

Employment Taxes and Classifying Workers

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Being an employer carries important responsibilities. Critical issues include making sure all workers are properly classified as employees or independent contractors and making sure taxes are withheld and paid in a timely way.

This fact sheet, the 19th in the Tax Gap series, helps business owners better understand their responsibilities regarding employment taxes and classifying workers.

It is a common misconception that someone working part time or earnings less than \$600 per year should be classified as an independent contractor. But in fact, part time status and the number of hours worked are generally not factors that determine whether a worker is an employee or independent contractor.

Worker Classification

Employers must withhold Social Security and income taxes from employee paychecks. Conversely, independent contractors are responsible for reporting and paying their own Social Security and income taxes.

Businesses use several factors to determine how to classify its workers, including the degree of control the business has over its workers. Generally, the more control the business has over a worker, the more likely it is that the worker is an employee rather than an independent contractor.

Facts that provide evidence of the degree of control and independence fall into three categories:

- Behavioral control
- Financial control
- Type of relationship

Behavioral control relates to whether the business has a right to direct and control how the worker performs the task for which they are hired. In general, anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that the employer has the right to control the details of how the services are performed. Such details include:

- 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

Financial control looks at whether a worker has the ability to affect financial decisions. Does the worker have a significant investment in assets or tools? Are there unreimbursed expenses that the worker has to bear themselves? Are the worker's services available to the public? What is the method of payment; do they get paid whether the work is done or not or do they get paid only if they finish the job? Independent contractors can realize a profit or loss on a job. Can the worker make business decisions that affect his bottom line?

Relationship of the parties looks to whether or not there is a contract between the worker and the business and how it is worded; whether the worker gets any type of benefits – vacation and sick pay, pension plan, and health or life insurance; and the permanency of the relationship such as continuing indefinitely or only for a specific project or period. Also, does the worker have his own business, which he markets to others?

If you want the IRS to determine whether a specific individual is an independent contractor or an employee, file [Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding](#).

Employment Tax Obligations

If you have employees, you are responsible for several federal, state, and possibly local taxes. As an employer, you must withhold certain taxes from your employees' pay checks. Before you become an employer and hire employees, you need a federal [Employer Identification Number](#).

Employment taxes include the following:

- Federal income tax withholding
- Social Security and Medicare taxes
- Federal unemployment taxes (FUTA)

You generally must withhold federal income tax from your employee's wages. To figure how much to withhold from each wage payment, use the employee's Form W-4 and the methods described in Publication 15, [Employers Tax Guide](#) and Publication 15-A, [Employers Supplemental Tax Guide](#).

Social Security and Medicare taxes pay for benefits that workers and families receive under the Federal Insurance Contributions Act (FICA). Social Security tax pays for benefits under the old-age, survivors, and disability insurance part of FICA. Medicare tax pays for benefits under the hospital insurance part of FICA. You withhold part of these taxes from your employee's wages and you pay a matching amount yourself.

The federal unemployment tax is part of the federal and state program under the Federal Unemployment Tax Act (FUTA) that pays unemployment compensation to workers who lose their jobs. You report and pay FUTA tax separately from social security and Medicare taxes and withheld income tax. You pay FUTA tax only from your own funds. Employees do not pay this tax or have it withheld from their pay.

In general, you must deposit income tax withheld and both the employer and employee social security and Medicare taxes (minus any advance EIC payments) by mailing or delivering a check, money order, or cash to a financial institution that is an authorized depository for federal taxes. However, some taxpayers are required to deposit using the Electronic Federal Tax Payment System (EFTPS).

A business generally does not have to withhold or pay any federal taxes on payments to independent contractors. However, independent contractors are subject to self-employment and income taxes and should plan accordingly.

Most employers make every effort to meet their employment tax obligations. If an employer does make an error and classifies an employee as an independent contractor, the employer should correct that mistake. IRS.gov has instructions for correcting reporting of misclassified employees.

Professional Help

Determining worker status and filing and paying employment taxes can be a complex process. Business owners who need assistance are encouraged to consult a tax professional or payroll service provider.

If you outsource some or all of your payroll duties, you should keep in mind you are still responsible for the payment of the taxes. If a third-party fails to make your employment tax deposits, you are still liable for the unpaid amounts. IRS.gov has additional tips for outsourcing payroll services.

Additional Resources:

- [Publication 15](#), Employer's Tax Guide
- [Publication 15-A](#), Employer's Supplemental Tax Guide
- [Publication 1779](#), Independent Contractor or Employee brochure
- [Publication 1976](#), Independent Contractor or Employee? Section 530 Employment Tax Relief Requirements
- [Employment Taxes for Small Businesses](#) IRS Web page
- [IR-2007-184](#), IRS and States to Share Employment Tax Examination Results
- [Payroll and Practitioner Resources](#)
- The IRS's archived Tax Talk Today November 2007 webcast, "What's Hot in Employment Taxes: Independent Contractor or Employee?" focuses exclusively on

worker classification issues.