

# SAUNDERS PORTUGAL

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## The Independent Contractor vs. Employee Quandary: 1099's vs. W-2's

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In an attempt to give you some guidance through this issue I have compiled some of the key points from both the IRS and IDES publications available on this matter.

From the IRS - The general rule is that an individual is an independent contractor if you, the person or business for whom the services are performed, has the right to control or direct only the result of the work and not the means and methods of accomplishing the result. If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you are liable for employment taxes for that worker.

The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. These relevant facts fall into 3 main categories:

1. BEHAVIORAL CONTROL – The key consideration is whether the business has retained the right to control the details of a worker's performance or instead given up that right. Does the business train the individual in order to perform the duties? Does the business control...
  - a. when and where to do the work
  - b. what tools or equipment to use
  - c. where to purchase supplies and services
  - d. what workers to hire or to assist with the work
  - e. what work must be performed by a specified individual
  - f. what order or sequence to follow
2. FINANCIAL CONTROL – Facts that show whether the business has a right to control the business aspects of the worker's job include...
  - a. Unreimbursed business expenses – Independent contractors are more likely to have unreimbursed expenses than are employees.
  - b. The worker's investment in their business – An independent contractor often has a significant investment in the facilities and tools they use in performing services for someone else.
  - c. The extent to which the worker's services are available in the marketplace – An independent contractor is generally free to seek out other business opportunities.
  - d. How the business pays the worker – An employee is generally guaranteed a regular wage per hour/week/or other time period. An independent contractor is often paid a flat fee or on a time and materials basis for a job. However, it is possible to pay an independent contractor by the hour if the facts and circumstances support it.
  - e. The extent to which the worker can realize a profit or loss – An independent contractor can make a profit or incur a loss.

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## 3. RELATIONSHIP OF THE PARTIES –

- a. Is there a written contract describing the relationship
- b. Does the business provide the worker with employee type benefits, such as insurance, pension plan, vacation pay, sick pay, etc.
- c. The permanency of the relationship
- d. The extent to which services performed by the worker are an important part of the regular business of the company

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The Illinois Department of Employment Security (IDES) statute that covers independent contractors is Section 212. Section 212 defines an independent contractor as someone who meets ALL of the following:

1. They must be free from control or direction over the performance of the services for which they have been engaged both through the written contract and in fact. **AND**
2. The services performed must be outside of the normal course of the business retaining the services or that the service performed is outside of all the places of the business. (However, just because the services are performed outside the engaging units' premises does not preclude an individual from being found to be in employment if the facts and circumstances do not support it.) **AND**
3. The individual must be engaged in an independently established trade, occupation, profession or business. In other words the individual has a proprietary interest in the business which he can sell, give away, or operate without hindrance from any other party. Below are some (not all) of the guidelines used by IDES...
  - a. The individual's interest in the business is not subject to cancellation or destruction upon severance of the relationship.
  - b. The individual has an investment of capital and owns the capital goods of the business enterprise.
  - c. The individual bears the losses and gains the profits of their own business enterprise.
  - d. The individual makes his services available to the general public or the business community on a continuing basis.
  - e. The employing unit does not represent the individual as an employee of the firm to its customers.
  - f. The individual has the right to perform similar services for others on whatever basis and whenever he chooses.
  - g. The individual maintains a business listing in the telephone directory or in appropriate trade journals
  - h. If the services require a license, the individual has obtained and paid for the license in his own name.
  - i. A written contract between the business and the individual engaged for services exists.

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Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while others may indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another. The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control and finally, to document each of the factors used in coming up with the determination.

If you need additional assistance in making the employee vs independent contractor decision, please contact our office, we are happy to help. There is still time this year to turn those incorrectly classified independent contractors into employees so that they are handled correctly.

Disclaimer: This information is meant for informational purposes only and is not legal or tax advice. It is not uncommon for a state legislature to change its state's unemployment insurance definition of independent contractor. Also, certain industries may have special legal tests concerning independent contractor issues. These matters are very fact sensitive as well. Therefore, readers should not act upon this information without seeking the advice of a qualified professional.

## Sources for additional information

- IRS Publication 15-A
- IRS Publication 1779
- <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee>
- IDES Illinois Unemployment Insurance Law Handbook
  - Rules of the Illinois Department of Employment Security
    - Title 56: Subchapter c: Part 2732: Subpart B: Section 2732.200
  - Illinois Unemployment Insurance Act
    - Section 212

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