

Independent Contractor (IC) Status Determination and Documentation (ICSDD)
Guidelines for Completion of ICSDD Form

Introduction

Michigan State University must comply with Internal Revenue Service (IRS) regulations in our role as an employer. Failure to do so can result in assessments of taxes, penalties and interest in addition to possible criminal prosecution. One University responsibility in this regard is the accurate categorization of workers as either employees or as IC's, with the corresponding tax withholding and reporting functions inherent in each category of worker. Categorizing a worker as an IC exposes the University to the greatest amount of risk in this regard, since the IRS assumes that all workers are employees unless it can be documented otherwise.

Since relationships with IC's typically have their origin at the departmental level, it is essential that departmental staff have an awareness of factors that justify a worker being categorized as an IC. It is critical that departmental staff make good faith efforts to scrutinize relationships with contractors to determine the true nature of the relationship with the worker. Lastly, if worker categorization as IC is justified, it is necessary that the departmental staff accurately document the factors that establish this justification.

Section 76 of the Manual of Business Procedures, the ICSDD form and the following guidelines are provided for your use in determining, justifying and documenting worker status as an IC. In order to be classified as an IC, our relationship with a worker must fully satisfy one of the following two categories:

- **Category I: Incorporated Status**
- **Category II: Essential Relationships With Worker Justifying Contractor Status**

If the conditions of our relationship with a worker do not fully satisfy at least one of these two categories, the worker should be categorized and paid as a University employee. Generally, questionable cases should be categorized conservatively as employees - this is the path the IRS would follow if they audit the specific worker relationship. It is also important that departmental staff be aware that should an IRS audit determine that the University has misclassified workers as contractors when they should have been employees, an audit penalty may be assessed against the University. Accounts Payable (3-2011) staff are available to counsel you in your determination of the proper worker categorization.

A fully completed ICSDD form, a *Professional Personal Services Contract With Independent Contractor (PSC)* form, and a vendor invoice should be sufficient to document worker classification as an IC and protect your department from incurring audit penalties.

Category I: Incorporated Status

If the worker is incorporated (e.g. incorporated, inc., corporation, corp., limited, ltd., PC), contractor status is presumed. If you have documented incorporated status for your contractor (either on the ICSDD form or in the appropriate space of the PSC), you need not complete Category II. If you have completed and attached a PSC and documented "incorporated" status on that document, you need not complete and forward the ICSDD form. If not, you may simply sign the ICSDD form as provided on the back of the form and include it with the direct payment voucher you submit for payment.

Category II: Essential Relationships With Worker Justifying Contractor Status

These factors are essential to holding the status of an IC and are based on the common law rules. All factors (A. through G.) of this category must be satisfied in order for the worker to be categorized as an IC. Failure of any one of the factors will generally require that the worker be categorized as an employee and paid through the payroll system. If the worker fails this, and in the department's judgment other factors may still support contractor status, forward documentation of this to Accounts Payable for consideration BEFORE engaging the worker as an IC.

- A. *The University does not control, nor does it have the right to control the details of how or when the work is done. The University only stipulates the end result contracted for with the worker.*

This factor is at the core of having the status of an IC. An IC provides independent judgment and expertise to provide a service as agreed to in a contract. Typically, rendering that service is done when the contractor sees fit, in the order and manner deemed most appropriate by the contractor to accomplish the end result desired. While the University may specify general timing or delivery requirements, the details of how to perform are left to the worker. The University has no legal right to dictate these issues.

In contrast, many employees are permitted a great deal of latitude in the manner in which they perform their jobs for their employer. Despite such employee discretion, the employer has an absolute legal right to tell the worker specifically how the worker must render the required service.

- B. *The worker offers similar services to the public.*

This factor is important because it supports the fact that the worker is indeed independent. Lack of independence is indicated if the worker is engaged elsewhere as an employee and is only offering service to the University on a one-time basis. The IRS has the capability of isolating "contractors" who in fact have only one client. Engaging a worker under these circumstances may raise questions about worker classification as an IC.

Offering services to the public is generally done in a public forum such as classified advertisements, business cards, or yellow pages listings. This establishes the potential for the worker to have his or her services in demand by more than one client at any given time. Conversely, an employee is typically in demand only by the employer, and does not advertise publicly to render the same service at competing times or prices to those agreed upon with the employer. An employer has the exclusive claim on the time of an employee. An IC is free to offer service to anyone they choose.

The ICSD form provides spaces for three client references of the proposed contractor for whom the contractor has performed work as an IC during the preceding twelve months. It is important to obtain client references to validate the existence of a public domain presence by the contractor in offering and delivering service. This contributes to documenting contractor status.

One problematic area is the engagement of recent graduates as IC's. Often these individuals have no history of providing service as a contractor and have no client list to offer. Admittedly, every contractor must start somewhere with a "first" client, so our engaging them as their first client is not out of the question. Graduates of Michigan State University will face the greatest obstacles to qualification as contractors since we have trained them and (for many) have employed them as graduate assistants or student employees in an area related to that for which we now seek them as contractors. In this regard, by policy, a University graduate may not be engaged as a contractor by the department in which they earn their degree within the first three months following graduation. The worker may certainly be hired as an employee.

- C. *The worker is not a University employee, nor has the worker been a University employee within the last three months just preceding the start of this contractual relationship. If the worker is doing business under a business name, none of the principals of the company are University employees.*

Concurrent status as an employee and as a contractor calls into question the legitimacy of a worker's classification as a contractor. This is based on the IRS view and case law findings that a worker generally cannot hold both statuses with the same employer. If this situation arises, the

burden of proof increases on the employer to document the extent and viability of the worker's public enterprise. Issues of particular importance include the numbers of public clients; frequency and dates of contracts with public clients; nature, time, and location of work performed for the University as a "contractor" as compared with that performed as an employee; and ownership of tools used to perform the work done for the University and for the public clients. Engaging a worker simultaneously as both employee and as an IC will result in the University issuing to the worker both an IRS Form W2 and a Form 1099MISC. This will highlight a potential problem area for the IRS.

The fact that a worker is not now a University employee, but has been just preceding the start of their relationship as a contractor similarly compromises their contractor status vis-à-vis the University. This is due to the tendency of such contractor relationships to be, in effect, merely extensions of the relationship previously held as an employee.

The fact that a current employee (or one of recent employ) of the University offers services to the University either as a contractor using a business name, or as a principal of a business entity does not abate concern about dual status (worker and contractor).

- D. *Neither the University nor the worker have the right to terminate the relationship without violating contractual obligations and incurring the risk of consequent penalty.*

An IC commits to delivering a specific service. Similarly, the University engages a contractor to perform that service. Neither the contractor nor the University can unilaterally terminate the relationship before the contract to perform (and pay) is satisfied. Certain contractual provisions providing for length of notice and compensation for partial completion (or the costs incurred to that point) do not invalidate this limitation on unilateral termination.

On the contrary, an employee has the right to terminate the relationship with the University at any time without notice. Similarly (except where limited by union contracts or other employment guidelines), the University typically has the right to terminate the relationship with the employee at any time.

- E. *By fulfilling the contract, the worker has the opportunity for either a financial profit or a loss.*

If an IC is able to deliver a service to the satisfaction of the University while consuming fewer supplies, in less time than originally estimated to be required to complete the service, the contractor may realize a profit. If, however, more of the worker's supplies were consumed, or it took more time to deliver the service contracted for by the University, or the worker's equipment wore out more than expected in performing the service, the contractor may realize a financial loss.

On the contrary, an employee is generally guaranteed to be paid hour-for-hour for effort expended in providing service to the employer. Also, since necessary tools are generally provided by the employer, the employee is shielded from realizing a financial loss in delivering the service.

- F. *The work performed by the worker is not integral to the functioning of the University.*

The University is a large, diverse enterprise. Nearly any service could be (and probably is) provided by a University employee somewhere on the campus or at one of our many off-campus locations. The specific character of work that is "integral to the functioning of the University" therefore cannot be precisely defined. The general character of a non-integral service might best be generalized as being either limited in scope (either serving as an input to or as an output from University function); or so massive in scope as to cross departmental or function boundaries.

Functions which are integral to the operations of the University would include instruction, research and public service efforts, and administrative support activities which accompany those core functions.

- An individual engaged to teach a class (either credit or non-credit) typically is an employee. An individual engaged to lecture during one class session could qualify as a contractor.
- An individual engaged to conduct research in parallel to our own faculty would be an employee while a worker developing a survey document for use by a University PI in fulfilling a grant requirement could qualify as a contractor.
- An individual engaged to visit people in their homes to explain good nutrition principles would be an employee, while someone engaged to compile a mailing list of 1,000 individuals in a target area for nutrition counseling to be used by our extension staff could qualify as a contractor.
- Individuals engaged to type departmental correspondence or exams for courses, or perform departmental bookkeeping would be employees. Persons training all University staff in the use of a campus-wide word processing software package using non-University training materials could be contractors.

G. *The relationship between the University and the worker is limited in duration (back-to-back, recurring contracts could be considered to be a continuing relationship rather than separate, finite relationships).*

Limitation of the duration of the relationship reinforces the attributes of:

- the worker offering the service to the public;
- the restrictions on termination;
- lacking the character of being integral to the functioning of the University.