WHO IS A STATE GOVERNMENT EMPLOYEE?

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This fact sheet was designed to provide awareness of social security coverage and reporting responsibilities for Kentucky state 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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The Kentucky Division of Social Security (DOSS) 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 responsible for ensuring that the social security withholding and reporting obligations of the Commonwealth are met.

All personal service contracts with individuals (not companies or corporations) must be routed through the DOSS. This ensures that DOSS has an opportunity to review the employment relationship and the FICA withholding status of these contracts with individuals.

State agencies, boards and commissions must be consistent in the treatment of withholding and reporting of FICA from remuneration paid via personal services contracts. The Internal Revenue Service requires federal employment tax withholding and reporting on any worker considered an “employee,” no matter if remuneration is provided via a contract, master agreement, petty cash or a standard payroll system.

Whether an individual is an “employee” is based on the degree of control that the agency may have the right to exercise over the contract holder. This is not an optional program. Individuals performing service in an employment relationship with an agency do not have a choice of being treated not as an employee and, therefore not paying FICA taxes.

In order to assist agencies in ensuring the proper FICA taxes are being paid on applicable personal services contracts, all personal services contracts with individuals are routed through the on-line Procurement Desktop system to DOSS for that division’s review. Specifically, all personal service contracts with an individual must be routed in PD to James Driver (FINSS7) who will, in turn, route them to Darla Hoagland in the Finance and Administration Cabinet.

EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

To determine whether an individual is an employee on an independent contractor under the common law, the relationship between the worker and the state 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 Internal Revenue Service (IRS) considers 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 agency has a right to direct and control how the worker performs the specific task for which the worker is hired. 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 agency retains the right to direct and control the worker, regardless of whether the agency actually exercises that right.
**Instructions**

An employee is generally subject to the agency’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 agency 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 agency 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.

The following are examples of types of instructions about how to do work that may indicate an individual is an employee. For example, does the agency tell the worker:

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or 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.
- When to obtain prior approval before taking certain actions.

**Training**

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

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

For example, a state statute requires that animal control officers receive state-sponsored training. Or, a statute requires that inspectors of sanitary facilities are trained and state certified. These facts are indicative of a right to control.

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 agency’s policies, or applicable statutes or government regulations, and
- Programs that are voluntary and are attended by a worker without compensation.
Government Identification

Government workers may be required to identify themselves by wearing a uniform, driving a marked vehicle, etc. When an individual represents himself or herself as an agent of a government, that gives the individual an appearance of authority. Wearing a uniform, displaying government identification for the purpose of representing the agency, or using forms and stationary that indicate one is representing a government are highly indicative of employee status. A government is legally responsible for the acts and omissions of its employees. It is not responsible for the acts of independent contractors.

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 agency to instruct the worker on how to perform the services because it may lack the essential knowledge and skills to do so.

Attorneys, doctors and other professionals can be employees, however. In such cases, the agency may not train the individuals or tell them how to practice their professions, but may retain other kinds of control, such as requiring work to be done at government offices. The agency can still control scheduling, holidays, vacations and other conditions of employment. Consult state statutes to determine whether a professional position is statutorily created.

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. It is an indication of control by the agency if the worker is required to perform the services personally. For example, is an attorney required to do the work personally or may it be completed by a law firm associate?

Evaluation Systems

Evaluation systems 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 an agency’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 might 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.

Financial Control

This category includes facts that illustrate whether there is a right to direct or control how the business aspects of the worker’s activities are conducted.

Profit or Loss

Employees do not have the risk of incurring a loss in the course of their work, since employees receive a salary as long as they work. An independent contractor has a genuine possibility of profit or loss. 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.
Facts showing possibility of profit or loss include:

- Significant investment in equipment, tools or facilities. (An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else).
- Un-reimbursed expenses, including the requirement of providing materials or hiring helpers. (Independent contractors are more likely to have un-reimbursed expenses than employees. Especially important are fixed ongoing costs that are incurred regardless of whether the work is currently being performed).
- Working by the day or by the job rather than on a continuous basis.
- Having fixed costs that must be paid regardless of whether the individual works.
- Payment based on contract price, regardless of what it costs to accomplish the job. (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).

**Method of Payment**

The method of payment must be considered. An individual who is paid a contract price, regardless of what it costs to accomplish the job, has a genuine possibility of profit or loss. An individual who is paid by the hour, week, or month is typically an employee.

**Offering Services to the Public**

Another factor favoring independent contractor status is whether the individual makes his or her services available to the public or a relevant segment of the market. An independent contractor is generally free to seek out additional business opportunities. Factors to consider:

- Does the individual advertise?
- Does the individual use a private business logo?
- Does the individual maintain a visible workplace?
- Does the individual work for more than one agency?

**Corporate Form of Business**

A worker may provide services to an agency 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 agency but as an employee of the corporation.

**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 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:

**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, workers compensation or a pension plan, this constitutes some evidence of employee status. The evidence is strongest if the worker is provided with benefits under an agency’s workers compensation program or tax qualified retirement plan.

**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 an agency 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 agency’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 agency could terminate the relationship only if the worker failed to provide the intended product or service, thus indicating the parties’ intent that the agency not have the right to control how the work was performed.

In practice, however, the agency rarely has complete flexibility in discharging an employee. The reasons for which an agency 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 the agency 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.
Services Integral to the Agency

If a worker provides services that are a key aspect of the agency’s regular business activity or integral to the agency’s mission, it is usually more likely the agency has the right to direct and control the worker’s activities. For example, does the worker supervise or control the work of other employees of the agency? If so, this is an indication that the worker is an employee.

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 should be used to determine the status of such “gray area” contracts. Form SS-8 is available from the IRS web site at www.irs.gov/formspubs/ or by calling 1.800.829.3676.

What if the individual is an employee?

If you determine that the individual is an employee for purposes of Social Security, then your next step is to work with your payroll officer and initiate payment through the UPPS system.

Examples

A state agency contracts with an individual as a part-time hearing officer pursuant to a written contract. The worker receives an hourly wage for actual hours worked and also receives travel reimbursement. The agency provides the necessary equipment and supplies. The hearings are conducted in the agency’s facilities. The worker is required to provide the services personally and acts in the agency’s name. The IRS concludes the worker is an employee for FICA purposes because the function of hearing officer is an integral part of the agency’s business and the agency has the sufficient right to exercise control over the manner the worker performs service.

A medical professional is contracted to work on site in a state institution because the institution’s patients can not be transported to an off site medical facility. The agency provides facilities and equipment. The agency does not retain the right to stipulate the exact manner of patient treatment, does not instruct how to treat the patient nor prescribe specific therapies. The professional pays business expenses, maintains a medical practice outside the institution and is not required to perform the services personally. The agency is only exclusively interested in the end result of the medical treatment—the overall medical health and well being of the patient. The worker is considered an independent contractor for FICA purposes.

A state agency contracts with a medical professional to provide medical consultation for the purposes of preparing an assessment of impairment pursuant to certain federal statutes. The professional must perform the services personally at the agency’s office, is subject to quality reviews by agency, receives training from the agency, must provide a summary describing medical findings for each assigned case and acts in the agency’s name. The agency maintains a journal of assigned cases, reimburses travel expenses, provides office equipment and compensates for CEU hours. The professional is considered an employee for FICA purposes.