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Overview

The University is required by the Internal Revenue Service, and the State of California, to properly classify individuals providing services as either employees or independent contractors. This document provides guidance on the independent contractor classification process. Independent contractors are individuals who render a service and meet contractor conditions as established by the taxing authorities. An independent contractor is an individual or non-corporate business entity such as a sole proprietorship, partnership or limited liability company (four employees or less) that has established a name that it uses to carry on business. The University has a process in place that adheres to the criteria set forth by the taxing authorities when classifying these individuals as either employees or independent contractors.

The improper classification of an individual can have significant negative consequences for the University. For example, if the individual is incorrectly classified as an independent contractor, the University may be subject to fines and penalties by the taxing authorities. Further, the taxing authorities may require the University to pay for the employer's share of payroll taxes. If the individual is incorrectly classified as an employee of the University, the University may incur additional, unnecessary expenses such as employer payroll taxes. Additionally, the University may be subject to liability that it could have been avoided under the independent contractor agreement.

It should be noted that for tax purposes, payments to U.S. Citizens and nonresident aliens are treated differently, so it is important to determine the residency status of an individual at the beginning of the hiring process. The University's Office of Tax & Compliance (Tax Office) **must** be consulted in advance of a department hiring a nonresident alien in the capacity of an independent contractor.

Department Responsibilities

The hiring department is required to complete the Independent Contractor Evaluation form and return it to the Tax Office prior to the department engaging in business with the individual. The department should send the completed form to Tax & Compliance by e-mail at compliance@sandiego.edu. The Tax Office will make a determination of status between employee or independent contractor. Once a decision has been made, the Tax Office will notify the department via e-mail. **The approval of independent contractor status must be received by the hiring department before signing any contract or commencing work.**

If the individual is determined to be an independent contractor, the department should proceed in preparing an Independent Contractor Agreement. Contact the Office of the General Counsel for an Independent Contractor Agreement. A copy of the Independent Contractor Evaluation form should be attached to the Independent Contractor Agreement and forwarded to Procurement, along with all necessary documents for vendor setup. Contact Procurement for additional vendor setup documents. Procurement will keep the documents on file to demonstrate that USD performed its due diligence to determine the proper classification of the service provider. If the service provider is determined to be an employee of USD, the department should contact Human Resources and inform them of the intent to hire the individual as an employee. The department should forward a copy of the Independent Contractor Evaluation form to HR to be maintained in the employee's file to demonstrate that USD performed its due diligence in determining the proper classification of the individual.

Independent Contractor Evaluation Form

An Independent Contractor Evaluation form has been developed to gather factual information about the work and the individual. An Independent Contractor Evaluation form is required for any independent contractor providing services to the University for a cost of \$5,000 or more for the calendar year. NOTE: See below, *Services Exempt from Independent Contractor Review*. The form is used in evaluating whether an individual should be classified as an employee or an independent contractor and is required for obtaining approval of independent contractor status.

The Independent Contractor Evaluation form is available on the Procurement Services website
(<http://www.sandiego.edu/procurement/forms/index.php>)

Who is an Employee?

An individual who performs services for the University where the University has the right to control and direct the individual who performs the services, not only as to the result to be accomplished, but also as to the details and means by which that result is to be accomplished. It is not necessary that the University actually directs or controls the manner in which the services are performed; it is sufficient to establish an employee-employer relationship that the University has the right to do so.

Who is an Independent Contractor?

An independent contractor is an individual who performs services for the University in which the contractor exercises complete control and direction over how the work is completed. This control refers not only to the result to be accomplished by the work but also the means and details by which that result is accomplished. These individuals are customarily engaged in an independently established business and do not carry ongoing relationships with the University. By law, individuals who are paid as independent contractors are responsible for reporting all additional income earned and for paying the appropriate federal and state taxes, as well as the self-employment tax.

The state taxing authorities also require that additional conditions must be satisfied for an individual to qualify as an independent contractor. These conditions include but are not limited to services that are offered by the individual. In particular, the work must be outside of the usual course of business for the department hiring the individual and the work cannot be integrated into the hiring department's operation. Also, if an existing occupation is held by an employee of the University, then the individual performing a similar occupational service should be paid through payroll and not as an independent contractor. Therefore, individuals should not be hired as independent contractors to perform services that are similar to services performed by paid employees of the University.

How is an individual classified as an employee or independent contractor?

There are three major areas the taxing authorities use to define an individual. They are: (1) control of work; (2) financial control, and; (3) the relationship between the University and the individual. As indicated above, the most important consideration in determining whether an employer-employee relationship exists with an individual is whether the University has the right to instruct and control the individual with respect to both the results and the details of the work that is to be performed. The taxing authorities have developed criteria that are used by the University to determine whether sufficient control and supervision exist to warrant an employee classification of an individual. However, there are other factors that have been established by the taxing authorities that must be taken into consideration before a determination can be made.

The financial area includes indicators that show how the individual is paid and to what extent they risk suffering a loss or the potential to realize a profit. In addition, the individual should be able to show they represent themselves as an independent contractor. In most cases, reimbursement of expenses by the University to the individual suggests an employer-employee relationship.

The relationship of both parties is the third area that is considered when making a determination. Although a contract indicates the intention of the relationship between the individual and the University, it is not definitive with regards to the actual relationship. An ongoing relationship usually indicates an employer-employee relationship.

The taxing authorities classify individuals as employees if they must comply with the employer's instructions about their work, receive training or direction from the employer, provide services that integrate into the employer's business, render their services personally (cannot subcontract), have a continuing working relationship with the employer, follow set hours of work, work full-time for the employer, perform the work at the employer's site, regularly report to the employer, are paid regularly (i.e., weekly),
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are paid for business expenses, use the employer's tools, materials, etc., lack a major investment in facilities used to perform services, cannot make a profit or suffer a loss from their services, work for one employer at a time, do not offer services to the public, can be fired, and may quit work at any time and not incur a liability. Thus, to qualify as an independent contractor, the opposite of all of these would have to be true. In making a determination, all the factors are reviewed and the entire relationship between the University and the individual is weighed.

Services Exempt from Independent Contractor Review

The following services are exempt from independent contractor review:

- One time job with payment less than \$5,000;
- Research study participants;
- Special events or entertainment/performances;
- Guest lecturers, guest speakers, or honorariums;
- Services being performed under an existing agreement and this is a no cost extension under the same terms;
- Services are being performed by an employee from an approved temporary agency;
- Translation;
- Close captioning;
- Copy editing;
- Graphic design;
- Film editing;
- Photographer; and
- Videographer.

The above exemptions do not apply to current and former University employees, current University students, and work performed in international locations. For work performed by nonresident aliens either in the U.S. or international locations, the Tax Office must be contacted to resolve any taxation issues prior to an agreement being signed. Further, the above exemptions do not preclude the hiring department from collecting the necessary information for vendor setup (Procurement) or payment (Accounts Payable)

Frequently Asked Questions

1. If an independent contractor is already setup as a vendor in Oracle but working for another department, will the hiring department need to complete the Independent Contractor Evaluation form again and another contractual agreement?

Yes, every time an independent contractor applies for work, the related independent contractor documents must be completed.

2. If an individual is already classified as an independent contractor, do they have to go through the independent contractor approval process each time they apply for a new contract?

Yes, the taxing authorities looks at each beginning and ending work period as a separate contract performed by an individual. They require full documentation for each separate contract. Caution: The taxing authorities will regard an ongoing working relationship with an individual as an employee and not an independent contractor even if the work is intermittent.

3. How does a continuing relationship affect services exempt from the independent contractor review process?

The University will monitor services exempt from independent contractor review to identify the frequency and total payments made.

4. What if I want to hire a former University employee as an independent contractor?

If an individual you wish to hire is a current University employee or a former employee (including retirees) and is providing a service that is somewhat related or similar to current or past work, the individual will be classified as an employee and not as an independent contractor by the Tax Office and paid through the payroll system. If the current University employee or former employee is providing a service that is significantly different than current or past work, the individual will be reviewed to see if they meet the qualifications for independent contractor certification.

5. Can I hire a faculty member or an employee as an independent contractor who works in another department?

Generally, USD faculty and employees may not be paid as independent contractors. An exception may be provided for faculty and employees who contract with a department other than their own to provide a service **substantially different** than the service provided as part of their ordinary responsibilities and who meet all legal criteria of an independent contractor. Ordinarily, in order to be paid as an independent contractor, the individual must be in the business of providing the contracted service to customers other than USD in addition to meeting all other taxing authority criteria.

6. Can I hire an individual to work as an independent contractor in an international location?

Yes, independent contractor engagements in international work locations are allowed. However, not all countries recognize independent contractors. Please note that the University is still developing guidance in this area. Contact the Office of Tax & Compliance, at 619-260-4197 or compliance@sandiego.edu, for further information.

7. If I want to hire an individual for a one time job and payment is less than \$5,000, do I need to go through the same independent contractor review process as I would for an amount above \$5,000?

No, the University does not review independent contractor engagements that are under \$5,000 for one-time occurrences. However, if the independent contractor has multiple engagements with the University, the individual may need to go through the independent contractor review process. Exclusion from independent contractor review is not a determination of independent contractor status. If an individual does not meet independent contractor criteria, the individual must be processed as an employee.

8. I have several independent contractors who work intermittently throughout the year. Can I create a contract that is based on the entire year for each of them in order to capture all work performed during that year?

No, contracts must be limited based on the time frame of the work to be completed. Any additional work must go through the independent contractor process.

9. Can a partnership or LLC bill for independent contractor work? If no, how do they bill and receive payment for services? Can payment be made to their company or to the individual?

Generally, a partnership or LLC that employs more than four individuals will be processed as a corporation not subject to the independent contractor evaluation process. A partnership or LLC that employs fewer than five individuals may be reviewed for independent contractor status and processed accordingly. All payments should be made to the individual, or business entity, listed on the Independent Contractor Evaluation form and corresponding agreement.

10. Why should I wait to receive the independent contractor status determination e-mail before asking the independent contractor to sign the Independent Contractor Agreement?

Approval must be received before completing and signing any contractual agreement. If the individual does not meet the taxing authority criteria for independent contractor status, then an agreement is not needed. The hiring department should instead contact Human Resources to obtain further instruction on how to hire the individual as an employee.

11. Can I hire a student as an independent contractor?

Generally, students should not be hired as independent contractors.

12. Can I hire an individual as an independent contractor for work on a grant or contract who has had prior involvement with the grant or contract while working as an employee at USD?

No, an individual that has worked as an employee performing similar work on the grant usually will not be allowed by the taxing authorities to work as an independent contractor. The individual should be permitted to continue on payroll until the work on the grant has been completed.

13. Who can I contact if I need assistance or I am not sure how to answer a question on the Independent Contractor short form?

You may contact the Office of Tax & Compliance, at 619-260-4197 or compliance@sandiego.edu, if you need assistance with any questions.