



Employee vs. Independent Contractor

- Who are employees?
- Section 530 of the Revenue Act of 1978
- Classification Settlement Program
- IRC Section 7436

Types of Employees



- Common law or specific tax statute
- Identified as an employee under a Section 218 Agreement
- Identified as employee under state or local law
- Status may differ for FICA and for Federal income tax withholding

Employment Under the Internal Revenue Code



- IRC Sec. 3121(d)(2) Common law test
- IRC Section 3121(d)(3) Other employees by statute
- IRC 3401(c) Officer, employee, or elected official of government
- Reg. 1.1402(c)-2(b) Holder of public office is not self-employed



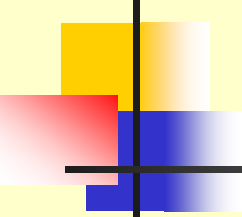
Examples of Public Officials

- Mayor
- Legislator or elected representative
- County commissioner
- Judge/justice of the peace
- County or city attorney, marshall, sheriff, constable
- Registrar of deeds
- Tax collector or assessor
- Road commissioner
- Board members



Fee-Based Public Officials

- Individuals who receive their income solely from fees received directly from the public are subject to self-employment tax and are not employees
- If fees are received by government and paid over to the official, they are considered wages paid to an employee



Common-Law Employee

Reg. Sec. 31.3121(d)-1(c)

Generally the employer-employee relationship exists when the person for whom services are performed has **the right to control and direct** the individual who performs the services, not only as to result, but also as to details and means.



Control Test

- Worker subject to control as to:
 - What is to be done
 - How it is to be done
 - Employer may allow broad freedom, but retains right to control



Tests Under Common Law

The IRS recognizes three categories of facts to consider when making a determination of employee status:

- Behavioral control
- Financial control
- Relationship of the parties

Behavioral Control

Facts that indicate whether entity has a right to direct and control how work is performed

- Instructions provided
- Training provided
- Government identification (i.e., badge)
- Nature of occupation
- Evaluation systems

Financial Control

Facts that indicate whether entity controls business and financial aspects of worker activities

- Significant investment in equipment, tools, or facilities
- Unreimbursed expenses
- Offers service to general public
- Method of payment (by job vs. by hour, etc.)
- Opportunity for profit or loss
- Part-time vs. full-time status
- Worker has corporate status

Relationship of the Parties

Facts to consider in determining how the parties view the relationship

- Can refuse payment for nonperformance
- Provide fringe benefits
- Discharge/termination rights
- Permanency
- Regular business activity
- Work is integral to business



Form SS-8

- If you are not sure whether a worker is an employee or independent contractor, you can complete Form SS-8 and send it to IRS for determination
- Information requested from worker and payer
- Not an examination, or re-examination of previously examined returns



Section 530

- Refers to Section 530 of the Revenue Act of 1978; not an IRC provision
- Originally one-year provision, extended indefinitely
 - May terminates taxpayer's employment tax liability with respect to an individual not treated as an employee



Section 530 - Examinations

- IRS must notify taxpayer at beginning of examination of section 530
- Publication 1976 should be provided
- Taxpayer does not need to make request to be eligible for section 530 treatment



Section 530 Requirements

- Reporting consistency
- Substantive consistency
- Reasonable basis



Reporting Consistency

- Filing all required Federal tax returns on a basis consistent with treatment of individual as not being an employee
- Employers that do not timely file Forms 1099-MISC cannot receive section 530 relief for those workers for that year



Substantive Consistency

- Treating all workers in similar positions the same
- Cannot be claimed if taxpayer has treated any individual holding substantially similar position as an employee



Reasonable Basis

- Business must have reasonably relied on one of the following--
 - Prior audit
 - Judicial precedent
 - Industry practice
 - Other reasonable basis



Section 7436

Limited grant of jurisdiction to Tax Court to

1. Review IRS determination that individuals performing services for taxpayer are employees
2. Review IRS determination that taxpayer is not entitled to relief treatment under section 530 with respect to those individuals
3. Determine the proper amount of employment tax under the above determinations



Section 7436 Requirements

- Must involve examination
- Actual controversy (218 cases- FIT only)
- Involving IRS determination that
 - Workers are employees under subtitle C Of Code, or
 - Service recipient not entitled to section 530 relief



Section 3509

- Special rates for employee share of tax
- Employer cannot recover employee share of taxes
- Employer remains liable for full employer share of taxes
- Employee liability for FICA tax not affected



Section 3509

- Available for Section 218 workers
- Counsel Guidance - Program Manager
Technical Advice 2009-034
- Not available for intentional disregard
- No 3402(d) relief provisions



3509 Rates

- If Form 1099-MISC was filed:
 - 20% of employee social security rate
 - 20% of employee Medicare rate
 - 1.5% of compensation FITW rate
- If Form 1099-MISC was not filed:
 - 40% of employee social security rate
 - 40% of employee Medicare rate
 - 3% of compensation FITW rate



Section 530 and Section 218 Agreements

- Anyone holding a position covered by a Section 218 Agreement is considered an employee
- 1993 Technical Advice Memorandum (PLR9336005)
- SSA jurisdiction (FICA)
- IRS jurisdiction (Federal income tax)



Section 530 Consequences

- Business meets 530
 - No worker status examination as to those workers
- Business does not meet 530
 - Worker status can be examined as to those workers
 - If workers are employees, Classification Settlement Program may be available



Classification Settlement Program (CSP)

- Provides standard agreement for closing examination agreements
- Only available for worker classification issues
- CSP consideration is mandatory in worker reclassification cases
- Acceptance is voluntary



CSP Resolution

- Settlement offer is based on Section 530 analysis
- Program offers a graduated settlement AND
- Prospective compliance



CSP Exclusions

Exclusions:

- Information Returns not timely filed
- A prior closing agreement on same issue
- Workers covered under Section 218(unless specifically excluded)
- Wage issues



CSP – More Exclusions

Exclusions (continued):

- Litigation/Judicial Proceedings
- Fraud/Criminal Investigations
- Third Party Arrangements



CSP Settlement Offers

3 types of Settlement Offers:

- 100% of tax for 1 year + prospective compliance
- 25% of tax for 1 year + prospective compliance
- No tax + prospective compliance (530)

More than one can apply to each case



Classification Settlement Program (CSP)

- Prospective compliance generally begins in the next quarter
- No Forms W-2 are required
- If the CSP offer is rejected normal audit procedures continue
- CSP offer is extended in the appeals process



CSP Case Study 1

Local Government :

- Has 218 agreement which excludes janitors
- Entity hires janitors and issues Forms 1099 timely
- Entity also janitor employees, wages reported on Form W-2
- Does CSP apply in this case?



Case Study 1 - Answer

Answer :

- CSP would apply, if inconsistency in hiring is not due to intentional disregard
- Workers are excluded from 218 agreement
- Entity hired both employee and independent contractors (no Sect. 530)
- 1 yr offer and 3509(a) rates apply



CSP Case Study 2

City Government Entity:

- Entity hires computer technicians, some receive earnings reported on Form 1099, some on Form W-2, performing same tasks (all returns timely filed)
- Entity has 218 agreement with no exclusions
- Does CSP apply? Do 3509 rates apply?



Case Study 2 - Answer

Answer:

- No - CSP does not apply
- Section 218 defines FICA coverage (SSA has jurisdiction)
- Section 3509 rates must be considered