

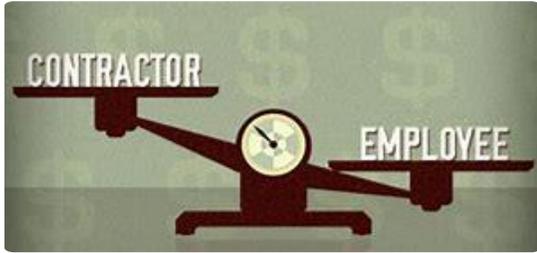
Benefits and Tax Reporting Worker Classification

AASBO Certificate Program

September 20, 2022

Disclaimer

- This information is presented to the Alabama Association of School Business Officials (AASBO), Payroll/Personnel Certificate Program, on September 20, 2022.
- The information contained herein has been prepared in good faith on behalf of AASBO and is for the sole purpose of information and education. Every effort has been made to ensure the accuracy of the information presented as factual. This presentation is designed to provide information and not a specific determination for your situation. Users are directed to countercheck facts when considering the use of the information.



Workers may be:

- Employees
- Independent Contractors

How do you know?



W2 vs. 1099

- In this session 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.

W-2 vs. 1099

- 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.

The Problem: *Misclassification*

- A common problem arises where employers misclassify workers who are employees under the law as independent contractors.
- Studies suggest that 10 to 30 percent of employers may misclassify their employees as independent contractors.

The Problem: *Misclassification*

- Workers misclassified as independent contractors are wrongfully denied access to important benefits and protections, such as:
 - Minimum wage and overtime pay
 - Insurance and other benefits
 - Family and medical leave
- Misclassified employees may still be eligible for unemployment insurance, but misclassification complicates their ability to collect these benefits.

The Problem: *Misclassification*

- 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



**Worker classification
determinations are made on a case-
by-case basis, depending on the
specific facts and circumstances**

EMPLOYEES

- Based upon the finding of the review, an individual classified as an employee will be set up as such in Human Resources.
- The employee will track his or her hours in the Time and Attendance System, receive payments, including proper tax withholdings, through Payroll Services and they will receive a W-2 for their earnings.
- Under an employer and employee relationship, the employer must withhold all applicable income tax and the employer's portion of social security and Medicare taxes. The board is also required to pay a portion of the Social security, Medicare and unemployment taxes on these wages.
- Employees are issued W-2, Wage and Tax Statements, detailing all taxes withheld from wages.
- Employees may also deduct unreimbursed business related expenses on their income tax return.

A large, white, cloud-shaped thought bubble with a black outline is centered on a solid blue background. Inside the bubble, the words "INDEPENDENT" and "CONTRACTOR" are written in a bold, black, sans-serif font, stacked vertically. Three smaller, white circles with black outlines trail from the bottom-left corner of the main bubble, suggesting a thought process.

**INDEPENDENT
CONTRACTOR**

INDEPENDENT CONTRACTORS

- If the individual is deemed to be an Independent Contractor, they will be set up in the Accounts Payable vendor master.
- Payments will not be made without ALL required documentation including a certified FORM W-9.
- Accounts Payable will not withhold taxes from payments made. All amounts exceeding \$600 for a given calendar year will be reported to the IRS as Non-Employee Compensation (Box 7) of Form 1099-MISC.
- Independent Contractors are responsible for paying their own income and self-employment taxes and may deduct business related expenses on their income tax return.

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.

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

Public Officials

- Mayor
- Legislator or elected representative
- County commissioner
- Judge/justice of the peace
- County or city attorney, marshal, sheriff, constable
- Registrar of deeds
- Tax collector or assessor
- Road commissioner
- Board members

Determining Worker Classification

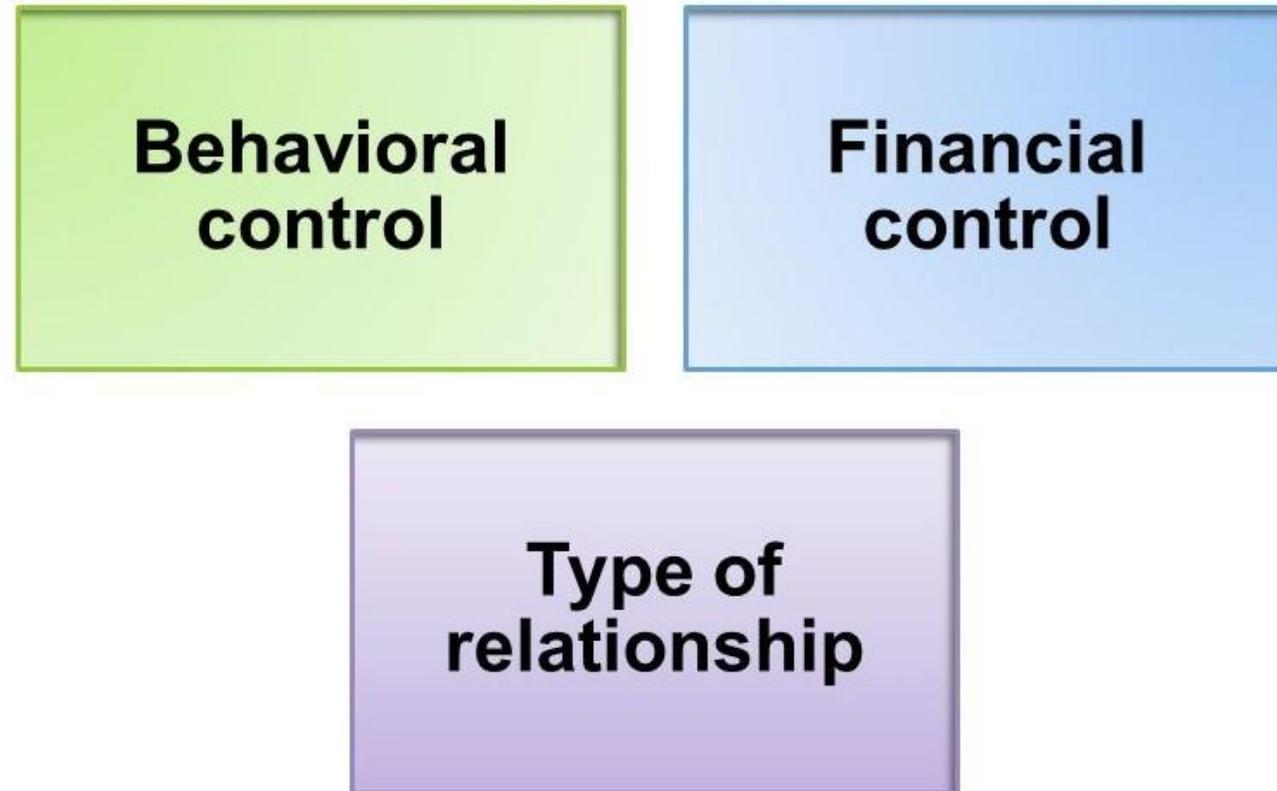
- One factor that distinguishes an independent contractor from an employer-employee relationship is the degree of control the school system has and the right to exert over the individual performing the services.
- An employer-employee relationship exists when the school system has the right to:
 - Control 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

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

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.

CLASSIFICATION CRITERIA

COMMON LAW FACTORS

	Most likely considered an IC if you:	Most Likely considered an employee if you:
BEHAVIORAL CONTROL		
Factors that show whether a hiring firm has the right to control how a worker performs the specific tasks he or she has been hired to do	<ul style="list-style-type: none"> Do not give him or her instructions on how to perform the work Do not provide training Do not evaluate how the worker performs 	<ul style="list-style-type: none"> Provide instructions that the worker must follow about how to work Give the worker detailed training Evaluate how the worker does the job
FINANCIAL CONTROL		
Factors showing whether a hiring firm has the right to control a worker's financial life	<ul style="list-style-type: none"> Has a significant investment in equipment and facilities Pays business or travel expenses him or her self Makes his or her services available to the public Is paid by the job Has an opportunity for profit and loss 	<ul style="list-style-type: none"> You provide equipment and facilities free of charge You reimburse the worker's business or traveling expenses The worker makes no effort to market his or her services to the public You pay the worker by the hour or other unit of time The worker has no opportunity for profit or loss – for example, because you pay by the hour and reimburse all expenses.
RELATIONSHIP OF THE WORKER AND HIRING FIRM		
Factors showing whether you and the worker believe he or she is an IC or Employee	<ul style="list-style-type: none"> You do not provide employee benefits such as health insurance You sign an IC agreement with the worker The worker performs the services that are not part of your regular business activities 	<ul style="list-style-type: none"> You provide employee benefits You have no written agreement The worker performs services that are part of your core business

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 as an 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 worker classifications?
- 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?

Consider:

- 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
• Required to comply with employer's instructions about when, where, and how to work	• Sets own hours; determines own sequence of work
• Works exclusively for the employer	• Can work for multiple employers; services available to the public
• Hired by the employer	• Is self-employed
• Subject to dismissal; can quit without liability	• A contract governs how the relationship can be severed
• Has a continuing relationship with the employer	• Works by the job
• Work done personally	• Permitted to employ assistants
• Performs services under the company's name	• Performs services under the worker's business name
• Paid a salary; reimbursed for expenses; participates in company's fringe benefits programs	• Payment by the job; opportunity for profit and loss
• Furnished tools, equipment, materials, and training	• Furnishes own tools, equipment, and training; substantial investment by worker
• If an outside salesperson: company provides leads, sets terms and conditions of the sale, assigns a territory, and controls the sales process	• 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.

Resources

- www.irs.gov
 - Type keywords “worker classification” in search box
- [Pub 15-A PDF](#) – *Employer’s Supplemental Tax Guide*
- [Pub 1779](#)

[Pub 963](#)

www.ncssa.org/statessadminmenu.html



QUESTIONS?

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