

Independent Contractor or Employee

Withholding Fact Sheet 8

When workers perform services for your business, they may be classified as independent contractors or employees. You are responsible for classifying them correctly.

This fact sheet explains how to classify your workers and covers the differences between workers and independent contractors.

How to Classify a Worker

To determine if an individual is an employee or an independent contractor, the business relationship between you and the individual performing the services must be examined. All evidence of control and independence must be considered.

Many factors are considered when deciding if a worker is an employee or an independent contractor. These factors fall into three main categories:

- Behavioral control
- Financial control
- Relationship of the parties

If you are generally in control of (or have the right to control) these factors, the worker is most likely your employee. Not all of these factors need to be present to determine worker status. Nonetheless, all factors must be considered.

Behavioral Control

If you have the right to direct or control the manner and means in which services are performed, you have behavioral control over the worker. You do not have to actually direct or control the way work is done, so long as you have the right to do so.

These behavioral control factors indicate the worker is an employee:

- You direct how, when, or where the work will be done
- You specify which tools or equipment will be used
- You specify the sequence in which services will be performed
- You determine who will be hired to assist with the work
- You decide where supplies and services will be purchased
- You establish work hours
- You require reports to be submitted
- You provide training regarding procedures and methods

Financial Control

If you have the right to direct or control the administrative aspects of the work, you have financial control over the worker.

These financial aspects indicate the worker is an employee:

- You reimburse or pay travel and business expenses
- You pay at regular intervals (hourly, weekly, etc.)
- You provide tools, materials, and other equipment

These financial aspects indicate the worker is an independent contractor:

- The worker has an opportunity for profit or risk of loss
- The worker has a significant investment in the work
- The worker offers services to the general public
- The services provided are not an integral part of the business (for example, a bank hiring a plumber)

Relationship of the Parties

These factors illustrate how you and your worker perceive your relationship and indicate your worker is an employee:

- The worker has the right to quit without incurring liability
- You have the right to fire the worker
- The worker has the right to receive employee benefits
- There is a continuing relationship between you and the worker
- Services performed by the worker are a key aspect of the regular business activities

Written contracts are considered when determining worker classifications, but they do not make a worker an employee or an independent contractor. The actual relationship between the parties must be examined.

Worker Classification Examples

Here are some examples of employees and independent contractors.

- Maria, a computer science student, gets a part-time job as a customer service representative at a computer software company. Maria works designated hours at the business location, is paid hourly, has no investment, and is trained on how to help customers. Maria is an employee.
- Jack's Construction is building a house that must be completed in six months. Jack's Construction is not licensed to do the electrical work. Carrie's Electric is subcontracted to do the work. Carrie bids the job and will be paid upon completion. The work is done without the supervision of Jack's Construction. Carrie advertises her business in the telephone book and newspaper. She uses her own tools and equipment and works with many construction companies. Carrie is an independent contractor.
- Kristine is the President of ABC Company, an S corporation. She works approximately 20 hours a week and pays herself \$2,000 per month. Kristine is an employee of ABC Company. For more information on corporate officers, see [Withholding Fact Sheet 6, Corporate Officers](#).
- Joseph drives a truck for Amber's Leasing, a company that leases tractor-trailer rigs with drivers to contract carriers. Amber's Leasing retains the right to direct and control Joseph to the extent necessary to protect its investment. Joseph is an employee.
- Rachel drives cars to a distant auction for Nick's Used Car Sales. Nick determines the minimum selling price. Nick reimburses all of her expenses. She is paid on a commission basis. Rachel is an employee of Nick's Used Car Sales.

Employees

If the worker is an employee, you must generally withhold and deposit income taxes, Social Security Taxes, and Medicare taxes. In addition to these taxes, you must pay unemployment taxes and carry worker's compensation insurance. These requirements generally do not apply to independent contractors.

You must register for, file, and deposit all required federal and state taxes for employees. For details, see [Withholding Fact Sheet 10, New Employer Guide](#).

Independent Contractors

If the worker is an independent contractor, you must have them complete federal Form W-9 to obtain a taxpayer ID number (TIN).

If the independent contractor fails to provide you with a TIN, you must withhold 9.85% Minnesota income tax from the independent contractor's pay. This is called "backup withholding."

For details on Minnesota backup withholding, see the [Minnesota Income Tax Withholding instructions](#). For details on federal backup withholding, see [Publication 15, Circular E](#) and [Publication 1281](#).

You may be required to file federal Form 1099-NEC to report payments made to independent contractors. To obtain federal forms, instructions, and publications, contact the IRS.

Request a Determination

An employer or employee wanting a worker classification determination may complete and submit federal Form SS-8 to the IRS. The IRS will review the request and determine whether the worker should be classified as an employee

or an independent contractor.

The Minnesota Department of Revenue will abide by the IRS's decision. Send a copy of Form SS-8 (marked "Minnesota copy") to Revenue at the same time you submit it to the IRS. Mail a copy of the determination to us as soon as it is received from the IRS.

Mail to:

Minnesota Department of Revenue
Mail Station 6501
600 N. Robert St.
St. Paul, MN 55146-6501

Classifying Workers Incorrectly

Both the IRS and Minnesota Department of Revenue may determine worker classifications. If you incorrectly treat employees as independent contractors, you could be liable for all back taxes plus any penalties and interest.

If you misclassify an employee as an independent contractor, you are subject to a tax equal to 3% of the wages paid to the employee. The employee may not claim the tax as a credit (withholding) on their Minnesota Individual Income Tax return.

Other Agencies to Help You Correctly Classify Workers

Internal Revenue Service

Website: www.irs.gov

Phone: 1-800-829-4933

For free IRS publications, go to their website or call 1-800-829-3676.

IRS Publications you might find helpful include:

- [Pub. 15, \(Circular E\) Employer's Tax Guide](#)
- [Pub. 15-A, Employer's Supplemental Tax Guide](#)
- [Pub. 51, \(Circular A\) Agricultural Employer's Tax Guide](#)
- [Pub. 926, Household Employer's Tax Guide](#)

Minnesota Department of Employment and Economic Development, Unemployment Insurance

Website: www.uimn.org

Email: deed.customerservice@state.mn.us

Phone: 651-296-6141 or 1-800-657-3858

Minnesota Department of Labor and Industry

Website: www.dli.mn.gov

Email: dli.communications@state.mn.us

Phone: 651-284-5005 or 1-800-342-5354

Information and Assistance

Additional forms, information, and fact sheets are available on our website.

Website: www.revenue.state.mn.us

Email: withholding.tax@state.mn.us

Phone: 651-282-9999 or 1-800-657-3594