

# WHO IS AN EMPLOYEE?

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*This fact sheet was designed to provide awareness of social security coverage and reporting responsibilities for Kentucky state and local government employers. This fact sheet should not be cited or used as authority with respect to federal employment taxes. The Internal Revenue Code and the Social Security Act, along with the associated regulations, rulings and case law, are the only valid citations of authority.*

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## Who is a Governmental Employee?

The Kentucky Division of Social Security is authorized under KRS 61.410-61.500 to administer the federal social security program in the Commonwealth for the benefit of state agencies and political subdivisions within Kentucky. The DOSS is, in short, responsible for ensuring that the social security withholding and reporting obligations of the Commonwealth and its political subdivisions are met.

The definition of a state or local governmental employee, for social security and medicare purposes, can be found in the following:

1 Under the Social Security Act, the term employee includes:

- Section 218(b)(3) - An officer of a State or a political subdivision.
- Section 210(j)(2) - An individual who, under the usual common-law rules applicable in determining an employer-employee relationship, has the status of an employee.

2 Section 3121 of the Internal Revenue Code defines an employee as:

- 3121(d)(2) - Any individual who, under the usual common law rule applicable in determining the employer-employee relationship, has the status of an employee.
- 3121(d)(4) - Any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

3 The Kentucky Revised Statutes says an employee is:

- KRS 61.420(3) - Any person in the service of the Commonwealth, a political subdivision or an interstate instrumentality of which the Commonwealth is a principal and shall include all persons designated officers, including those which are elected and those which are appointed.

### Elected and Appointed Officials

The Social Security Administration and the Internal Revenue Service consider elected and appointed officials to be employees of their governmental employer. Some examples include, but are not limited to the following:

- Appointed members of state boards, commissions and authorities.
- Elected and appointed state officials.
- Elected and appointed city and county officials.
- Elected members of local boards of education.
- Elected supervisors of conservation districts.
- Appointed members of local boards, commissions, districts and authorities.

## EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

To determine whether an individual is an employee or an independent contractor under the common law, the relationship between the worker and the agency must be examined. All evidence of control and independence must be considered. In any employee-independent contractor determination, all information that provides insight to the degree of control and the to the degree of independence must be considered.

The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. These facts fall into three main categories.

- Behavioral Control
- Financial Control
- Relationship of the Parties

## **Behavioral Control**

Included under this category are facts that show whether the government entity has a right to direct and control how the worker performs the specific task for which the worker is hired. This includes evaluation of the following issues.

### **Instructions**

An employee is generally subject to the government entity's instructions about when, where and how to work. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved.

Virtually every government entity will impose on workers, whether independent contractors or employees, some form of instruction (for example, requiring that the job be performed within specified time frames). This fact alone is not sufficient evidence to determine the worker's status.

As with every relevant fact, the goal is to determine whether the government entity has retained the right to control the details of a worker's performance or, instead, has given up its right to control these details. Accordingly, the weight of "instructions" in any case depends on the degree to which instructions apply to how the job gets done rather than to the end result.

Instructions about how to do the work may cover a wide range of topics, for example:

- when to do the work
- where to do the work
- what tools or equipment to use
- what workers to hire to assist with the work
- where to purchase supplies or services
- what work must be performed by a specified individual (including ability to hire assistants)
- what routines or patterns must be used
- what order or sequence to follow

The requirement that a worker obtain prior approval before taking certain actions is an example of instructions.

### **Degree of Instruction**

The degree of instruction depends on the scope of instructions, the extent to which the government entity retains the right to control the worker's compliance with the instructions and the effect on the worker in the event of noncompliance. All these provide useful clues for identifying whether the government entity keeps control over the manner and means of work performance (leaning toward employee status), or only over a particular product or service (leaning toward independent contractor status).

The more detailed the instructions are that the worker is required to follow, the more control the government entity exercises over the worker, and the more likely the government entity retains the right to control the methods by which the worker performs the work. Absence of detail in instructions reflects less control.

### **Presence of Instructions or Mandated Rules**

Although the presence and extent of instructions is important in reaching a conclusion as to whether a government entity retains the right to direct and control the methods by which a worker performs job, it is also important to consider the weight to be given those instructions if they are imposed by the government entity only in compliance with governmental or governing body regulations. If a government entity requires

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its workers to comply with rules established by a third party (for example, municipal building codes related to construction), the fact that such rules are imposed by the government entity should be given little weight in determining the worker's status. If, however, the government entity develops more stringent guidelines for a worker in addition to those imposed by a third party, more weight should be given to these instructions in determining whether the government entity has retained the right to control the worker.

### **Suggestions v. Instructions**

A suggestion does not constitute the right to direct and control. If compliance with the suggestions are mandatory, then the suggestions are, in fact, instructions.

### **Unique Identification**

In the past, a requirement that a worker wear a uniform or put a logo on a vehicle had typically been viewed as consistent with employee status.

If the nature of the worker's occupation is such that the worker must be identified with the government entity for security purposes, wearing a uniform or placing the government entity's name on a vehicle is a neutral fact in analyzing whether an employment relationship exists.

### **Nature of Occupation**

The nature of the worker's occupation also affects the degree of direction and control necessary to determine worker status. Highly trained professionals such as doctors, accountants, lawyers, engineers or computer specialists may require very little, if any, training and/or instruction on how to perform their services. In fact, it may be impossible for the government entity to instruct the worker on how to perform the services because it may lack the essential knowledge and skills to do so.

In analyzing the status of professional workers, evidence of control or autonomy with respect to the financial details of how the task is performed tends to be especially important, as does evidence concerning the relationship of the parties.

### **Nature of Work For Instructions**

The absence of need to control should not be confused with the absence of right to control. The right to control as an incident of employment requires only such supervision as the nature of the work requires. The key fact to consider is whether the government entity retains the right to direct and control the worker, regardless of whether the government entity actually exercises that right.

### **Evaluation Systems**

Evaluation systems, like instructions, are used by virtually all government entities to monitor the quality of work performed by workers, whether independent contractors or employees. Thus, in analyzing whether a government entity's evaluation system provides evidence of the right to control work performance or the absence of such a right, you should consider how the evaluation system may influence the worker's behavior in performing the details of the job.

If an evaluation system measures compliance with performance standards concerning the details of how the work is to be performed, the system and its enforcement are evidence of control over the worker's behavior. The lack of a formal evaluation system is, however, a neutral factor.

### Training

An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

### Detailed Methods and Procedures

Training is a classic means of explaining detailed methods and procedures to be used in performing a task. Periodic or ongoing training provided by a government entity about procedures to be followed and methods to be used indicates that the government entity wants the services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship.

Not all training, however, rises to a level signifying an employer-employee relationship. The following types of training, which might be provided to either independent contractors or employees, should be disregarded:

- orientation or information sessions about a government entity's policies, or applicable statutes or government regulations, and
- programs that are voluntary and are attended by a worker without compensation.

### Financial Control

This category includes facts which illustrate whether there is a right to direct or control how the business aspects of the worker's activities are conducted. It also includes facts pertaining to whether there is a significant investment, unreimbursed expenses, services available to the market, and opportunity for profit/loss. The method of payment must also be considered.

- Independent contractors are more likely to have unreimbursed expenses than employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. Employees, however, may also incur unreimbursed expenses in connection with services they perform for the government entity.
- An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. A significant investment is not required for independent contractor status, however.
- An independent contractor is generally free to seek out business opportunities. As a result, independent contractors often advertise, maintain a visible business location and are available to work in the relevant market.
- An employee is generally guaranteed a regular wage amount for an hourly, weekly or other period of time. An independent contractor is usually paid a flat fee for the job. In some professions, however, such as law, it is not unusual to pay an independent contractor hourly.
- The ability to realize a profit or loss is probably the strongest evidence that a worker controls the aspects of services rendered. An employee usually cannot make a profit or incur a loss.

### Relationship of the Parties

Courts often look at the intent of the parties. This is most often embodied in a contract. Thus, a written agreement describing the worker as an independent contractor is viewed as evidence of the parties' intent

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that a worker is an independent contractor.

A contractual designation, in and of itself, is not sufficient evidence for determining worker status. The facts and circumstances under which a worker performs services are determinative of workers' status. The IRC provides that the designation or description of the parties is immaterial. The substance of the relationship, not the label, governs the worker status. The contract may, however, be relevant in ascertaining methods of compensation, expenses that will be incurred, and the rights and obligations of each party with respect to how work is to be performed.

In addition, if it is difficult, if not impossible, to decide whether a worker is an independent contractor or an employee, the intent of the parties, as reflected in the contractual designation, is an effective way to resolve the issue. The contractual designation, is very significant in close cases.

The following items may reflect the intent of the parties:

### **Corporation Providing Services**

A worker may provide services to a government entity through the worker's own closely held or professional corporation. Provided that corporate formalities are properly followed and at least one non-tax business purpose exists, the corporate form is generally recognized for both state law and federal law, including federal tax purposes. Thus, the worker will usually not be treated as an employee of the government entity but as an employee of the corporation.

### **Employee Benefits**

Providing the worker with employee benefits traditionally associated with employee status has been an important fact in several court decisions. If a worker receives employee benefits, such as paid vacation days, paid sick days, insurance or a pension, this constitutes some evidence of employee status.

### **Other Governmental Characterizations**

State laws, or determinations of state or federal agencies, may characterize a worker as an employee for purposes of various benefits. For the purpose of determining worker classification with respect to federal employment tax liability and withholding requirements, characterizations based on these laws or determinations should be weighed with caution and in some cases disregarded, because the laws or regulations involved may use different definitions of employee or be interpreted to achieve particular policy objectives.

### **Discharge or Termination**

The circumstances under which a government entity or a worker can terminate their relationship have traditionally been considered useful evidence bearing on the status the parties intended the worker to have. Some court decisions continue to explore such evidence. In order to determine whether the facts are relevant to the worker's status, however, the impact of modern business practices and legal standards governing worker termination need to be considered.

Under a traditional analysis, a government entity's ability to terminate the work relationship at will, without penalty, provided a highly effective method to control the details of how work was performed and, therefore, tended to indicate employee status. Conversely, in the traditional independent contractor relationship, the government entity could terminate the relationship only if the worker failed to provide the intended product or service, thus indicating the parties' intent that the government entity not have the right to control how the

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work was performed.

In practice, however, the government entity rarely has complete flexibility in discharging an employee. The reasons for which a government entity can terminate an employee may be limited; by law, by contract, or by its own practices. As a result, inability to freely discharge a worker, by itself, no longer constitutes persuasive evidence that the worker is an independent contractor.

### **Permanency**

The existence of a permanent relationship between the worker and service recipient is considered relevant evidence in determining whether there is an employer-employee relationship. If a worker is engaged with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence of their intent to create an employment relationship.

A long-term relationship may exist between a government entity and either an independent contractor or an employee. It may exist because the contract may be a long-term contract or contracts may be renewed regularly due to superior service, competitive costs or lack of alternative service providers.

### **Services Integral to the Entity**

If a worker provides services that are a key aspect of the government entity's regular business activity or integral to the entity's mission, it is usually more likely the entity has the right to direct and control the worker's activities.

## **Weighing the Facts and Determining Worker Status**

In exploring the relevant facts, it is probable that some will support independent contractor status and others will support employee status. This is because independent contractors are rarely totally unconstrained in the performance of their contracts. Also, employees almost always have some degree of autonomy. The facts need to be weighed as a whole in order to determine whether control or autonomy predominates.

There will occasionally be a contract that does not obviously place the worker in either the employee or contractor category. Form SS-8 (available from the DOSS web site or the Social Security Administration) should be used to determine the status of such "gray area" contracts.

Local government entities should complete a Form SS-8 and submit it, along with a copy of the contract to the Internal Revenue Service. The IRS will then send a Form SS-8 to the worker to be completed. Upon review of both Forms SS-8, the IRS will reach a determination as to the status of the worker.

State government agencies should complete a Form SS-8 and, also, have the worker complete a Form SS-8. Both completed forms should then be forwarded to the Division of Social Security which will, in turn, work with the IRS in reaching a determination.