

6.5.2 Individual Consultants

There are legal distinctions and ramifications between retaining a consultant and hiring an employee. For example, the State incurs liabilities for withholding and/or the payment of State, Federal, and Local income taxes, OASDI and Medicare, workers compensation, unemployment compensation, and pension for employees.

To ensure the State does not incur any liability for these employment costs, the State, from time to time, hires consultants to perform various activities. Special care must be exercised to distinguish between a "consultant" and an "employee" prior to executing any contract for services with prospective consultants.

DOA reviews prospective consulting contracts using the IRS 20-Factor Test (common-law control test) to determine whether an employer/employee relationship will exist. Generally, an employer/employee relationship exists when the employer has the right to control. Control of the workplace is met when the employer determines when the employee works, where he works, and how he works. Control does not need to be exercised for an employer/employee relationship to exist – the right to control is sufficient.

A. Policy:

Human Resources, Payroll, and Fiscal representatives must correctly classify workers who provide services to their agency. The status of a worker as either an independent contractor or employee must be determined accurately to ensure the worker and the State meet tax obligations in a timely and accurate manner. The State withholds income taxes, withholds and pays OASDI and Medicare taxes, and pays unemployment taxes on wages paid to an employee. The State does not make tax payments on behalf of independent contractors. Therefore, due diligence must be applied when hiring individuals to ensure workers are appropriately classified.

When the IRS determines a worker has been misclassified as a contractor, the employer is responsible for the employer and employee shares of OASDI and Medicare and may also incur penalties in the form of fines and interest for each instance the worker was paid incorrectly.

B. IRS Regulations

The IRS may submit an inquiry for a worker who receives both a W-2 and a 1099 from the same employer.

C. State of Delaware Policy

The *State of Delaware* is **one** employer, paying employees at Merit Agencies, School Districts, and Higher Education facilities.

An employee who has separated from state service may not be hired as an independent contractor within two years of separation. Exceptions may be made if the services being provided are not related to the field of former state employment and subjected to review by the Delaware Public Integrity Commission (DEPIC).

D. Definitions:

Contractor –an individual hired to do a specific task with little or no direction from agency. The **worker has the control** over how the job will be accomplished. Contract includes language of when and how payment for services will be made.

Employee – an individual hired to do a specific task with direction from the employer on when and how the task is to be performed and when and how payment for services is made.

E. IRS Worker Classification Test:

Common Law Test – focuses on the “right to control” which is grouped into three factors. No one factor stands alone, all must be considered:

- *Behavioral Control* – the right to direct and control the details and means by which the worker performs the work to be done; to the extent of instructions given regarding how, when and where to do the work; what tools and equipment to use; what assistants to hire to help with the work; where to purchase supplies and services; and any training provided about required procedures and methods.
- *Financial Control* – the right to direct and control the economic aspects of the worker’s job; whether business expenses are reimbursed; if there is a significant investment in the work; how the worker is paid; whether the worker incurs a profit or a loss; and whether services are offered to public.
- *Relationship of the Parties* – looks at such things as are there written agreements; are employee benefits offered; the length of the relationship; and the importance of the services to the regular operations of the agency.

For additional information, agencies should refer to *Publication 1779, Independent Contractor or Employee ...* a publication of the Internal Revenue Service.

Reasonable Basis Test – this test takes court decisions, IRS rulings, past IRS audits, and longstanding industry practices into account.

20-Factor Test – provides 20 criteria to determine if the employer has the right to control. This test is included in the Budget and Accounting Policy Manual in **Exhibit A at the end of this chapter**.

Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding. A Form SS-8 determination may be requested only in order to resolve federal tax matters. The IRS does not issue a determination letter for proposed transactions or on hypothetical situations.

F. Procedure:

Prior to awarding a bid, or hiring a contractor, these steps must be followed:

- Determine if the worker is currently employed by or has previously been employed by the State of Delaware.
 - Agency HR representative must search the PHRST system by Social Security Number to determine if an employee relationship exists.
 - If the worker is a state employee, ask the following questions:
 1. Is the employee relationship and the contractor relationship the same?
 - If yes, the worker must be hired as an employee
 - If no, the worker may be hired as a contractor
 2. Does the independent contractor have a valid business license?
 - If yes, obtain a copy.
 - If no, agencies should refer to the State of Delaware One Stop Business Registration and Licensing web site, <https://onestop.delaware.gov/osbrlpublic/Home.jsp>.
 - If the worker terminated state employment within the past two years, contact the DEPIC for a ruling.
- Apply the Common Law Test.
 - Look at the entire relationship and the length of the relationship.
 - Consider the degree or extent of the right to direct and control.
 - Consider written agreements and how important the services to operations.
- Document each of the factors used in making determination.
- Is the work being contracted substantially different from the work performed as an employee of the state?
- Complete Form SS-8, if classification is still unclear.

G. Additional Considerations:

The following questions can help agencies determine if an individual is an employee or a contractor:

1. What services are performed?
2. Are these services essential to the agency?
3. Is there a written contract between the worker and the agency?
4. Is there a written contract between the worker and the State?
5. Who directs and controls the details of how the work is to be performed?
6. Does the worker have a current business license?

H. Supporting Documents:

May 15, 2008, PHRST Memorandum #08-02 *Worker Classification Compliance – Employee vs. Contractor, 1099 Misc Issued for Tax Year 2007*

The Delaware Public Integrity Commission:

- 410 Federal Street, Suite 3, Dover, DE 19901, 302-739-2399
- www.deplic.delaware.gov
- Ethics Bulletin 007, Post Employment
- Ethics Brochure, Promoting Ethics in Delaware

American Payroll Association – *Payroll Source* (Sec. 1: The Employer-Employee Relationship)

IRS Pub 15-A, *Employer’s Supplemental Tax Guide* (www.irs.gov)

State of Delaware, Office of the Budget, *Budget and Accounting Policy* (<http://budget.delaware.gov/accounting-manual>)

6.5.3 Insurance

The Insurance Coverage Office of OMB, has the centralized responsibility for the operation of the State Insurance Coverage Program. **No other agency is authorized to place any insurance.** This approval is required for all insurance-related requisitions, purchase orders, and direct claim transactions. This approval is not needed for insurance payments for Higher Education and DOE, if State General Fund monies are not expended.

Exhibit A

The IRS 20 Factor Test:

Workers are generally employees if they:

1. Must comply with the employer's instructions about when, where, and how to work.
2. Receive training from or at the direction of the employer. This may include having to work along with an experienced employee or having to attend meetings.
3. Provide services that are integrated into the business. That is, the success or continuation of the employer's business depends significantly on the performance of certain services which the worker provides.
4. Perform the work personally.
5. Hire, supervise, and pay assistants for the employer.
6. Have a continuing relationship with the employer. This may exist where work is performed at frequently recurring, although irregular, intervals.
7. Must follow set hours of work.
8. Work full-time for the employer.
9. Do their work in a sequence set by the employer.
10. Must do their work in a sequence set by the employer.
11. Must submit regular oral or written reports to the employer.
12. Receive payments of regular amounts at set intervals.
13. Receive payment for business and/or traveling expenses.
14. Rely on the employer to furnish tools and materials.
15. Lack a significant investment in facilities used to perform the service.
16. Cannot make a profit or suffer a loss from their services.
17. Work for one employer at a time.
18. Do not offer their services to the general public.
19. Can be fired by the employer.
20. May quit work at any time without liability.