Worker Classification and Payroll Tax Issues

Chapter 9

SS Wage Limit for 2015

SSA Fact Sheet released 10/22/14

$118,500


$117,000 in 2014

(c) Annette Nellen, Gary McBride, 2014
Wages paid to children

Ross, TC Summary Opinion 2014-68 (7/10/14)
- Sole proprietor working in her home
- Children ages 8, 11 and 15
- Odd jobs – shredding, copying, clearing
- Paid via food and tutoring services via debit and credit cards
- No FICA, FUTA or withholding
- Court disallowed

Reminders – wages to children

- FUTA and FICA exempt (different ages though)
- Factors to consider - “Facts that militate against deductibility include: (1) failing to pay employment taxes and file information returns; (2) paying child a flat amount determined at beginning of year that is not based on services actually performed; (3) a lack of correlation between dates and amounts of payments and hours allegedly worked by child; (4) failing to maintain adequate records of child’s hours worked and amounts earned; and (5) compensating child for services which are in the nature of routine family chores.”
- Children were not paid set hourly wage.
Reasonable cause and FTP employment taxes

- *Stevens Technologies, Inc.*, TC Memo 2014-13
  - Delays in paying employment taxes for a few years
  - President of company and two family members had significant health problems during this time
  - S argued reasonable cause for FTP taxes
  - Court – no – ST “was able to continue its operations, market its services to clients and potential clients, increase its workforce, and hire an accounting firm to prepare its Forms 941.”
  - Decision not to pay was “deliberate” – ST focused more on business than tax compliance.

LLC members and SE tax

CCA 201436049 (9/5/14)

- LLC = investment management company with partners working full-time and EEs
- Paid everyone wages and issued W-2
- LLC members did not pay SE tax on distributive share of LLC income
- IRS dismissed these arguments:
  - Wages were reasonable comp; no SE tax owed
  - Distributive share of income = investment income
LLC and SE tax

- No specific guidance
- CCA referred to
  - Leg history (1977) of §1402(a)(13)
    - For ltd partners, income is really like investment income
  - *Renkemeyer* (LLC law firm)
  - Reither (H&W LLC, paid wages)
  - Rev. Rul. 69-184 – partners are not employees of the p/s
- 2014-2015 IRS-Treasury Priority Guidance Plan
  - includes to issue guidance on how §1402(a)(13) applies to LLCs

New view – Federal payments and SE tax

*Morehouse*, No. 13-3110 (8th Cir. 10/10/14)

- Tax Court held federal payments subject to SE tax
  - Not rentals
  - Construe 1402 broadly
- 5th Circuit
  - Not subject to SE tax
  - Land conservation payments to non-farmers = RE rentals, so no SE tax
  - Relied on Rev. Rul. 1960-32
    - Will IRS modify it?
  - Dissent – M’s activities = T or B
Worker classification

Non-tax cases

- Almost 3,000 FedEx drivers found to be employees
- NLRB & College Football Players
- DOL misclassification initiative still underway
  - + MOUs with 14 states and IRS
- State misclassification efforts

DOL Misclassification Initiative continues

- “In September 2011, former Secretary of Labor Hilda L. Solis announced a major step forward with the signing of a MOU between Department and IRS. Under this agreement, agencies work together and share information to reduce incidence of misclassification of employees, to help reduce tax gap, and to improve compliance with federal labor laws.”
- Also have MOUs with 14 states.
  - “enable Department to share information and to coordinate enforcement efforts with participating states in order to level the playing field for law-abiding employers and to ensure that employees receive the protections to which they are entitled under federal and state law. Employers that misclassify their employees may not be paying the proper overtime compensation, FICA and Unemployment Insurances taxes, or workers’ compensation premiums.”
- OMB FY2015 budget includes $14 million to “combat misclassification” including $10 million for grants to states
NYS Dept. of Labor

- Annual report of Joint Enforcement Task Force on Employee Misclassification (Feb. 2014)
  - DOL completed over 2,200 fraud investigations
    - Found about $271 million of unreported wages and about $10 million in unemployment insurance contributions due.
  - Found about 24,000 cases of misclassification.
  - 2 key problems found:
    - Misclassified workers (really employees)
    - “Off-the-Books” work


Connecticut Joint Enforcement Commission for Worker Misclassification

- Over 1 year completed:
  - 1,600 audits
  - 9,000 individual wage complaint investigations
  - Yielded:
    - Reclassification of about 6,500 workers.
    - About $50 million of unreported or underreported payroll.
  - “worker misclassification is an expanding problem that adversely affects businesses and workers.”
- Worker Misclassification Complaint Form created

[https://www.ctdol.state.ct.us/wgwkstnd/JEC/JEC.pdf](https://www.ctdol.state.ct.us/wgwkstnd/JEC/JEC.pdf)
[http://www.ctdol.state.ct.us/wgwkstnd/JEC/JEC.htm](http://www.ctdol.state.ct.us/wgwkstnd/JEC/JEC.htm)
Worker classification, athletes and scholarships

- March 2014 – NLRB – football players on scholarship are employees for NLRA purposes
- Under challenge now
- Relevance for tax purposes?
  - Excludable scholarship under §117 or payment for services? See IRS Info Letter 2014-0016.
  - Employee v contractor v neither?
  - If employee, payroll taxes and ACA!

Worker classification and §4980H

Reminders from Chapter 3 and earlier discussion

Improperly classified workers = Significant exposure!
Worker classification relevant for §4980H penalty

- To know if employer is ALE
  And
- If yes, which EEs need to be offered coverage
- Preamble to final reg (TD 9655; 2/12/14), pages 8567-8568
  ■ Section 530 relief n/a to §4980H penalty.
- §54.4980H-1(a)(15) defining employee:
  ■ "Employee means an individual who is an employee under the common-law standard. See §31.3401(c)-1(b). For purposes of this paragraph (a)(15), a leased employee (as defined in section 414(n)(2)), a sole proprietor, a partner in a partnership, a 2-percent S corporation shareholder, or a worker described in section 3508 is not an employee."

Data, problems and changes for VCSP

TIGTA, Better Worker Identification Data Are Needed For the Voluntary Classification Settlement Program (9/14)

- IRS does not get sufficient info to determine accuracy of application, payments or to monitor agreements.
  ■ EX – no info on names and SSN of workers reclassified.
- TIGTA made 5 recommendations for improvements and IRS agreed.
Misclassified worker

  - Manager of group home for health care provider (H)
  - Full-time + on call 24/7
  - Numerous responsibilities
  - H covered costs of groceries, repairs, etc.
  - R – nothing out-of-pocket
  - R – had not reported 1099 from H or 1099-G from gov’t for unemployment comp
  - Court – 7 factor analysis used
    - R is employee
    - R does not owe SE tax
    - Did owe §6662 penalty.

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**Figure 2: Summary of VCSP Applications Through April 25, 2014**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Applications Reviewed</th>
<th>Workers Requested to be Reclassified</th>
<th>Agreements Accepted</th>
<th>Workers Reclassified</th>
<th>VCSP Payments Received</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>638</td>
<td>12,437</td>
<td>565</td>
<td>11,749</td>
<td>$1,498,850</td>
</tr>
<tr>
<td>2013</td>
<td>629</td>
<td>11,083</td>
<td>532</td>
<td>10,071</td>
<td>$1,728,318</td>
</tr>
<tr>
<td>2014</td>
<td>241</td>
<td>4,323</td>
<td>206</td>
<td>3,623</td>
<td>$681,545</td>
</tr>
<tr>
<td>Total</td>
<td>1,508</td>
<td>27,843</td>
<td>1,303</td>
<td>25,443</td>
<td>$3,908,713</td>
</tr>
</tbody>
</table>

Source: VCSP monthly briefing as of April 25, 2014.
7 classification factors used by court

1. Control – Employee
2. Investment in Facilities – Employee
3. Opportunity for Profit or Loss – Employee
4. Right to Discharge – Employee
5. Integral Part of Regular Business - Employee
6. Permanency of Relationship – Employee
7. Relationship Contemplated by the Parties – Contractor

Wife as contractor for husband’s business

- *Jones*, TC Memo 2014-126
  - H & W separate businesses
    - H – law office
    - W – paralegal and business services
  - W hired to do a few projects for H to help with overload
    - Worked in home; H gave much leeway to avoid strain on marriage
  - All properly reported on return and SE tax paid by W
Court’s analysis

<table>
<thead>
<tr>
<th>Factor</th>
<th>Court’s analysis</th>
<th>Court finding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree of control principal exercised over details of the work</td>
<td>H told W what work was needed, but W decided how to accomplish that work</td>
<td>IC</td>
</tr>
<tr>
<td>Which party invested in the facilities the worker used</td>
<td>W worked in her home and H did not cover any expenses</td>
<td>IC</td>
</tr>
<tr>
<td>Worker’s opportunity for profit or loss</td>
<td>W received no regular wages, only paid when case completed. Possibility of receiving nothing.</td>
<td>IC</td>
</tr>
<tr>
<td>Whether the principal could have discharged the worker</td>
<td>H could discharge W.</td>
<td>EE</td>
</tr>
<tr>
<td>Whether work was part of principal’s regular business</td>
<td>Nature of work was of type performed by a law office.</td>
<td>EE</td>
</tr>
<tr>
<td>Permanency of relationship</td>
<td>No; related to specific cases. While worked over many years, could end at any time.</td>
<td>IC</td>
</tr>
<tr>
<td>Relationship the parties believed they were creating</td>
<td>H issued 1099-MISC; W paid SE tax</td>
<td>IC</td>
</tr>
</tbody>
</table>

Matchmaker web businesses

- Web-based company matches service providers with customers
  - Issue – who is the employer?
    - Read the “terms of use”
      - **Customer** may be the employer or responsible for any employment taxes and penalties imposed on the company.

- Query?
  - Are new rules needed?
Dealing with misclassification

Reminders …

- SS-8 option
- Form 8919, *Uncollected Social Security and Medicare Tax on Wages*
  - So worker gets SS credited to his account.
  - Filed by worker if employment taxes not withheld, worker is not contractor and 1 or more of 7 specified reasons applies to worker.
  - Also see IRM 21.6.4.4.15.1
- State reporting form may exist
Seek to be self-employed entrepreneur and has own established company.

Treatment as employee:
- Raises issues regarding retirement plans and health care coverage.
- Complicates employment taxes.
- Provides unemployment coverage.

Work with employer on alternatives.

Contractors …

- Should be filing Schedule C and paying SE tax.
- No benefits coverage from employer.
- ISRP (§5000A) if no health insurance and not exempt.
- No “safety net” laws.
- Add’l tax obligations
  - Local business license tax
  - Register for sales or similar tax if provide taxable goods or services.
- Recent example – NM – manicurist for salon treated as IC, assessed GRT, interest and penalty.
ACA Concerns for worker

- Misclassified contractor
  - Actual MAGI may be higher (w/o Sch C deductions)
    - Perhaps not eligible for PTC (or should be less)
  - Perhaps should have been covered by employer
  - ER perhaps not eligible for small business health credit

A few more updates …

- IRS Employment Tax Study – expect results in 2015
- Revisions to SS-8
- Help for When a Small Business Is Behind on Payroll Tax Payments
  - In-Business Trust Fund Express Installment Agreement (IBTF-Express IA).