The Employee/Contractor Determiner

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Abstract

A side-effect of the national debate about employer-provided benefits has been to focus attention on the cost of hiring and retaining employees. This has led to renewed interest in the issue of when a worker is an employee *vs.* an independent contractor. The IRS must make determinations regarding worker status. This determination process which has evolved through judicial precedent, is subjective and has generated substantial controversy. It is based upon Treasury regulations which include 20 common law factors used to evaluate the amount of direction and control a firm may exercise over a worker. The IRS AI Lab developed a PC-based expert system to help individuals make determinations on this issue. It is based upon the 20 common law factors and the combined expertise of a number of employment tax authorities. After being field tested in 1993, the SS-8 Determiner has been deployed in five of the IRS's seven regions. Based on this experience, annual salary savings over $1 million, or increased revenues over $22 million, will result from nation-wide implementation. An IRS district office which specializes in employment taxes and which has C++ programming expertise, is assuming responsibility for code maintenance.

Problem Description

When a firm hires a new employee, it becomes liable for paying and withholding a number of taxes such as the employer's portion of Social Security tax, the employee's portion of Social Security tax and income tax, unemployment tax, various state or local payroll taxes, etc. In addition, a competitive labor market (and perhaps soon, federal law) often require that the employer contribute toward pension plans, health insurance, and other fringe benefits. However, if the firm contracts out work, most of these costs are legally avoided. Therefore, the firm has a strong bias in favor of treating the worker as an independent contractor. Workers may at first prefer being treated as contractors, but often change their minds when told they do not qualify for unemployment insurance or workman's compensation upon termination by the firm, or when billed for self-employment tax by IRS.

If workers wish to dispute their contractor status, they may submit to IRS, Form SS-8, *Determination of Employee Work Status For Purposes of Federal Employment Taxes and Income Tax Withholding.* This 4-page form asks questions about the relationship between the worker and the firm, such as:

- who regulates the work hours,
- whether the worker can be fired,
- who provides any tools required for the job, or
- whether the worker serves more than one firm.

Upon receiving an SS-8 from a worker, IRS will ask the firm to tell its side of the story on a separate SS-8 before making a determination. If it seems likely that the firm has a number of misclassified "contractors", IRS may conduct an audit of the firm.

IRS's manual SS-8 processing is done by experienced professional employment tax auditors, usually Revenue Agents. They receive the initial SS-8 from the worker, ask the firm to complete an SS-8, compare the firm's and worker's responses, research court precedents for that industry, make a determination, issue a letter ruling to the firm, and inform the worker of the final disposition of the case. IRS classifiers make determinations using 20 common law factors to evaluate a worker-firm relationship. (See the appendix for a list of Common Law Factors.) These common law factors, which evolved through judicial precedent from the concept of master-slave defined in English Law, define areas in which a firm exercises the right to direct what is to be done by a

worker and how it is to be accomplished. Interpreting whether a worker-firm relationship meets the criteria defined in the 20 common law factors is a subjective decision and varies among individuals. This has lead to a perception of inconsistency and has resulted in pressure from industry groups for a more definitive test.

The number of SS-8s filed annually has increased from 1,000 annually in the 1980's to 15,000 currently. They are generally processed in one of the IRS's 63 Districts. Because of their unique nature, employment taxes are handled by a small number of specialists in each district. A total of 4-6 hours per case is required to make a manual determination. As workloads have grown in recent years, many districts have developed backlogs which were frustrating to the taxpayers who requested rulings, as well as to IRS managers responsible for the work.

Backlogs of SS-8s were also impeding a new approach to tax administration, called Compliance 2000 (dubbed "C2K" by the acronym makers). The key idea of C2K is to promptly identify segments of the taxpaying population which have patterns of non-compliance with some aspect of the law, and to launch education and persuasion campaigns to deal with the causes of low compliance. In the employment tax arena, good clues to pockets of non-compliance are found in SS-8s. So it is now even more important to process SS-8s promptly and to analyze any patterns found within them.

In addition to the factors described above, most of the usual incentives for automation are present: the desire for more consistency among offices in making determinations, the inability of one human being to keep current with the latest developments in all industries, and the threat of losing IRS institutional expertise when a district office specialist retires.

The SS-8 Determiner Design

The SS-8 Determiner project was written in C++ in an object oriented style for use on any 386 or better PC, running DOS. The hardware and software choices were driven by the equipment and software configurations found at our customer sites. Our goal was to deliver a system which could be used by any IRS field agent, District Office or Service Center. These organizations were running various levels of DOS ranging from 3.2 to the latest release, on a variety of PCs. Because of this, we decided that our product should be self-contained and not require the

purchase of additional software, such as Windows.

The interface is graphically oriented and can be run with or without a mouse. We used the Zinc Interface Libraries to produce the screens which prompt the user for input and display the system's conclusions. The input screens are based on the SS-8, with the elimination of a number of text fields which our field experts felt had a negligible bearing on the final classification.

The internals of the system are modelled after the way field experts make a decision when classifying a worker as an independent contractor or employee. Based on the worker's and firm's SS-8 responses, the experts accumulate evidence in their minds supporting a contractor or employee determination. The evidence is grouped under 20 common law factors (i.e. areas in which the firm is potentially exerting control and direction over the worker). Some of these factors are weighted more heavily than others and this is reflected in the system design.

All information within the system is represented in the form of objects. Logical entities such as rules, common law factors, SS-8 responses and letter information form natural groupings for descriptive elements, and functions which act upon these elements. We were concerned with keeping the executable as small as possible. Consequently, minimizing the amount of data kept in memory at any one time became a high priority. To accomplish this, the objects record only essential information such as whether the rule fired, total contractor and employee scores, and a position within the file where the rule or common law factor descriptions are stored.

There are approximately 200 rule objects which if "true" increment a score. Rules are typed as either contractor or employee. Based on their type, which is recorded within the rule object, they increment either the total contractor or employee score for the common law factor to which they belong. The scores are recorded within the common law factors and will be discussed in the paragraph describing common law factors, below. A rule can belong to more than one common law factor and thus can increment multiple scores. This may sound confusing at first, but based on our knowledge acquisition sessions, it was determined that information such as whether a worker is "instructed" by the firm, can have a bearing on the "Instructions" common law factor as well as the "Training" common law factor. Whether a rule "fires" based on the worker's or firm's SS-8 information, is stored in the rule object. The rule's antecedent or

"condition" is stored within a function called "fire_rules" which repeatedly supplies an antecedent and a rule identifier to the function, "testRule()", for each of the 200 rules in the rule array. A typical rule would consist of: "if (hours_worked_per_day > 8) increment employee score". Rules which test text fields for evidence of employee or contractor conditions, use string search functions which look for typical phrases such as "9 - 5" or "hourly wage". All of the rules attempt to fire every time a determination is made. Thus our rule engine could be described as procedural. (See Figure 1 for a description of the rule object elements and functions.)

Each common law factor object contains a contractor and employee score and an array of pointers to rules, which can affect those scores. See illustration below for the relationship between common law factor and rule objects. The scores are incremented based on how the rules fired. Common law factor objects have default weights which all rules belonging to them, use when incrementing the contractor and employee scores. Default weights were assigned based on how much importance our field experts assigned to a particular factor when classifying a worker. However, a rule can also have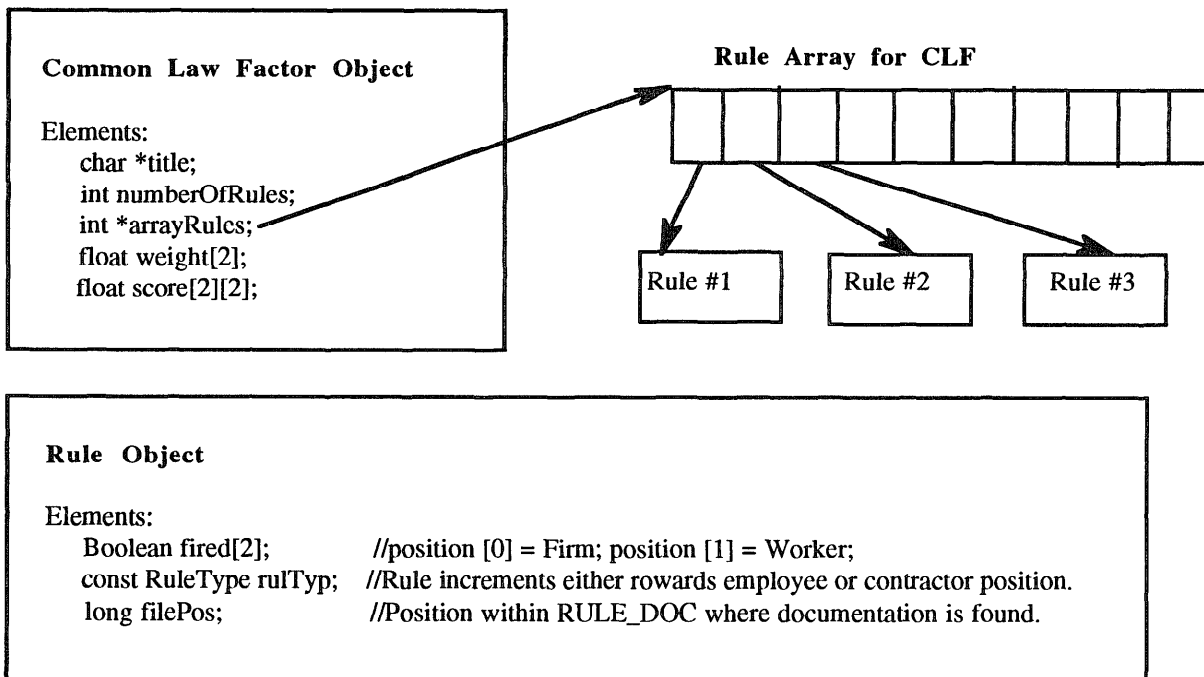 a special override weight. After all rules have fired, the larger of the employee and contractor scores determines which position the common law factor supports. (See Figure 2 for a description of the common law factor object elements and functions.)

The SS-8 responses are accessed through an array of pointers to string, char and integer objects. Arrays must be of one type in C. However we were able to store strings, integers and characters in the same array by defining a generic parent object which was the defined "type" of the array. We then defined objects to hold the strings, integers, and characters, which inherited from the generic array type.

An object called "consensus" holds important summary information such as final score totals, determinations, and audit information. When the system generates its final reports and letters to the firm and worker, it consults this object and also iterates across the rule and common law factor arrays to summarize scores and to group rule explanations under appropriate categories. These reports are displayed upon request, to give the user a thorough understanding of why the system came to a particular conclusion.

When making a determination for an SS-8, the system sums the contractor and employee scores for all 20 common law factors. The larger score

Relationship between CLF & Rule Objects

Common Law Factor Object

Elements:
    char *title;
    int numberOfRules;
    int *arrayRules;
    float weight[2];
    float score[2][2];

Rule Array for CLF

Rule #1   Rule #2   Rule #3

Rule Object

Elements:
    Boolean fired[2];   //position [0] = Firm; position [1] = Worker;
    const RuleType rulTyp;   //Rule increments either rowards employee or contractor position.
    long filePos;   //Position within RULE_DOC where documentation is found.

determines the worker's status. The same principle applies to determining the case, consisting of a worker's and firm's SS-8. The contractor and employee scores are totalled for both the worker and firm. However, if any of the following conditions exist, the system will report "undetermined" and request a manual review:

- too large a difference between the firm and worker SS-8s (meaning they disagree on many issues),
- too little information to make an effective recommendation,
- too little difference between the contractor and employee scores,
- statutory or audit issues.

The system produces letters to the firm and worker based on the individual situation, which inform them of the worker's status as either a contractor or employee. This is the task which requires the most time and effort when performed by a Revenue Agent. Generating the letter represented a challenging aspect of coding the system since the letters had to reflect the worker's situation using the appropriate pronouns and verbs, as well as the format of the IRS District using the system. We designed the letter generation portion of the system using "boilerplate" text files mixed in with generated paragraphs which mentioned the worker's dates of employment and work situation facts. The "boilerplate" paragraphs can be easily changed by editing the ascii files which are read by the system and incorporated into the letter. The individualized sections are generated in several ways. The most important individualized section is produced by reporting the six common law factors which contributed most heavily to the final determination, as well as the rules which fired for those common law factors. For example, if the common law factor "Training" had the most compelling difference between its contractor and employee scores, it would be mentioned first in this section of the letter. A general description of the "Training" common law factor would be followed by the answers to the questions about the worker's training, which were reported by this worker and firm. Other individualized sections are added if various statutory conditions are met or if the taxpayer needs to be informed of his rights and responsibilities. We are currently adding features to the system to allow users to tailor the letter to their district's format. This is accomplished by editing a "letter option" ascii file which contains a series of Y's or N's indicating their preference for such things as having the current date and case number

specified in the heading. See Figure 3 for an example of an employee determination letter addressed to the firm.

A number of "shells" and implementations were tried before deciding to write our own in C++. Some such as Goldworks Common Lisp required a lot of memory and didn't provide much flexibility in designing the screens. The system was originally programmed on a Symbolics Lisp Machine. The flexibility and ease of design afforded by the Symbolics were cancelled out by the fact that none of our users owned one, nor did they have the expertise to operate and maintain one. Since C compilers are so widely used, we felt C++ offered the most flexibility and the greatest hope of finding a maintenance organization.

Development History

In 1987, author Wagner and John Hampton were IRS AI Specialists in training at BBN Laboratories. Their initial exploration of this domain resulted in a fairly robust prototype by 1988. This prototype was written in Symbolics LISP and ran on dedicated hardware. Although demos were always well received by offices concerned with employment taxes, the prototype hardware was too expensive for field use. The project languished until 1992 when a partnership was struck with IRS's Austin Compliance Center (AUCC). They offered to contribute to the refinement of the prototype if the AI Lab rebuilt the SS-8 Determiner to run efficiently on a 386 PC.

The re-engineering for efficiency and compactness was done by Ms. Wagner and Mr. Carey Seth Meltzer of the AI Lab. They chose C++ and the ZINC GUI Library running under DOS as the best platform for their implementation. Rather than translate or mimic the original LISP code, they redesigned the application to fully exploit the object-oriented capabilities of C++. They produced an architecture in which rules, common law points, and SS-8 form pages were all objects.

The C++ version can be run on any desktop or portable DOS PC with 640K memory and an EGA or better monitor. When recompiled with the UNIX version of the ZINC libraries, it can also run on the UNIX-based workstations IRS is buying as part of its Tax Systems Modernization effort. This interoperability ensures that SS-8 Determiner can be deployed almost anywhere in IRS on existing or soon-to-be-acquired hardware. Thus, hardware

considerations are seldom a factor in implementation decisions.

The total cost of developing the SS-8 Determiner was 5 staff-years (@ $60,000), developmental and testing hardware ($45,000), plus travel ($30,000), for a total cost of $375,000. This yields an annual return on investment of 266% using just the salary savings cited above. The return rises to 5866% if the opportunity benefits are included.

Testing

In January, 1990 the IRS's AUCC expressed an interest in testing the Symbolics LISP SS-8 Determiner as well as supplying employment tax experts from the Southwest region for knowledge engineering. It was decided to use 226 cases from the San Antonio SS-8 inventory to test the program. Two Symbolics computers were shipped to AUCC to be used for the test. The 226 cases were entered into the computers and classified by both the system and human experts. The test was divided into two parts. The first part consisted of getting eight experts to classify 25 cases. The experts then discussed any differences in their results and classification methods, and attempted to come to a consensus. The second part consisted of having at least one of the experts classify each of the remaining 226 cases. The computer's classification of each case was compared to either a consensus of the eight experts' classifications or to the single expert who classified the case. The results are shown below. "Same" means that the computer and the expert agreed. "Different" means that either the computer recommended a contractor determination and the expert an employee determination, or vice versa. "Unknown" means that the computer decided that there was insufficient data or other factors which warranted manual review. "Unknown" was actually a subset of "Different" for this test because the experts were asked to make a determination of contractor or employee, despite the insufficient or confusing data. The SS-8 Determiner fairly easily recommends "Unknown" in order to ensure that confusing or missing data is fully assessed by a human expert.

Human Expert Vs. LISP SS-8 Determiner Classification

Same	Different	Unknown
197	2	27

Agreement % (Only Same and Different)	Agreement % (Including Unknowns)
98.5	87.17

As a result of the initial test and the discussions with the employment tax experts, a number of changes to the rules and weights were made.

Following the evaluation of the LISP SS-8 Determiner, the system was rewritten in C++, and two additional tests were conducted at AUCC. The first test which was begun in February and completed in May of 1993, consisted of 281 Form SS-8a cases from the AUCC Correspondence Examination inventory. The SS-8a Form features an eight question test which they invented to informally determine a worker's employment tax status. These forms were classified using both the SS-8 Determiner system and employment tax experts. Each case was then reviewed by the SS-8 program coordinator who is also a Revenue Agent. It should be noted that the SS-8a is a small form which contains only a limited set of the questions from the complete Form SS-8. Therefore, the SS-8 Determiner was classifying these cases with much less data than is usually found in a case. The results of this test are as follows.

Human Expert Vs. C++ SS-8 Determiner Classification

Same	Different	Agreement %
273	8	97.15

The second test of the C++ SS-8 Determiner was begun in June and ended in October, 1993. This test consisted of 200 cases taken from the San Antonio SS-8 inventory. For this test, each case was classified by the SS-8 Determiner program, an SS-8 Tax Examiner, and a Revenue Agent reviewer. IRS Chief Counsel and an employment tax expert from the IRS's Midwest Region were asked to review 25 of the cases. The results of this test are still being tabulated. However, AUCC was impressed enough by the initial

results of the test to recommend that all processing of SS-8s for the Southwest Region be centralized in AUCC using the SS-8 Determiner system. AUCC did request that changes be made to the program to enhance its effectiveness. Some of these changes include a display of differences between the firm's and worker's SS-8 responses and a separate report of the most compelling common law points which contributed to the employee determination. These improved the quality of the decision making process by pointing out areas of conflict between the worker and firm and by eliminating the possibility of bias or error in reporting the most important common law points for a particular case. The system generally improved the decision making process by eliminating the variability introduced when individuals make a subjective decision about whether a worker's situation meets the 20 common law criteria for employee status.

The number of firms who challenge the IRS's Form SS-8 determinations, has decreased with the use of the system. It is felt that this is due to the thoroughness of the generated letter. Furthermore, the cases are being processed timely. Prior to the use of the SS-8 Determiner, backlogs of unprocessed SS-8s frequently occurred in some districts. This is because the SS-8 classification process is very time-consuming and the agents who normally perform these classifications are often more effectively utilized working audit leads. However, with the use of the SS-8 Determiner, lower-graded individuals within the Districts can process cases. This means that decisions are made more quickly and any resulting back taxes can be collected without unnecessary delay.

Impact of Deploying SS-8 Determiner

The SS-8 Determiner passed its field test in July 1993 and is still in the process of nation-wide deployment. Based on field trials and early results at AUCC, we can report the following effects of system implementation:

- SS-8 Determiner reduces processing time by about two hours per case. Several additional steps were added to the automated processing to meet new objectives for compliance improvement. But even with those extra costs added in, SS-8 Determiner will boost productivity more than 25%.
- GS-4 to GS-7 paraprofessionals are guided through a determination by the software, at less

than half the salary cost of the Revenue Agents who previously handled SS-8s. This provides an avenue for less experienced employees to gain knowledge in the employment tax area.

- These staff-year savings will reduce salary costs by more than $1 million annually when implemented nationwide. Another way to view SS-8 Determiner's impact is to note that freeing the Revenue Agents from SS-8 processing allows them to conduct more audits (largely employment tax cases) which will generate an additional $22 million in tax revenue annually.
- Automation of the letter-generation process for determinations has focused attention on significant differences in substance, style, and philosophy among the various offices handling SS-8s. There has always been a program management goal of finding the best ideas or techniques and disseminating them to all offices. SS-8 Determiner has captured and automated most of the details of the SS-8 process. As various offices incorporate SS-8 Determiner into their operation, they undoubtedly will challenge the choices that are embedded in the system, sparking a national debate on the best approach.
- SS-8 Determiner generates data from all completed cases to a format suitable for import into a number of commercial databases. This will enable the first nationwide database of employment tax cases, with precise information about the size, location, industrial activities, and types of work in dispute. This will be very valuable for district, regional, and national analysis of compliance trends in the employment tax arena.
- The traditional benefit of rule-based systems, i.e. ease of maintenance, will be extremely valuable if employment taxes enter a period of rapid change or special considerations for particular industries. As mentioned earlier, the health care debate almost guarantees rule volatility.

Current Status and Users

The SS-8 Determiner has been deployed in five of IRS's seven regions with plans to be fully deployed in the remaining regions by the end of 1994. AUCC is using the SS-8 Determiner system to process all of the Southwest regional SS-8s. Courtesy copies of the system have been distributed to each district within the Southwest region but it is assumed they are using

it on a very limited basis, since AUCC is now processing nearly all of their SS-8s. The total inventory of SS-8 cases processed by AUCC from October, 1993 through March, 1994 is 900. They are using 9 individuals to operate the SS-8 Determiner program.

Most IRS Districts have traditionally used one or two individuals to process SS-8s. The following IRS Districts have copies of the program and are using it in various ways: Buffalo Small Business Center, Buffalo District Collection Division, Des Moines District, Pittsburgh District, Chicago District, Fort Lauderdale District, Memphis District, Atlanta District and Birmingham, Alabama District. The IRS plans to release the program to the remainder of its 63 districts before the end of 1994.

The system is being used on a limited basis in Newport, Vermont (North Atlantic regional SS-8 processing site) and Cincinnati (Central regional SS-8 processing site). These sites either use a subset of the features of the SS-8 Determiner system or are waiting for enhancements such as the LAN capability. Newport has four users who operate the program, and Cincinnati, two. IRS Service Centers in Ogden, Utah and Fresno, California, which are located in the Western Region, recently requested the SS-8 Determiner system. These centers are not yet actively using the system at the time of this writing.

The AI Lab will retain oversight responsibility at least through fiscal year 1994. AUCC is actively involved in distributing the system to new users, and in training them in its use. A bulletin board system has been created in Newport, Vermont so that users can download program and documentation changes. Future plans include converting the system to run on a LAN with a database server so that a compliance database can be more easily assembled, and recompiling the system on a UNIX platform to comply with the IRS's Tax Systems Modernization standards.

Maintenance Strategy

IRS AI Lab is not in the maintenance business, nor should it be. Because we are completely separate from mainstream data processing organizations, there is no automatic hand-off of a completed AI project to a designated software maintenance office. We find a unique maintenance solution for each project that becomes mature enough to leave the nest.

For SS-8 Determiner, several software maintenance options were considered. The chosen solution was to use the IRS North Atlantic Regional SS-8 Processing Center in Newport, Vermont. They process a large volume of SS-8s, and hence understand the domain well. Newport is dedicated to SS-8 processing, so this work need not compete with traditional IRS workloads for management attention there. And, most importantly, that office has programming expertise in C++ and is agreeable to the task.

One and one-half programmer staff-years in Newport will be devoted to SS-8 Determiner maintenance during 1994, concentrating on studying the program structure, making enhancements, and establishing a procedure to release new versions through an IRS-wide bulletin board. IRS Headquarters offices responsible for employment tax policy will need to approve any requests for changes in the rules or functionality of SS-8 Determiner. Procedures for this have not yet been established.

After the transfer of responsibility is completed (sometime in 1994), the role of the AI Lab will be consulting and training. We are committed to funding training that can improve Newport's skills in object-oriented design and programming. And we will be available to consult about the design of any new functionality that is needed in response to changes in government health care or employment tax policies.

Summary

The IRS's manual process for classifying workers is performed by specially trained individuals and is based on the 20 common law factors. IRS classifiers must interpret whether a worker-firm relationship meets the common law criteria for an employee or independent contractor. Because decisions tend to vary among classifiers, some industry representatives feel the IRS has been inconsistent when ruling on this issue. Furthermore the process is time-consuming and is normally performed by specialists. The AI Lab has developed an expert system tool which consistently makes correct classifications, enables lower-graded individuals to classify workers, and which generates personalized and well-written ruling letters to the firm and worker. The system also compiles case data in a format suitable for import into compliance databases. Developing this tool has enabled the IRS to realize significant productivity gains as well as freeing Revenue Agents from a tedious task.

Figure 1. Rule Object

Rule

```
//class to hold a rule which tests some element in the SS-8.
Elements:
Boolean fired[2];           //position [0] = Firm; position [1] = Worker;
const RuleType rulTyp;      //Whether the rule increments towards employee or contractor position.
long file_pos;              //Position within RULE_DOC where documentation is found.


Functions:
Rule(RuleType _rulTyp = Empl);  //Constructor


//"testRule" takes up to 5 Common Law Factors (CLFs) which can be affected by
//its firing. Also an override weight can be supplied for each of the 5 CLFs.
//Finally the array of SS-8 answers and the array of CLFs are supplied as arg's
//so that they are available while the rule is firing.
testRule(int c1, int clf1, int clf2, int clf3, int clf4, int clf5,
         float weight1, float weight2, float weight3, float weight4, float weight5,
         Q_Array &SS-8ans, CLF &arry );


//Whether rule fired (true) for firm or worker.
Boolean ruleFired(FileBy fb);


 //Returns the documentation for the rule.
char * retDoc(ostream& os);


//Whether the rule is employee or contractor type.
RuleType typeRule();


//Initializes rule back to NOT fired.
void init_rule();


//Prints out everything about rule to COUT.
void debug_info();


//Sets file position within object based on the position of the documentation within RULE_DOC.
void set_file_pos(long new_value);
```

Figure 2. Common Law Factor Object

```
CLF     //class which holds information about Common Law Factors including
        //title, an array of applicable rules, default weights and scores.
        Elements:
        char *title;
        int numberOfRules;
        int *arrayRules;        // array of rules whose firing affects scores
        float weight[2];        // Empl = [0], Cont = [1]
        float score[2][2];      // FrmEmp[0,0], FrmCont[0,1], WkrEmp[1,0], WkrCont[1,1]


        Functions:
        virtual ~CLF(); //This is virtual because CLF_wCondition inherits from it.
        CLF( char *_title, float weightEmp, float weightCont, int _arrayRules[] );


        //Increments the firm or worker "scores" depending on how a rule fired.
        virtual void increment(FileBy fb, RuleType rt, float weightOverRide);


        //Returns common law point documentation which was gotten from file.
        ostream& documentation(ostream&);


        //Writes documentation about all rules which fired, to a stream.
        virtual ostream& allRulesFired(FileBy, ostream&, RuleType);


        //Writes CLF title to a stream.
        ostream& printTitle(ostream&);


        //Returns CLF title.
        char * getTitle();


        //Returns true if any rules fired (antecedent was true).
        virtual Boolean anyRulesFired(FileBy, RuleType);


        //Returns position which CLF supports: contractor or employee.
        Determination compare_scores(FileBy fb);


        //Initializes CLF.
        void init_CLF();


        //Writes only the rules which fired for one of worker or firm, to a stream.
        virtual ostream& RulesFiredWorkerFirm(ostream&, RuleType);


        //Returns true if any rules fired for either worker or firm.
        virtual Boolean RulesFiredBoth(Rule Type);
```

Figure 3. Example of Employee Determination Letter to Firm

Internal Revenue Service	Department of the Treasury
District Director	Internal Revenue Service
	5 Main Street
	Anytown, NY 99999

Person to contact:
    SS-8 Technician
Contact telephone number:
    (999) 999-9999
Refer reply to:
    Determination letter

April 1, 1994

Firm:	We Fix Anything Car Repairs
TIN:	999999999
Address:	100 Main Street
	Anytown, NY 99999

Worker:	Cheryl Wagner
SSN:	999999999

Dear Taxpayer:

This letter is in response to a request we received to determine the employment tax status of your firm with respect to the above named worker.

From the facts presented, it appears that the firm had the right to control the worker. Therefore the worker's status during his service as a mechanic/maintenance worker from 01-03-83 to 03-13-93 was employee.

Our usual procedure is to request information from both parties about the working relationship. Since the worker and your firm responded, this decision is based on information received from both of you. Section 3121 (d) (2) of the Internal Revenue Code provides that the term "employee" means any individual who, based on the usual common law rules used to classify a worker-firm relationship, has the status of employee.

Whether an individual is an independent contractor or an employee is determined based on the facts describing the work environment and relationship, and the application of the law and regulations in a particular case. Guides for determining that relationship are found in three substantively similar sections of the employment tax regulations. These include Sections 31.3121 (d)-1, 31.33061 (i)-1, and 31.3401 (c) - 1 relating to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding.

Section 31.3121 (d)-1 (c) (2) of the regulations provides that generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services. Control encompasses not only specifying the results to be accomplished, but also the details and means by which the result is accomplished. That is, an employee is subject to the will and control of the employer not only in what is to be done but also in how it is to be done. Furthermore, it is not necessary that the employer actually direct or control the manner in which services are performed. It is sufficient that he or she has the right to do so.

There are twenty common law factors which are generally used to determine whether an individual is an employee. These factors are areas in which the firm may be exerting control over the individual. The degree of importance of each factor varies depending upon the occupation or industry, and the situation in which services are rendered. See Revenue Ruling 87-41, 1987-1 C.B., 296.

Based on the information submitted, the following issues were relevant in determining this case.

Paying a worker regular amounts at stated intervals, such as by the hour, week or month, strongly indicates an employer-employee relationship. The assumption is that to protect its investment, a firm will control the performance of the worker. In your case:
. Federal income taxes are withheld from the worker's pay.
. The firm reports the worker's income to the IRS on Form W2.
. The worker's compensation is from salary or hourly wage.
. Social Security taxes are deducted from the worker's pay.

Paying for the services of a worker whose skills are integral to the success or continuation of the business generally means that a firm must control the performance of those services. Failure to exert such control would mean risking the business's continuance. In your case:
. The work, business, location of services, or method of payment description contains words indicating an employee.
. The firm engages the worker for an indefinite period.
. The worker's job is integral to the type of business.
. The worker's compensation is from salary or hourly wage.
. The worker has performed services for the firm for more than a year.

Maintaining a continuing relationship with a firm usually indicates an employer-employee relationship. Continuing services may include work performed at frequently recurring though irregular intervals (either on call to the employer or whenever the work is available). In your case:
. The firm engages the worker for an indefinite period.
. The worker works more than 6 hours daily for the firm (full time).
. The worker has performed services for the firm for more than a year.

Furnishing tools and materials indicates that an employer-employee relationship probably exists. An employer can determine which tools the person is to use and, to some extent, in what order and how they will be used. However, certain skilled workers, such as carpenters, auto mechanics, barbers, and beauticians customarily supply their own small tools for their trade. For these occupations, this practice does not indicate that a firm lacks control over the worker. In your case:
. The firm supplies substantial tools for the worker.
. The firm supplies substantial supplies for the worker.
. The firm supplies tools valued at least 2 times greater than the worker's.
. The firm provides supplies valued at least 2 times greater than the worker's.

Setting the order or pattern which workers must follow in performing services indicates control. Often because of the nature of the industry an employer does not set the order of services. However, having the right to control the order or pattern is sufficient to contribute to the case for an employer-employee relationship. In your case:
. The firm has the right to change the worker's methods.
. The worker follows a routine.
. The worker receives instructions from the firm.
. The firm supervises the worker.

The right to fire the worker is an important factor indicating that you are an employer. Employers exercise control through the ever present threat of dismissal. In your case:
. The worker can be discharged.

Section 31.3121(d)-1(a) (3) of the regulations provides that if an employer-employee relationship exists, the designation or description of the parties as anything other than that is immaterial. Thus, if such a relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor or the like.

Careful consideration has been given to the information submitted in this case. The facts show that the worker was subject to the restraints and conditions that are indicative of the firm's control over him. Based on these factors, we conclude that the worker was the firm's employee under the usual common law rules for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages.

This ruling is applicable to any other individuals engaged by your firm to perform services under similar circumstances. This ruling is directed only to the taxpayer who requested it; section 6110(j) (3) of the Internal Revenue Code provides it may not be used or cited as precedent.

This determination is based on the employment conditions set forth by both your firm and the worker. Any other conditions which were not known or furnished could change this determination.

Sincerely,

Group Manager

CC: Cheryl Wagner

Appendix.

20 Common Law Factors Used to Determine Employee Status

Workers are generally considered employees for Federal tax purposes if they:

1.   Must comply with employer's instructions about the work.
2.   Receive training from or at the direction of the employer.
3.   Provide services that are integrated into the business.
4.   Provide services that must be rendered personally.
5.   Hire, supervise, and pay assistants for the employer.
6.   Have a continuing working relationship with the employer.
7.   Must follow set hours of work.
8.   Work full-time for an employer.
9.   Do their work on the employer's premises.
10. Must do their work in a sequence set by the employer.
11. Must submit regular reports to the employer.
12. Receive payments of regular amounts at set intervals.
13. Receive payments for business and/or travelling expenses.
14. Rely on the employer to furnish tools and materials.
15. Lack a major investment in facilities used to perform the service.
16. Cannot make a profit or suffer a loss from their services.
17. Work for one employer at a time.
18. Do not offer their services to the general public.
19. Can be fired by the employer.
20. May quit work at any time without incurring liability.

Source: Exhibit 4640-1, Internal Revenue Manual 4600 (Employment Tax Procedures), and Rev. Rul. 87-41, 1987-1 C.B. 296.