



DILLWOOD BURKEL & MILLAR, LLP

EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

The Internal Revenue Service has renewed their efforts to identify workers who are misclassified as independent contractors when in fact they should be treated as employees. The cost to employers who incorrectly treat workers as an independent contractor includes payroll taxes, penalties, and interest, not to mention the time and effort to file amended payroll tax returns and possible back payments related to employee benefits, such as retirement plans, overtime pay, vacation and sick leave. The California Employment Development Department is perhaps even more aggressive than the IRS in payroll tax audits, and the EDD does not conform to the Internal Revenue Code that contains some Federal relief provisions.

There are a number of factors that are considered when evaluating whether a worker is an employee or an independent contractor. The most basic test for determining whether a worker is an employee or an independent contractor is the right of the employer to control the manner and method by which the work is performed. This right of control is irrespective of whether the employer actually exercises the control.

Some other examples to indicate an employee relationship are: 1) If the work performed is an integral part of the employer's normal operations, 2) if the worker follows company procedures, 3) if the worker is considered unskilled, 4) if the worker uses the company equipment, and 5) if the worker does not perform similar work for other businesses. This list is by no means all-inclusive. A worker can be seasonal or part-time – this has no bearing on whether they are an independent contractor or an employee. There are many considerations that should be considered in making a proper determination. The IRS lists the various factors on their website, as does the EDD. We strongly encourage you to consult with legal counsel experienced in employment practice matters if you have any questions.

1099 CONSIDERATIONS

The IRS requires companies to file an information return to independent contractors who performed services and received \$600 or more during the year. There are other types of 1099's with other requirements that are listed on the IRS website. The penalties for failure to file correct 1099's are significant.

In their efforts to enforce the 1099 filing requirements, various tax forms now require an affirmation that all necessary 1099's are filed. If there are outside services, contract labor, professional services, or other similarly worded expenses on the business forms, the IRS will be looking for a match. Failure to file correct 1099's could result in not only significant penalties and interest, but also a disallowance of the underlying deduction.

We can assist with 1099 filings if you request our services.