

City and County of Denver, Colorado

TAX GUIDE

Topic No. 41

INDEPENDENT CONTRACTORS AND EMPLOYEES

Generally an employer-employee relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he/she has the right to do so. In general, if an individual is subject to the control or direction of another person merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he/she is an independent contractor. The totality of the circumstances must be examined to determine whether the relationship is one of employer and employee or one of an independent contractor.

Various factors are used to determine whether a person is an employee or an independent contractor. No one factor solely determines whether a person is an employee or an independent contractor. The factors are guides for determining whether an individual is an employee or independent contractor. Special scrutiny is required to assure that the formalities of the arrangements do not obscure the substance of the relationship. The way the parties refer to themselves does not determine whether a claimant is an independent contractor or employee.

Factors considered in determining whether an employer-employee relationship exists include, but are not limited to, the following:

1. **Instructions.** A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the person for whom the services are performed has the right to require compliance with instructions.
2. **Furnishing Tools and Materials.** The fact that the person for whom the services are performed furnishes tools, materials, and other equipment tends to show an employer-employee relationship.
3. **Right to Discharge.** The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer.
4. **Right to Terminate.** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship.
5. **Full Time Required.** If the worker must devote substantially full time to the business of the person for whom the services are performed, such person has control over the amount of time the worker spends working and implicitly restricts the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses.
6. **Significant Investment.** If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship.

7. **Realization of Profit or Loss.** A worker who can realize a profit or suffer a loss as a result of providing his or her services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor; the worker who cannot is generally an employee. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.
8. **Payment by Hour, Week, Month.** Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payments made by the job or on a straight commission generally indicate that the worker is an independent contractor.
9. **Continuing Relationship.** A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.

If the employer-employee relationship exists, it is immaterial how the parties themselves describe the relationship.

Business enterprises employing workers sometimes fail to correctly classify the worker. For instance, the business enterprise may incorrectly classify the worker as an independent contractor to avoid paying Social Security (FICA) taxes. If an incorrect classification has occurred, the worker should be correctly classified as an employee and the occupational privilege taxes due must be remitted to the City along with penalty and interest.

Compensation received by an employee is reported on Form W-2. This form shows the total wages earned during the year, as well as the FICA, Medicare, federal, state, and local tax withheld. Compensation received by an independent contractor is reported on Form 1099-Misc. Generally, no taxes are withheld on such compensation, thus no tax withholding will appear.

The Employee Occupational Privilege Tax (OPT) Ordinance requires employers to withhold the \$5.75 per month Employee OPT for each taxable employee. If a business claims to have independent contractors working for them, these persons must be registered to report their own Business Occupational Privilege Tax (OPT) of \$4.00 per month. If these individuals, claimed by the business to be independent contractors, are not registered to report their own Business OPT, the City may hold the business liable for these taxes.

EXAMPLE

Dean entered into an oral contract last year to provide accounting services for Granite Homes. Granite Homes controls the hours Dean must work, gives him his assignments, provides him with all materials and equipment he needs to perform his services, gives him deadlines for completing each assignment, and pays him an hourly "commission." This is a 12-month temporary work arrangement. Granite Homes considered Dean to be an independent contractor. Thus no taxes were withheld and Dean received a Form 1099-Misc. for the year. A review of the facts clearly shows Dean to be an employee. Granite Homes had the power or right to control and direct the work performed by Dean. The fact that Granite Homes may describe the relationship as an independent contractor relationship is immaterial. Granite Homes is liable for both the Employee OPT and the Business OPT on this person.

- * DRMC Section 53-240 – Employee Occupational Privilege Tax, Definitions
- * DRMC Section 53-241 – Employee Occupational Privilege Tax, Tax Levy
- * DRMC Section 53-295(1),(4) – Business Occupational Privilege Tax, Definitions
- * DRMC Section 53-296(a) – Employee Occupational Privilege Tax, Imposition of tax

THE ABOVE INFORMATION IS A SUMMARY IN LAYMAN'S TERMS OF THE RELEVANT DENVER TAX LAW FOR THIS INDUSTRY OR BUSINESS SEGMENT. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE DRMC AND APPLICABLE RULES AND REGULATIONS.