

NSDCCAPA 2016

CPP & FPC Study Group

Section 1

The Employer/Employee Relationship

1.1-Importance of the Determination

Payroll Source 2016 pg. 1.2

The most basic decision an employer must make when hiring a worker to perform a service is whether the worker is an employee.

Under the Internal Revenue Code (IRC), an employer must withhold income, social security, and Medicare taxes from employees' wages and match the withheld social security and Medicare taxes with employer funds.

Under the Federal Unemployment Tax Act (FUTA), covered employers must pay a certain % based on each employee's wages to support federal & state unemployment insurance programs. (public sector employers are exempt).

1.1 - continued

- Most states and some local governments also require income tax withholding from EE's wages
- All states require most ER s to pay "contributions" based on their EE s' earnings into state unemployment funds
- A few states also require ER s to withhold amounts from EE s' for unemployment insurance
- Several states require ER s to withhold amounts from EE s wages to fund state disability insurance benefit payments & make contributions to the disability plan out of their own funds
- A few state require EE withholding to fund paid family leave benefits
- Most companies have their own list of benefits and other entitlements they provide to their EE s as well (e.g., retirement plans, vacations, sick pay, health insurance, etc.)

1.2 Employee vs. Independent Contractor

Most of the problems ER s have in regard to worker classification arise when determining whether a worker is an EE or an independent contractor.

It is much less expensive to use an independent contractor as long as they provide the ER with a Taxpayer Identification Number (TIN), the ER s only obligations are to provide the contractor a Form 1099-MISC at the end of the year stating how much the contractor was paid for services rendered (if the total was at least \$600) and to send the IRS a copy of the form

 WATCH OUT – Page 1.3 *make sure to read*

- Social security and Medicare taxes need not be withheld from an independent contractor
- No federal or state unemployment insurance taxes are required
- EE benefits do not have to be funded, paid or administered on their behalf.

1.2-1 - Common Law Test

Payroll Source 2016 (pg 1.3 & 1.4)

There is no uniform definition of an EE under all payroll laws, most workers can be classified as either EEs or independent contractors once the “Common Law Test” has been applied.

The IRS relies on the common law test for the purpose determining whether taxes should be withheld.

The Right to Control is the key. Does the ER have the right to control what work will be done and how that work will be done? This will determine if an ER/EE relationship exists - the EE would be a common law EE.

Common Law Test

IRS looks to identify key control factors:

- *Behavioral Control*
 - *Level of instruction the business gives the worker*
 - *Level of training provided to the worker*

1.2-1 cont'd

Payroll Source 2016 (pg 1.4)

- *Financial Control*
 - Whether the worker has unreimbursed business expenses
 - Whether the worker has a substantial investment in the work
 - Whether the worker's services are available to the public
 - How the worker is paid
 - Whether the worker can realize a profit or incur a loss

1.2-1 Cont'd

- *Type of Relationship*
 - Whether there is a written agreement
 - Whether employee type benefits are provided
 - The term of the relationship
 - Whether the worker's services are an important aspect of the business's regular operations

 WATCH OUT PAGE 1.4 make sure to read (*Examples too*)

Managers are employees, too.

- Federal payroll tax laws apply to all levels of employees, including supervisors, managers, and other executives.
- Length of employment makes no difference. So long as an individual meets the common law test for employment status, a part-time or temporary employee is covered under the federal payroll tax laws.

1.2-2 Reasonable Basis Test page 1-6

- As determined by Section Code 530 (Safe Harbor), of the Revenue Act of 1978, even though the worker meets the definition of an EE under the common law test, an ER may treat the worker as an independent contractor exempt from federal payroll taxes if it has “reasonable basis” for doing so.
- The reasonable basis may consist of one or more of the following:

1.2-2 cont'd

- Court decisions, published IRS rulings, IRS technical advice sent to the ER, or a private letter ruling from the IRS indicating that the worker (or workers in similar situations) is not an EE.
- A past IRS audit of the ER (not of it's workers)
- A longstanding, recognized practice in a significant segment of the ER's industry of treating workers in similar situations as IC's

Consistent treatment is a must! In order to take advantage of the "safe harbor" provided by the reasonable basis test, the ER must treat the worker whose status is in question consistently as an independent contractor and must file all federal tax and information returns for the period in question based on that treatment. The treatment must have been consistent since 1978 by the ER and/or its predecessor.

WATCH OUT PAGE 1-8 make sure to read (*Examples too*)

1.2-2 cont'd

However, an employer cannot take advantage of s530 relief by filing the appropriate information returns only after the IRS has already challenged the ER treatment of workers as independent contractors in an audit, found them to be common law employees, and assessed back taxes and penalties.

Notice of Section 530 must be provided by IRS. Before a worker classification audit can begin, the IRS employee conducting the audit must give the ER written notice of the availability of the Section 530 safe harbor protections .

Form SS-8: IRS makes the status determination.

1.3 Employment Status Determined by Law

- The status of some workers is determined by law, specifically the Internal Revenue Code, regardless of what their classification would be under the common law or reasonable basis test. This means that a worker who would be considered independent contractors under one of these tests nevertheless are “statutory employees” for certain purposes. And some workers who would be considered employees under one these tests are treated as “statutory nonemployees” under the IRC.

1.3-1 Statutory Employees

- Statutory Employees are workers who, while they are not EE's under the common law , are treated as EE's for certain employment tax purposes:
 - Not subject to FITW
 - Subject to EE/ER SS & Medicare
 - In some instances subject to FUTA

Statutory EE's fall into to Four Categories:

1. Agent Drivers or Commission-Drivers
2. Full Time Life Insurance Sales Persons
3. Traveling or City Salespersons
4. Home Workers

Remember – ***DISH***-(Acronym for *Drivers, Insurance , Sales , and Home Workers*)

General Requirements:

Agree all service performed by worker

No substantial investment by worker

Work is part of the continuing relationship, not a single transaction

1.3-2 Statutory NonEmployees

- Certain categories of workers, while they may qualify as employees under the common law test, are nevertheless treated under the IRC as independent contractors for FITW, SS, Medicare and FUTA tax purposes. They are known as Statutory Nonemployees:
 - Not subject to FITW, SS, Medicare or FUTA so long as the specific criteria is met.

There are two categories:

Qualified Real Estate Agents

Direct Sellers

Remember **READS** – (*acronym for Real Estate Agents and Direct Sellers*)

General Requirements:

Most compensation directly related to sales or work output, not hours worked

Work is performed under a written contract and not subject to taxes

Importance of Determination

- Employee

- Required withholding and/or ER Contribution

- FITW
- Social Security & Medicare, EE & ER
- FUTA
- State & local Taxes

Worker's Compensation

Independent Contractor – Tax withholding not required with valid TIN (tax payer identification number)

ER must only submit 1099MISC when payments => \$600

Misclassification results in revenue loss for the IRS

Common Law Test

- IRS relies on this test in making worker status determination for tax purposes
- Factors under the Common Law Test
 - Right to control is Key-
 - What work will be done and how it will be done – EE
 - If control is only related to the outcome – IC (independent contractor)

Control Factors

Behavioral Control

Level of instruction given

Level of training provided

Common Law (Cont'd)

Financial Control

- Un-reimbursed business expense
- 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 relationship

Services are important aspect of regular operations

Other Types of Employee -1.4

EE's from Temporary Help Agencies

- Short term assignment
- Agency is paid a fee
- Employees of the agency
- ER has right to hire or fire
- Agency is responsible for paying taxes

Leased Employees

Leasing Co. hires and trains

ER can make decisions on hiring and firing, setting pay rate and supervising work

EE's of leasing Co. – pays wages, taxes, and benefits

Agency is paid a fee

Federal Wage-Hour Laws 1.6-1

- Also have definitions of employee status
- FLSA Regulates
 - Child Labor
 - Record Keeping Requirements
 - Overtime Pay
 - Minimum Wage Rates
 - Equal Pay
 - Remember Acronym – CROME

Finds EE/ER relationship exists where worker is “economically dependent “ on ER

State Unemployment Insurance Laws 1.6-4

Because the aim of state unemployment insurance laws is to provide benefits for individuals who are out of work through no fault of their own.

Under the ABC test, a worker is an independent contractor only if:

- Absence of Control
- Business is unusual and/or away
- Customarily independent contractor.

Worker Misclassification- Enforcement and Penalties 1.7

pg 1-19

- IRS Penalties – Unintentional
 - 1.5% of wages paid for not withholding FIT. Increases to 3% if returns are not filed
 - 20 % for not withholding SS & MC. 40% if 1099-MISC returns are not filed
- IRS Penalties – Intentional
 - Full amount of FIT that should have been withheld and 100% of EE/ER SS/MC
 - Plus penalties for not filing returns
- Enforcement efforts focused on:
 - 1099MISC
 - Receives W2 and 1099MISC in same year from same ER
- Worker Complaints

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

Proof of the Right to Work in the U.S.

1.8 pg 1-24

- Once the ER hire a worker as an EE, the EE must prove his or her identity and right to work in the US.
- Employers can protect themselves-ER will not be penalized under IRCA if they have acted in good faith.
 - Having EE fill out Section 1 of Form I-9, Employment Eligibility Verification
 - Making sure EE provide original documentary evidence of their identity and authorization to work within 3 business days of the date of hire
 - Making sure the documents establishing the EE identity and authorization to work appear genuine within 3 business days of the date of hire

Proof of the Right to Work in the U.S.

1.8 Cont'd pg 1-30

Documents prove identity and/or work authorization

Documentation changes. The Illegal Immigration Reform and Immigrant Responsibility Act of 1996 reduce the number of documents that USCIS must accept as proof of eligibility to work in the U.S.

In December 2008, USCI issued an interim final rule making further changes.

No expired documents are no longer acceptable to prove identity of work authorization.

Read BE CAREFUL and Watch Out too

PENALTIES: ER that knowingly hire or continue to employ unauthorized aliens face civil penalties of \$375 - \$3,200 for each worker hired for a first offense, \$3,200 - \$6,500 for a second offense and \$4,300 - \$16,000 for more than two offenses. Employers that fail to comply can be fined \$110-\$1,100 for each person for non proper verification.

New Hire Reporting pg 1-37

Federal Requirement

- Effective October 1, 1997 states who had no new hire reporting 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
- ER's are required to report EE name, address and SSN, and ER name, address and EIN
- ER's 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 7-20 calendar days*(read chart) of the date of hire
- States may require more information than fed regs
- Fed does not require reporting of IC but some states may
- W4 can be used
- Penalties - \$25 each failure, \$500 if conspiracy
- Can be used to enforce child support