

Greater Los Angeles Chapter of the APA

LAAPA CPP Study Group, Chapter One



Employee Classification

Why is it important?

Employee

- Withhold income, social security, and Medicare taxes from wages
- Pay social security and Medicare taxes
- Pay and in some states withhold unemployment taxes
- Provide Form W-2 at year-end

Independent contractor

- Obtain Taxpayer Identification Number
- Provide Form 1099-MISC at year-end

Other issues:

- Workers' Compensation Coverage
- Independent Contractor Reporting and withholding –tax withholding not required with valid TIN (Form W9)
- Employer provides a 1099-MISC when payments => \$600
- BIG ISSUE: Misclassification results in revenue loss for the IRS

Employee Classification

Employee or Independent Contractor

Common law test



Determining Classification

Degree of Control or Independence

Behavioral control	Does the worker or the company control the way the work is performed?
Financial control	Does the worker have an opportunity to make a profit or a loss?
Relationship of Parties	Does the company provide the worker benefits?

Determining Classification

Behavioral Control (Common Law Test)

- What level of instruction given?
- If control is only related to the outcome?
= IC
- What work will be done and how is it done? = EE
- Who provides training on how to perform the work?



Determining Classification

Financial Control (Common Law Test)

Un-reimbursed business expenses

- Substantial investment in the work
- Services available to the public
- Method of payment
- Profit or loss

Type of relationship

- Written agreement
- EE type benefits provided
- Term of the relationship
- Services are important aspect of regular operations



Determining Classification

Reasonable Basis Test

Although a worker may qualify as EE under Common Law Test they may qualify as an IC if there is a “reasonable basis” for doing so.

- Court decisions
- Published IRS rulings
- IRS technical advice/private letter ruling
- Guidance from attorney or CPA
- Past IRS audit
- Significant segment of industry
- Form SS-8 (Appendix page A-48)

Determining Classification

Form SS-8

Obtain IRS ruling

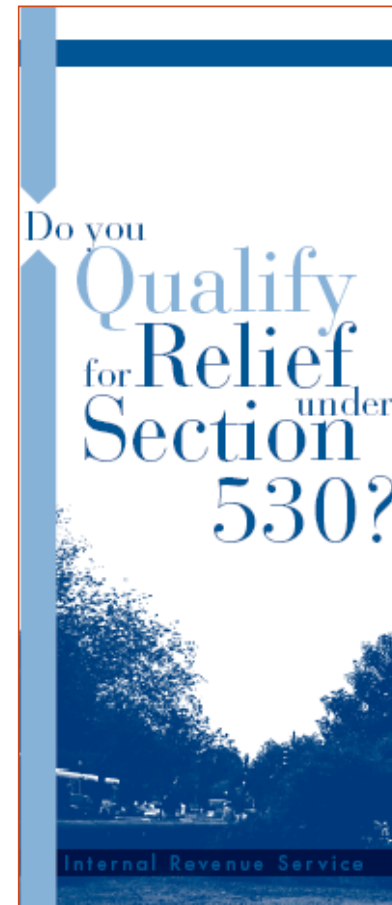
- Worker?
- Employee or Independent contractor

Form SS-8 (Rev. August 2011)		Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding		OMB. No. 1545-0004
Department of the Treasury Internal Revenue Service				For IRS Use Only: Case Number: Earliest Receipt Date:
Name of firm (or person) for whom the worker performed services		Worker's name		
Firm's mailing address (include street address, apt. or suite no., city, state, and ZIP code)		Worker's mailing address (include street address, apt. or suite no., city, state, and ZIP code)		
Trade name	Firm's email address	Worker's daytime telephone number	Worker's email address	
Firm's fax number	Firm's website	Worker's alternate telephone number	Worker's fax number	
Firm's telephone number (include area code)	Firm's employer identification number	Worker's social security number	Worker's employer identification number (if any)	
Note. If the worker is paid for these services by a firm other than the one listed on this form, enter the name, address, and employer identification number of the payer. ►				

Determining Classification

More Classifications

- Reasonable Basis Test
- Rulings from the IRS
- Other federal and state laws



Determining Classification

Small Business Job Protection Act of 1996

Clarifies how the reasonable basis test can be applied to workers.

- No need for previous determination by employer
- Employers protected when work status changes
- IRS must consider relationship when comparing two workers
- Burden of proof is on IRS after employer offers sufficient proof

Temp Agencies & Leased Employees

Temporary help agency

- Client may request or deny particular workers, but not hire and fire.

Employee leasing company

- Client may hire and fire, but leasing agency handles payroll, benefits, etc.

Statutory Employees

Payments not subject to FITW, subject to SS and MC and FUTA

General Requirements:

- Agree all services are performed by worker
- No substantial investment by the worker
- Work is part of continuing relationship, not a single transaction
- Report income on Form W-2, Box 1 and check Statutory Employee in Box 13

- Agent-drivers or commission drivers
- Full-time life insurance salespersons
- Traveling or city salespersons
- Homeworkers

D **I** **S** **H**

Statutory Nonemployees

- Qualify as employees under the common law test but treated as independent contractors
- Payment not subject to SS, MC and FUTA if certain conditions are met
 - Compensation related to sales or other work output
 - Work performed under written contract; not treated as employee for tax purposes
 - **Qualified real estate agents**
 - **Direct sellers**

A **statutory nonemployee** is defined by law and is treated as self-employed for federal tax purposes, including income, social security, and Medicare taxes.

R **E** **D** **S**

Statutory Nonemployees

- Payments are reported on Form 1099-MISC.

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Rents \$	2 Royalties \$	3 Other income \$	4 Federal income tax withheld \$	OMB No. 1545-0115 2016 Form 1099-MISC Miscellaneous Income Copy B For Recipient		
		PAYER'S federal identification number	RECIPIENT'S identification number	5 Fishing boat proceeds \$	6 Medical and health care payments \$		7 Nonemployee compensation \$	8 Substitute payments in lieu of dividends or interest \$
		RECIPIENT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds \$		11	12
Account number (see instructions)	FATCA filing requirement <input type="checkbox"/>	13 Excess golden parachute payments \$	14 Gross proceeds paid to an attorney \$	This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.				
15a Section 409A deferrals \$	15b Section 409A income \$	16 State tax withheld \$	17 State/Payer's state no.			18 State income \$		
		19	20			21		

Form **1099-MISC** (keep for your records) www.irs.gov/form1099misc Department of the Treasury - Internal Revenue Service

Backup Withholding

- Requirements
- Form W-9
- 28% of reportable payments



Unintentional Misclassification

For Not Withholding	Penalty
Federal income tax	1.5% of wages paid; increases to 3% if no Form 1099-MISC filed
Social security and Medicare tax	20% of employee's share of the tax; doubled to 40% if no Form 1099-MISC filed Must also pay employer's share of taxes

***IRS shares information with state agencies.
Retro benefits may also be required***

Intentional Misclassification

For Not Withholding	Penalty
Federal income taxes	Full amount of taxes that should have been withheld
Social security and Medicare taxes	Full amount of employee and employer portion of taxes
For failing to file returns or pay taxes	Additional penalties can be assessed

Mitigation of Misclassification



Voluntary Classification Settlement Program (VCSP) The VCSP is a voluntary program that provides an opportunity for taxpayers to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes

State Unemployment Insurance

Many states use the common law test, more than half use “ABC” test

- Absence of Control
 - Business is unusual and/or away
 - Customarily Independent contractor
- Tougher to exclude workers from state UI coverage under ABC test

Right to Work in US

- EEs hired after November 6, 1986 must complete for I-9. Complete at time of hire and can be electronic
- Verify required ID –must be original documents within 3 days (list on pgs. 1-25 to 1-26)
- Expired documents no longer acceptable
- I-9s must be kept for at least 3 years from date of hire or 1 year from date of termination, whichever is longer
- Penalties on page 1-30

E-Verify & Employment Verification

- Checks SSA and DHS databases to verify employment authorization of newly hired EEs
- Participation is voluntary in most instances
- Enroll on internet
- Photo matching tool available
- Not a prescreening tool
- Cannot be used to follow up on expired I-9 documents
- If not able to confirm must terminate EE – Penalties \$550 to \$1,100
- Federal contractors must use E-Verify
- Some states have their own programs

New Hire Reporting

- Federal requirement
- Effective October 1, 1997 states who had no new hire reporting requirement on Aug. 22, 1996 had to establish one. States who did had until Oct. 1, 1998 but had to report data received from ER to National Directory of New Hires by Oct. 1, 1997
- ERs are required to report EE name, address and SSN, and ER name, address and EIN
- ER in one state report to that state, in multi states filing electronically may designate one state to the Secretary of Health and Human Services
- Report new hires within 20 calendar days of date of hire
- States may require more information then federal Regs. Pg.N 1-40
- Fed does not require reporting of IC but some state may
- W4 can be used
- Penalties - \$25 each failure, \$500 if conspiracy
- Can be used to enforce child support and UI fraud