ADMINISTRATIVE DIVISION	FINA Administration and Finance
POLICY NUMBER	FINA 2.40
POLICY TITLE	Independent Contractors
SCOPE OF POLICY	USC System
DATE OF REVISION	November 12, 2024
RESPONSIBLE OFFICER	Vice President for Finance and Chief Operating Officer
ADMINISTRATIVE OFFICE	University Finance – Controller's Office

PURPOSE

This policy provides guidelines for complying with Internal Revenue Code provisions, Internal Revenue Service (IRS) regulations, state laws and regulations, and University policies for the engagement of independent contractors.

Departments often engage the services of individuals who are not employees of the University, including independent contractors, recipients of honoraria, entertainers, suppliers, etc. It is important to correctly classify independent contractors and employees to ensure appropriate compensation methods and tax obligations. This policy details the criteria that define independent contractors and the required process for correctly classifying and paying them.

DEFINITIONS AND ACRONYMS

Employee: An individual legally employed by the University in any official capacity (and hired through the Division of Human Resources), including faculty, staff, students, salaried and temporary appointments, etc. Employees receive compensation for work or services (1) in which the University has the right to supervise and control the manner of performance and (2) from University-controlled funds, regardless of the source of the funds. As a result of the employee classification, income is reported on a Form W-2 (Wage and Tax Statement) rather than a Form 1099 (Miscellaneous Income [MISC] or Nonemployee Compensation [NEC] Statement).

Honorarium: A one-time, nominal payment made to someone outside of the University as an expression of gratitude for a special service that would normally be provided free of charge. Examples include payments for volunteered services unrelated to an individual's official duties, or payments granted in recognition of an academic activity conducted for the benefit of the University's mission, such as lecturing, teaching, consulting, conducting research, attending meetings, or otherwise sharing knowledge. Honoraria are not paid to employees. Any payments for additional services provided by employees should be paid through Payroll.

Independent Contractor: An individual or firm who provides services to the University but is not an employee. As a result of the independent contractor classification, income is reported on Form 1099 rather than Form W-2. Specific criteria are detailed below.

POLICY STATEMENT

Federal and state law requires the University to properly classify its workers as either employees or independent contractors. This policy serves to guide departments/units seeking to engage independent contractors. The preference of a worker or department is not relevant to the classification determination. Unless the strict requirements for independent contractor classification are met, as detailed below, individuals are to be classified as employees and paid as such. The determination of whether an individual is an independent contractor must be made prior to the individual's performance of service.

These requirements are vital to ensure the University remains compliant with the Department of Labor, the IRS, and other regulatory agencies. Misclassifying workers as independent contractors (instead of employees) may cause the University to fail to meet its legal obligations and give rise to significant liability, including taxes and related penalties, criminal sanctions, and civil liability.

This policy, and the accompanying Procedure, identify the criteria, steps, documents, and processes necessary to ensure proper classification of and subsequent payment to independent contractors. The criteria and factors listed below are not exhaustive and no single factor is weighed more significantly – all information and factors must be considered comprehensively.

A. U.S Department of Labor Standards

The U.S. Department of Labor sets forth a six-factor economic reality test, known as the "totality-of-circumstances" approach, for determining whether individuals may be classified as independent contractors. These factors include:

1. Opportunity for profit or loss: Whether there is potential for economic success or failure based on the individual's business acumen, judgement, and/or initiative.
2. Nature of investments: Whether any investments by the individual are capital (e.g., equipment) or entrepreneurial.
3. Degree of permanence of the work relationship: Whether the working relationship is definite in duration, non-exclusive, project-based, or sporadic.
4. Nature and degree of control: Whether the individual or employer has control over scheduling, supervision, setting prices of goods and services, the ability to work for others, etc.
5. Extent to which the work performed is an integral part of the employer's business: Whether the function performed is critical, necessary, or central to the business, or an independent function, service, project, etc.
6. Skill and initiative: Whether the individual brings specialized skills to the relationship or obtains them from the employer.

B. Common Law Rules

The IRS also details the following three categories for consideration:

1. Behavioral: Does the University control or have the right to control what the worker does and how the worker does their job?

2. Financial: Are the business aspects of the worker's job controlled by the University (e.g., whether expenses are reimbursed, who provides tools/supplies, etc.)?

3. Type of Relationship: Are there written contracts or employee type benefits (e.g., pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

C. **Additional Considerations for Identifying Independent Contractors**

An individual who meets all the following criteria is generally an independent contractor:

1. renders a service to the University for a specified payment amount for a specified result;

2. is engaged in an independently established profession or business (e.g., offers similar services to the general public on a consistent basis);

3. provides a service outside of the University's usual course of business;

4. is not currently paid through University Payroll and has not been paid through Payroll within the current calendar year;

5. provides services through a written contract (e.g., the University's Independent Contractor Agreement or another University-approved form of agreement); and

6. is free from University control or direction when providing services.

Further, to supplement the criteria above, affirmative responses to the following questions below generally indicate the individual is an employee:

1. Is there a continuing relationship between the individual and the University?

2. Are the services provided by the individual within the University's usual course of business?

3. Is the individual substantially full-time to the University?

4. Does the individual perform the engaged services exclusively for the University?

5. Does the University provide training and detailed instructions as to how the work is to be performed and/or require it to be performed in a certain way/sequence?

6. Does the employee receive employee benefits, insurance, vacation, or sick pay from the University?

7. Does the individual have the right to end the relationship without incurring any liability?

8. Will the individual receive predetermined earnings and have little chance to realize significant profit or loss through their services?

D. Payments and Tax Reporting

Payments to independent contractors are processed through Accounts Payable rather than through the Payroll Department – refer to FINA 2.12. The University will report payments to individuals who are independent contractors to the IRS on Form 1099 in accordance with IRS regulations.

In general, an individual hired as a permanent, full-time employee of the University or any other state agency cannot be an independent contractor. Employees are hired through the University's Division of Human Resources and paid through the Payroll Department – refer to HR policies below. Services provided by an employee within the University's usual course of business must be paid through Payroll (e.g., Additional Pay), and not via a Form 1099. In certain rare cases, an independent contractor classification may be appropriate if the additional services provided by an employee are outside the scope of their normal duties and responsibilities and are entirely unrelated to the University's primary purpose. Any exceptions must be approved by the University Controller.

E. Paying Non-U.S. Citizens and International Parties as Independent Contractors

For independent contractor services performed within the United States: To ensure compliance with IRS regulations, **prior** to engaging a non-U.S. citizen for services, the University must analyze the individual's U.S. immigration status for compatibility with proposed activity and residency status for tax purposes. Contact the Controller's Office Tax Department and the HR Office of International Services for citizenship and U.S. immigration status verification for assistance.

For independent contractor services performed outside the United States: It is necessary to contact the Controller's Office Tax Department (and, if needed, the Office of International Services for citizenship verification) **prior** to the engagement of any worker for services to be performed outside the U.S. Each country has unique criteria and regulations that define whether an individual is an independent contractor or an employee. Incorrectly paying an

individual for services performed outside of the U.S. may adversely impact the University, as well as the individual performing the work.

F. Reimbursing Travel or Other Business Expenses to Independent Contractors

If non-employees travel for official University business, the respective contractual agreement governs the reimbursement allowances and methodologies. However, in the absence of an agreement, the University's travel policy (FINA 2.50) can be used to provide guidelines for appropriate reimbursement to non-employees.

PROCEDURES

The procedure for this policy provides details on identifying and engaging an independent contractor. The procedure is located at: Policies and Procedures - Office of the Controller

RELATED UNIVERSITY, STATE AND FEDERAL POLICIES

ACAF 1.00 Recruitment and Appointment of Tenured, Tenure-Track, and Non-Tenure Faculty
ACAF 1.01 Recruitment and Appointment of Academic Administrators
FINA 1.00 Chart of Accounts
FINA 2.12 Accounts Payable
FINA 2.13 Honorariums and Royalties
FINA 2.14 Acquisition and Payment of Goods and Services
FINA 2.50 Travel
FINA 6.00 Payroll Authorizations
HR 1.24 Recruitment and Appointment of Classified, Unclassified, Research Grant, and Time Limited Employees
UNIV 2.60 Appointment and Employment of Foreign Nationals
HR 1.86 Student Employment
IRS Publication 15-A Employer's Supplemental Tax Guide
U.S. Department of Labor 2024 IC Rule (Employee or Independent Contractor Classification Under the Fair Labor Standards Act)

HISTORY OF REVISIONS

DATE OF REVISION	REASON FOR REVISION
November 12, 2024	New policy