing this response, the firm must be mindful that the description should make the need for independent contractors easily understandable. The IRS will be asking itself why the firm needs to retain the services of an independent contractor rather than an employee.

Line 7

Line 7 asks if the worker received pay from more than one entity because of an event such as a sale, merger, acquisition, or reorganization (an ''event'') of the firm for whom the services were provided. If a firm classifies a worker as an employee and, because of the event the worker is classified as an independent contractor, the IRS will question why the classification of the worker changed. Question 7 asks for information that will allow the IRS to identify the firm's previous owner and other information that will allow the IRS to access the tax records of the firm before the event. The post-event firm may have to demonstrate to the IRS that either the services being rendered by the worker have changed from those of an employee to those of an independent contractor or the pre-event firm incorrectly classified the worker as an employee. It appears that the purpose of this question is to flesh out those situations in which the new owner uses the event to reclassify the worker. For example, the pre-event firm terminates the worker as an employee followed by the post-event firm bringing the worker back as an independent contractor. While the change in classification may be justified, this is a difficult fact patter for the firm to defend.

Line 8

Line 8 asks the firm to describe the work done by the worker and the worker's job title. This is a critical question. How does the work done by this worker differ from the work done by the firm's employees? Does this worker possess skills that are not required by the firm's other employees? Are the skills of this worker needed for a limited purpose? Generally, the fact that a worker is needed for a limited time does not justify classifying the worker as an independent contractor. Temporary employees can be used for short-term needs. There must be factors other than the limited duration that justify classifying the worker as an independent contractor.

Line 9

Line 9 asks the firm to explain why it believes the worker is an employee or an independent contractor. The answer to Line 9 will be based, in large part, on the answer to Line 8. In most cases, a firm will be explaining why it believes the worker is an independent contractor. The worker likely will have told the IRS that he or she is an employee. The firm should anticipate what the employee told the IRS in explaining why he or she should be classified as an employee. The firm should also anticipate what co-workers might say. *See* Line 11 below.

Line 10

Line 10 asks whether the worker performed services for the firm in a capacity before providing the services that are the subject of this determination request. If the answer is ''yes,'' there are two follow-up questions. First, what are the dates of the prior service? Second, explain the differences, if any, between the current and prior services.

Line 10 is related to Line 5 which, in part, asks for an explanation if the worker was issued both a Form W-2 and a Form 1099. As noted in connection with Line 5, the IRS is suspect when a worker has provided services for the firm as an employee and an independent contractor, especially if the status

[19] The term ''litigation'' is defined in a somewhat circular manner. Black's Law Dictionary (10th Edition) provides the following definition, ''The process of carrying on a lawsuit: a lawsuit itself.'' It defines ''lawsuit'' as ''to proceed against (an adversary) in a lawsuit: to sue.'' Black's defines ''sue'' as ''to institute a lawsuit against (another party).'' The definition in Webster's Dictionary is not much more helpful. It defines ''litigation'' as ''the act or process of litigating; a matter that is still in litigation.'' It defines ''litigate: as to make the subject of a lawsuit; contest a law.'' The American Heritage Dictionary of the English Language (4th Edition) defines ''litigate'' as ''To engage in legal proceedings.''

of independent contractor follows the status of employee. The IRS is much less likely to challenge a shift in classification from independent contractor to employee. Moreover, such a shift is less likely to be the subject of a Form SS-8 inquiry.

It is common for an independent contractor to provide services to a firm intermittently over an extended period of time, and only a portion of this time may be the subject of a Form SS-8 inquiry. Two facts that are particularly important in this situation are (1) whether the worker was performing services for other firms at the time he or she was performing services for the firm, and (2) whether the services performed were those that are traditionally performed by an independent contractor. If a firm is using workers that it classifies as independent contractors to supplement the firm's workforce when demand is high, the IRS will tend to classify such workers as short-term or part-time employees.

A particularly bad fact patter is one in which a worker provided services to a firm as an employee, the employment terminated, and the worker returned as an independent contractor performing essentially the same services. While the IRS does not take the position that once a worker is an employee he or she always is an employee, this is almost always the case when the nature of the services provided do not change in a material way.

Line 11

If work is done under a written agreement, Line 11 asks the firm to provide a copy of the written agreement. Line 11 also asks for a description of the terms and conditions of the work arrangement. The written agreement is important, but the IRS is more concerned with the actual terms and conditions of the work arrangement. On a day-to-day basis, did the work arrangement exhibit the attributes of an independent contractor or employer-employee relationship?

The firm must be mindful that the worker has provided the IRS with his or her perception of the control that the firm exercised over him or her in connection with the services performed. The worker may have provided specific examples that he or she believes supports classification as an employee. The employee may use statements by co-workers or supervisors or practices of supervisors as support for his or her position, even though those statements or practices do not reflect the firm's policy with respect to independent contractors. Before responding to Line 11, a firm should interview any employee or independent contractor who interacted with the worker to ascertain a complete picture of the working relationship.

Questions to ask co-workers include:

- Do you know [name of worker] through work?
- Do you know whether [name of worker] is an employee or independent contractor of [name of firm]?
- Are you familiar with the work (tasks, responsibilities, etc.) [name of worker] does for [name of firm]?
- How is the work performed by [name of worker] different from the work performed by other employees or independent contractors of [name of firm]?
- Where is the work done?
- How is the work supervised?
- How is the work measured (hourly/project)?
- What control does [name of worker] have in the manner of getting the work done?
- Do you know whether [name of worker] has a supervisor at the [name of firm], and, if so, who it is?
- Has [name of worker] spoken to you about his [or her] status with [name of firm] as an employee or independent contractor?
- If [name of worker] has spoken to you about his or her status, did [name of worker] tell you whether he [or she] is an employee or independent contractor and why he [or she] believes that is his [or her] worker status?

4.2. Part II — Behavioral Control

As discussed in Chapter Two on factors considered in determining employee status, the IRS digested the common law factors of employment into 20 factors that it listed in Rev. Rul. 87-41.[20] Over time, the IRS further digested the employment factors into three broad categories: behavioral control, financial control, and relationship of the worker to the firm.

Behavioral control focuses on the facts that show whether the firm has a right to direct and control how the worker does the task for which the worker is hired. In this regard, the IRS looks to (1) the type of instructions that the firm gives the worker, (2) the degree of instructions, (3) evaluation systems, and (4) the training that the firm gives the worker.

An employee, as opposed to an independent contractor, is generally subject to the firm's instructions about when, where, and how to work. The following are examples of types of instructions about how to work:

- When and where to do work.
- What tools or equipment to use.
- What workers to hire or to assist with work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

Line 1

Line 1 asks for a description of any specific training or instruction the worker is given by the firm. The general thinking by the IRS is that independent contractors do not require training. Thus, if the firm is providing training, this factor indicates that the worker is an employee. In addition, independent contractors do not need much instruction from the firm. The more instructions the firm provides the worker, the more the worker looks like an employee.

When responding to this questions, a firm must draw a distinction between training or instruction that is aimed at assisting the worker in performing his or her services, on the one hand, and training or instruction that enable the worker to communicate the results of the services rendered in the format required by the firm, on the other hand. Training or instruction

[20] 1987-1 C.B. 296.

that relates to a firm's request for receipt of the results of the services in a particular format, but does not address how the work is done, should not be viewed as a factor suggesting an employer-employee relationship.

For example, a bank may retain a worker to appraise residential real property in connection with loans issued by the bank. If the bank provides training or instruction to the worker on how to appraise a single family residence, that type of training or instruction would suggest an employer-employee relationship. If the bank does not provide training or instruction on how to appraise a single family residence, but does provide training or instruction on how all appraisers are to submit their appraisal reports electronically to the bank, such training or instruction would not suggest an employer-employee relationship. Many firms require service providers to submit reports in a specific format. The worker is not being trained or instructed on how to do the work; rather, the training and instruction relates to communicating the results of the work.

Line 2

Line 2 asks for a description of how the worker receives work assignments. The manner in which work is assigned may indicate whether the relationship between the firm and the worker is more like an employer and employee or a firm and independent contractor.

Independent contractors are generally retained for specific projects for which the scope of the engagement (the work to be performed) is clear at the time of the engagement. A contract between the firm and the worker may set forth the scope of the work, the time for completion, and the payment for the services. The independent contractor decides how the work is to be done, so there is not much need for work assignments.

An employee generally performs the services the firm assigns. While an employee generally understands the type of tasks for which he or she has been hired, the specific work assignments are not detailed at the time the employee is hired. The work assignments are issued on a periodic basis, as needed, and are often done in an informal manner.

The more formal the structure in which work assignments are made, the more they tend to indicate an independent contractor relationship. Continuous work orders under a general retainer agreement are not particularly helpful in indicating an independent contractor relationship. Such work orders may be a neutral factor, whereas separate contracts for each project may indicate an independent contractor relationship.

Line 3

Line 3 asks for a description of who determines the methods by which assignments are performed. In general, if the firm determines the methods by which assignments are performed, the IRS will consider this a factor indicating an employer-employee relationship. If the firm must determine the methods by which the work is performed, the firm should provide an explanation as to why this is necessary. What is it about the work being performed that prevents an independent contractor from determining the methods by which it is performed? Are there unique circumstances?

Line 4

Line 4 asks for a description of who the worker is required to contact if problems or complaints arise and who is responsible for their resolution. The question is not clear on the types of problems or complaints to which it relates. Does it relate to problems or complaints with customers of the firm for which the services are being provided? Does it relate to problems or complaints the worker has with employees or other workers of the firm?

The material issue is the status of the person to whom the worker is required to report problems or complaints. Does the worker report to a supervisor or manager of the firm? Does the worker report to a person who negotiates and manages the contracts? Does the firm have a project manager to whom independent contractors working on the project report problems or complaints? What sanctions are imposed if a worker is not performing satisfactorily? Is the threat to the worker termination (suggesting employer-employee relationship) or damages for breach of contract (suggesting independent contractor relationship)?

A firm's normal recourse for an independent contractor who is not performing satisfactorily is to seek a breach of contract claim if the independent contractor does not correct the perceived problem. There may be a contractor administrator assigned for the contract with the independent contractor, but this person is not a supervisor or manager.

If an independent contractor is having difficulty performing his or her tasks because of the actions of the firm's employees or workers, this should be reported to the firm's contract administrator. If the independent contractor is expected to follow the same procedures an employee of the firm would follow if he or she was having a problem with an employee or other firm worker (that is, the independent contractor is treated the same as any other firm employee with respect to complaints about another employee or worker), this will be a factor suggesting an employer-employee relationship. The relationship between the independent contractor and the firm is controlled by their agreement, and its terms should be followed for any problems or complaints.

Line 5

Line 5 asks what types of reports are required of the worker and for examples to be attached. Frequent and detailed reports indicate an employer-employee relationship. An independent contractor may provide periodic reports on progress, but the reports tend not to be descriptive of the manner in which the work is being performed. Reports that describe what the worker has been doing and the progress he or she is making indicate an employer-employee relationship. Reports may be good management tools, but the firm should not be managing an independent contractor. If reports are required, the firm should carefully evaluate the reason for requesting the reports. It may be that the reports are needed for some purpose(s) other than typical management oversight of employees.

Line 6

Line 6 asks for a description of the worker's daily routine, such as schedule, hours, etc. Generally, a firm would not know much, if anything, about the daily routine of an independent contractor. If the independent contractor needs access to the firm's premises, the firm may know the arrival and departure times of the independent contractor and may subject the worker to the same security procedures for the firm's employees who have access to the same areas of the firm's facilities. The more

a firm controls the daily routine of a worker, the more that fact indicates an employer-employee relationship.

Line 7

Line 7 asks for the location(s) at which the worker performs services, such as the firm's premises, the worker's own shop, office or home, or a customer's location. Line 7 further asks for an indication of the appropriate percentage of time the worker spends in each location, if more than one. The ability of a firm to control the location at which the worker performs services indicates an employer-employee relationship. There may be valid reasons for an independent contractor to perform services at the firm's location. For example, if the independent contractor is installing carpeting, the independent contractor will need to be on the firm's premises to do so. Similarly, the independent contractor may need to perform services at the location of a customer of a firm. For example, a company that sells carpeting may contract with an individual who installs carpeting for several carpet retailers. The fact that an installer performs services at a firm's location or at a firm's customer's location does not indicate that the installer is an employee of the firm having the carpet installed or the carpet retailer.

A carpet installer who holds himself out to the public as a carpet installer and who works for a number of carpet retailers is likely an independent contractor. If he or she works only for one carpet retailer and does not market himself or herself as a carpet installer, the IRS may be inclined to classify that worker as an employee.

The location at which services are performed and the percentage of time spent at that location relative to other locations at which work is performed is a factor in determining a worker's classification. In many cases, a firm will not know how much time a worker spends at locations other than the firm's location. This would not be information the firm would need to know of an independent contract. A firm may only know how much time, if any, the worker spends at the firm's location.

If services must be performed at a firm's location, the firm should explain in responding to Line 7 why it is necessary for the worker to perform the services at the location. The reasons should not focus on any aspect of the firm's desire to manage the worker's performance of the services.

Line 8

Line 8 asks for a description of any meetings the worker is required to attend, such as sales meetings, monthly meetings, staff meetings, and any penalties for not attending the meetings. In general, the requirement that a worker attend meetings indicates an employer-employee relationship. A firm should not have sufficient control over an independent contractor to require him or her to attend a meeting. The *right* to require a worker to attend a meeting, even if the worker is never asked to attend a meeting, indicates an employer-employee relationship. Even inviting a worker to attend meetings, but not requiring attendance, suggests that there is something about attendance at the meeting that is beneficial to the relationship between the firm and the worker. This too can indicate an employer-employee relationship, depending on the frequency of the invitations.

The contract between a firm and an independent contractor can require meetings without causing the relationship to be viewed as an employer-employee relationship. These meetings should be tied to phases of the contract or milestones, and not merely periodic reviews of the worker's services.

Line 9

Line 9 asks if the worker is required to provide the services personally. Generally, a contract between a firm and an independent contractor is for a specific project or task, but not for that specific project or task to be completed by a particular worker. If the personal services of a particular worker are required, this requirement tends to indicate an employer-employee relationship. If a firm requests the services of a particular worker, the firm should explain why the specific project or task requires that worker's services. The worker may have a particular experience or expertise that is required by the firm and that distinguishes that worker from other available workers. For example, a firm may have a unique piece of equipment that needs to be repaired and the firm knows of only one worker with the experience and expertise to repair that piece of equipment.

Line 10

Line 10 asks who hires substitutes or helpers if they are needed. Because an independent contractor generally is hired for a particular project or task, the independent contractor is the person to hire substitutes or helpers if they are needed. If the firm is the person that hires substitutes or helpers, that fact indicates an employer-employee relationship. If a firm has retained the right to hire substitutes or helpers, it will need to explain why the worker is not the person doing this.

Line 11

Line 11 asks whether approval is required for any substitutes or helpers hired. If approval is required, who must approve? If approval is required by someone unrelated to the firm (such as a firm customer), this should not be a factor indicating an employer-employee relationship. If approval is required by the firm, the firm must explain why it needs to require such approval.

The firm may have a valid business reason for knowing whether workers performing certain services for it meet certain requirements. These requirements could relate to safety or security. If there are valid business reasons, the firm can establish these as a requirement that the worker must meet in providing substitutes or helpers without the firm retaining the right to hire the substitutes or helpers. The firm may be able to retain the right to confirm that the substitute or helper meets its requirement without such right being treated as the right to hire. The important point is that, whatever right the firm retains with respect to the independent contractor's use of substitutes or helpers, the firm not retain a right that allows it to control who can work as substitutes or helpers.

Line 12

Line 12 asks who pays the substitutes or helpers. If the firm pays the substitutes or helpers, this will indicate that the worker and the substitute or helper are employees. It should be the responsibility of the independent contractor to pay the substitutes and the helpers. There should be no direct relationship between the substitutes and helpers, on the one hand, and the firm, on the other hand.

If the firm must make payments to the substitute or helpers, it should make clear, if possible, that it is making the payments

at the direction of the worker. The worker should provide written instructions to the firm to make a payment to the substitute or helper. Moreover, the economic burden of paying the substitute or helper should be borne by the worker under his or her contract with the firm. *See* Line 13 below. In this regard, the firm should be the agent of the worker in making the payment. If the worker fails to pay the substitute or helper, the firm should have no liability to the substitute or helper.

Line 13

Line 13 asks if the worker is reimbursed for payments made to the substitutes or helpers, and, if so, by whom. If the worker is reimbursed for payments to the substitutes or helpers, then the worker is not bearing the economic burden of the payments to these workers. This makes the worker's relationship with the firm look more like an employee. There should be no reason why the firm would reimburse the worker for payments made to the substitutes or helpers.

The contract between the firm and the worker may provide that the firm will pay costs plus a percentage of costs for any changes to the original project or task. The worker may need to add helpers and be entitled to recover the cost of these helpers. The percentage of costs the worker may be entitled to charge for helpers may be based on an estimate of the additional labor costs that worker will incur to add helpers for the change to the original contract. Under these facts, the worker would not be reimbursed for the cost of the helpers. Rather, the worker would be entitled to recover his or her additional costs plus a percentage of those costs. It is important to understand the worker's specific rights to payment under its contract with the firm in responding to this question.

4.3. Part III — Financial Control

Financial control focuses on the facts that show whether the firm has a right to control the business aspects of the worker's job. These facts include:

- The extent to which the worker has unreimbursed business expenses;
- The extent of the worker's investment;
- The extent to which the worker makes his or her services available to the relevant market;
- How the firm pays the worker; and
- The extent to which the worker can realize a profit or loss.

Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. It should be noted, however, that employees also may incur unreimbursed expenses in connection with the services that they perform for their firms.

An independent contractor often has significant investment in the facilities he or she uses in performing services for someone else. A significant investment, however, is not necessary for independent contractor status.

An independent contractor is usually free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, maintain an Internet website and business e-mail address, and are available to work in the relevant market.

An employee is generally guaranteed a set wage for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. It is common in some professions, however, such as law, to pay independent contractors hourly.

An independent contractor can make a profit or loss.

Line 1

Line 1 asks the firm to list the supplies, equipment, materials, and property provided by the firm, the worker, and any other party. Generally, an independent contractor provides these items. Thus, in many cases, the firm may not know all the supplies, equipment, materials, and property provided by the worker or any other party. If the firm provides supplies, equipment, materials, or property, it should explain why it is necessary for the firm to provide these, rather than the worker. Is there something unusual about some or all of these items that would require the firm to provide them to the worker?

If the firm generally knows the supplies, equipment, materials, and property that are required for the project or task being performed by the worker and the firm has not provided them, it is helpful to note the items that are needed and to note who is providing them. If the firm does not know who is providing them, it should still note them but state that it does not know whether the worker or some other person is providing them. The important point is that the firm is not providing them.

One fact pattern that arises when a firm needs a worker to use a computer is for the firm to provide the computer/laptop. There may be security reasons for this if the worker needs to access the firm's electronic data or the firm may want to protect proprietary software loaded on the computer/laptop. While there are understandable reasons why a firm would want a worker to use the firm's computer, the IRS has viewed this as the firm providing the worker with the tools needed to perform his or her job, and accordingly, as a fact indicating an employer-employee relationship.

Line 2

Line 2 asks if the worker leases equipment. If the answer is ''yes,'' Line 2 asks for a description of the terms and a copy of the lease or explanatory statement.

In general, it should not matter whether a worker owns his or her equipment or leases it. In either case, the worker would be providing the equipment, which would indicate an independent contractor status. The real issue here is whether the worker leases equipment from the firm. If the worker leases equipment from an unrelated third party, the IRS likely will not be very interested in the terms of the lease. If the firm leases the equipment to the worker, however, the IRS will be interested in reviewing the terms of the lease.

Under a common lease, the lease payment is based on the period of time the lessee uses the property (months, days, hours of running time, etc.). The lease payment is not tied to the income or productivity of the lessee. If a firm leases property to a worker on terms that tie the lease payments to the income or productivity of the worker such that the worker's potential for a loss due to the expense of fixed lease payments is lessened, the fact that the worker provides the equipment is less of a factor indicating independent contractor status.

If a firm leases equipment to a worker, it should demonstrate, to the extent possible, that the lease terms are consistent with market terms. The firm also should explain why it is necessary for it to be leasing equipment to an independent contractor, rather than other parties. In some industries, such as the cosmetology industry, it is common for a worker to lease space or property from the firm for whom, or at whose facility, the worker is performing services.[21]

Line 3

Line 3 asks what expenses are incurred by the worker in performing the services for the firm. Consider all the expenses the worker must incur in performing the services. Are transportation expenses involved for equipment, supplies, helpers, etc.? Does the worker pay for helpers or other workers who are rendering services? Is the expense of the helpers or other workers solely the responsibility of the worker (e.g., the worker is not reimbursed for this expense)? Does the worker provide parts, and, if so, are they included in the price or are they itemized in the invoice? The more expenses the worker incurs that are not reimbursed or separately itemized, the more this treatment of expenses indicates an independent contractor status.

Line 4

Line 4 asks which, if any, expenses are reimbursed by the firm or another party. The more expenses are reimbursed, the less likely the worker is to experience a loss. In describing expenses that are reimbursed, the firm must, when possible, describe such reimbursements in a way that does not undermine the firm's contention that the worker bears an economic risk in providing the services. If certain expenses are reimbursed, such as additional costs incurred because of change orders, distinguish these from expenses normally incurred by an independent contractor; that is, why should the firm and not the independent contractor bear the economic burden of these expenses?

Line 5

Line 5 asks for the type of pay the worker receives, and provides the following choices: salary, commission, hourly wage, piece work, lump sum, and other (specify). Salary and hourly wage generally indicate employee status. Payment on a piece work basis indicates employee status if the services are rendered on the firm's premises. Also, § 3121(d)(3)(C) provides that certain home workers who perform piece work are employees for FICA purposes.

Services performed on a straight commission basis generally indicate that the worker is an independent contractor.

Line 6

Line 6 asks whether the worker is allowed a drawing account for advances, and, if so, how often. Line 6 also asks for any restrictions on advances.

Independent contractors generally do not receive advances based solely on the passage of time. Rather, there is often an initial deposit or advance with future payments based on the completion of certain phases of the work. The IRS is sensitive to periodic payments that would be typical for an employee being characterized as advances. In responding to Line 6, the firm should demonstrate, if possible, that advances are made at stages of work completion pursuant to the terms set forth in the contract between the firm and the worker.

Line 7

If the worker is performing services for a customer of the firm, Line 7 asks whether the customer pays the firm or the worker. If the customer pays the worker, does the worker pay the total amount to the firm? If the worker does not pay the total amount to the firm, Line 7 asks for an explanation.

Federal employment tax liability arises from wages paid to employees. If a worker is not paid any ''wages,'' there cannot be any employment tax liability. In Rev. Rul. 69-26,[22] the IRS ruled that a golf club does not incur federal employment tax liability for the remuneration paid to caddies either directly by the club members or by the members through the use of the club itself as agent for the payment. The payments to the caddies are not ''wages'' paid by the golf club.

Although the purpose of the question in Line 7 is not clear, the IRS may be trying to ascertain if the customer, rather than the firm, is the employer of the worker. If the worker is merely collecting the payment from the customer on behalf of the firm (i.e., merely serving as a conduit), then the customer will not be consider paying the worker. If the worker keeps the payment, however, the customer may be paying ''wages'' to the worker. In this case, the firm is not liable for the employment taxes.

Line 8

Line 8 asks whether the firm carries worker's compensation insurance on the worker. Generally, a firm would not carry worker's compensation insurance on an independent contractor. If the firm is carrying worker's compensation insurance on the worker, is it required to do so by a governmental agency or other third party? If a governmental agency requires worker's compensation to be carried, the firm should determine the policy behind this requirement. For example, if this is in the construction industry and the worker performs construction related services, the governmental agency may take the position that the worker is an employee.

Line 9

Line 9 asks for a description of the economic loss or financial risk, if any, the worker can incur beyond the normal loss of salary, such as loss or damage of equipment or materials. For various unanticipated reason, an independent contractor may lose money on a project because the project expenses are more than the contract price. One of the fundamental differences between an employee and an independent contractor is that an employee generally is not exposed to economic loss or financial risk, other than having his or her employment terminated. Independent contractors often work under a contract pursuant to which he or she provides his or her own supplies, equipment, materials, and property and the payment is based on factors other than the hours worked.

There are independent contractors, such as lawyers, accountants, and consultants, that charge for their services based

[21] In *Ren-Lyn Corp. v. United States*, 968 F. Supp. 363 (N.D. Ohio 1997), cosmetologists who rented chairs from a beauty salon were found to be independent contractors because they possessed the characteristics of independent contractors notwithstanding that they leased their chairs from the beauty salon.

[22] 1969-1 C.B. 251.

on the number of hours spent on a client's matter. Receiving an hourly fee does not cause these workers to be employees, but there are factors that generally distinguish these workers from employees. These independent contractors often maintain an office and staff, hold themselves out to the public as providing services for a fee, incur various expenses, such as licensing fees, continuing education fees, and professional association fees, in connection with the service they render, and work for many clients.

Line 10

Line 10 asks if the worker establishes the level of payment for the services provided or the products sold. If not, than who does? There are many ways the level of payment could be structured: fix fee, cost plus a certain percentage, hourly, etc. If payment is based on an hourly rate and the firm establishes the hourly rate, this will tend to indicate an employer-employee relationship. As noted above, the fact that work is done on an hourly rate does not mean the worker is an employee. Many independent contractors charge an hourly rate plus certain costs. While an independent contractor may have an established hourly rate, he or she may negotiate with a customer on the rate for a specific project. Similarly, if a project is to be done on a fixed-fee basis, the fixed fee is often the result of negotiations between the firm and the worker.

Because employers and employees often negotiate a salary before the employee is hired, the fact that the level of payment is negotiated between the firm and the worker does not indicate either an employer-employee relationship or an independent contractor relationship. The nature of the negotiation, however, can be important. If the starting point is the request for bids by the firm for a specific project, it will indicate an independent contractor relationship. The starting point in such a negotiation is the bid offer submitted by the worker. In contrast, if the firm advertises that it has a project for which it will paid qualified workers a certain hourly rate, this indicates an employer-employee relationship.

4.4. Part IV — Relationship of the Worker and Firm

The relationship between the worker and the firm is considered in determining the classification of the worker. The facts that show the relationship between the parties include:

- Written contracts describing the relationship the parties intended to create.
- Whether the firm provides the worker with employee-type benefits, such as insurance, a pension plan, vacation, or sick pay.
- The permanency of the relationship.
- The extent to which services performed by the worker are a key aspect of the regular business of the firm.

Line 1

Line 1 asks for a list of the benefits available to the worker (e.g., paid vacation, sick pay, pensions, bonuses, paid holidays, personal days, insurance benefits). The issue here is the extent to which the firm provides employee-type benefits to the worker.

Generally, firms do not provide benefits to independent contractors. If a firm provides benefits to a worker, the firm should explain, if possible, how the particular benefit(s) provided does not indicate an employer-employee relationship. For example, if a worker is entitled to a "bonus" if certain objectives are obtained, this may be an incentive payment for completing the particular project or task within a certain time frame. Such incentive payments are not uncommon in an independent contractor relationship.

Line 2

Line 2 asks whether the relationship can be terminated by either party without incurring liability or penalty. If the answer is no, Line 2 asks for an explanation.

Most employees are employees at will. This means that the employer can terminate the employee without cause and the employee can quit without cause, and, in either case, there is no liability or penalty to the other party. An independent contractor relationship generally is created pursuant to a contract that requires the independent contractor to perform certain services and for the firm to pay for those services. The independent contractor cannot unilaterally decide not to perform the services, and the firm cannot unilaterally decide that it no longer will accept the services, without breaching the terms of the contract.

If the relationship can be terminated by either party without liability or penalty, this fact indicates an employer-employee relationship. Some firms reserve the right in contracts to terminate a worker's services to the firm without limiting such termination to certain unacceptable conduct of the worker. This makes it easier to terminate the worker's services, but makes the relationship appear more like an employer-employee relationship.

Line 3

Line 3 asks if the worker performed similar services for others during the same period. If the answer is yes, Line 3 asks if the worker is required to get permission from the firm.

Independent contractors generally hold themselves out to the public as being available for hire. They often work for many firms during a year, and may work for several firms during the same period. In contrast, employees generally work for one firm during a given period, although some employees do work at more than one job.

A firm may not necessarily know whether a worker performs similar services for others during the same period. Based on the representation by the worker that he or she is an independent contractor and the amount of time the worker has available to work for others while he or she is working for the firm, the firm may reasonably believe that the worker is performing services for others. If the worker is working 40 hours or more per week for the firm, it becomes less reasonable to assume the worker is performing services for others.

A firm has every reason to expect that an independent contractor will perform the services he or she agrees to perform at the time he or she agrees to perform them. A contract between an independent contractor and a firm generally will set forth these items. It is not common, however, for a firm to require an independent contractor to obtain the firm's approval to work for other firms during the period the independent contractor is providing services to the firm. It is the independent contractor's responsibility to ensure that the work is timely performed.

The right to request a worker to obtain approval from the firm before working for others suggests an employer-employee relationship. There may be unusual circumstances that justify the firm requiring such approval of an independent contractor, but this will be the exception. For example, the firm may require its approval for fear the worker will perform services for a competitor during the same period. If the firm does request such approval, it should, if possible, explain the unusual circumstances that justify the firm requiring its approval.

As noted above, independent contractors will often have business cards, an Internet website, a business e-mail address, and will advertise. A firm should check for these items before responding to this question. Being able to demonstrate that the worker performs services for other firms on a regular basis is a significant factor for an independent contractor relationship.

Line 4

Line 4 asks for a description of any agreement prohibiting competition between the worker and the firm while the worker is performing services or during any later period, and requires any available documentation to be attached. Firms often require employer-employees with a skill set that would be valuable to the firm's competitors to sign a non-competition agreement that prohibits the employee from directly competing with the firm or working for a competitor after the employee relationship with the firm terminates. Non-competition agreements generally are enforceable provided they are not too restrictive.

Because an independent contractors generally performs services to a number of firms before, during, and after the time he or she is performing services for a particular firm, an independent contractor would be significantly limiting his or her work options if he or she agreed not to compete. Accordingly, arrangements with independent contractors typically do not contain a non-competition agreement.

A non-competition agreement is to be distinguished from a non-disclosure agreement. A non-disclosure agreement prevents a worker from disclosing trade secrets or other valuable information that he or she gains while performing services for a firm. It is common for a firm to require employees and independent contractors to sign non-disclosure agreements if they will have access to valuable information while performing their services.

If a firm has a non-competition agreement with a worker it has classified as an independent contractor, the firm should explain, if possible, why it is necessary to have a non-competition agreement with the worker. The explanation should distinguish the non-competition agreement from a typical non-competition agreement with an employee.

Line 5

Line 5 asks if the worker is a member of a union. The purpose of this question is unclear. If a worker is a member of a union, the union may impose restrictions on when or how the worker is to perform services. It appears that the IRS considers restrictions imposed by a union or third parties as neutral in determining worker classification; that is, it will not view those as restrictions imposed by the firm.[23]

Line 6

Line 6 asks for the type of advertising, if any, the worker does (e.g., a business listing in a directory, business cards, etc.). Line 6 asks the firm to provide copies, if applicable.

Independent contractors generally hold themselves out to the public as available to perform certain services. They often list their business in a business directory, have business cards to distribute, have a business e-mail address, have an Internet website, and maintain all required licenses. An independent contractor may be a member of a profession (doctor, lawyer, certified public accountant, architect, etc.), a professional organization or society (the Appraisal Institute (MAI/SRA designations), National Association of Certified Valuation Analysts (CVA designation), the National Academy of Arbitrators, American Arbitration Association), and may have completed the necessary training or level of experience to receive a professional designation. A firm may be aware of these attributes when a worker is retained. Each of these is helpful in demonstrating that the worker is an independent contractor.

The worker may have an Internet website for his or her business that presents the worker as an independent contractor eligible for hire. He or she may describe himself or herself as an independent contractor on LinkedIn or Facebook. These are sources a firm generally can check.

The firm also should make inquiries of the worker as to any advertising the worker does. Because advertising is more a trait of independent contractors than employees, the firm should demonstrate as much advertising and other indicia of independence on the part of the worker as possible.

Line 7

Line 7 deals with workers who work from home. Line 7 asks who provides materials and instructions or patterns if the worker assembles or processes a product at home.

Certain workers are treated as employees for FICA (Social Security and Medicare) and FUTA purposes, even if they would not be classified as employees under common law. (Full-time life insurance salespersons and full-time traveling or city salespersons are discussed in more detail below.) These workers are referred to as ''statutory employees.'' A worker who is an employee under common law cannot be a statutory employee. Statutory employees fall into four occupational groups:

- Agent-drivers or commission drivers engaged in distributing meat, vegetable, fruit or bakery products, beverages (other than milk), or who picks up and delivers laundry or dry cleaning.[24]

[23] A worker who is a member of a union may be entitled to certain benefits that must be provided by the firm. The IRM's Technical Guidelines for Employment Tax Issues instructs IRS examiners when determining compensation to consider fringe benefit issues, and to identify the sources of fringe benefits. See IRM 4.23.5.15 (11-22-17).

[24] § 3121(d)(3)(A).

• Full-time life insurance salespersons whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.[25]

• Home workers performing work according to furnished specifications on materials provided, which products are required to be returned to the principal.[26]

• Full-time traveling or city salespersons soliciting orders from wholesalers or retailers for merchandise for resale or for supplies used in their business operations. The work performed for the firm must be the salesperson's principal business activity.[27]

In addition to the specific requirements for each occupational statutory employer, statutory employees must meet the following general requirements:

1. The contract of service contemplates that the worker will personally perform substantially all the work;

2. The worker has no substantial investment in facilities other than transportation facilities used in performing the work; and

3. There is a continuing work relationship with the person for whom the services are performed.

The firm does not withhold federal income tax from the wages of a statutory employee, but furnishes a Form W-2 to the statutory employee and checks ''Statutory Employee'' in box 13. Payments are shown as ''other compensation'' in box 1. Social security wages are shown in box 3, social security tax withheld in box 4, Medicare wages in box 5, and Medicare tax withheld in box 6.[28]

Homeworkers are subject to a special wage requirement. Under § 3121(a)(10), pay received by a homeworker is not wages for employment tax purposes unless $100 or more in cash is received by the homeworker in the calendar year from one firm. Thus, a homeworker may be employed by several firms, but if the pay from one firm is to constitute wages, the homeworker must receive at least $100 cash in the year from that firm. If the $100 cash-pay test is met, all the non-cash pay from the same firm can be included as wages.

A home worker for statutory employee purposes is a person who: (i) performs work in accordance with specifications provided by the person for whom the work is performed; (ii) works on materials or goods furnished by that person; and (iii) must return the finished product to that person or to someone designated by that person.[29] A home worker includes a worker who performs services off the premises of the person for whom the services are performed.[30]

Home work is employment that is distinguished from domestic work, and is of a much broader character. The occupational group is meant to cover persons who manufacture such items as quilts, buttons, gloves, bedspreads, needlework, etc. The IRS National Office has advised that workers who performed piecework sewing in their homes with materials furnished by the company were statutory employees where the workers were required to perform the work personally and had no substantial investment in the work facilities.[31] It should be noted that the work does not have to be performed in the worker's home for the worker to fall into this occupational group. The key is that the work be performed off the firm's premises. Thus, the worker can perform the work in his or her house, the house of another, or a workshop.

A worker is not a statutory employee if he or she has a substantial investment in the equipment or buildings used for doing the work. Workers' investments in sewing machines were not substantial investments in equipment that excluded them from being a statutory employee.[32]

The IRS Internal Revenue Manual 4.23.5 (Technical Guidelines for Employment Tax Issues) contains instructions for IRS personnel examining employment tax issues. IRM 4.23.5.6 (02-03-11) and IRM Exhibit 4.23.5-2 (Statutory Employees) contain guidance for determining whether a worker is a statutory employee, and should be reviewed when answering Line 7 and 8.

IRM Exhibit 4.23.5-2 provides the following guidance regarding whether a statutory employee has made a substantial investment in facilities:

Substantial Investment in Facilities. The term ''substantial investment'' refers to substantial facilities being furnished by the worker for conducting the business. All the facts of each case must be considered to determine whether the facilities furnished by the worker for the work are substantial. Several factors listed below will be considered in these determinations:

1. What is the value of the worker's investment compared to total investment?

2. Are the facilities furnished essential to the work or for the personal convenience of the worker?

3. Are the facilities being purchased or leased from the person for whom the services are performed?

4. Are the facilities furnished by the worker considerably more extensive than those usually furnished by other workers performing comparable services?

Facilities include such items as office furniture and fixtures, premises, tools, and machinery. An expense may or may not relate to furnishing facilities. Expenses for facilities (for example, expenses for an office, store, showroom, warehouse, stenographic service, utilities, etc.) may be considered in determining whether the facilities furnished represent a substantial investment. Generally, a worker who maintains an office in his own home does not have a substantial investment, but the worker who maintains an office outside his home frequently has a substantial investment in facilities.

[25] § 3121(d)(3)(B) (not applicable for FUTA).
[26] § 3121(d)(3)(C) (not applicable for FUTA).
[27] § 3121(d)(3)(D).
[28] IRS Pub. 15-A. If a worker is an employee under common law, the regular withholding rules apply, which include withholding for income taxes.
[29] § 3121(d)(3)(C).
[30] Reg. § 31.3121(d)-1(d)(3)(iii).
[31] TAM 9511001.
[32] *Id*.

Facilities do not include:

1. Education, training or experience, or goodwill,

2. Tools, instruments, or clothing commonly or frequently provided by employees,

3. A vehicle for the worker's transportation, or

4. Transportation facilities for carrying the goods or commodities or for supplying laundry or dry-cleaning services.

With respect to the requirement of a continuing relationship, IRM Exhibit 4.23.5-2 provides:

> **Continuing Relationship**. Work is considered to be of a continuing nature if it is regular or frequently recurring. Regular part-time work (for example, two days a week), is considered a continuing relationship. Regular seasonal employment is also work of a continuing nature. A single-job transaction, even though it takes a considerable period of time, is not generally a continuing relationship.

While a worker who does piece work for a firm off the firm's premises may not appear to be an employee, he or she may be a statutory employee. A firm must be mindful of these rules and not assume that a worker who works from home on a piecework basis is not an employee for FICA and FUTA purposes.

Line 8

Line 8 is a follow-up to Line 7. Line 8 asks what the worker does with the finished product (e.g., return it to the firm, provide it to another party, or sell it). This question is focused on the third prong of the three-prong test for determining if a worker is a home worker, and therefore, a statutory employee. If the worker is not required to return the finished work to the person who provided the materials, the worker may not be a statutory employee.

Line 9

Line 9 asks how the firm represents the worker to its customers (e.g., employee, partner, representative, or contractor). How a firm represents a worker to its customers and public will indicate the classification of the worker. If the firm is classifying the worker as an independent contractor, it should not represent the worker as an employee, partner, or representative. There should be no indication that the worker represents or speaks on behalf of the firm.

The firm may indirectly represent the worker as an employee in its marketing materials or letters to current or prospective customers. For example, a firm that retains a number of workers it classifies as independent contractors may include them when describing the size of its staff or workforce. If so, then it must carefully examine the words it has used to describe these workers. For example, the firm may have described workers with a particular skill set that it classifies as independent contractors as available to the firm or individuals with whom the firm has a close working relationship, rather than describing them as employees, partners, representatives, or otherwise part of the workforce.

An example of a common fact patter to avoid is illustrated by retailers of floor coverings (carpet, tile, vinyl, etc.) that work with specific installers they treat as independent contractors. Sales personnel may refer to the installers as ''company installers'' when speaking with customers. The sales personnel may not know that the installers are independent contractors. From the perspective of the sales personnel and customers, the installers appear and act as employees. This misperception of the installers' worker status can be problematic when contending that the installers are independent contractors.

Line 10

Line 10 asks about how the relationship between the worker and the firm ended if the worker is no longer performing services for the firm. For example, did the worker quit, was he or she fired, was the job completed, did the contract end, or did the firm or worker go out of business. As noted in connection with Line 2, the arrangement under which independent contractors perform services generally does not allow them simply to quit or for the firm simply to fire them without breaching the terms of the arrangement. Thus, if the relationship ended because the worker quit or was fired, this fact tends to indicate an employer-employee relationship. In most cases, the relationship with an independent contractor ends because the job is completed or the contract ends.

4.5. Part V — For Services Performed by Salespersons

A firm completes Part V if the worker provided a service directly to customers or is a salesperson.

As discussed in Part IV, certain workers (statutory employees) are treated as employees for FICA (and possibly FUTA) purposes, even though they are not employees under common law. Conversely, a ''qualified real estate agent'' and a ''direct seller'' are not treated as employees (''statutory nonemployees'') for any federal tax purpose, even though they may be common law employees.[33] Rather, they are treated as self-employed for all federal tax purposes. The person for whom the services are performed is not an employer of the worker for any federal tax purpose.

There are two conditions for these workers to be treated as statutory nonemployees. First, 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. Second, their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes.

Statutory nonemployee direct sellers fall into three occupational groups:

- Persons engaged in selling (or soliciting the sale of) consumer products in the home or place of business other than in a permanent retail establishment;

- Persons engaged in selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis prescribed by regulations, for resale in the home or at a place of business other than in a permanent retail establishment; and

- Persons engaged in the trade or business of delivering or distributing newspapers or shopping news (including

[33] § 3508.

any services directly related to such delivery or distribution).

Direct selling includes activities of individuals who attempt to increase direct sales activities of their direct sellers and who earn income based on the productivity of their direct sellers. Such activities include providing motivation and encouragement; imparting skills, knowledge, or experience; and recruiting.

IRM Exhibit 4.23.5-2 contains guidance for determining whether a worker is a statutory employee, and should be reviewed when answering the questions in Part V.

While direct sellers who meet the requirements discussed above are not treated as employees, full-time life insurance salespersons and full-time traveling or city salespersons are treated as statutory employees, as discussed in Part IV.

To determine whether a salesperson is a statutory employee, the salesperson must meet all eight elements of the statutory-employee test. A salesperson is a statutory employee if he or she:

1. Works full time for one person or company except, possibly, for sideline sales activities on behalf of some other person,

2. Sells on behalf of, and turns his or her orders over to, the person or company for which he or she works,

3. Sells to wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments,

4. Sells merchandise for resale, or supplies for use in, the customer's business,

5. Agrees to do substantially all of this work personally,

6. Has no substantial investment in the facilities used to do the work, other than in facilities for transportation,

7. Maintains a continuing relationship with the person or company for which he or she works, and

8. Is not an employee under common-law rules.

The Treasury Regulations specifically state: ''City or traveling salesmen who sell to retailers or to others specified, operate off the premises of their principals, and are generally compensated on a commission basis, are within this occupational group. Such salesmen are generally not controlled as to the details of their services or the means by which they cover their territories, but in the ordinary case they are expected to call on regular customers with a fair degree of regularity.''[34]

As discussed above, one of the general requirements for a statutory employee is that the contract of service between the firm and worker contemplates that the worker will personally perform substantially all the work. With respect to the contract of service, IRM Exhibit 4.23.5-2 provides the following:

> **Contract of Service**. Work performed in these occupational groups is done under a contract of service. The term ''contract of service'', means the arrangement, oral or written, under which the work is done. This arrangement must contemplate that the worker will do substantially all the work. Thus, if the contract contemplates that the worker will do all the work personally and the alleged employer does not acquiesce in delegating part of this work to another, the fact that the worker does so would not preclude his coverage under this section. The important thing is not whether the worker delegates part of the work to another, but rather whether the arrangement contemplates the worker will do so. The mutual intent of the parties governs.
>
> Sometimes a worker delegates part of his work to another when his contract or work agreement expressly forbids doing so. Conversely, the contract may contemplate a delegation of part of the work and the worker performs all the services himself. The examiner should determine whether the contract of service is being violated or whether it was modified to permit the change.
>
> A contract that contemplates hiring a chauffeur would not affect the personal service requirement because the services of the chauffeur are incidental to the selling activity. Similarly, the right to hire a substitute or assistant occasionally would not preclude qualifying for this provision.

Another one of the general requirements is that there is a continuing work relationship with the person for whom the services are performed. With respect to the continuing relationship requirement, IRM Exhibit 4.23.5-2 provides the following:

> **Continuing Relationship**. Work is considered to be of a continuing nature if it is regular or frequently recurring. Regular part-time work (for example, two days a week), is considered a continuing relationship. Regular seasonal employment is also work of a continuing nature. A single-job transaction, even though it takes a considerable period of time, is not generally a continuing relationship.

The questions in Parts I through IV for the most part focus on the common law factors for determining whether a worker is an employee or independent contractor. The questions in Part V are designed to determine whether the worker is a statutory employee (e.g., a full-time traveling or city salesperson) or a statutory nonemployee (e.g., a direct seller). The firm must understand the rules relating to statutory employees and statutory nonemployees in responding to these questions.

Line 1

Line 1 asks what are the worker's responsibilities in soliciting new customers. This question is rather vague and open ended. Is the worker responsible for soliciting new customers only for products made by the firm? Is the worker soliciting wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments (city or traveling salesperson) or individual customers who will use the products (direct sellers)? Are the new customers identified by the firm or the salesperson? The firm should consider answering the other questions in Part V before answering Line 1.

Line 2

Line 2 asks who provides the worker with leads to prospective customers. Whether leads are provided by the firm or the worker is not determinative of the worker's status, but if

[34] Reg. § 31.3121(d)-1(d)(3)(iv)(a).

most leads are provided by the firm it will indicate the worker is a city or traveling salesperson (a statutory employee).

Line 3

Line 3 asks for a description of any reporting requirements pertaining to the leads. If a worker is required to report to the firm following contact with a lead, this will indicate that the worker is a city or traveling salesperson, particularly if the firm provided leads to prospective customers. (This also would be the case with a life insurance salesperson who is soliciting sales of life-insurance policies and annuities offered by a firm.) The detail the worker must provide in the report also will be a factor. As noted above, a city or traveling salesperson is expected to call on regular customers with a fair degree of regularity. Although a regular customer is not a lead, the reporting requirements for leads may imply the regular communications the worker has with the firm on all contacts.

Line 4

Line 4 asks for the terms and conditions of sale, if any, required by the firm. The terms and conditions of sale can vary greatly. As noted above, one of the requirements of a city or traveling salesperson is that he or she sells *on behalf of*, and turns his or her orders over to, the person or company for which he or she works. The terms and conditions of sale must be examined to determine if the sales are on behalf of the firm. The worker may be required to purchase the goods from the firm, and the worker may control the price at which they are sold to the customer. Little control is exercised by the firm. These facts would indicate that the sales would not be on behalf of the firm. Conversely, the firm may control all aspects of the sale with the worker merely soliciting the order. The more control exercised by the firm, the more likely the facts will indicate the sales are being made on behalf of the firm.

The IRM does not speak directly to the terms and conditions of sales, but guidance provided in the IRM implicates the terms and conditions of sales. It does address the requirement that the worker must work for one principal firm. This applies to both life-insurance salespersons and city and traveling sales persons. With respect to the requirement that the worker must work for one principal firm, IRM Exhibit 4.25.5-2 provides the following:

> **They Must Work for One Principal Employer**. A worker who buys merchandise and sells it on their own account is not included in this occupational category. Neither is a manufacturer's representative who holds themselves out as an independent businessperson and serves the public through their connection with a number of firms.
>
> The multiple-line salesperson generally is not an employee because their principal business activity is not soliciting orders for one principal. However, a salesperson who solicits orders primarily for one principal is not excluded because of side-line activities on behalf of other persons or firms. The salesperson may be an employee of the person for whom the orders were principally solicited.

Whether a worker is selling on his or her own account or is an independent businessperson may be reflected in the terms and condition of sales.

Line 5

Line 5 asks whether orders are submitted to and subject to approval by the firm. This question also addresses the requirement that the salesperson sells on behalf of, *and turns his or her orders over to*, the person or company for which he or she works.

Line 6

Line 6 asks who determines the worker's territory. Who determines a worker's territory is general a neutral factor. A firm may have valid reasons to limit an independent contractor's territory without such limitation indicating an employer-employee relationship. Because a firm will exercise more control over an employee, it is likely that a firm will control where an employee will operate. If a worker has no restrictions where he or she can sell goods or services, it may indicate an independent contractor status. If the firm controls the worker's territory and regularly changes it, this would indicate an employer-employee relationship.

Line 7

Line 7 addresses whether the worker paid for the privilege of serving customers on the route or the territory. If there was payment, to whom did the worker make the payment and how much did the worker pay. One of the factors considered in worker classification is the worker's opportunity for profit or loss. An employee generally has no financial risk other than losing his or her job. He or she makes little investment. If a worker pays for a route or territory, he or she has made an investment not typical of an employee. If the worker pays a third party, rather than the firm, it is a further indication that the worker is making an investment that gives him or her the opportunity for profit or loss. The amount of the payment also is relevant. A nominal payment to the firm may have little relevance, while a significant payment would.

Line 8

Line 8 asks where the worker sells the product (e.g., in a home, retail establishment, etc.). As explained above, city or traveling salespersons are statutory employees, while direct sellers are statutory nonemployees. Where a worker sells products may indicate whether he or she is a statutory employee or a statutory nonemployee.

IRM Exhibit 4.23.5-2 contains the following discussion of the classes of purchasers for city or traveling salespersons:

> **Classes of Purchasers**. Salespersons must sell to the classes of purchasers described in IRC 3121(d)(3)(D). They may also sell incidentally to others. In addition to considering the percentage of a salesperson's total working time spent in soliciting orders from the specified classes of purchasers, other factors, e.g., rates of income, number of sales, etc., should also be considered. If the sales to excluded purchasers are incidental, all of the salesperson's services for its principal are considered within the occupational category.
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> 1. A wholesaler buys merchandise in large quantities and usually sells in small quantities to jobbers or to retail dealers but not to the ultimate consumer. The wholesaler does not process the merchandise in any way to cause it to lose its identity.

2. A retailer deals in merchandise by selling it in small quantities, usually to persons who consume or use it.

Retail establishments may perform service functions or processing or manufacturing operations with respect to the items they sell without losing their character as retail establishments. For example, a store that sells drapery and slip cover material and also makes draperies and slip covers for the consumer is a retail establishment and not a manufacturer. A neighborhood bakery is essentially a retail store, even though it changes the form of raw or prepared materials.

3. Contractors include such service organizations as window-washing contractors, wall cleaning contractors, other service contractors, and construction contractors.

4. The phrase ''other similar establishments'' refers solely to establishments similar to hotels and restaurants. It is limited to establishments whose primary function is furnishing food and/or lodging.

Status of Purchasers Composed of Several Business Units. An entity not within the included classes of purchasers may, through a unit of its organization, carry on a clearly identifiable and separate business which is in the included category. A salesperson who solicits orders from the entity for merchandise for resale by or for use in business operations in that unit has met the requirement regarding ''classes of purchasers.'' For example, sales made to an unincorporated university bookstore, owned and operated by the university, are sales made to a purchaser included in the statutory definition of ''traveling or city salesman.''

Merchandise for Resale or Supplies for Use in Purchaser's Business Operations. Merchandise must be for resale or for use in the business operations of the purchaser. The phrase ''merchandise for resale'' includes only tangibles that do not lose their identity as they pass through the hands of the purchaser. ''Supplies for use in the business operations'' means supplies principally used in conducting the purchaser's business. Generally, it includes all tangible merchandise not considered ''merchandise for resale.'' Services such as radio time, advertising space, etc. are intangible and outside of this definition. However, advertising novelties, calendars, etc. constitute supplies within this definition.

The fact that a salesperson performs substantial work in servicing the article sold does not necessarily preclude their meeting the requirements of IRC 3121(d)(3)(D). For example, a salesperson that spends a day selling a machine and a day supervising its installation, and perhaps training the purchaser's personnel in its use, may still have performed services as a full-time salesperson. Furnishing such services by a salesperson may be a necessary part of the inducement for the buyer to purchase. The question, therefore, is whether their total activity is essentially a selling activity. If it is, the services related to such sales, even though substantial, are an integral part of the sale. If it is not, they do not meet the requirements for coverage.

Line 9

Line 9 asks for a list of the product and/or services distributed by the worker (e.g., meat, vegetables, fruit, bakery products, beverages, or laundry or dry cleaning services). If more than one product and/or service is distributed, Line 9 asks for the principal one to be specified. One of the four occupational groups of statutory employees is a driver who distributes beverages (other than milk) or meat, vegetables, fruit, or bakery products, or who picks up and delivers laundry or dry cleaning, if the driver is the firm's agent or is paid on commission. This occupational group is sometimes referred to as ''agent-driver'' or ''commission driver.'' This question appears to be exploring whether the worker meets the definition of a statutory employee. If the worker distributes products other than those listed, he or she may not meet the definition of agent driver or commission driver. The incidental (20 percent or less) sale of items not listed above does not preclude the worker from being an agent driver or commission driver.

Exhibit 4.23.5-2 provides the following guidance on agent drivers and commission drivers:

(1) **Agent-Driver or Commission-Driver**

This group is limited to workers who distribute meat or meat products, vegetables or vegetable products, fruit or fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services. These products and services are defined in their commonly accepted sense. The worker may sell at retail or wholesale establishments. He may operate from his own truck or one belonging to the company for which he works. Ordinarily, the worker services customers designated by the company as well as those the worker solicits. The following requirements, in addition to the three general requirements previously listed, must be met if the worker is to qualify as a statutory agent-driver or commission-driver.

The Worker Must Distribute One or More of the Types of Products or Services Listed Above. The worker may also be engaged in distributing products or services in addition to these if handling the additional products or services is incidental to handling the specified items. If the products are sold for the same principal, all the services are considered within the occupational category. *A rule of thumb is that the services are incidental if the time spent handling the additional products or services is 20 percent or less of the time spent handling all products or services.* [Emphasis supplied.] If the time factor does not appear realistic, consider other factors such as ratio of income. If distributing additional products or services for the same principal is not incidental to handling the products or services listed above, the worker is not an employee. If the worker distributes for more than one principal, the services for each principal will be considered separately.

The Worker Must Perform the Services for the Person Engaging Him. The worker, who on his own account, buys merchandise and sells it, or furnishes services to the public as a part of his own independent business, is not included in this occupational category.

Line 10

Line 10 asks if the worker sells life insurance full time. One of the four occupational groups of statutory employees is a full-time salesperson whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company. Line 10 and Line 11 are designed to determine if the worker is a statutory employee because he or she sells life insurance full time.

There are a number of issues raised by this question. Is the worker selling life insurance? Is the worker full time or part time, and how is this determined? Is the firm a life insurance company? Is the principal activity of the salesperson the sale of life insurance? IRM Exhibit 4.23.5-2 provides the following guidance on these issues:

> In addition to meeting the three general requirements, an individual must be a full-time life insurance salesperson, that is, one whose entire or principal business activity is devoted to soliciting life insurance and/or annuity contracts primarily for one life insurance company. Generally, the contract of employment will show whether a salesperson meets these requirements.
>
> The intention of a salesperson and the company, shown by the contract of employment and their mutual performance, not the time devoted to the work, will govern in determining whether an individual is a full-time or a part-time salesperson. Thus, the entire or principal business activity of an insurance salesperson will be considered to be soliciting life insurance or annuity contracts if their arrangement with a life insurance company provides for soliciting life insurance or annuity contracts (or for soliciting such contracts and only incidentally soliciting accident and health insurance contracts) for such company as their entire or principal business activity.
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> **Intent Expressed in Contract**. When the contract clearly shows that full-time services are intended, a salesperson meets the full-time requirement. On the other hand, if part-time services are contemplated by the contract, a salesperson is not a statutory employee. This applies, regardless of the amount of time devoted to the work, unless a question is raised that the contract does not show what both parties originally or later intended.
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> **Deviation From Original Intent—Parties Agree**. If the performance of a salesperson is not consistent with the written contractual terms, determine whether the parties came to a mutual understanding on the deviation. If the parties agreed to the change in their original agreement or the company acquiesces in it, a salesperson's status will be modified, effective with the date the change took place. Their status before that date will be governed by the terms of the original contract.
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> **Deviation From Original Intent—Parties do not Agree**. If the performance of a salesperson is not consistent with the contract terms and the company knows of the inconsistency but refuses to change the original agreement or to acquiesce in the deviation, determine whether there is a reasonable basis for the company's position.
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> **Example of Reasonable Position**. The company has a set policy restricting the number of full-time salespeople it may employ in a certain territory and notifies all its salespersons under part-time contracts of this policy. It is aware that some of its part-time salespersons are devoting their whole time to selling for the company, but it discourages this custom and treats such salespersons as part-time workers in every respect, that is, pays them at a lower rate of commission than a full-time salesperson and does not include them in its pension and bonus plans, etc.
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> **Example of Unreasonable Position**. The company considers all its salespeople full-time if they work exclusively for their company. The company may know that only one hour a month is devoted to the sale of insurance by the salespersons, and the remainder of their time is spent in other work.
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> If the company's position is reasonable, a salesperson's status will be determined by the terms of the contract, regardless of his work history. However, if the company's position is unreasonable, a salesperson's status will be determined by a complete evaluation of the situation.
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> **Intent Not Expressed in Contract—Parties Agree**. If there is no written contract, or the contract does not clearly reveal the mutual intent of the parties on the full-time or part-time aspects of the relationship, a salesperson's status will be determined by the mutual intent of the parties shown by their answers to questions posed by the examiner.
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> **Intent Not Expressed in Contract—Parties Do Not Agree**. If the contract does not show whether full-time or part-time services are intended and the parties disagree, the determination of a salesperson's status will be based on a complete factual evaluation. Whether a salesperson's work for the company is their entire or principal business activity will be decided after considering the factors discussed in the following paragraphs under those headings. The company's classification of a salesperson should be given considerable weight, if there is a reasonable basis for the classification.
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> **Concept of "An Entire Business Activity."** An entire business activity may or may not be full-time. A salesperson does not necessarily have to spend 8 hours a day, 5 days a week, in one sole business activity to meet the full-time requirement. A salesperson may work regularly a few hours a day and qualify as a full-time insurance salesperson if other factors in the work relationship indicate a full-time status.
>
> On the other hand, many salespersons work for only one firm but spend only an hour or two a day, or a day or two a week, at their occupations or make sales only occasionally. Generally, even though the services are a salesperson's only work effort, the services are not substantial enough to be considered an ''entire business activity.'' In other words, a salesperson is not an employee if his/her efforts are so irregular, intermittent, or sporadic that the salesperson would be considered not to be engaged in any business activity.

Concept of "A Principal Business Activity." A principal business activity is one which takes the major part of a salesperson's working time and attention. When a salesperson is engaged in several business activities, it is necessary to determine the principal business activity. In making this determination, consider factors such as:

1. The opinions of the parties involved. A statement by the company that a salesperson is or is not required to devote their work effort principally to the sales of its policies should be given considerable weight. A similar statement by a salesperson should be supported by other evidence.

2. The salesperson's total working time; that is, the amount of time spent in connection with all business activities. What proportion of that time do they spend in soliciting for the firm?

3. The ratio of earnings from the services to total earnings. Does the ratio indicate that the major part of the sales income comes from this firm?

4. Insurance companies usually treat part-time and full-time salespersons differently for commission rates, renewal schedules, pension plans, etc. In what category has the company placed the salesperson?

Line 11

Line 11 asks if the worker sells other types of insurance for the firm. If the answer is yes, Line 11 asks for the percentage of the worker's total time spent in selling insurance other than life insurance. This is a follow up to Line 10. To be a statutory employee under the full-time life insurance salesperson, the principal type of insurance being sold must be life insurance or annuity contracts.

With respect to the type of insurance being sold, IRM Exhibit 4.23.5-2 provides the following guidance:

Type of Insurance Sold. The salesperson's efforts must be devoted principally to soliciting life insurance or annuity contracts. Occasional or incidental sales of other types of insurance, such as accident and health insurance will not affect this requirement. However, a salesperson who is required to devote substantial effort to selling applications for insurance contracts other than life insurance or annuity contracts (e.g., accident and health, fire, automobile, etc.), does not meet the requirement.

In responding to the second part of Line 11 regarding the percentage of time spent in selling insurance other than life insurance, the language from IRM Exhibit 4.23.5-2 quoted above in connection with the Concepts of ''An Entire Business Activity'' and ''A Principal Business Activity'' provides the IRS's view on how to apply the full-time requirement.

Line 12

If the worker solicits orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments, Line 12 asks for the percentage of the worker's time spent in the solicitation. One of the four occupational groups of statutory employees is a full-time city or traveling salespersons soliciting orders from wholesalers or retailers for merchandise for resale or for supplies used in their business operations. The work performed for the firm must be the salesperson's principal business activity. Line 12 and Line 13 are designed to determine if a worker is a statutory employee because he or she is a city or traveling salesperson. Line 12 focuses on the ''full-time'' aspect of the requirement to be a city or traveling salesperson. IRM Exhibit 4.23.5-2 states that ''[T]he definition of an entire and a principal business activity, given under ''Full-time life insurance salesperson'' applies here.''

Line 13

Line 13 asks if the merchandise purchased by the customers is for resale or use in the customers' business operations. Line 13 further asks for a description of the merchandise and whether it is equipment installed on the customers' premises. Line 13 focuses on whether the merchandise and customers are of the type described in the description of a city or traveling salesperson. The language from IRM Exhibit 4.23.5-2 quoted in connection with Line 8 above addresses ''Merchandise for Resale or Supplies for Use in Purchaser's Business Operations.'' Also, the merchandise a city or traveling salesperson sells and the customers to whom the merchandise is sold differ from those of a direct seller and other salespersons. Line 13 is focused on these distinctions.