

University of Washington Tax Office
Employee/Independent Contractor Determinations:
Higher Education Cases and Rulings

Determining whether an individual should be hired as an employee or an independent contractor is critically important for the University of Washington. In recent compliance and enforcement initiatives, both the Internal Revenue Service (IRS) and Department of Labor (DOL) have focused on whether organizations have correctly classified individuals as employees or independent contractors, and this is one of the top audit priorities and findings for tax exempt organizations.

There are a number of court cases, Revenue Rulings, Private Letter Rulings (PLRs), and other informal guidance documents addressing this issue. This document focuses on guidance which specifically addresses situations which are unique to institutions of higher education. Questions about this document should be directed to the University of Washington Tax Director.

Cases

1. Teaching

Chester C. Hand, Sr., 16 TC 1410: In denying a taxpayer certain deductions, the Tax Court found that a teacher in the Chicago Public Schools (who was also a licensed CPA) teaching night courses at DePaul University was an employee of both the Public Board of Education and DePaul University. The Tax Court does not go into great detail in addressing what factors led to the finding that the taxpayer was an employee, but does indicate that one factor in reaching this conclusion was the taxpayer's lack of clients as an independent entity.

Richard G. Newhouse, et ux. v. Commissioner, TC Summary Opinion 2002-18: In denying several deductions, the Tax Court found that an individual who had rendered services to four separate junior colleges as a part time professor (and separately, to Safeway, Inc.) was an employee of all four junior colleges. The court focused on the junior colleges' right to control the professor's work, noting that for professional services (such as teaching), the degree of control required to find that an individual is less than that required where other services are rendered. The Court also noted that the colleges, not the professor, had invested in the facilities to provide the courses; the professor's pay was fixed, eliminating the possibility of profit or loss on the contract; the work performed was an integral part of the colleges' business; two of the colleges had provided employee benefits to the professor; and the colleges had issued the professor forms W-2, indicating that they believed the professor to be their employee.

a. Executive Education

Reece, TC Memo 1992-335: In a memorandum opinion, the Tax Court found that an individual providing continuing education seminars under a per-semester contract with a University's Department of Executive Education was an independent contractor, despite the individual's role as a professor at the University for other purposes. The Tax Court focused on the relative lack of control over the content of the seminars (noting that in the context of university teaching activities, the lack of control over course content often will not be sufficient to find that the individual was an independent contractor), the fact that the university considered the activity outside compensation under policies governing faculty conduct, the fact that the professor was retained separately each semester, and that the professor had seminar clients other than the university. The Tax Court also noted the similarity between the relationship between that of the professor and the institution and those entered into between the institution and other, completely independent parties.

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Pulver v. Comm’r TCM 1982-437: The taxpayer was both an employee and an independent contractor with regard to organization for whom taxpayer performed services. Taxpayer was employed as chief engineer with the organization and also designed inventions which he was required to offer to the organization if within the organization’s industry. Despite the fact that because the taxpayer engaged in professional services work, for which the organization would only be required to exercise minimal control to result in a finding of employment, the court focused on the fact that the taxpayer was not subject to supervision, control, or deadlines by the organization in his inventing activities, the organization retained other independent contractors to develop inventions, and taxpayer’s inventions did not relate exclusively to the organization’s industry.

Rulings:

- **Teaching**

Revenue Ruling 55-206, 1955-1 CB 485: The IRS found that an individual engaged in the business of private tutoring as an independent contractor, who also rendered services as a substitute teacher, was an employee when engaged in substitute teaching. The IRS does not go into great detail, but finds that the individual was subject to sufficient direction and control as a substitute teacher to merit a finding that the individual was an employee. The IRS distinguishes the taxpayer’s services as a private tutor as constituting a separate trade or business which do not influence the determination with regard to whether the individual was an employee or independent contractor when rendering services as a substitute teacher.

Revenue Ruling 70-338, 1970-1 CB 200: The IRS found that music teachers who taught regularly at a music conservatory were employees, while those who merely gave private lessons in exchange for a percentage of the gross receipts were independent contractors. In reaching this conclusion, the IRS focused on the conservatory’s ability to exercise control over the teachers who taught regular courses, the relative lack of control over those giving private lessons with regard to their methods, the limited-duration contracts with those teachers giving private lessons, and the fact that those teaching private lessons could control the acceptance, refusal, dismissal of students (and refund of any student fees). Although it is not explicitly stated, it is clear that some weight was given to the fact that those teaching private lessons had significant opportunity for profit or loss, as their income was based on a percentage of gross revenue collected by the conservatory on their behalf.

Rev. Rul. 70-363, 1970-2 CB 207: The IRS found that attorneys who were retained by a law school to teach courses were employees of the law school. In finding that the attorneys were employed by the law school, the IRS focused on the law school’s ability to control both the course content and attorneys’ conduct, finding that the law school could control and direct the means by which the attorneys’ accomplished the teaching which they were engaged in. The IRS distinguished the attorneys’ separate business endeavors as practicing attorneys from their provision of instruction at the law school (which, as noted above the IRS found was not a separate business).

Rev. Rul. 87-41, 1987-1 CB 296: The “20 factor” test Revenue Ruling. Although the IRS has moved away from explicitly using the 20 factor test, the factors are derived from a number of cases, and are still useful in understanding the analytical framework under which employee/independent contractor determinations are made. The 20 factors are:

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1. The *right* to instruct the worker;
2. The provision of training to the worker;
3. The degree of integration of the worker's services into the organization's business activities;
4. A requirement that services be rendered *personally* (by the particular individual);
5. The worker's *right* to hire, supervise, and/or pay assistants;
6. A continuing relationship between the parties;
7. Requiring the worker to keep set hours;
8. Requiring the worker to work full-time;
9. Requiring that work be done on the employer's premises;
10. Requiring the worker to perform tasks or work in a particular order or sequence;
11. Requiring the worker to provide oral or written reports;
12. Making payments based on a set interval (hourly, weekly, monthly, etc.);
13. Payment of business/travel expenses;
14. Providing the worker with tools and/or materials required to perform the work;
15. Whether the worker has made a significant investment in facilities, equipment, or material required to perform the work;
16. Whether the worker has the ability to make a profit or realize a loss from the contract entered into with the organization;
17. Whether the worker works for more than one organization at a time;
18. Whether the worker makes the worker's services available to the general public on a regular and consistent basis;
19. Whether the organization has the right to discharge the worker (for other than failure to meet contract specifications);
20. The worker's right to terminate the worker's relationship with the organization at any time without incurring a penalty for failure to perform under the worker's contract with the organization

Each of these factors are relevant in assessing whether the organization has the type of control over the worker that would indicate the type of control present in an employer/employee relationship.

PLR 9825017: A literacy instructor was held to be an employee of an institution for which the instructor performed services. The institution had the right to terminate the worker at any time without liability, the worker had made no significant investment in the business, and the worker neither advertises the services nor performs them for others. In ruling that the literary instructor was the institution's employee, the IRS reviewed the factors in determining whether a worker under the common law control test is an employee or an independent contractor and concluded that the institution exercised sufficient control for the instructor to be considered an employee.

PLR 9821053: A teacher, who taught English as a second language for three hours, three nights per week, was an employee of a school district where the teacher was required to instruct courses personally, was provided with instructions regarding teaching the courses, was observed and evaluated by the school's vice principal, had no significant investment in the business of teaching, was paid on a regular basis and could not incur a profit or loss, and the school had treated the instructor as an employee prior to a certain date (after which, the individual was treated as an independent contractor, despite performing the same duties). In finding that the instructor was an employee, the IRS reviewed

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the 20 factors laid out in Rev. Rul. 87-41, and although the reasoning is not explicitly stated, the IRS appears to have considered the worker to have clearly been an employee.

PLR 9814011: An individual hired by a federal agency to tutor children of personnel enrolled in an after-school tutoring program was an employee of the federal agency. The individual was provided with significant instructions regarding when and how to accomplish the tutoring services, the federal agency provided all facilities, any substitute teachers were required to be approved by the federal agency, the tutor provided reports to the agency on a weekly basis, and the tutor did not perform a similar service for others or hold himself out as being in the business of providing such services.

PLR 9735027: Individuals who worked under a “fellowship” with a federal agency to instruct teachers of English as a second language under a grant were held to be employees. The grant provided funding for travel, living, housing, books, insurance and other miscellaneous expenses. In finding that the individuals were employees, the IRS focused on the mandatory trainings the individuals were required to attend, the fact that the workers were required to be rendered personally and were a core part of the federal agency’s mission, that the workers were subject to direction with regard to the methods used, that the workers could not make a profit or loss as a result of their services, and had no financial investment in the business of teaching.

PLRs 9612016, 9612020, 9612021, 9612022: The IRS found that instructors at state-affiliated institutions of higher education were employees of the institution. The IRS focused on the institution’s right to provide guidance to the workers on how the work was to be done and the methods to be used, the institution’s right to supervise the workers, that the worker is expected to perform services personally, and that the worker performs services under the institution’s name. The IRS found that these workers were employees despite the fact that the institution did not provide training to the workers, the services were provided on a part-time basis, the worker had a financial investment in a business, performs similar services to other organizations, and some workers had business licenses. Ultimately, the IRS found that the factors present indicated that the institution had sufficient control over the workers.

PLR 9216021: Students at a private university that participated in an “internship” program under which they served as substitute teachers for area schools and received free tuition, books, and a stipend, were employees of the institution. The IRS focused on a training seminar provided by the institution and instructions given by the local school’s principal, that they were required to render services personally, keep certain set hours of work, and had neither a significant investment in teaching, nor could they realize a profit or loss from their services. The IRS found that although the student interns performed their services at the public schools, rather than at the university, they were employees of the university for federal tax purposes.

PLR 9131030: Workers who performed counseling/daycare services at a school affiliated with a 501(c)(3) hospital were employees, according to the IRS. This PLR addresses many of the 20 factors listed in Revenue Ruling 87-41 in coming to the conclusion. Several of the major factors which led the IRS to conclude that these workers were employees included the degree of instruction and training provided to the workers, that the workers performed services which were an integral part of the school’s business, and that services were required to be rendered personally, on a substantially full time basis.

PLR 9123010: Despite working for multiple organizations, engagement on a short-term, performance-by-performance basis, and the worker maintaining a separate business and advertising to the public, the

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IRS found that the worker (a bassoonist) was an employee of an orchestra because he was required to attend performances personally and on time, was subject to some instruction as part of the orchestra, and the orchestra retained the right to both change the methods used and/or discharge the worker at any time. Although the specific situation is not directly relevant to teaching relationships, the framework—that despite several factors pointing toward independent contractor treatment, a worker can be reclassified as an employee if the IRS finds that the organization exercised even a small degree of control over the worker’s performance.

PLR 9105007: Part time instructors at a state college were employees despite a unique set of facts in which the instructors were subject to substantially less control than typical college or university instructors. The instructors had full time jobs elsewhere and typically taught one class for the College during a semester. Instructors were paid a lump sum for teaching a course, half of which was paid at the midpoint of the semester and half of which was paid at the end of the semester. The IRS noted that for professional employees, the degree of control necessary to find that a worker is an employee is less than for other types of workers. In this case, the IRS found that despite the fact that instructors retained substantial control over the course content and structure, because the college retained the right to review course objectives and course instruction was a core service provided by the institution, the college retained the minimal amount of control necessary to find that the workers were the college’s employees.

PLR 8925001: A number of adjunct faculty members at an institution of higher education were employees of the institution. Despite minimal control by the institution over the adjunct faculty members’ activities, differences in compensation between regular faculty and adjunct faculty, and engagement in a separate trade or business by certain adjunct faculty, the IRS found that these workers were employees. In this PLR, the workers’ outside businesses (as attorneys) were distinguished as not being related to their teaching activities, and the IRS emphasized that because teaching was an integral part of the institution’s business and the adjunct faculty were professional employees, a minimal level of instruction and supervision was needed to find that they were subject to the level of control required to find that they were employees.

PLR 8801019: Dance instructors retained by a dance studio were employees of the dance studio because the services provided are an integral part of the dance studio’s business, instructors are required to render services personally, there is a continuous relationship with the dance studio, and compensation is based on an hourly rate with no unreimbursed business expenses incurred by the instructors.

PLR 8728022: An art instructor who provided similar services to the general public was an employee of a college. The IRS found that the art course was part of the college’s core business, the worker was not engaged in an independent profession (despite spending less than 25% of the instructor’s time at the college and performing similar services for others), and the university accepted payment for the courses from students, provided the space in which the instructors taught, and paid the instructor a set salary.

- **Research**

Revenue Ruling 55-583, 1955-2 CB 405: The IRS found that payment to a professor who was released from certain teaching duties to allow the professor to perform research duties under a grant to which the university which employed the professor had assigned to the professor. The IRS indicated that while the university only had very general control over the manner of the work to be performed (the professor

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developed the methodology and protocols for performing the research), the university had retained sufficient control over the professor's work to constitute employment. The IRS also found that a stenographer who the professor hired was an employee of the university.

- **Medical**

PLR 8937039: Psychologists with their own practices who also provided similar services (in their capacity as psychologists) for an organization which provided psychological services were employees of the organization with regard to the services provided for the organization. The IRS found that despite the fact that the psychologists were engaged in their own private practice, when working on behalf of the organization, they were subject to a sufficient degree of control, were required to render services personally, on the organization's premises, and the services constituted an integral part of the organization's business. The IRS emphasized that with regard to professional services, the degree of control necessary to find that a worker is an employee, rather than an independent contractor, is less than that required for other types of employees—and, despite the fact that the psychologists were subject to minimal control and supervision, general instructions regarding organizational standards and procedures were to be performed were sufficient to find that they were employees.

- **Students**

PLR 8803041: A PhD student who received a grant from a local government agency to perform certain research was not required to treat the grant as income under §61 of the Internal Revenue Code, and was instead able to exclude the amount from income under §117 as a qualified scholarship. The IRS found that this payment was excludible from income because the research required under the grant was not in excess of that required to satisfy the student's requirements to obtain a PhD, the student and the student's advisor determined the topic of research, the student had not performed past services for the grantor, nor was there an expectation that the student would perform services for the grantor in the future, and the grantor had no control over the manner in which the student conducted the research.