

Overview

This section of the Financial Management Guide (FMG) provides guidance to assist agencies in determining whether an individual should be classified as a special personal services (SPS) employee or an independent contractor.

Policy

To comply with Internal Revenue Service (IRS) regulations, agencies must review all personal service contracts to determine if the resulting business relationship is an employer-employee or independent contractor relationship.

As a general rule, an employer-employee relationship does not exist if the contract is reached with a business or nonprofit organization which will provide individuals to perform the agreed upon services. In this instance, the business or nonprofit you have contracted with is responsible for the tax reporting related to those individuals. A business, as referenced in this paragraph, does not include an individual who is a Sole Proprietor classified as “Doing Business As” (DBA). Those contracts would be reviewed as if they are between the State of Michigan and the individual providing the service.

If a contract for services is reached directly with an individual or a sole proprietor operating under a DBA, the State of Michigan is responsible for the appropriate classification of the relationship and, based on that, the appropriate tax reporting. As a general rule, when a contract is agreed upon with an individual or a DBA an employee-employer relationship exists if:

- The work is required to be performed personally by the hired individual or sole proprietor.
- The agency controls when, where, and how the work is done.
- The agency hires, supervises, and pays the individual’s or sole proprietor’s co-workers and/or assistants.
- The agency reimburses expenses, supplies office space or provides supplies, tools or equipment.
- The individual doing the work is an appointed or elected official.

As a general rule, an independent contractor relationship exists if:

- The contractor determines which individuals perform the work.
- The agency sets expected results, but the contractor controls how the work is done.
- The contractor is not held harmless from potential losses.

Agencies wishing to do a more in depth analysis can apply the Common Law Rules (see Exhibit A) and/or the IRS 20 Factors (see Exhibit B).

If an employer-employee relationship exists, the individual must be treated as an SPS employee. SPS employees are paid through the state payroll system (HRMN), so that applicable payroll taxes are withheld and amounts paid are reported as compensation on Form W-2.

If an employer-employee relationship does not exist, the individual is treated as an independent contractor. Independent contractors are paid through the state accounting system (MAIN), so that amounts paid are reported on Form 1099.

If agencies are unsure of the appropriate classification or believe that Form SS-8 should be submitted to request an IRS determination, they should contact their payroll liaison in the Office of Financial Management, Payroll and Tax Reporting Division.

Scope

This policy applies to all State agencies.

Procedures

For all personal service contracts, agencies must prepare a written analysis that supports their conclusions regarding the classification of the individual as an SPS employee or an independent contractor. The written analysis must be based on the Common Law Rules and/or the IRS 20 Factors and must be retained until five years after the contractual relationship terminates.

Page 3
4/9/2015

State of Michigan
Financial Management Guide
Part V – Tax Reporting

Chapter 2, Section 500

SPS Employee vs. Independent Contractor

For questions regarding this section of the FMG, contact your OFM agency payroll liaison.

Exhibit A – Common Law Rules

Exhibit B – IRS 20 Factors