

Texas Workforce Press Release

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MEDIA CONTACT: Larry Jones

PHONE: (512) 463-8556

Texas Workforce Commission Targets Statewide Concern: Employee vs. Contract Labor

AUSTIN – “Contract labor” may be the most widely used misnomer in business today and poses a growing concern for Texas employers – tax penalties that could have been avoided.

One of the most frequently asked questions of the Texas Workforce Commission’s (TWC) Office Representing Employers regards the definition of contract labor. Although the Texas Unemployment Compensation Act does not directly define “independent contractor,” it does set forth a broadly inclusive test, known as the “direction or control” or “common law” test.

The Texas Labor Code creates the presumption of employment based on the performance of a service for wages, and the burden for proving otherwise is on the recipient of those services. In basic terms, an employee is someone over whose work an employer exercises direction or control. Employers need to be aware that there are extensive wage reporting and tax responsibilities that accrue as a result of the employer/employee relationship. It is important for employers to understand the differences between employees and independent contractors, as there are also interest payments and financial penalties levied against those who attempt to circumvent unemployment taxes.

An independent contractor is self-employed, bears responsibility for his or her own taxes and expenses, and is not subject to an employer’s direction and control. The distinction depends upon much more than what the parties call themselves.

TWC has the legal obligation to collect taxes on the wages of all individuals who qualify as employees under the Texas Unemployment Compensation Act. Each year, hundreds of employers are required to participate in Unemployment Insurance appeals cases that involve questions arising over the classification of independent contract workers. At issue is whether a given worker is considered an employee or an independent contractor. TWC is charged with auditing businesses to ensure that employee wages are being reported and that proper taxes are being paid on those wages. When TWC determines that an individual who has been classified as an independent contractor is really an employee, then back taxes, penalties and interest are assessed.

The Internal Revenue Service (IRS) is notified of TWC’s findings via a federal reporting program. The IRS will then investigate those same employers for compliance with federal laws.

In determining if an individual is an employee or an independent contractor, TWC uses a 20 common law factor test which can be found at www.texasworkforce.org.

The following comparison outlines the differences in each classification of workers:

Significant Differences Between Employees and Independent Contractors

Employer/Employee

- Worker asserts he is an employee or seems unsure of his status
- Worker has no DBA (Doing Business As), does not own his own company, has no client base, and/or has no business cards or independent advertising
- Worker performs services on an ongoing basis for the employer
- Worker's services are directly integrated in the primary service supplied by the employer
- Pay is by hourly wage or salary, rather than by the job
- Pay is unilaterally set by the employer
- Employer supervises the worker in the details of the projects or assignments
- Employer provides the facilities, tools, equipment and/or supplies for the work
- Employer provides office space and clerical help to the worker at no cost
- Worker requires training and periodic supervision
- Worker is subject to routine quality control checks
- Worker is required to furnish regular reports to the employer
- Worker has no right to engage assistants to help him perform the contract services, or if the worker hires assistants, the employer pays their wages
- Employer reimburses the worker for expenses associated with the job
- Worker is covered by all or part of the employer's benefits plan and liability insurance
- Worker does not determine the hours or the details of the work

Independent Contractor

- Contractor asserts self-employment and generally maintains client list or customer base
- Contractor is usually hired locally where the customer performs the project
- Contractor performs a service the customer is not qualified or able to supply
- Work is generally performed at customer site and/or contractor's office/home
- Tools and equipment are furnished by contractor or customer
- Supplies are furnished by contractor without reimbursement from customer
- Contractor is highly skilled and requires no training or supervision
- Contractor and customer are interested only in the outcome of the work, not in the details of how the work is done
- Contractor has some voice in determining the hours of performing the work
- Work is not on a continuous basis, but rather on a job-to-job basis
- Pay is generally by the job and is negotiated with the contractor
- Contractor invoices the customer for work performed
- Payment is to the contractor
- Contractor has the right to hire assistants and to pay them out of pocket
- Contractor is not reimbursed for expenses
- Contractor is not covered by the customer's benefit plan
- Contractor maintains own errors and omissions liability insurance
- Contractor is not required to submit performance, cost, or progress reports other than invoices or perhaps work or progress reports verified and signed by the employer's clients

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The Texas Workforce Commission is a state agency dedicated to helping Texas employers, workers and communities prosper economically. For details on TWC and the programs it offers in unison with its network of local workforce development boards, call (512) 463-8556 or visit www.texasworkforce.org.