# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>I.</th>
<th>Introduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>II.</td>
<td>Independent Contractor (Providing Service)</td>
</tr>
<tr>
<td></td>
<td>Factors Used By the IRS</td>
</tr>
<tr>
<td>III.</td>
<td>Consultants (Providing Advice)</td>
</tr>
<tr>
<td></td>
<td>Internal</td>
</tr>
<tr>
<td></td>
<td>External</td>
</tr>
<tr>
<td>IV.</td>
<td>University of Maine System Guidelines</td>
</tr>
<tr>
<td>V.</td>
<td>Examples</td>
</tr>
<tr>
<td></td>
<td>University of Maine System Personal Service Contract</td>
</tr>
<tr>
<td></td>
<td>1099 Miscellaneous Income Form</td>
</tr>
<tr>
<td></td>
<td>Check Request</td>
</tr>
</tbody>
</table>

Exhibit I: University of Maine System Personal Service Contract
Exhibit II: 1099 Miscellaneous Income Form
Exhibit III: Check Request
INTRODUCTION

The purpose of this manual is to provide assistance to University of Maine System campuses in identifying the appropriate classification for individuals who provide professional advice (Consultants) or render a service (Independent Contractors). These guidelines do not apply to contracts with corporations, partnerships and the like under which professional consultant services may be provided. The Internal Revenue Service has set forth certain conditions that are looked at in determining if an individual is an consultant/independent contractor or employee. When an individual does not meet the conditions of a consultant or independent contractor, the IRS says an employee/employer relationship exists and they must be paid on payroll. An employer who does not treat an individual as an employee is subject to penalties for failure to withhold taxes and to pay social security taxes on that employee (e.g., up to 40% of FICA taxes).

This manual will look at the conditions established by the IRS. It will outline the methods of payment to be used in these situations and address questions often asked by campuses regarding Consultants and Independent Contractors. Campuses will be responsible for implementing the guidelines and making determinations about the proper payment method and will be responsible for monitoring payments made to individuals through the accounting system to assure consistent application of the guidelines.

The material in this manual is intended to be only a guide. It is not to be viewed as a comprehensive treatment of all University policy in relation to Consultants and Independent Contractors. Campus questions should be directed to either the SWS Office of Human Resources or the SWS Controller’s Office.
INDEPENDENT CONTRACTOR

One of the most frequent coverage questions arising under the employment tax laws is whether an individual worker should be treated as an “employee” or an “independent contractor” for payroll tax purposes.

Independent contractors are considered self-employed persons who provide a professional service not readily available within the University System. They are responsible for making their own tax payments and the employer has no tax withholding or tax payment obligations with respect to compensation paid to an independent contractor.

DEFINED

The primary method used to determine whether an employee-employer relationship exists is the Common Law test. The central focus of the Common Law test is determining who has the right to control two basic elements: (1) what must be done, and (2) how it must be done. Under this test, a worker is considered an employee subject to payroll tax withholding if the employer has the right to control both the result to be accomplished and the method or means by which the result is achieved. If the employer has the right to control or direct only the result of the work and not the means used to accomplish the result, the individual generally qualifies as an independent contractor.

The Common Law test can be difficult to apply to specific cases or situations. Proper application of the test requires an employer to consider a number of factors or characteristics of the work in question to determine whether an employee-employer relationship exists. For example, two characteristics typically indicating that an individual has “employee status” are: (1) the employer has the right to discharge the worker, and (2) the employer supplies the worker with tools and a place to work. On the other hand, individuals who offer their services to the general public in the pursuit of an independent trade, business or profession normally are not considered employees. Keep in mind,
however, that no one factor or set of factors is automatically controlling. All the facts and circumstances of a particular situation must be taken into account in determining whether an individual worker should be treated as an employee or as an independent contractor.

**FACTORS USED BY THE IRS**

In determining the status of a worker the IRS has a number of work factors or characteristics that it takes into account in deciding whether an employer’s control over an individual is sufficient to establish an employer-employee relationship. None of the factors, standing alone, is necessarily controlling or decisive. Rather, the IRS stresses, “the degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed”.¹

The factors the IRS focuses on in determining an individual’s employment status under the payroll tax laws are:

- **Risk of Profit or Loss** – Independent Contractors typically can invest significant amounts of time or capital in their work without any guarantee of success. In other words, they realize a profit or sustain a loss based on their success in performing the work or service. When workers are protected from loss or are restricted in the amount of profit they can gain, they usually are classified as employees.

- **Continuing Relationships** – Employees usually are hired for a continuing, indefinite period. This generally applies even to work or services performed on an irregular but recurring basis, as well as to part-time, temporary and seasonal work. The relationship between an independent contractor and employer usually ends when the job is completed.

¹ Bureau of National Affairs, Payroll Administration Guide
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING
EMPLOYEES
OR
INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

• **Compliance with Instructions** – An individual who must comply with another person’s instructions about when, where or how to work, generally is considered an employee. This applies even if the other person simply has the right to require compliance, but does not exercise that right.

• **Training** – Requiring that an individual be trained through such methods as working with an experienced employer, attending instructional sessions or training courses, or corresponding with the employer is indicative of employee status because it shows that the employer wants to control the way the work is done or the method used. Independent contractors, on the other hand, normally are not trained by the purchasers of their services.

• **Personal Services Required** – Employee status is suggested if an individual is required to personally render the services in question. Such an arrangement, says the IRS, indicates the employer is interested in controlling the methods used to accomplish the results. By contrast, an individual’s right to substitute another’s services without the employer’s knowledge suggests the existence of a contractor relationship.

• **Integration into the Business** – The fact that an individual’s services are so integrated into an employer’s operations that the success or continuation of the business depends on the performance of the services generally indicates that the individual is subject to a certain amount of control by the owner of the business.

• **Control Over the Hiring, Supervising and Paying of Assistants** – An employer that hires, supervises and pays an individual’s assistants usually is viewed as controlling the work (and the individual performing the services) in question. On the other hand, individuals who hire, supervise and pay other workers in accordance with an arrangement in which they have agreed to provide the labor needed to attain a certain result are generally treated as independent contractors.
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING EMPLOYEES OR INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

• **Set Hours of Work** – A requirement that individuals adhere to certain work hours established by the employer generally is viewed as a factor indicating employer control.

• **Full-time Work Requirement** – Employee status is suggested if an individual must work on a substantially full-time basis for the employer since this indicates that the employer controls the amount of time the individual spends working and thus essentially restricts the worker’s ability to perform for someone else. By contrast, independent contractors usually are free to work when and for whom they choose.

• **Working on the Employer’s Premises** – Performance of the work on employer’s premises may be viewed as evidence of employer control, especially if the work could be done elsewhere. While performance at an off-premises site demonstrates some freedom from employer control, it does not by itself mean that the worker is an independent contractor. According to the IRS, the importance of the work-on-premises factor “depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer’s premises”\(^2\). Employer control is suggested when the employer has the right to have the worker work at a specific place.

• **Required Work Order Sequence** – A degree of control is suggested, says the IRS, where an individual is required to submit regular oral or written reports to the employer.

• **Payment by the Hour, Week or Month** – Employees generally are paid by the hour, day or month, while independent contractors typically are paid by the job or on a lump sum or straight commission basis.

\(^2\) Bureau of National Affairs, Payroll Administration Guide
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING EMPLOYEES OR INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

• **Payment of Business or Travel Expenses** – Employer payment of work related business or travel expense generally indicates employee status.

• **Furnishing of Tools and Materials** – An employer-employee relationship is indicated where an employer supplies a worker with significant amount of tools, materials or other equipment. Moreover, in some occupations and industries where it is customary for individuals to provide their own tools, these workers also may be treated as employees.

• **Investment in Facilities** – Workers are like to be viewed as independent contractors if they have a significant investment in facilities they use in the course of performing services.

• **Working for More Than One Firm** – Individuals who perform services for a number of businesses or people at the same time usually are considered independent contractors. IRS cautions, however, that “a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement”.

• **Worker’s Availability to the General Public** – Individuals who make their services available to the public on a “regular and consistent basis” are generally treated as independent contractors.

• **Employer’s Discharge Rights** – If an employer has the right to discharge an individual, that worker is viewed as an employee. Independent contractors cannot be fired as long as they perform in accordance with their contract specifications.

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3 Bureau of National Affairs, Payroll Administration Guide

Office of the Controller
September 3, 1993
M55(01)
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING
EMPLOYEES
OR
INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

- **Worker’s Termination Rights** – Employees typically can end their employment relationship at any time without incurring liability, whereas independent contractors might be liable for a breach of contract if they leave without completing their work.

It is irrelevant that the employer allows the individual considerable discretion and freedom in deciding how to perform or carry out the work of the job. Rather, the decisive factor is that the employer possess the legal right to control or direct both the results and the method of the work or services in question. As long as the employer is entitled to control both what must be done and how it gets done, the individual worker is **NOT** an independent contractor.

If it is determined that there is an independent contractor relationship, i.e., not an employee, then in addition to any formal contract for services a Personal Service Contract (See Exhibit I) needs to be signed and maintained on file.

The work factors used by the IRS are not, however, the last word in determining worker status. There are hundreds of court cases and rulings that further complicate this difficult question.

Adding even more complications is Section 530 of the 1978 Revenue Act which may provide some measure of protection to the employer that has treated certain classes of workers as independent contractors on a consistent basis since 1978.

In order to be covered under this “safe harbor” provision, an employee must meet the following conditions:

1. A Form 1099 must have been consistently issued to the independent contractor.

2. Workers who do basically the same type of work must NOT have been treated as employees after 1977.
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING EMPLOYEES OR INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

3. The employer has a “reasonable basis” for treating this particular individual as an independent contractor. The “reasonable basis” can be met by having relied on court cases and rulings or by IRS audits that did not result in worker being reclassified as an employee or long-standing, recognized industry practice.

Even with the safety net provided in Section 530, missing just one 1099 Form can be critical and the safe harbor protection is only for employment taxes. Employees can face trouble from the IRS in other employment related areas such as retirement plans. It should be noted that the IRS takes the position that arguing for safe harbor relief from payroll taxes is an admission by the employer that a worker is an employee under the Common Law Test.4

CONSULTANTS

Consultants are individuals who provide professional advice. There are two types of consultants:

• INTERNAL CONSULTANTS

These are individuals who are currently on the payroll and must continue to be paid through the payroll system. For non-salaried individuals, overtime concerns must be considered when making payments to the employee.

• EXTERNAL CONSULTANTS

External Consultants are individuals who are NOT on payroll. Their particular skill or knowledge is not available within the system. They need to sign a PERSONAL SERVICE CONTRACT (See Exhibit I) and are paid through the Accounts Payable System. The Personal Service Contract must be maintained on file.

4 Journal of Accountancy, May 1991
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING
EMPLOYEES
OR
INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

UNIVERSITY GUIDELINES

The following guidelines will be used throughout the University of Maine System in contracting services from individuals. These guidelines should be reviewed and adhered to when entering into a contractual agreement with individuals who are **NOT** to be considered employees of the University, but who perform services for or give advice to a campus, department or program specific to the terms of a contractual agreement.

1. An independent contractor is defined as an individual over whom the University would have the right to control or direct **ONLY** the result of the work performed. The University would not have the right to control or direct the methods or means of accomplishing the result of the work.

2. The factors used by the IRS and discussed in Section II will be used as criteria in determining the status of individuals who perform services for the University of Maine System. If employee status is determined to be appropriate, the existing mechanisms for recruitment, search, hiring and payment of wages that are used for regular or temporary employees are to be used. If an independent contract is determined to be appropriate, payment for services will be in accordance with accounts payable procedures specific for personal contract services.

3. These criteria are in accordance with federal government regulations pertaining to the determination of whether an individual is an employee or an independent contractor. The State of Maine may also be involved in this determination for taxation or other purposes such as unemployment compensation. Under State of Maine, Department of Labor criteria specific to unemployment compensation, the State has the following standards,

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Office of the Controller
September 3, 1993
M55(01)
University of Maine System

Guidelines for Determining Employees or Independent Contractors/Consultant Relationships

Commonly referred to as the “ABC Test”. The State of Maine Employment Security Act considers an individual to be an independent contractor if all three of the following criteria are met.

a. The individual has been and will continue to be free from control or direction over the performance of such services under their contract of service; and

b. The service is either outside the usual course of the business for which such service is performed or outside of all places of business of the enterprise for which such service is performed; and

c. The individual is customarily engaged in an independently established trade, occupation or business.

4. Individuals who provide services to the University of Maine System will comply with policies and procedures established by the Board of Trustees as well as those established by this document. The campus, department, program or college that enters into a contractual agreement shall be responsible for assurance of compliance by both the University and the contractor to the terms of the agreement. The campus, college, department or program shall also be responsible for determining whether an individual is to be considered an employee, independent contractor or external consultant.

5. When a campus, college, department or program of the University of Maine System enters into a contractual agreement with an individual for the performance of a service or external advice, it will be necessary to complete the UNIVERSITY OF MAINE SYSTEM PERSONAL SERVICE CONTRACT [EXHIBIT I]. Prior to entering into an agreement for the services of an independent contractor or external consultant, the University official signing the Personal Service Contract should review the guidelines outlined in this manual.

Office of the Controller
September 3, 1993
M55(01)
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING EMPLOYEES OR
INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

6. A Personal Service Contract may not be used to acquire the services of an individual who is to teach credit courses or development course work. Such an individual must be employed as an employee of the University and may also be subject to terms of a collective bargaining agreement.

The PERSONAL SERVICE CONTRACT is applicable to individuals only and is NOT to be used in the following circumstances:

- Contracts with firms or organizations.
- Part-time faculty teaching credit or developmental course work.
- Individuals who do not qualify as independent contractors or external consultants and may in fact be employees.

Once the appropriate University official(s) has determined that the individual is an independent contractor or external consultant then the PERSONAL SERVICE CONTRACT should be completed. A detailed description of the services to be rendered should also be provided as an attachment to the PERSONAL SERVICE CONTRACT.

This attachment can also be used to strengthen the University’s position that the worker is a Consultant/Contractor by making sure the attachment:

a. clearly states the University controls only the results of the work, not how it gets done.

b. makes reference to the Consultant/Contractor’s obligation to pay income and self-employment taxes.
c. does not set hours per day to be worked or number of days per week to be worked, only a start date and an expected completion date.

d. states that any additional help needed to complete the work will be hired and paid for by the Consultant/Contractor.

e. states that any tools needed will be furnished by the Consultant/Contractor.

f. makes it clear the Consultant/Contractor is free to work for other individuals or companies.

g. makes it clear that by signing the PERSONAL SERVICE CONTRACT the Consultant/Contractor is obligated to fulfill their contract responsibility and the UNIVERSITY cannot fire them nor can they quit.5

The University’s position that this is a Consultant/Contractor relationship can be further strengthened by stating that the cost of meals, travel, etc. are part of the contract amount and not billable to the University.

Following these guidelines may not guarantee the Consultant/Contractor’s relationship will not be challenged by the Internal Revenue Service, but it will certainly add strength to the University’s case that it is indeed a Consultant/Contractor relationship.

Under a PERSONAL SERVICE CONTRACT, payments made to a Consultant/Contractor will result in the University issuing a 1099 {EXHIBIT II} for tax purposes when required by IRS regulations. It should also be understood that an independent contractor or external consultant is NOT eligible for any University provided benefits or programs.

5 Journal of Accountancy, May 1991
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING
EMPLOYEES
OR
INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

When a PERSONAL SERVICE CONTRACT form is completed, the campus should assign a “CONTRACT NUMBER” for identification and control purposes. This number can be defined by individual campuses but should appear on the contract and any other documents related to the contract.

Each campus has its own accounts payable office which is responsible for processing, among other things, payments to independent contractors or external consultants. Requests to pay independent Consultant/Contractors are processed on the CHECK REQUEST FOR SERVICES RENDERED [EXHIBIT III]. This form should be completed by the appropriate campus official and forwarded along with a copy of the contract to the accounts payable office (or designated campus office) for payment. The contract number should appear on the CHECK REQUEST FOR SERVICES RENDERED which will allow the campus office to cross reference multiple check requests to assure prompt and correct payment.

EXAMPLES

Example 1: Independent Contractor

The University’s department of Chemical Engineering expanded their degree program and needed a computerized database program to manage the student records. The department contracted the professional services of John James, a local self-employed computer programmer.

Mr. James has his own office, uses his own equipment, offers his service to the general public and overall controls the details and the results of the work he does. Mr. James is considered an Independent Contractor and must complete a contract for personal services (Exhibit I) with the Department of Chemical Engineering.

The fee of $1,000 for Mr. James’s services will be paid through the accounts payable system. A check request for services rendered should be submitted by the Chemical Engineering Department along with a copy of the Personal Service Contract.
UNIVERSITY OF MAINE SYSTEM

GUIDELINES FOR DETERMINING
EMPLOYEES
OR
INDEPENDENT CONTRACTOR/CONSULTANT RELATIONSHIPS

Example II: Payment to an Individual Who Does Not Meet Independent Contractor Conditions

The University Press needed editorial services to meet a publication deadline and used the services of Amy Snow, an Administrative Assistant II in the library. Ms. Snow offered to work for the press on Saturdays and evenings and obtained the permission of her supervisor at the library.

Ms. Snow will be paid through the University Payroll System because she does not meet any of the independent contractor conditions.

The University Press must pay Ms. Snow at her overtime rate and use an additional compensation form to authorize payment from University Press funds to Ms. Snow.

Example III: External Consultant

The University’s Office of Physical Facilities needs some professional advice on a recent architectural engineering project. They secure the services of Robert Varney, an architect with a local firm.

Mr. Varney is considered to be an External Consultant and should complete a Personal Contract with the Office of Physical Facilities.

His consultation fee of $500 will be processed for payment through the Accounts Payable System. Physical Facilities must complete a Check Request for services rendered and attach a copy of the contract for personal services.
EXHIBIT I

UNIVERSITY OF MAINE SYSTEM
PERSONAL SERVICE CONTRACT

DOLLAR AMOUNT $_________COMMENCEMENT DATE_______TERMINATION DATE____

PROJECT TITLE________________________________________________________

THIS AGREEMENT made this_______day of_____, ______is by an between the University of Maine System hereinafter called the “University” and the Consultant/Contractor

WHEREAS THE UNIVERSITY AND THE CONSULTANT/CONTRACTOR DO MUTUALLY AGREE THAT:

1) The individual Consultant/Contractor agrees to the Specifications of Work to be Performed as described in ATTACHMENT A, herein incorporated. Any materials produced in performance of this agreement are the property of the University and shall be turned over to the University upon request.

2) The University shall pay the Consultant/Contractor for personal services rendered in an amount not to exceed $________, at a rate of $_____per (day,wk,hr,qtr,presentation) for a maximum of_____(days, wks,hrs,qtr,presentation). Said payment to be made by the University upon receipt and certification of an itemized invoice submitted on the Consultant/Contractor’s usual billing form or letterhead.

3) The Consultant/Contractor is an Independent Consultant/Contractor for whom no Federal or State Income Tax will be deducted by the University, and for whom no retirement benefits, social security benefits, group health or life insurance, vacation and sick leave, workers’ compensation and similar benefits available to University employees will accrue. The Consultant/Contractor further understands that annual information returns as required by the Internal Revenue Code and Maine’s Income Tax Law will be filed by the University with copies sent to the Consultant/Contractor.

4) The Consultant/Contractor will indemnify, defend and save harmless the University, its officers, agents and employees from any claim or loss resulting to any person, firm or corporation in connection with the performance of this agreement, including costs for violation of proprietary rights, copyrights, or rights of privacy, arising out of a publication, translation, reproduction, delivery, performance, use of disposition of any data furnished under this agreement or based on any libelous or other unlawful matter contained in such data.

5) This agreement may be amended only in writing with the mutual consent of both parties.

6) This agreement may be terminated with ten days written notice by either party.

7) This agreement may not be assigned in whole or in part.

IN WITNESS WHEREOF, the University and the Consultant/Contractor have executed this Agreement

BY THE CONSULTANT/CONTRACTOR FOR THE UNIVERSITY

Signed______________________________   Signed_______________________________
Name_______________________________   Name________________________________
Title________________________________   Title_________________________________
Address_____________________________   Address______________________________
____________________________    ______________________________
SS#Fed ID___________________________   Univ. Acct.#___________________________

ATTACHMENT A FOLLOWS

EQUAL OPPORTUNITY STATEMENT: In complying with the letter and spirit of applicable laws and in pursuing its own goals of diversity, the University of Maine System shall not discriminate on the grounds of race, color, religion, sex, sexual orientation, national origin or citizenship status, age, disability, or veteran status in employment, education, and all other areas of the University. The University provides reasonable accommodations to qualified individuals with disabilities upon request. Questions and complaints about discrimination in any areas of the University should be directed to the campus Equal Opportunity Director.
Specifications of Work to be Performed

The individual Consultant/Contractor agrees to the Specifications of Work to be Performed as follows: