

# **Higher Education Tax Institute**

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## **Worker Classifications**

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## **I. Employee or Independent Contractor – Basic Rules**

A. Tests used by IRS and courts are derived from the common law definition of an employee – that is, a worker is an employee if the person for whom the services are performed has the right to direct and control the worker, not only as to the result to be accomplished by the work but also as to the details by which the work is accomplished. (Treas. Reg. § 31.3401(c)-1(b)).

B. IRS has issued two significant documents— one in 1987 and the other in 1996—that together set forth the agency’s basic position on how the employee/independent contractor classification should be made.

C. Rev. Rul. 87-41 sets forth 20 different factors that the IRS said were historically most often used by courts in making employee/independent contractor determinations. No single factor or group of factors is necessarily controlling; rather, they are all reviewed and evaluated in making a subjective facts and circumstances test.

D. While the IRS still sometimes refers to this “20-factor” test, it more often uses a more recent set of tests set forth in a 1996 training manual. In this manual, the IRS tells agents to look for evidence relating to the extent to which the service recipient evidences behavioral and financial control over the worker and the nature of the relationship between the two parties.

E. “Behavioral control” relates to the nature and extent of training and instruction provided to the worker.

F. “Financial control” looks to whether the recipient of the services has the right to direct and control business-related means and details of the worker’s performance, including such items as whether the worker has made a significant investment in the business activity (indication of independent contractor); whether the worker is reimbursed for business expenses (indication of employee); and whether the worker provides the same or similar services to other members of the general public (indication of independent contractor).

E. The “relationship between the parties” factor looks to how the two parties perceive their own relationship, including whether the worker receives employee-type benefits, whether a written employment contracts exists, and whether the relationship is expected to be temporary or permanent.

F. The training manual also sets forth certain factors that the IRS views as potentially applicable but less important, such as whether the individual works part-time or full-time, whether the employment is temporary, the location where the worker conducts his or her activities, and the hours that the individual is required to work.

G. The courts do not generally follow either the 20-factor or training manual tests but rather use their own methods of making the employee/independent contractor

determination. A 1992 Supreme Court case (*Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992)), is representative in this regard, and it looked to the following factors in making the determination:

1. Skill required of the worker
2. Whether the worker supplied his or her own tools
3. The location of the work
4. The duration of the relationship between the parties
5. Whether the hiring party had the right to assign additional projects to the worker
6. The extent of the worker's discretion over when and how long to work
7. The method by which the worker was paid
8. The worker's role in hiring and paying assistants
9. Whether the work was part of the regular business of the hiring party
10. Whether the hiring party provided employee benefits to the worker
11. How the hiring party classified the worker.

H. A more recent summary of the factors used in various judicial opinions can be found in *Jones v. Commissioner*, T.C. Summary Opinion 2003-61.

## **II. Worker Classification Issues Commonly Faced by Higher Education**

### **A. Instructors and Adjunct Faculty**

1. Regarding instructors, Rev. Rul. 70-338 involved two groups of music instructors.
  - a. First group taught classes for normal remuneration and was required to spend certain designated hours in the music conservatory performing their duties. These persons were treated as employees.
  - b. Second group gave private lessons in a studio furnished by the conservatory, agreed not to teach elsewhere without the conservatory's consent, and permitted the conservatory to retain a certain percentage of

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