

1099 vs. W2

Classifying Independent Contractors and Employees

February 23, 2019



1099 vs. W-2

- In this webinar we will discuss the classification criteria used to identify an individual/worker as an independent contractor or an employee
- Provide information on how to use IRS classification guidelines to determine whether an individual should be paid as an
 - Independent Contract (Accounts Payable)
 - Employee (Payroll)
- Focus on major issues school districts need to be aware of in order to avoid costly IRS penalties.

1099 vs W-2

- School districts must be aware that when paying an individual, the IRS requires Boards to make the correct worker classification prior to the services being performed.
- If in doubt, payment as employee reduces the risk of future tax problems for the individual and school district.
- The IRS and Department of Labor are teaming up and sharing information.

Issues with Misclassifications

- School districts increased use of independent contractors is being scrutinized by the federal government and state government agencies.
- Misclassifications cost the federal government lost revenue.
- Misclassifications may cost employees substantial sums in lost benefits, overtime and extra payroll tax liability
- State and federal agencies are increasingly auditing employers for compliance with the classification laws, and impose penalties on employers and employees in cases where misclassification is found.

Legal Considerations

- Various governmental agencies may audit school districts to make sure they do not classify employees as independent contractor
 - IRS
 - Federal Payroll Taxes
 - ACA requirements-Insurance
 - State Government
 - State payroll Taxes, unemployment insurance premiums
 - U.S. Department of Labor
 - (Employees rights, Minimum wage, overtime, etc.)
- Consequences of misclassification may include back taxes, interest, penalties and fines



Determining Worker Classification

- Only individuals who meet the legal requirement to be considered *independent contractors* can be paid through requisition/purchase order and accounts payable.
- *Independent Contractors* will received a 1099 for all payments in excess of \$600 per calendar year
- *Employees*, including part-time and temporary, should not be paid via accounts payable but should be hired by the board and paid thorough payroll.
- *Employees* receive a W-2 form for all payroll payment for the calendar year.

Independent Contractors

- A worker who individually contracts with an employer to provide specialized or requested services on an as-needed or project basis.
- This individual is free from the control and direction of the performance of their work, and the individual is customarily engaged in an independent trade, occupation, profession, or business.
- Independent Contractors are generally not covered by laws that apply to the employer-employee relationship.

Determining Worker Classification

- One factor that distinguishes an independent contractor from an employer-employee relationship is the degree of control the school system has and the right to exert over the individual performing the services.
- An employer-employee relationship exists when the school system has the right to:
 - Control and direct the individual performing the service
 - The results to be accomplished by the work
 - The means by which the result is accomplished
 - Whether or the rights are exercised

Classifying Independent Contractors

- Independent contractor determination is required for:
 - Individual
 - Sole Proprietor
 - DBA's
 - Disregarded single member LLC's
- The use of an employer identification number DOES NOT prove independent contractor status
- School system must request a W-9
- Contract and W-9 determines who the payee is, not what is on the invoice

Classifying Independent Contractors

- Independent contractor determination is not required for:
 - Corporations
 - Partnerships
 - Multimember LLC's
 - Single member LLC's electing to be treated as a corporation for tax purposes

Examples of Professional Services - Independent Contractors

- Substitutes
- Bus Services
- Tutors
- Therapists (Speech/Language & OT/PT)
- Nurses
- Custodial Services
- Security Services/SRO
- IT Services
- Consultants

IRS 20-Factor Test

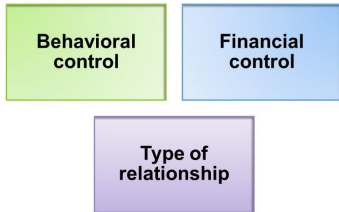
- | | |
|---|---|
| 1. Instructions | 12. Payments by hour, week or month |
| 2. Training | 13. Payment of expenses |
| 3. Integration | 14. Furnishing of tools and materials |
| 4. Services rendered personally | 15. Significant investment |
| 5. Hiring, supervising and paying assistant | 16. Profit or loss |
| 6. Continuing relationship | 17. Working for more than one firm at a time |
| 7. Set hours of work | 18. Making services available to the general public |
| 8. Full time required | 19. Right to discharge |
| 9. Work done on premises | 20. Right to terminate |
| 10. Order or sequence set | |
| 11. Oral or written reports | |

IRS 20-FACTOR TEST	YES	NO
1. Instructions Does the worker report or comply with the employer's instructions about when, where, and how to work?	<input type="checkbox"/>	<input type="checkbox"/>
2. Training Is the worker required to receive training from or at the direction of the employer, including attending meetings and courses with educational objectives?	<input type="checkbox"/>	<input type="checkbox"/>
3. Integration Are the worker's services integrated with activities of the employer? Does the success of the employer's business significantly depend on the performance of the worker personally?	<input type="checkbox"/>	<input type="checkbox"/>
4. Services Rendered Personally Does the worker have the ability to hire, supervise and pay assistants for the employer?	<input type="checkbox"/>	<input type="checkbox"/>
5. Continuing Relationship Does the worker have a continuing relationship with the employer?	<input type="checkbox"/>	<input type="checkbox"/>
6. Set Hours of Work Does the worker work full-time for the employer?	<input type="checkbox"/>	<input type="checkbox"/>
7. Full-time Work Required Does the worker perform work for the employer's premises and use the employer's facilities substantially?	<input type="checkbox"/>	<input type="checkbox"/>
8. Place of Work Does the worker perform work for the employer on the employer's premises and use the employer's facilities substantially?	<input type="checkbox"/>	<input type="checkbox"/>
9. Sequence of Work Does the worker perform work for the employer in a sequence set by the employer? Does the worker follow a schedule?	<input type="checkbox"/>	<input type="checkbox"/>
10. Reporting Obligations Does the worker submit regular written or electronic reports to the employer?	<input type="checkbox"/>	<input type="checkbox"/>
11. Method of Payment Does the worker receive payment for services and travel expenses?	<input type="checkbox"/>	<input type="checkbox"/>
12. Payment of Business and Travel Expenses Does the worker only on the employer for tools and materials?	<input type="checkbox"/>	<input type="checkbox"/>
13. Furnishing of tools and materials Does the worker make an investment in the facilities or equipment used to perform the work?	<input type="checkbox"/>	<input type="checkbox"/>
14. Investment Is the payment made to the worker on a fixed basis regardless of profitability or loss?	<input type="checkbox"/>	<input type="checkbox"/>
15. Risk of Loss Does the worker only work for one employer at a time?	<input type="checkbox"/>	<input type="checkbox"/>
16. Working for more than one company at a time Are the services offered to the employer available to the general public?	<input type="checkbox"/>	<input type="checkbox"/>
17. Availability of services to the general public Can the worker perform work at any time without limitation?	<input type="checkbox"/>	<input type="checkbox"/>
18. Right to discharge Can the worker quit work at any time without limitation?	<input type="checkbox"/>	<input type="checkbox"/>

Determining Worker Classifications

- IRS follows the common law test for determining whether an individual is an employee for federal tax purposes.
- The common law test to see if an employer-employee relationship exists.

IRS Control Test for Independent Contractors



IRS Control Test for Independent Contractors

- **Behavior Control:**
Behavior Control addresses the issue of the school district to direct and control/instruct how the individual performs the services for which they are hired.
- The individual/worker is an employee if the school system has the right to control/instruct:
 - What will be done?
 - How it will be done?
 - When it will take place?
 - Who provides materials, tools, equipment?

This is true even if the employee is allowed to exercise a great deal of freedom of action.

IRS Control Test for Independent Contractors

Behavior Control:

Factors to consider when looking at behavioral control include:

- the type and degree of instruction given
- the presence of a formal and regular evaluation process
- the type and amount of training provided

Precise instructions, formal evaluations and regular training are standard tools used to exercise control over not just the end product, but also the process involved in achieving that product.

IRS Control Test for Independent Contractors

Financial Control:

To determine that the employer does not control the business aspects of the job

- Does the individual possess a significant investment in assets or tools required to operate his/her own business?
- Are there expenses related to the performance of the services that the individual is responsible for paying and will not be paid or reimbursed by the school system?
- Does the individual advertise his/her services to the public?
- Will the school system be responsible for paying the individual whether or the work is done properly, or will he/she be paid only if the work is completed according to the specification?
- Will the individual be paid upon completion of services or upon completion of specific milestone or are structured payments required?
- Does the individual/worker have the opportunity to realize profit or loss?

IRS Control Test for Independent Contractors

Type of Relationship:

The employer does not control the business aspects of the job

- A written contract describes the relationship that the parties intended to create.
- Employer does not provide the worker with benefits, such as insurance, retirement, vacation or sick pay.
- The relationship's duration is finite and not long-term.
- The services performed by the worker are not part of the school system's regular business/mission.

Reasonable Basis Test

- When applying the IRS guidelines to the scope of work to be performed:
 - Does the person own and operate a business selling his/her services to the general public?
 - While the person performing the services for the school system, will he/she continue to perform similar services for other customers or would they have the right and ability to do so?
 - Does the school system expect the individual to work full time or virtually full time, or be available when needed by the school system?

Department of Labor Economic Realities Test

- The work performed is not an integral part of the employer's business
- The worker's opportunity for profit or loss depends on his or her managerial skill
- The worker's investment in performing the work is significant compared to employer
- The work performed require special skill and initiative
- The worker's relationship with the employer is not permanent or indefinite
- The employer's control over the worker is limited in nature an degree

Employee or Independent Contractor?

- The individual is an *employee* if the Board has the right to control the result of the services, the means and the methods of providing it.
- An *employee* is subject to the will and control of the employer not only as to what shall be done but how it shall be done.
- The factor is whether the Board has the right to control, not whether it actually did.
- *Independent contractor* decides the means and methods to get the results. The Board defines the result or outcome expected.

Employee or Independent Contractor

- *Employees* have periodic or ongoing training about procedures and methods on how to do the job.
- Evaluations are common for both employees and independent contractors. The more the evaluation measures how the tasks are completed, the stronger the indication the worker's an employee.
- An *employee's* risk of incurring a loss is very small.
- An *employee* provides his or her services to one business.
- An *employee* is guaranteed a regular wage amount for an hourly, weekly, or other rate. This is true even when the employer supplements the wage or salary.
- *Employees* often receive a variety of benefits from their employers including, but not limited to:
 - Retirement • Insurance • Leave

Misclassification: What's at Stake?

- If you classify an employee as an independent contractor and you have no reasonable basis for doing so, IRS may hold the school districts liable for employment taxes for that worker.
- The Board may be charged for the employee and employer share of the following taxes on the contracted individuals:
 - Federal Income Tax
 - Social Security Tax
 - Medicare Tax

School Districts IRS Audits

- School districts are becoming increasingly popular for IRS payroll audits.
- In the past, the IRS audits of school district have focused on whether compensation was properly reported to the government.
- The IRS is now looking at much more.
- There are some triggers for an IRS audit and you should be aware of what you can do to limit your exposure to potential IRS audits.

School Districts IRS Audits

Why is the IRS doing audits?

- Money (federal income taxes, Social Security, and Medicare tax plus interest and penalties)
- Non-compliance
- Why would they choose your district to audit

School Districts IRS Audits

What may trigger an audit?

- The issuance of a W-2 and 1099 for an individual in the same calendar year.
- 1099 for only one business
- Hiring a retiree an a independent contractor
- Unemployment request from a worker who received a 1099
- The IRS compliance efforts are generally focused on employment tax and information return reporting because school district are generally exempt from federal income tax

School Districts IRS Audits

What does the IRS look for?

- Are completed (name, address, TIN, type of entity) and signed Forms W-9 secured from all contractors prior to the work being performed or prior to payment for services rendered?
- How you determine who receives a Form 1099?
- Who determines and what criteria are used to determine whether a worker should be treated as an independent contractor or employee?

School Districts IRS Audits

What does the IRS look at?

- Does the district engage the services of former employees? If so, are they treated as employees or independent contractors?
- What employee fringe benefits does the district provide?
- What classes of employees receive what benefits?

School Districts IRS Audits

What does the IRS look at?

- IRS may review the purchased services expenditures - basically object 300's.
- IRS may ask for a electronic file of all the object 300 expenses in the past two years.
- They may review the list of vendors and compare with the list of W-2 employees

Other Potential IRS Data Request

- | | |
|---|--------------------------------------|
| • Payroll Files | • Superintendent Contract |
| • Chart of Accounts | • Vehicle Policy |
| • General Ledger | • Inventory |
| • Cash Disbursements Journal | • Employee Handbook |
| • W-2's | • Employee Fringes |
| • 1099 's | • 125 Cafeteria Plan |
| • Vendor File | • Employee Assistance Program |
| • Vendor W-9 | • Travel Reimbursement Documentation |
| • Quarterly 941 | |
| • Contracts with Individual Contractors | |

Relief Provision

- If a school district has a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker.
- To qualify for relief under Section 530 the school district must satisfy three conditions:
 - Reasonable Basis
 - Substantive Consistency
 - Reporting Consistency
- To get this relief, you must file all required federal information returns on a basis consistent with your treatment of the worker.
- The school district must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977.

Conclusion

- Certain factors will almost always define a worker as an independent contractor in every case:
 - not relying on the business as the sole source of income
 - working at his or her pace as defined by an agreement
 - being ineligible for employer provided benefits
 - retaining a degree of control and independence

Conclusion

- Are you giving 1099's to people whose work the school district really do direct and should be considered employees?
- Do you have individuals who receive a 1099 and a W-2 in the same calendar year?
- Are you paying stipends or incentives to "volunteer" coaches from student account funds via accounts payable?
- Are you issuing employees gift cards that should be taxable income but was excluded from their gross income and employee taxes not withheld and paid?
- Are you verifying vendors' classifications in NextGen to insure accurate classification in the vendor file set-up?

Common Law Test for Determining Whether a Worker is an Employee

Employee	Independent Contractor
<ul style="list-style-type: none"> Required to comply with employer's instructions about when, where, and how to work 	<ul style="list-style-type: none"> Sets own hours; determines own sequence of work
<ul style="list-style-type: none"> Works exclusively for the employer 	<ul style="list-style-type: none"> Can work for multiple employers; services available to the public
<ul style="list-style-type: none"> Hired by the employer 	<ul style="list-style-type: none"> Is self-employed
<ul style="list-style-type: none"> Subject to dismissal; can quit without liability 	<ul style="list-style-type: none"> A contract governs how the relationship can be severed
<ul style="list-style-type: none"> Has a continuing relationship with the employer 	<ul style="list-style-type: none"> Works by the job
<ul style="list-style-type: none"> Work done personally 	<ul style="list-style-type: none"> Permitted to employ assistants
<ul style="list-style-type: none"> Performs services under the company's name 	<ul style="list-style-type: none"> Performs services under the worker's business name
<ul style="list-style-type: none"> Paid a salary; reimbursed for expenses; participates in company's fringe benefits programs 	<ul style="list-style-type: none"> Payment by the job; opportunity for profit and loss
<ul style="list-style-type: none"> Furnished tools, equipment, materials, and training 	<ul style="list-style-type: none"> Furnishes own tools, equipment, and training; substantial investment by worker
<ul style="list-style-type: none"> If an outside salesperson: company provides leads, sets terms and conditions of the sale, assigns a territory, and controls the sales process 	<ul style="list-style-type: none"> Controls the sales process and terms

IRS Publication 15

- IRS Publication 15, the Employer's Tax Guide, explains your responsibilities as an employer.
- The IRS updates this publication annually. You should download a current version at the beginning of each year and review "What's New" for any changes.



QUESTIONS?

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