

Always Sweat the Small Stuff With Independent Contractors

By Robert W. Wood

If you operate a business, you may well feel like the Internal Revenue Service and state tax agencies want to tax you to death (and then tax you some more). Apart from income tax rates that are always in the news, payroll tax revenues are also terribly important at both the federal and state levels. One of the prime areas in which both federal and California governments are pushing enforcement is payroll taxes. You should not have to think too hard to understand why.

Withholding on wages involves an immediate tax payment to the government, and gets the state and federal government money quickly and efficiently. Statistics show a dramatic difference between the efficacy of payroll taxes collected at the source and money sent in once a year with tax returns. There are also the extra taxes both employers and employees pay on payroll. The government gets up to 15 percent more this way, half from the employer and half from the employee.



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While it's true that the self-employment tax is the financial equivalent of both halves of the employment tax, it is notoriously under-collected. The self-employment tax is self-assessed and sent in once a year with income tax returns. There is a huge difference between withholding payment, immediate payment and sending money once a year.

The IRS has a far harder time collecting taxes from individuals. In fact, the sad reality is that if a worker gets a gross check and a Form 1099, the IRS may never see the money. Thus, the IRS has an overwhelming penchant to come out in favor of withholding and employment tax.

It's no secret that the IRS takes a dim view of employees masquerading as "independent contractors." Its view is that many employers thrust this treatment on workers so they will not have to pay payroll taxes. Classically, an employee is someone working full-time for wages, only for you, and doing what you say where, when and how.

Conversely, an independent contractor does a one-time job for you for a fee on his own schedule, with his own tools and in his own way. But given the blended roles, work habits and lifestyles of today's economy, these polar extremes seem increasingly rare. Instead, a mishmash of factors may make it very hard to discern who is an employee or an independent contractor in an often confused and blended fact pattern.

In this vast and changing landscape, is it still possible for someone to be an independent contractor? Yes, but the fact patterns are becoming more isolated. A one-time plumber who comes to your house or business may clearly be an independent contractor. A regular worker who does deliveries for you full time for years is a far more complex case.

If you are not sure, you can ask the IRS to rule whether a worker is an independent contractor or employee by submitting a Form SS-8 — a streamlined ruling form. Any worker or company can request a ruling. Moreover, although most other rulings from the IRS require a hefty fee, this type of worker status ruling is free.

However, as an old adage says, "Don't ask the question if you can't stand the answer." The vast majority of forms submitted — about 90 percent — are by workers. And most forms produce an IRS ruling that the worker is an employee. In fact, in one recent year, 72 percent of Form SS-8 requests produced rulings saying "employee." Twenty-five percent were closed without ruling, and only 3 percent were ruled to be independent contractors.

The IRS has revised the Form SS-8 form to request additional contact information from the employer and the worker, including fax numbers, e-mail addresses and website address. A new line asks if the worker was paid by more than one entity because of a sale, merger, acquisition, or reorganization. There are new questions whether the worker leases equipment, space, or a facility. Another asks whether the worker sets pay for services or products.

Even more importantly, the form asks how the company tells the public about the worker. Is it really clear to everyone that this person does not work as an employee and is independent? The IRS changes in the Form SS-8 should tell you that it looks at many nuances.

Of course, worker status questions often involve a plethora of factors, including: the amount of control exercised by the company, which party pays for work facilities, the worker's opportunity for profit or loss, whether the company can fire the worker, whether the work is part of the company's regular business, the permanency of the relationship, what relationship the parties believed they had; and whether employee benefits are provided.

These topics, however, are only the tip of the iceberg. In many respects, virtually anything that happens in the workplace can bear on the fundamental worker status question. Contractor vs. employee disputes are messy and hard to describe to anyone who does not do them for a living.

Although the stakes are high, determining who is an employee can be tough and can involve multiple legal tests. Much of the debate is about control, and which details impact the kind of "control" that makes a worker an employee. But some control is not fatal. Sometimes the terminology companies use can make all the difference.

Finally, you may need to throw some traditional business sense out the window. For example, we know it generally does not make sense to spend \$10,000 fighting a \$5,000 bill. But with worker status disputes, a small matter sometimes blossoms into a bigger one and then into a bigger one still. State and federal taxing and employment authorities share information today far more effectively than they did in the past. So don't be shortsighted. In this area, always sweat the small stuff.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.