

Sage Abra HRMS



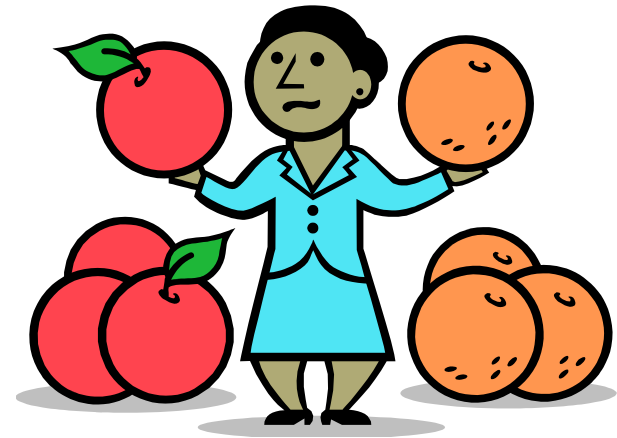
The HR Manager's Guide to Proper Worker Classification

sage

Classifying Workers

One of your **main responsibilities** as an employer is to make sure all workers are properly classified as employees or independent contractors.

If you incorrectly classify a worker, you could be subject to penalties by the IRS, and by many states.



Why Is Proper Classification Important?

1

Employers must withhold income tax for employees as well as their portion of social security and Medicare taxes.

2

Employers must also pay the employer portion of social security, Medicare, and unemployment (FUTA) taxes on employee wages.

3

Independent Contractors are responsible for paying their own income and self-employment taxes.

Why Is Worker Misclassification an Issue?

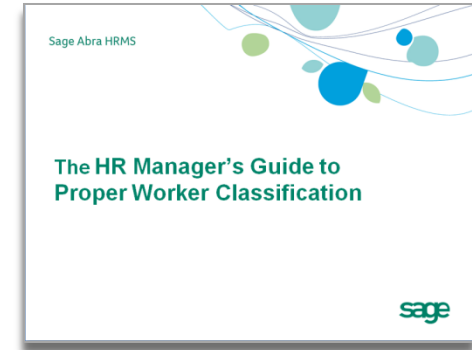
- The federal government believes that misclassified workers represent a large part of the employment tax gap.
- With soaring federal deficits, the current administration has made closing this gap a top priority.
- This year, the **IRS will perform 2,000 random employment tax audits** and one of the things they are scrutinizing is the classification status of independent contractors.



Where Can I Find Help to Properly Classify Workers?

1. This Guide

You've come to the right place—in this guide you'll find information and advice about how to properly classify workers.



2. The Internal Revenue Service

The IRS has a number of articles and publications online to help. For further reference, view the article ["Independent Contractor \(Self-Employed\) or Employee?"](#) or download [IRS Publication 1779](#).



Who Is Considered an Employee?

Employees are . . .

Individuals who perform services for the business and must follow the employer's guidelines regarding what and how the work will be done.

If the employer retains the right to direct and control, then the worker is an employee.

Who Are Independent Contractors?

An **Independent Contractor** is . . .

Someone who performs services for the business but can determine the means and methods of accomplishing the work.

In this case, the business who hires the contractor controls only the project deadline or result of the work.

Employee or Independent Contractor?

Businesses must examine the degree of control the business has over each worker by looking at three categories of factors from IRS Ruling 87-41:

1. Behavioral Control
2. Financial Control
3. Type of Relationship



Behavioral Control

Q:

Does the business have the right to direct and control how the worker performs the task for which s/he is hired?

A:

When an employer provides few details about how to perform services, it indicates that the worker is more likely an independent contractor.

Key Issues to Examine in Behavioral Control

- **Degree of Instruction**

If the instructions are detailed and include directives such as when and where to do the work or what tools and equipment to use, it indicates the worker is an employee.

- **Training**

- Did you provide the worker with training on how to do a job?
- Do you provide training about procedures and methods to follow when performing work?
- If so, this evidence points to an employer-employee relationship.



Financial Control

The IRS also looks at whether a worker has the ability to affect financial decisions.

These criteria are scrutinized:

- Are there unreimbursed business expenses that must be covered by the worker?
- Does the worker have a significant investment in assets or tools?
- Is the person available to work for other businesses?
- How does the business pay the worker, by the hour or by the project?
- Can the worker realize a profit or incur a loss?



Type of Relationship

Depending on how the parties work together, the worker may be an employee or an independent contractor.

- Does the worker receive any type of benefits such as vacation and sick pay or insurance?
- Is there a contract between the worker and the business?



Is the Relationship Permanent?

If a worker is hired for more than just a specific project or period, it is generally considered evidence that there is an employer/employee relationship.

However, simply because someone works part-time or earns less than \$600 per year does not automatically make them an independent contractor.



Seasonal vs. Part-time

The IRS states . . .

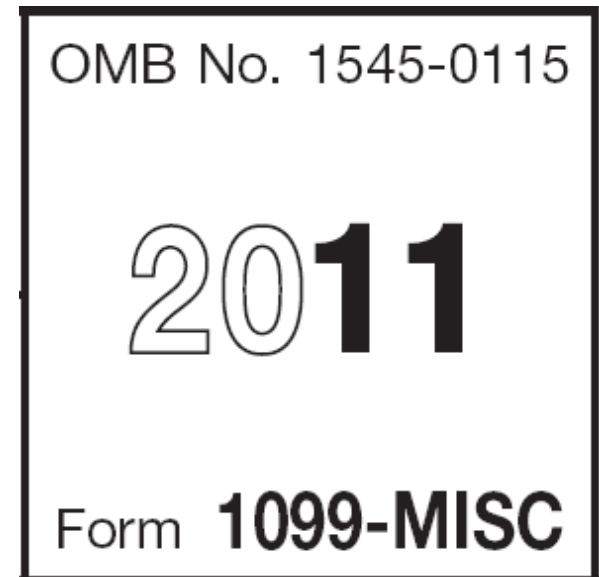
“There is no de minimis number of hours or minimum compensation which exempt an employer from the requirement to withhold income taxes and to pay and withhold employment taxes.”



“But They Signed a 1099?”

Just because a person signs a 1099 agreement, it does not automatically make that person an independent contractor.

All categories of evidence must be reviewed to determine if a worker is an employee or independent contractor.



If You Are Absolutely Stumped . . .

After reviewing the evidence, if you are unsure, you can file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

There is no charge for the determination, but it may take at least six months.

Form SS-8
(Rev. December 2009)
Department of the Treasury
Internal Revenue Service

**Determination of Worker Status
for Purposes of Federal Employment Taxes
and Income Tax Withholding**

OMB No. 1545-0041

Name of firm (or person) for whom the worker performed services
Firm's address (include street address, apt. or suite no., city, state, and ZIP code)
Trade name
Telephone number (include area code)
Firm's employer identification number

Worker's name
Worker's address (include street address, apt. or suite no., city, state, and ZIP code)
Daytime telephone number
Worker's social security number
Worker's employer identification number (if any)

Note. If the worker is paid by a firm other than the one listed on this form for these services, enter the name, address, and employer identification number of the payer. ▶

Disclosure of Information
The information provided on Form SS-8 may be disclosed to the firm, worker, or payer named above to assist the IRS in the determination process. For example, if you are a worker, you may disclose the information you provide on Form SS-8 to the firm or payer named above. The information can only be disclosed to assist with the determination process. If you provide incomplete information, we may not be able to process your request. See Privacy Act and Paperwork Reduction Act Notice on page 5 for more information. If you do not want this information disclosed to other parties, do not file Form SS-8.

Parts I-IV. All filers of Form SS-8 must complete all questions in Parts I-IV. Part V must be completed if the worker provides a service directly to customers or is a salesperson. If you cannot answer a question, enter "Unknown" or "Does not apply." If you need more space for a question, attach another sheet with the part and question number clearly identified.

Part I General Information

1 This form is being completed by: Firm Worker; for services performed (beginning date) to (ending date)

2 Explain your reason(s) for filing this form (for example, you received a bill from the IRS, you believe you erroneously received a Form 1099 or Form W-2, you are unable to get worker's compensation benefits, or you were audited or are being audited by the IRS).

3 Total number of workers who performed or are performing the same or similar services

4 How did the worker obtain the job? Application Bid Employment Agency Other (specify)

5 Attach copies of all supporting documentation (contracts, invoices, memos, Forms W-2 or Forms 1099-MISC issued or received, IRS closing agreements, IRS rulings, etc.). In addition, please inform us of any current or past litigation concerning the worker's status. If no income reporting forms (Form 1099-MISC or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue \$
If both Form W-2 and Form 1099-MISC were issued or received, explain why.

6 Describe the firm's business.

7 Describe the work done by the worker and provide the worker's job title.

8 Explain why you believe the worker is an employee or an independent contractor.

9 Did the worker perform services for the firm in any capacity before providing the services that are the subject of this determination request?
 Yes No N/A
If "Yes," what were the dates of the prior service?
If "Yes," explain the differences, if any, between the current and prior service.

10 If the work is done under a written agreement between the firm and the worker, attach a copy (preferably signed by both parties). Describe the terms and conditions of the work arrangement.

For Privacy Act and Paperwork Reduction Act Notice, see page 5. Cat. No. 16106T Form SS-8 (Rev. 12-2009)

Are There Federal Laws Concerning Worker Classification?

- **Fair Labor Standards Act**

The **Fair Labor Standards Act** of 1938 (29 US Code Chapter 8) is a federal statute that addresses the fair pay and treatment of employees. This law applies to employees but not to independent contractors.

- **Small Business Job Protection Act**

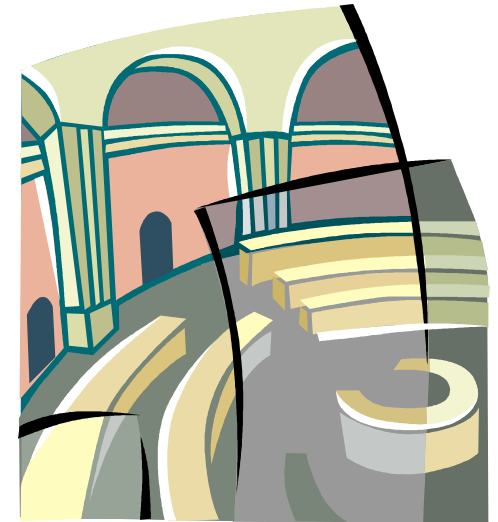
New worker classification rules were also enacted as part of the **Small Business Job Protection Act** of 1996 (SBJPA) [H.R. 3448](#). This law was meant to [clarify and amend](#) the rules of Section 530 relief, “which allows a taxpayer to treat a worker as an independent contractor rather than as an employee for employment tax purposes in specific circumstances.”

Potential Future Legislation?

Two bills were introduced in the last session of Congress but neither bill became law:

1. Employee Misclassification Prevention Act of 2010 (EMPA)
2. The Fair Playing Field Act of 2010

These bills could be reintroduced in the current session of Congress. If passed, they will place additional pressure on employers—especially those who use independent contractors. Both bills were strongly supported by the White House.



What is the Employee Misclassification Prevention Act (EMPA)?

If reintroduced and passed by Congress, the **Employee Misclassification Prevention Act** (EMPA) would authorize the Department of Labor (DOL) and the IRS to conduct audits to determine if workers are misclassified. The agencies can also share data with each other and with state agencies.

What are the Implications of EMPA?

It would amend the Fair Labor Standards Act to require employers to:

1. Maintain records of all hours worked by independent contractors.
2. Provide notification to employees and contractors of their status under FLSA.
3. Notify employees and contractors how to object to their classification to the DOL.
4. Pay penalties for misclassification.
5. Pay triple damages for willful violations of minimum wage and/or overtime wages resulting from the misclassification of an independent contractor.

What Is the Fair Playing Field Act?

If reintroduced, this legislation would seeks to close a safe harbor in Section 530 of the Revenue Act of 1978 that currently lets employers treat workers as independent contractors for employment tax purposes if they had a reasonable basis for their classification and always issued a 1099 to the worker.

What are the Implications of FPFA?

Going forward, this bill would reduce the use of the safe harbor by:

1. Letting the IRS issue guidance on worker classification issues.
2. Requiring the Secretary of Treasury to issue prospective guidance and annual reports on worker misclassification.
3. Changing the tax code so that a reduced penalty is not available where employers fail to comply with IRS/Treasury guidance.
4. Requiring businesses to provide independent contractors with written information about their tax obligations, the employment laws that do not apply to them, and their right to seek a status determination from the IRS.

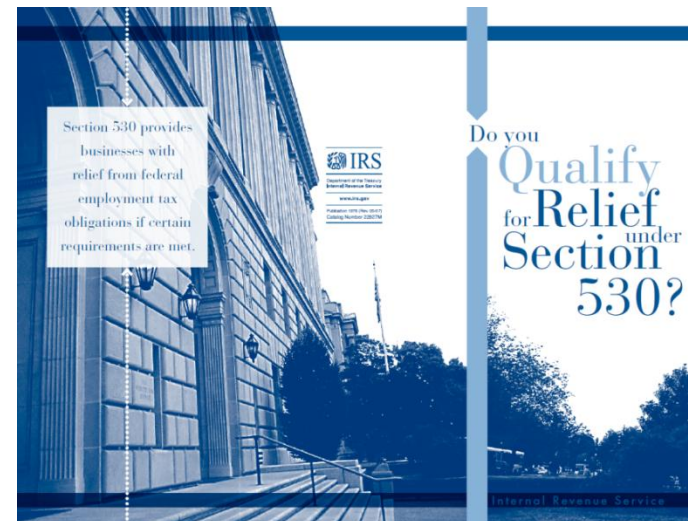
What is Section 530?

This section provides employer relief from federal employment taxes if certain requirements are met.

Relief requirements:

- Reasonable basis
- Substantive consistency
- Reporting consistency

Download [IRS Publication 1976](#) for more information.



Do State Laws Concerning Worker Misclassification Exist?

Yes

Pennsylvania Gov. Ed Rendell signed the Construction Workplace Misclassification Act ([H.B. 400](#)) in late 2010.

Robert W. Wood writes in [Forbes](#) that this law will . . .

*“make it a **criminal** offense for a contractor to knowingly misclassify an employee as an independent contractor. The more times you violate it, the worse the punishment. Other states imposing criminal penalties for at least some worker misclassifications include New York, Nebraska, Connecticut, Illinois, Massachusetts, and New Jersey, to name a few.”*

Are Employee Misclassification Issues Here to Stay?



The DOL received an increased budget and added 250 new field investigators. Congress has seen a number of bills introduced over the years, attempting to prevent misclassification.

Though these bills have not passed into law, more bills will be introduced to address the issue. More states are likely to add regulations to crack down on misclassification of independent contractors.

What Should My Company Do Now?

Compensation managers should be performing internal audits of all positions for inside and outside contractors to determine if they are appropriately classified.

If you have a contractor who works 40 hours a week in your facility with expectations that s/he will be present during particular hours each day—you may need to reconsider that worker's classification.

Five Tips for Proper Worker Classification

- 1 Read and understand the rules about worker classification.
- 2 Develop a checklist of items you need to see before hiring independent contractors.
- 3 Create written independent contractor agreements.
- 4 Routinely review worker classification status and maintain records to support your decisions.
- 5 Ask for help.

Things To See Before Hiring Independent Contractors

Always ask to review:¹

- Signed contract
- Signed W-9 form
- Copy of fictitious or assumed business name statement or application
- Information on how business is structured (sole proprietorship, partnership, corporation, or LLC)
- Business address and phone number
- Unemployment insurance number and Employer Identification Number (if contractor has employees)
- Copies of professional or business licenses
- Contact information for other clients
- Samples of marketing materials (ads, Yellow Pages listing, etc.)
- Business card, professional stationery, invoice form, or website address
- Copies of insurance certificates

¹ How to Manage Independent Contractors:

http://www.bnet.com/article/how-to-manage-independent-contractors/180223?tag=mantle_skin:content

Create Written Independent Contractor Agreements

Make sure you draft an agreement that addresses the specific items that the IRS has used to define an independent contractor relationship.

Independent contractors are self employed and should be able perform their duties with more flexibility than regular employees.

Read these [tips](#) for drafting agreements.

In Summary . . .

Routinely review worker classification statutes and maintain records to support your decisions.

- A worker's classification may change over time, so be sure to look at the behavioral control, financial control and relationship factors for each project.
- Keep records on file that support your decision.

Ask for Help

- If it is unclear which category a worker falls into, seek guidance.
- Besides asking the IRS, you can also ask compliance experts and law firms to review your situation.

About Sage Abra HRMS

Sage Employer Solutions is dedicated to helping organizations maximize their return on employee investment (ROEI).

Built by HR professionals for HR professionals, Sage Abra HRMS provides powerful yet easy-to-use automation to simplify management of HR, payroll, benefits, compliance, reporting, time off, training, employee self-service, and employee analytics.

To learn more, please visit: www.SageAbra.com