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DETERMINING STATUS AS AN EMPLOYEE REV. RULING 87-41

The Internal Revenue Service recently provided guidance for determining whether a technical service specialist is a common law employee, as opposed to an independent contractor, through Revenue Ruling 87-41.¹

The ruling provides guidance for purposes of the Social Security taxes (FICA contributions), federal unemployment taxes assessed under the Federal Unemployment Tax Act (FUTA), and income tax withholding by employers.² Further, the ruling is important as it also provides guidance for employers in determining an individual's status in relation to qualified retirement or health plans.³

The ruling itself presents three factual situations and twenty factors.⁴ The Service will take the twenty factors into account whenever it determines that an individual is a common law employee or an independent contractor. Also, the Service uses the twenty factors to determine whether the employer qualifies for employment tax relief under I.R.C. Section 530(d).⁵

Three substantially similar sections of the Federal Employment Tax Regulations⁶ provide that generally the relationship of employer and employee "exists when the person(s) for whom the services are performed have the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so."⁷

The twenty factors enumerated in the Rev. Ruling 87-41 are as follows.

1) **Instructions.** A worker who is required to comply with the instructions of others about when, where, and how he or she is to work is ordinarily an employee.⁸

2) **Training.** Training a worker by requiring an experienced employee to work with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person(s) for whom the services are performed

¹ Rev. Rul. 87-41, 1987-1 C.B. 296.

² The ruling provides guidance on the application of § 530(d) of the revenue act of 1978, as amended by 1706(a) of the Tax Reform Act of 1986.

³ Rev. Rul. 87-41, 1987-1 C.B. 296, 298.

⁴ The ruling analyzes each situation under the twenty listed factors and states its conclusions as to whether the worker is an employee of the firm. The ruling does not reach any conclusion concerning whether an employment relation exists for FUTA purposes because of § 530(d) of the rev act of 1978. Also, the designation which the parties attach to the relationship is immaterial. The identification of the relationship is based upon a facts and circumstances test.

⁵ Rev. Rul. 87-41, 1987-1 C.B. 296, 298.

⁶ See, 31.3121(d)-1(c)(2); 31-3306(i)-1(b); and 31.3401(c)-1(b).

⁷ Further, these sections provide that individuals who follow an independent trade, business, or profession in which they offer their services to the public, generally are not employees.

⁸ See, e.g., Rev. Rul. 68-598, 1968-2 C.B. 464, and Rev. Rul. 66-381, 1966-2 C.B. 449.

want the services performed in a particular manner or by use of a particular method and thereby indicate the requisite control to establish an employer-employee relationship.⁹

3) **Integration.** Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control.¹⁰

4) **Services Rendered Personally.** If the services must be rendered personally, presumably the person(s) for whom the services are performed are interested in the methods used to accomplish the work as well as in the results.¹¹

5) **Hiring, Supervising, and Paying Assistants.** If the person(s) for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job.¹²

6) **Continuing Relationship.** A continuing relationship between the worker and the employer indicates that an employer-employee relationship exists.¹³

7) **Set Hours of Work.** The establishment of set hours of work by the employer is a factor indicating control.¹⁴

8) **Full Time Required.** If the worker must devote substantially full time to the business of the person for whom the services are performed, such a person has control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses.¹⁵

9) **Doing Work on Employer's Premises.** If the work is performed on the employer's premises that factor suggests control over the worker, especially if the work could be done elsewhere.¹⁶

10) **Order or Sequence Set.** If a worker must perform services in the order or sequence set by the employer, that factor shows that the worker is not free to follow the worker's own pattern or work and indicates a degree of control.¹⁷

11) **Oral or Written Reports.** A requirement that the worker submit regular or written reports to the employer indicates a degree of control.¹⁸

12) **Payment by Hour, Week, Month.** Payment at these intervals usually points to an employer-employee relationship. Payment made by the job or on a

⁹ Rev. Rul. 70-630, 1970-2 C.B. 229.

¹⁰ *United States v. Silk*, 331 U.S. 704 (1947), 1947-2 C.B. 167.

¹¹ Rev. Rul. 55-695, 1955-2 C.B. 410.

¹² *Compare*, Rev. Rul. 63-115, 1963-1 C.B. 178, with Rev. Rul. 55-593, 1955-2 C.B. 610.

¹³ *See, e.g., Silk*, 331 U.S. at

¹⁴ Rev. Rul. 73-591, 1973-2 C.B. 337.

¹⁵ Rev. Rul. 56-694, 1956-2 C.B. 694.

¹⁶ Rev. Rul. 56-660, 1956-2 C.B. 693.

¹⁷ Rev. Rul. 56-694, 1956-2 C.B. 694.

¹⁸ Rev. Rul. 70-309, 1970-1 C.B. 199, and Rev. Rul. 68-248, 1968-1 C.B. 431.

straight commission generally indicates that the worker is an independent contractor.¹⁹

13) **Payment of Business and/or Traveling Expenses.** Payment of these expenses by the employer ordinarily indicates that the worker is an employee.²⁰

14) **Furnishing of Tools and Materials.** The furnishing of these items by the employer tends to show the existence of an employer-employee relationship.²¹

15) **Significant Investment.** If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by other employees of the employer, that factor tends to indicate that the worker is an independent contractor.²²

16) **Realization of Profit or Loss.** A worker who can realize a profit or suffer a loss as a result of the worker's services is generally an independent contractor, but the worker who cannot is an employee.²³

17) **Working for More Than One Firm at a Time.** If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor indicates that the worker is an independent contractor.²⁴

18) **Making Service Available to General Public.** The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.²⁵

19) **Right to Discharge.** This right is a factor indicating that the worker is an employee and the person possessing the right is an employer. An independent contractor, conversely, cannot be fired so long as he or she produces a result that meets the contract specifications.²⁶

20) **Right to Terminate.** If the worker has the right to end his or her employment at any time he or she wishes without incurring liability, an employer-employee relationship usually exists.²⁷

¹⁹ Rev. Rul. 74-389, 1974-2 C.B. 330.

²⁰ Rev. Rul. 55-144, 1955-1 C.B. 483.

²¹ Rev. Rul. 71-524, 1971-2 C.B. 346.

²² *Id.*

²³ Rev. Rul. 70-309, 1970-1 C.B. 199.

²⁴ Rev. Rul. 70-572, 1970-2 C.B. 221.

²⁵ Rev. Rul. 56-660, 1956-2 C.B. 693.

²⁶ Rev. Rul. 75-41, 1975-1 C.B. 323.

²⁷ Rev. Rul. 70-309, 1970-1 C.B. 199. This ruling considers the employment tax status of certain individuals who perform services as oil well pumpers for a corporations under contracts that characterize the individuals as independent contractors. Even though the pumpers perform their services away from the headquarters of the corporations and are not given day-to-day directions, the ruling concludes that the pumpers are employees of the corporation because the pumpers perform their services pursuant to an arrangement that gives the corporation the right to exercise whatever control is necessary to ensure proper performance of the services. Rev. Rul. 70-307, 1970-1 C.B. at _____. See also, Rev. Rul. 70-630, 1970-2 C.B. 229, which considers the employment tax status of salesclerks furnished by an employee service company to a retail store to perform temporary services for the store.

Section 530(a) of the 1978 Act, as amended by § 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, 536,²⁸ provides, for purposes of the employment taxes under subtitle C of the Code, that if a taxpayer did not treat an individual as an employee for any period, then the individual shall be deemed not to be an employee, unless the taxpayer had no reasonable basis for not treating the individual as an employee. For any period after December 31, 1978, this relief applies only if both of the following consistency rules are satisfied: (1) all federal tax returns required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee, and (2) the taxpayer has not treated any individual holding a substantially similar position as an employee for purposes of the employment taxes for periods beginning after December 31, 1977.²⁹

The determination under Rev. Rul. 87-41 requires an examination of all the facts and circumstances, including the activities and functions performed by the individuals.³⁰ Differences in the positions held by the respective individuals that result from the taxpayer's treatment of one individual as an employee and the other as "other than an employee" are to be disregarded in determining whether the individuals hold substantially similar positions.³¹

Section 1706(a) of the 1986 Act added to § 530 of the 1978 Act³² a new subsection (d), which provides an exception with respect to the treatment of certain workers. Section 530(d) provides that section 530 shall not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work. Section 530(d) of the 1978 Act does not affect the determination of whether such workers are employees under the common law rules. Rather, it merely eliminates the employment tax relief under section 530(a) of the 1978 Act that would otherwise be available to a taxpayer with respect to those workers who are determined to be employees of the taxpayer under the usual common law rules. Section 530(d) applies to remuneration paid and services rendered after December 31, 1986.

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²⁸ Pub. L. No. 97-248, 96 Stat. 324 (1982).

²⁹ Rev. Rul. 87-41, 1987-1 C.B. 296.

³⁰ *Id.*

³¹ *Id.*

³² Pub. L. No. 97-248, 96 Stat. 324 (1982).