

## The IRS three-category common law test

To determine a worker's status, the IRS will consider all evidence related to the degree of control and independence in the relationship. No single factor is decisive, and all facts are weighed collectively.

### 1. Behavioral control

This category examines whether the company has the right to direct or control how the worker does their job.

- **Instructions:** An employee is more likely to receive detailed instructions from the business on how and when to do the work. An independent contractor typically receives less extensive instructions and controls their own methods.
- **Training:** If a business provides a worker with training on procedures and methods, it suggests the company wants the work done in a certain way, indicating an employer-employee relationship.

### 2. Financial control

This category focuses on whether the business controls the financial and business aspects of the worker's job.

- **Significant investment:** An independent contractor often has a significant investment in the equipment or facilities used to perform the work. An employee does not.
- **Unreimbursed expenses:** Independent contractors are more likely to have unreimbursed business expenses. Employees typically have their business or travel costs covered by the company.
- **Opportunity for profit or loss:** An independent contractor can realize a profit or loss from their work. An employee is paid a regular wage regardless of their performance.
- **Payment method:** Employees are typically paid on a regular hourly or salary basis. Independent contractors are often paid a flat fee for the job.

### 3. Type of relationship

This category examines how the worker and the business perceive their relationship.

- **Written contracts:** A contract can state the intent of the parties, but the IRS looks at the actual working relationship to make a determination.
- **Employee benefits:** Providing benefits such as paid vacation, insurance, or a pension plan is an indicator of an employer-employee relationship.
- **Permanency:** An expectation that the relationship will continue indefinitely suggests an employee relationship. An arrangement for a specific project or a defined period suggests an independent contractor relationship.
- **Key activity:** If the work performed is a key part of the company's business operations, the worker is more likely to be an employee.

### Consequences of misclassification

Misclassifying an employee as an independent contractor can lead to serious legal and financial penalties, including liability for unpaid employment taxes.

- **For employers:** Misclassification can trigger an audit and result in penalties, back taxes, and fines. The IRS offers a Voluntary Classification Settlement Program (VCSP) for eligible businesses to reclassify their workers and resolve past issues with reduced penalties.
- **For workers:** If a worker was treated as an independent contractor but believes they should have been an employee, they can file Form SS-8 with the IRS to get an official determination of their status.

The IRS no longer uses the 20-factor test for determining whether a worker is an independent contractor or an employee. It has been replaced by a more streamlined common law test that examines the totality of the circumstances under three main categories: behavioral control, financial control, and the type of relationship.

While the 20-factor test is obsolete for federal tax purposes, its criteria are still relevant as they inform the modern common law test. Some states, like Tennessee, have adopted the 20-factor test into their own wage and labor laws.