

TouchPOINTS

...an HR / Benefits Administrator Publication written exclusively for MB clients & friends by Keystone HR Consulting

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Inside this issue:

EMPLOYEE VS. INDEPENDENT CONTRACTOR

The IRS and the U.S. Department of Labor are cracking down hard on employers who misclassify employees as independent contractors. Whether in good faith or by intent, classification errors are costing employers in back taxes, penalties, and headaches. Learn to tell the difference and protect yourself and your business.

RECOMMENDED BOOK

This issue's book recommendation comes with a money back satisfaction guarantee. It is an E-Book (Electronic Book that you download to your computer) and will help you to get your employees engaged and motivated to do their very best!



Employee Vs. Independent Contractor

Whether someone who works for an employer is an employee or an independent contractor is an important determination. Employers must pay federal and state unemployment taxes, Social Security and Medicare taxes, and worker's compensation premiums for all employees. Failure to pay these taxes can result in heavy fines and penalties.

The Fair Labor Standards Act requires the payment of a minimum wage and overtime for employees who are non-exempt. Employees who have worked overtime and not been paid for it because they were classified as "independent contractors" may be eligible for up to 3 years of back wages.

THE COMMON LAW

According to the IRS, "The general rule is that an individual is an independent contractor if you, the person for whom the services are performed, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result."

The IRS formerly used a 20 Factor "common law" test to determine whether a person is a contractor or an employee. The 20 factors have been reduced to 11 and grouped into 3 main categories: Behavioral, Financial, and Type of Relationship.

Behavioral factors include type and degree of detail of instructions given, such as when, where, and how to do the work or what tools or equipment to use. If the business provides training in how to do the work, the IRS will consider this strong evidence that the business wants the work done in a particular way, and this would indicate an employment relationship.

Financial factors include the extent to which the worker has a large investment in his business, whether or not the employer reimburses him for expenses such as travel, whether or not he has the risk of financial loss as well as the opportunity to make a profit, and whether or not the worker has the opportunity to offer his services to other businesses or is required to work full time for a single employer.

Type of Relationship factors include the permanency of the relationship, whether or not there is a formal written contract, employer provision of benefits (such as medical insurance, vacation pay, and pension rights) and whether the services provided by the individual are an integral part of the business.

The key element in every factor is who has the control. Of all the factors, the three that are most important in determining contractor vs. employee status are:

- If the employer gives specific instructions for how, when, and where the work is to be done,
- If the employer provides training in how to do the work, or
- If the contractor does not have his own business and has no financial stake in the project.¹

There is no pre-determined or set number of factors that automatically "makes" the worker an employee or an independent contractor. Likewise, no one factor stands alone in making this determination. Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. Also, factors which are relevant in one situation may not be relevant in another. It is important to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document all of the factors used in coming up with the determination.



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Employee Vs. Independent Contractor (Contd. from pg 1)

Statutory Employees

Some employers may not realize that even if workers are independent contractors under the common law rules, they may still be treated as “employees by statute” (statutory employees) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions for withholding Social Security and Medicare taxes as listed below.

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
- A full-time traveling or city salesperson that works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer’s business operation. The work performed for you must be the salesperson’s principal business activity.

An employer must withhold Social Security and Medicare taxes from the wages of statutory employees if all three of the following conditions apply.

- The service contract states or implies that substantially all the services are to be performed personally by them.
- They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
- The services are performed on a continuing basis for the same payer.²

The Reasonable Basis Test

The IRS has another means for determining contractor vs. employee status called “The Reasonable Basis” test. The reasonable basis test is considered a “safe harbor.” An employer may be able to use this rationale if they can prove that there was a reasonable basis for treating a worker as an independent contractor. In such a case, the IRS is prohibited from reclassifying the worker as an employee either prospectively or retroactively.

The IRS will recognize a reasonable basis for treating a worker as an independent if one or more of the following conditions exist:

- A court ruling in favor of treating workers in similar circumstances as non-employees;
- A ruling by the IRS (usually a Revenue Ruling) stating that similar workers are not employees subject to employment taxes;
- An IRS Technical Advice Memorandum or Private Letter Ruling issued to the employer, indicating that the particular worker isn’t an employee;
- A past IRS payroll audit that didn’t find workers in similar positions at your company to be employees; or a longstanding, widely recognized practice in your industry of treating similar workers as independent contractors.³

The IRS Is Coming

There has been a lot of flurry over the IRS announcement last year that it plans to launch an intensive employment tax research study of 6,000 randomly selected taxpayers as part of a national research program, or NRP, aimed at investigating tax compliance issues related to employment taxes, fringe benefits, independent contractor classification, expense reimbursements and other related “payroll” issues.⁴ They are hoping to find employee misclassifications in order to collect back taxes owed along with interest and penalties. They plan to add \$7 billion to the agency’s collections over the next 10 years.

The US Department Of Labor Weighs In

As if the IRS rules on independent contractors were not enough, the US Department of Labor, which oversees the enforcement of the Fair Labor Standards Act (overtime, minimum wage, and child labor) has its own set of rules and regulations with regard to the definition of an independent contractor. There is a downloadable Fact Sheet available: <http://www.dol.gov/whd/regs/compliance/whdfs13.pdf>.

The DOL makes its determinations independently of the IRS, so it is possible to meet the IRS test for independent contractor and fail the DOL test. Although there is some overlap between the IRS and the DOL factors, the DOL uses an “economic reality” test, not common law or the “Control” test used by the IRS.

What To Do Now To Protect Your Business

Although not foolproof, it may help to have the following documentation for each of your independent contractors:

- The worker’s employer identification number (Federal Tax ID Number)
- Copies of any business licenses, if required, and any professional licenses
- Certificates of insurance, including general liability insurance and workers’ compensation insurance (if the worker has employees)
- The worker’s business cards and stationery
- Copies of any advertisements done by the worker (e.g., yellow pages)
- A copy of the worker’s white pages business phone listing, if available
- A copy of the worker’s invoice form to be used for billing purposes



HR Metrics Why and What Should You Measure? *(Contd. from pg 1)*

- A copy of any office lease or other evidence of the worker's office or workplace
- The worker's unemployment insurance number issued by the state unemployment insurance agency (if the worker has employees)
- Copies of 1099s issued to the worker from other companies for which he or she has performed work
- The names and salaries of any assistants the worker has used on previous jobs for the past two years and proof that the worker has paid them

- Verification that the worker owns and maintains his or her own equipment and supplies necessary to perform the duties required under the agreement⁵

The IRS has a pamphlet to help employers properly classify their employees. It is available to download at: <http://www.irs.gov/pub/irs-pdf/p1779.pdf>. Businesses that employ individuals classified as "independent contractors" may want to take another look at those individuals and reconsider whether or not they meet the criteria for that status.

Notes

1. <http://www.comptroller.ilstu.edu/downloads/20-factor-test-for-independent-contractors.pdf>
2. <http://www.irs.gov/businesses/small/article/0,,id=179118,00.html>
3. <http://www.faegre.com/showarticle.aspx?Show=11290>
4. http://www.duanemorris.com/articles/irs_intensifies_employment_tax_audit_initiatives_3570.html
5. <http://www.faegre.com/showarticle.aspx?Show=11283>

Book Review Fire Up Your Staff On a Shoestring Budget

A Total System For Improving Employee Morale On A Daily Basis Without Spending a Lot of Money

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Are you in need of a morale boost for your company? Do you need something engaging yet cost effective? In 120 pages, this E-Book (A downloadable book that you keep on your computer) presents dozens of creative, easy-to-do ideas for improving employee morale. There are ideas on everything from rewards and recognition, employee recognition, and personal development to goal setting, emotional support, and team spirit. There are ideas for employee contests, newsletters, and finding low-cost seminars. The book also has certificates, coupons, and forms which can be downloaded and printed to your local printer. The book even comes with a full money-back guarantee if you are not happy with it. "Fire Up Your Staff" is a must-have for your business library!

Here's what others have said about "Fire Up Your Staff":

"We have purchased the "Fire Up Your Staff on a Shoestring Budget Kit", and have found it to be a very useful and insightful tool for motivating staff members. The philoso-

phies and ideas in the manual encourage ongoing training and motivational moments that are designed to have an enduring effect. I personally feel this is the only way to truly motivate staff - constant and continuous motivation is essential to create a positive working environment."

- Jodi R. Hulsey, QuestPro Consultants, Dallas, Texas.

"The information was creative, fun and most importantly affordable! We just loved the special awards ideas, especially the "Unsung Hero" award."

- Cheryl Gray, Army and Air Force Exchange Service, Dallas, Texas.

"My supervisors are completely fired up, and their enthusiasm has done wonders for our employees. Absenteeism has been virtually eliminated! "

- Jill Turner, Manager of Proxy Communica-

