

# IRS Construction Destruction: Worker Classification

**H**istorically, the IRS has focused on worker classification audits, with random and targeted audit selections of the construction industry. The already multifaceted laws governing the differentiation of “Employee” or “Independent Contractor” is further complicated by the Affordable Care Act’s employer mandate set to be implemented in 2015 that will include expanded enforcement actions by the IRS.

Even if an employer avoids random selection there is still a risk of an audit. Individual workers, competitors or informants alert the Service to possible misclassifications. For example, a worker may file Form SS-8, “Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding,” with the Service. This form requests that the Service make a formal determination of the individual worker’s classification and may trigger a more extensive audit of the employer’s worker classification practices. Forms SS-8 are typically filed by disgruntled former workers seeking Maryland unemployment benefits, current workers filing claims for worker’s compensation, or current/former workers who have been treated as independent contractors and are now facing income tax liabilities due to failure to make estimated tax payments.

The test to determine worker classification varies depending on the nature and purpose of the inquiry. Different facts and circumstances are considered by the Service, the U.S. Department of Labor, the Comptroller of Maryland, and the Maryland Department of Labor, Licensing and Regulation (“DLLR”). A worker may be an independent contractor for purposes of federal employment tax, but classified as an employee for purposes of Maryland unemployment insurance contributions.

In determining worker classification, the Service looks to the common-law rules governing employer-employee relationships. Generally, an employer-employee relationship is found when the business has the right to control and direct the worker with regard to the result as well as the details and means used to reach that result.

The common-law rules evolved into 20 factors to be considered when determining worker classification.

These factors consist of the following:

1. Instructions to the worker;
2. Training;
3. Integration into business operations;
4. Requirement that services be rendered personally;
5. Hiring, supervising, and paying assistants;
6. Continuity of the relationship (permanency);
7. Setting the hours of work;
8. Requirement of full-time work;
9. Working on employer premises;
10. Setting the order or sequence of work;
11. Requiring oral or written reports;
12. Paying workers by the hour, week, or month;
13. Payment of worker’s business and/or traveling expenses;
14. Furnishing worker’s tools and materials;
15. Significant investment by worker;
16. Realization of profit or loss by worker;
17. Working for more than one business at a time;
18. Availability of worker’s services to the general public;
19. Employer’s right to discharge the worker; and
20. Worker’s right to terminate relationship with the employer.

No one factor is determinative and not all factors are relevant in every case. Instead, all facts regarding the employer’s right to control the worker are relevant and the final determination will be based on the

employer's particular facts and circumstances. The Service emphasized the importance of "control" when it organized the common-law factors into three general categories of evidence:

**Behavioral control:** This is the amount of control the business has over how the worker performs the task. Factors include the type and degree of instructions provided to the worker as to when, where and how to perform the work. They also include the amount of training provided to perform the work in a specific manner.

**Financial control:** This is the amount of control the business has over the business aspects of the job. Factors that indicate a worker should be classified as an employee include reimbursed business expenses, little to no financial investment in the job, an inability to seek out other job opportunities, a regular periodic wage instead of a flat fee per job and an inability to realize a profit or loss.

**Type of relationship:** This category looks at the relationship between the parties as the parties perceive it. Evidence illustrating the perceived relationship includes the intent of the parties as evidenced through written contracts, whether employee benefits are provided, the permanency of the relationship and the extent to which the worker's services are integral to the business.

Generally, if an employer has the *right* to control or direct not only what *is* to be done by the worker, but also *how* it is to be done, then the worker is more likely to be classified as an employee. If, on the other hand, an employer can direct or control only the *result* of the work done, and not the means and methods of accomplishing the result, then the worker is more likely to be classified as an independent contractor.

The Service shares information obtained in employment tax audits with other federal and state agencies. Maryland returns the favor by sharing information developed in its worker classification investigations. As noted, federal and state agencies impose different tests for worker classification, but an adverse finding by any agency can result in the commencement of

an employment tax audit by the Service. As a result, employers should take each contact regarding worker classification seriously, regardless of what appears to be the amount at issue in any particular examination.

The exposure for incorrect worker classifications can be severe and broad. If you wish to discuss the Service's employment tax examinations or other worker classification issues, or simply wish to have your current practices reviewed for potential exposure, please contact Brian J. Crepeau at (410) 649-4981 or [bcrepeau@rosenbergmartin.com](mailto:bcrepeau@rosenbergmartin.com).



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