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INDEPENDENT CONTRACTOR V. EMPLOYEE

The following are highlights of tax law. This is not meant to be a comprehensive list nor the complete wording of tax law, rules & regulations. This summary is not meant to replace tax advice on your specific tax situation nor is it meant to be relied on by existing clients or third parties. We are not responsible for any errors or omissions. This is not meant to be legal, accounting or other professional service. If legal advice or other expert assistance is required, the services of a competent professional should be sought. These materials are informational in nature and users of these materials may not rely upon them to avoid imposition of tax penalties.

NEW GUIDANCE BY DOL under the Fair Labor Standards Act (FLSA) (RIN 1235-AA43) Effective March 11, 2024

The new economic reality test calls for employers to consider six factors when determining whether a worker should be treated as an employee or independent contractor, without any "predetermined weight" given to any one factor:

- Any opportunity for profit or loss a worker might have;
- The financial stake and nature of any resources a worker has invested in the work;
- The degree of permanence of the work relationship;
- The degree of control an employer has over the person's work;
- Whether the work the person does is essential to the employer's business;
- and
- A factor regarding the worker's skill and initiative.

IRS GUIDANCE

The following is a link on the IRS website regarding classification of employee v. independent contractor.

<https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>

I have copied and pasted from the IRS website the Common Law Rules, which provide evidence of the degree of control and independence listed as Behavioral, Financial & Types of Relationship

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Behavioral Control

Behavioral control refers to facts that show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done – as long as the employer has the right to direct and control the work.

The behavioral control factors fall into the categories of:

- Type of instructions given
- Degree of instruction
- Evaluation systems
- Training

Types of Instructions Given

An employee is generally subject to the business's instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

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

Degree of Instruction

Degree of Instruction means that the more detailed the instructions, the more control the business exercises over the worker. More detailed instructions indicate that the worker is an employee. Less detailed instructions reflect less control, indicating that the worker is more likely an independent contractor.

Note: The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to

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instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Evaluation System

If an evaluation system measures the details of how the work is performed, then these factors would point to an employee.

If the evaluation system measures just the end result, then this can point to either an independent contractor or an employee.

Training

If the business provides the worker with training on how to do the job, this indicates that the business wants the job done in a particular way. This is strong evidence that the worker is an employee. Periodic or on-going training about procedures and methods is even stronger evidence of an employer-employee relationship. However, independent contractors ordinarily use their own methods.

Financial Control

Financial control refers to facts that show whether or not the business has the right to control the economic aspects of the worker's job.

The financial control factors fall into the categories of:

- Significant investment
- Unreimbursed expenses
- Opportunity for profit or loss
- Services available to the market
- Method of payment

Significant investment

An independent contractor often has a significant investment in the equipment he or she uses in working for someone else. However, in many occupations, such as construction, workers spend thousands of dollars on the tools and equipment they use and are still

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considered to be employees. There are no precise dollar limits that must be met in order to have a significant investment. Furthermore, a significant investment is not necessary for independent contractor status as some types of work simply do not require large expenditures.

Unreimbursed expenses

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. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their business.

Opportunity for profit or loss

The opportunity to make a profit or loss is another important factor. If a worker has a significant investment in the tools and equipment used and if the worker has unreimbursed expenses, the worker has a greater opportunity to lose money (i.e., their expenses will exceed their income from the work). Having the possibility of incurring a loss indicates that the worker is an independent contractor.

Services available to the market

An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

Method of payment

An employee is generally guaranteed a regular wage amount 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. However, it is common in some professions, such as law, to pay independent contractors hourly.

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NEVADA GUIDANCE

Although the NV State Business License is only applicable to Nevada, all Self-Employed workers and employers should read this. Other states may have similar laws and regulations and the Federal Government has laws and regulations regarding employee versus independent contractor status.

The NV Secretary of State's Office is applying a concentrated effort to catch people who have self-employed income and do not have a state business license or have considered themselves exempt, when they should not be.

Excerpt from the Clark County, Nevada, Code of Ordinances>> Title 6-Business Licenses-Chapter 6.04 General Provisions-6.04.010 – License Required.

It is unlawful for any person, firm, association, partnership or corporation, to commence, carry on, engage in or continue (including the making of deliveries of goods, wares, and merchandise sole elsewhere) in the county, outside the incorporated cities and towns, both within and without unincorporated cities and towns, any business, trade, occupation or employment upon which a license tax is imposed by the terms and provisions of Titles 6, 7 or 8 and for which a license tax is required to be procured by the terms of Titles 6, 7 or 8 without first paying such license tax and procuring such license as hereinafter provided.

Exclusions: Entities are no longer allowed the home-based business exclusion. Sole proprietors are excluded, if their net income is below 66.66% of the average Nevada annual wage, but must still register for the exclusion. The Secretary of State's Office states that entertainers do not come under the home-based business exemption, because they do their performing outside of their home. Do you do the work at home or not to be considered exempt?

The Nevada unemployment auditors are also applying a concentrated effort to catch people who are paying individuals, LLC's or partnerships as independent contractors, when they should be considered employees. On a state unemployment audit, I was told that they are expecting the independent contractors to have a state business license and the applicable county or city business license to not assess payroll taxes on that person to the one paying them.

The following is from the Nevada Employer's Handbook:

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“Nevada Unemployment Compensation Law does not define “independent contractor”. It uses what is commonly referred to as the “ABC” test. This test is Unique to the Unemployment Compensation Program. Unless otherwise specifically excluded, payment for personal services is deemed subject to unemployment taxes unless the following conditions are met. All three conditions must be met in fact; a written contract alone is not sufficient. The burden of proof rests upon the employer to demonstrate the existence of these conditions:

- A. The person has been and will continue to be free from control or direction over the performance of the services, both under his contract of services and in fact; and
- B. The service is either outside the usual course of the business for which the service is performed or that the service is performed outside of all the places of business of the enterprise for which the service is performed; and
- C. The service is performed in the course of an independently established trade, occupation, profession or business in which the person is customarily engaged, of the same nature as that involved in the contract service.

If you cannot demonstrate the above conditions, the person is an employee. A written contract, in itself, does not establish “independent contractor” status. If in doubt, contact the Contributions Section for a ruling.”

The auditor went further to state that the person must hold themselves out to perform the services for others not just your company and must have the expertise in that area. As an example, if you pay someone and they work as an employee for a company doing a different type of work than they do for you, then they may be considered an employee of yours. If you pay someone and they work as an employee for a company doing the same type of work, but also do work for others as an independent contractor, then only if they have the state business licenses or have a home based business exemption, will they be considered an independent contractor. I would suggest checking with those you pay as independent contractors to see if they have the applicable business licenses and work for others as self-employed. If the person only works as an independent contractor, then they should be working for more than just your company and should have the applicable business licenses. We were told by the Clark County Business License Department verbally that entertainers are exempt from the Clark County Business License. They are not exempt from the State Business License. I am not sure if North Las Vegas or Henderson considers entertainers exempt from their licenses.

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Nothing above is meant to be legal advice; you should consult your attorney concerning legal issues. This is just meant as a snapshot of the independent contractor v. employee issue for the DOL, IRS and for Nevada. Other states may also have stricter guidelines than the IRS on this issue. This is meant to alert you to the potential pitfalls of not having a NV State Business License and the potential pitfalls with the IRS and Nevada for designating an employee as an independent contractor incorrectly. The back taxes and penalties and interest can be considerable.

If you have concerns on this issue, please visit the IRS website at irs.gov, call us or seek other professional tax advice.

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