

## EMPLOYMENT DETERMINATION GUIDE

### Purpose:

This worksheet is to be used by the proprietor of a business to determine whether a worker is most likely an employee or an independent contractor.

### General Information:

Generally speaking, whether a worker is an employee or an independent contractor depends on the application of the factors contained in the California common law of employment and statutory provisions of the California Unemployment Insurance Code.

If a worker is an employee under the common law of employment, the business by which the worker is employed must report the worker's earnings to the Employment Development Department (EDD) and must pay employment taxes on those wages. If the worker is an independent contractor, reporting to EDD is not required. However, if the business pays \$600 or more in payments to an independent contractor, the business must file a Form 1099-Misc with the Internal Revenue Service (IRS) and must file a Report of Independent Contractor(s) (DE 542) with the EDD within 20 days of either making payments totaling \$600 or more, or entering into a contract for \$600 or more with an independent contractor in any calendar year. For more detailed information regarding your Independent Contractor reporting requirements, obtain the latest revision of the California Employer's Guide (DE 44).

The basic test for determining whether a worker is an independent contractor or an employee is whether the principal has the right to direct and control the manner and means by which the work is performed. When the principal has the "right of control," the worker will be an employee even if the principal never actually exercises the control. If the principal does not have the right of direction and control, the worker will generally be an independent contractor.

If it is not clear from the face of the relationship whether the worker or the principal has the "right of control," reference is made to a list of secondary factors that are evidence of the existence or nonexistence of the right of control.

If use of the attached worksheet clearly demonstrates that a worker is an employee, you should contact EDD and arrange to report the worker and pay the relevant taxes. You may also want to contact the IRS and your workers' compensation insurance carrier to ensure that you are in compliance with federal tax laws and with state workers' compensation statutes.

If after completing the worksheet you are not sure whether the worker is an independent contractor or employee, you may also contact the Taxpayer Education and Assistance (TEA) for consultation and advice by calling (888) 745-3886 or request a written ruling by completing a Determination of Employment Work Status, DE 1870. The DE 1870 is designed to analyze a working relationship in detail and serves as the basis for a written determination from EDD on employment status.

# WORKSHEET ON EMPLOYMENT STATUS

Questions 1 – 3 are significant questions. If the answer to any of them is "Yes," it is a strong indication that the worker is an employee, and you have a high probability of risk if you classify the worker as an independent contractor.

1. Do you instruct or supervise the person while he or she is working? Yes \_\_\_\_\_ No \_\_\_\_\_

Independent contractors are free to do jobs in their own way, using specific methods they choose. A person or firm engages an independent contractor for the job's end result. When a worker is required to follow company procedure manuals and/or is given specific instructions on how to perform the work, the worker is normally an employee.

2. Can the worker quit or be discharged (fired) at any time? Yes \_\_\_\_\_ No \_\_\_\_\_

If you have the right to fire the worker without notice, it indicates that you have the right to control the worker.

Independent contractors are engaged to do specific jobs and cannot be fired before the job is complete unless they violate the terms of the contract. They are not free to quit and walk away until the job is complete. For example, if a shoe store owner hires an attorney to review his or her lease, the attorney would get paid only after satisfactory completion of the job.

3. Is the work being performed part of your regular business? Yes \_\_\_\_\_ No \_\_\_\_\_

Work which is a necessary part of the regular trade or business is normally done by employees. For example, a sales clerk is selling shoes in a shoe store. A shoe store owner could not operate without sales clerks to sell shoes. On the other hand, a plumber engaged to fix the pipes in the bathroom of the store is performing a service on a one-time or occasional basis that is not an essential part of the purpose of the business enterprise. A certified public accountant engaged to prepare tax returns and financial statements for the business would also be an example of an independent contractor.

A "No" answer to questions 4 – 6 indicates that the individual is not in a business for himself or herself and would therefore normally be an employee.

4. Does the worker have a separately established business? Yes \_\_\_\_\_ No \_\_\_\_\_

When individuals hold themselves out to the general public as available to perform services similar to those performed for you, it is evidence that the individuals are operating separately established businesses and would normally be independent contractors. Independent contractors are free to hire employees and assign the work to others in any way they choose. Independent contractors have the authority to fire their employees without your knowledge or consent. Independent contractors can normally advertise their services in newspapers and/or publications, yellow page listings, and/or seek new customers through the use of business cards.

5. Is the worker free to make business decisions which affect his or her ability to profit from the work? Yes \_\_\_\_\_ No \_\_\_\_\_

An individual is normally an independent contractor when he or she is free to make business decisions which impact his or her ability to profit or suffer a loss. This involves real economic risk, not just the risk of not getting paid. These decisions would normally involve the acquisition, use, and/or disposition of equipment, facilities, and stock in trade which are under his or her control. Further examples of the ability to make economic business decisions include the amount and type of advertising for the business, the priority in which assignments are worked, and selection of the types and amounts of insurance coverage for the business.

6. Does the individual have a substantial investment which would subject him or her to a financial risk of loss? Yes \_\_\_\_\_ No \_\_\_\_\_

Independent contractors furnish the tools, equipment, and supplies needed to perform the work. Independent contractors normally have an investment in the items needed to complete their tasks. To the extent necessary for the specific type of business, independent contractors provide their own business facility.

Questions 7 – 13 are additional factors that should be considered. A "Yes" answer to any of the questions is an indication the worker may be an employee, but no one factor by itself is deciding. All factors must be considered and weighed together to determine which type of relationship exists. However, the greater the number of "Yes" answers to questions 7 – 13 the greater the likelihood the worker is performing services as an employee.

7. Do you have employees who do the same type of work? Yes \_\_\_\_\_ No \_\_\_\_\_

If the work being done is basically the same as work that is normally done by your employees, it indicates that the worker is an employee. This applies even if the work is being done on a one-time basis. For instance, to handle an extra workload or replace an employee who is on vacation, a worker is hired to fill in on a temporary basis. This worker is a temporary employee, not an independent contractor.

(Note: If you contract with a temporary agency to provide you with a worker, the worker is normally an employee but may be an employee of the temporary agency. You may wish to request EDD's DE 231F, Information Sheet: Temporary Services and Employee Leasing Industries, on the subject of temporary service and leasing employers.)

8. Do you furnish the tools, equipment, or supplies used to perform the work? Yes \_\_\_\_\_ No \_\_\_\_\_

Independent business people furnish the tools, equipment, and supplies needed to perform the work. Independent contractors normally have an investment in the items needed to complete their tasks.

9. Is the work considered unskilled or semi-skilled labor? Yes \_\_\_\_\_ No \_\_\_\_\_

The courts and the California Unemployment Insurance Appeals Board have held that workers who are considered unskilled or semi-skilled are the type of workers the law is meant to protect and are generally employees.

10. Do you provide training for the worker? Yes \_\_\_\_\_ No \_\_\_\_\_

In skilled or semi-skilled work, independent contractors usually do not need training. If training is required to do the task, it is an indication that the worker is an employee.

11. Is the worker paid a fixed salary, an hourly wage, or based on a piece rate basis? Yes \_\_\_\_\_ No \_\_\_\_\_

Independent contractors agree to do a job and bill for the service performed. Payments to independent contractors for labor or services are made upon the completion of the project or completion of the performance of specific portions of the project.

12. Did the worker previously perform the same or similar services for you as an employee? Yes \_\_\_\_\_ No \_\_\_\_\_

If the worker previously performed the same or similar services for you as an employee, it is an indication that the individual is still an employee.

13. Does the worker believe that he or she is an employee? Yes \_\_\_\_\_ No \_\_\_\_\_

Although belief of the parties is not controlling, intent of the parties is a factor to consider when making an employment or independent contractor determination. When both the worker and principal believe the worker is an independent contractor, an argument exists to support an independent contractor relationship between the parties.

## Interpretations of Answers

Depending on the services being performed and the type of occupation, this questionnaire may produce a variety of results. There may be some factors which lean toward employment and some which lean toward independence. The answers to questions 1 – 6 provide a strong indication of the presence or absence of direction and control. The answers to questions 7 – 13 when joined with other evidence may carry greater weight when indicating the presence or absence of direction and control.

1. If all of the answers to questions 1 – 3 are "No" and all of the answers to questions 4 – 6 are "Yes," there is an indication of independence. When this is the case, there are likely to be a number of "No" answers to questions 7 – 13 which add to the support of the determination.
2. If all of the answers to questions 1 – 3 are "Yes" and all of the answers to questions 4 – 6 are "No," it is very strong indication that the worker in question is an employee. When this is the case, there are likely to be a number of "Yes" answers to questions 7 – 13 which add to the support of the determination.
3. If the answer to question 1 or 2 is "Yes" or the answer to any one of questions 4 – 6 is "No," there is a likelihood of employment. At the very least, this pattern of answers makes the determination more difficult since the responses to questions 7 – 13 will probably be mixed. In such situations, the business owner would be well advised to complete a DE 1870, giving all of the facts of the working relationship and requesting a ruling from EDD.
4. If the answer to question 3 is "Yes" and the answer to question 4 is "No," there is a likelihood of employment. Given this pattern of answers, it is probable that the answers to questions 5 and 6 will also be "No." When this happens you may also see more "Yes" answers to the last group of questions (7 – 13). This scenario would support an employment determination.

These four scenarios illustrate only a few combinations of answers that could result from the use of this Employment Determination Guide, depending on the working relationship a principal may have with a worker and the type of occupation. The more the pattern of answers vary from the above four situations, the more difficult it is to interpret them. In situations 1 and 2, there is a greater chance that the interpretation will be accurate, and they present the least risk to the business owner of misclassifying the worker. With other combinations of answers, EDD recommends that business owners complete a DE 1870, giving a complete description of the working relationship and requesting a ruling from the Department.

**NOTE:** Some agent or commission drivers, traveling or city salespeople, homeworkers, artists, authors, and workers in the construction industry are employees by law even if they would otherwise be considered independent contractors under common law. If you are dealing with workers in any of these fields, request the DE 231SE, Information Sheet: Statutory Employees, from the Employment Tax Customer Service Office.

# SOME EXAMPLES OF INDEPENDENT CONTRACTORS AND COMMON LAW EMPLOYEES

## Independent Contractors

An attorney or accountant who has his or her own office, advertises in the yellow pages of the phone book under "Attorneys" or "Accountants," bills clients by the hour, is engaged by the job or paid an annual retainer, and can hire a substitute to do the work is an example of an independent contractor.

An auto mechanic who has a station license, a resale license, buys the parts necessary for the repairs, sets his or her own prices, collects from the customer, sets his or her own hours and days of work, and owns or rents the shop from a third party is an example of an independent contractor.

Dance instructors who select their own dance routines to teach, locate and rent their own facilities, provide their own sound systems, music and clothing, collect fees from customers, and are free to hire assistants are examples of independent contractors.

A repairperson who owns or rents a shop, advertises the services to the public, furnishes all of the tools, equipment, and supplies necessary to make repairs, sets the price for services, and collects from the customers is an example of an independent contractor.

**NOTE:** Payroll tax audits conducted by EDD have disclosed misclassified workers in virtually every type and size of business. However, certain industries seem more prone to have a higher number of misclassified workers than others. Historically, industries at higher risk of having misclassified workers include businesses that use:

- Construction workers
- Seasonal workers
- Short-term or "casual" workers
- Outside salespersons

## Employees

An attorney or accountant who is employed by a firm to handle their legal affairs or financial records, works in an office at the firm's place of business, attends meetings as needed, and the firm bills the clients and pays the attorney or accountant on a regular basis is an example of an employee.

An auto mechanic working in someone's shop who is paid a percentage of the work billed to the customer, where the owner of the shop sets the prices, hours, and days the shop is open, schedules the work, and collects from the customers is an example of an employee.

Dance instructors working in a health club where the club sets hours of work, the routines to be taught and pays the instructors from fees collected from the customers are examples of employees.

A repairperson working in a shop where the owner sets the prices, the hours and days the shop is open, and the repairperson is paid a percentage of the work done is an example of an employee.