

**To Be or Not To Be  
An Employee;  
That, indeed, is the  
Question.**

HEIZER | PAUL LLP

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**HEIZER | PAUL** LLP

EMPLOYMENT and  
EMPLOYEE BENEFITS for  
PUBLIC & PRIVATE  
SECTOR EMPLOYERS

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**“CONTRACT  
EMPLOYEE”**

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**“CONTRACT  
EMPLOYEE”**

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**EMPLOYEE** v. INDEPENDENT CONTRACTOR

You **hire** employees for a **wage or salary** to work for the City for an **indefinite period** and you issue them a **W-2**.

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**EMPLOYEE** v. INDEPENDENT CONTRACTOR

You **retain** independent contractors for a **fee** to perform a **specific project** within a **specific time** and you issue them a **1099**.

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**Make ‘em employees,  
unless you can prove they  
aren’t.**

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- Who Cares ???**
- Internal Revenue Service
  - US Department of Labor / OSHA
  - US Equal Employment Opportunity Commission (“EEOC”)
  - Social Security Administration/Medicare
  - Workers Compensation Program
  - Unemployment Insurance Programs
  - Colorado Dept of Labor & Employment
  - I.C.E.

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**IRS**

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**“MISCHARACTERIZATION”  
OF EMPLOYEES  
AS INDEPENDENT  
CONTRACTORS**

- ▶ MAYBE \$50 BILLION IN LOST TAXES
- ▶ MAYBE 30% OF EMPLOYERS GET IT WRONG AT SOME POINT

*And the IRS considers these easy taxes to collect*

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**IRS**

**Characterization  
of  
MUNICIPAL OFFICIALS  
and EMPLOYEES**

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**IRS**

- CALIFORNIA
- COLORADO
- FLORIDA
- NORTH CAROLINA
- OKLAHOMA
- TEXAS

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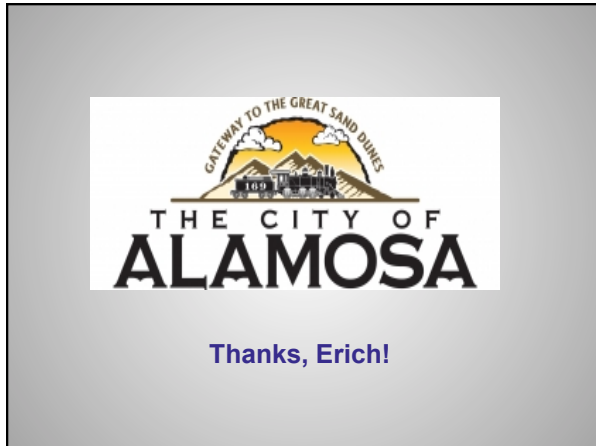
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**IRS**  
 Summer 2013  
 RE: Mischaracterized Municipal Employees  
 Greetings!  
 You're screwing up the following:

- **Municipal Judge**
- **City Attorney**
- **City Prosecutor**
- **Recreation Instructors**

Pay up.

XXOO,  
*The Service*

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**IRS**

Two Tests:

- ▶ **THE "PUBLIC OFFICIAL" TEST; and**
- ▶ **THE "COMMON LAW EMPLOYEE" TEST**

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▶ THE “PUBLIC OFFICIAL” TEST

Judicial Interpretations of IRC and TREASURY REGS:

“Employee” includes anyone who serves as an elected or appointed “Public Official.”

***BUT,***

No Express Definition of “Public Official” in the Code.

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▶ THE “PUBLIC OFFICIAL” TEST

Determination Factors:

- Position Created by Charter, Statute, or Ordinance.
- Authorized to Exercise Delegated Powers of Government.
- Authority & Duties Established by Legislative Body (e.g., GA or Council).
- Duties Performed Independently & Without Control by Superior Authority other than the Law. \* \* \*

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▶ THE “PUBLIC OFFICIAL” TEST

Determination Factors:

(Charter/Delegated Powers/Council Est'd/Independent)

- Position has “Permanency & Continuity.”
- Position requires Oath of Office.

*Service includes Judges & City Attorneys as examples of Public Officials in its regulations and published guidance. . . BUT*

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▶ **THE “PUBLIC OFFICIAL” TEST**

26 C.F.R. 31-3401(c)-1(c)  
(Defining “Employee” for Income Tax)

*“[g]enerally, physicians, lawyers ... and others who follow an independent trade, business, or profession, in which they offer their services to the public, are not employees.”*

(emphasis – and frustration -- added)

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▶ **THE “PUBLIC OFFICIAL” TEST**

**BUT**

26 C.F.R. 1.1402(C)-2  
(Defining “Public Official”)

*In general, “the performance of the functions of a public office does not constitute a trade or business.”*

Bummer...

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▶ **THE “PUBLIC OFFICIAL” TEST**

Bottom Line:

- Relatively Permanent Position
- Created by Statute, Charter, or Ordinance
- Authorized to Exercise City’s Authority
- Answers to Council
- Takes an Oath

You’re a **Public Official** and an **Employee**,  
And **CAN’T** be an Independent Contractor... \*

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▶ **THE “PUBLIC OFFICIAL” TEST**

**UNLESS**  
**You’re a**  
**FEE-BASED**  
**Public Official**

*Substantially All Income Derived  
 from Fees Paid Directly by Public*

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**IRS**

**Two Tests:**

▶ **THE “PUBLIC OFFICIAL” TEST; and**

▶ **THE “COMMON LAW  
 EMPLOYEE” TEST**

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▶ **THE “COMMON LAW  
 EMPLOYEE” TEST**

*In a word,  
 it’s all about*

**CONTRO**

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▶ **THE “COMMON LAW EMPLOYEE” TEST**

Applies to Both  
**INCOME TAX**

and

**FEDERAL INSURANCE CONTRIBUTION ACT (“FICA”) TAX**

*cf. Public Official Test applies only to Income Tax Liability*

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▶ **THE “COMMON LAW EMPLOYEE” TEST**

The Old Twenty-Three Factors were consolidated into

**THREE BROAD CATEGORIES:**

- ▣ **BEHAVIORAL CONTROL**
- ▣ **FINANCIAL CONTROL**
- ▣ **TYPE OF RELATIONSHIP**

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▣ **BEHAVIORAL CONTROL**

Who Has Authority to Decide:

- ▶ **WHEN & WHERE**
- ▶ **TOOLS, EQUIPMENT, OFFICE SPACE**
- ▶ **HOW MANY ASSISTANTS**
- ▶ **SEQUENCE OF WORK**
- ▶ **TRAINING**
- ▶ **SUPERVISION**

*The more often the answer is “the City,” the more likely the IRS will find Behavioral Control.*

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**▣ FINANCIAL CONTROL**

- ▶ COMPENSATION: Hourly, Salary, or Fee?
- ▶ SIGNIFICANT INVESTMENT
- ▶ SELF-PROMOTION
- ▶ EXCLUSIVITY
- ▶ POTENTIAL FOR PROFIT & LOSS

*The less risk the worker carries, the more likely the IRS will find Financial Control.*

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**▣ TYPE OF RELATIONSHIP**

- ▶ FORM W-2 or FORM 1099
- ▶ BUSINESS ENTITY with FORMALITIES
- ▶ BENEFITS (LEAVE/PTO/INSURANCE)
- ▶ INDEPENDENT TRADE or BUSINESS
- ▶ CENTRAL TO OPERATIONS
- ▶ INDEFINITE TERM

*And the thing every independent contractor needs...*

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**A  
WRITTEN  
CONTRACT**

*It's not dispositive, but man, it helps.*

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# IRS FORM SS-8

Read It;  
Don't Send It.

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# MUNICIPAL JUDGE

## PUBLIC OFFICIAL

**Charter/Answers to Council/  
Exercises City's Authority/Independent/  
Permanent & Continuing/  
Oath**

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# MUNICIPAL JUDGE

## COMMON LAW EMPLOYEE

- ▣ CONTRACT TERMINABLE AT WILL
- ▣ JUDGE ACTS AS AGENT OF THE CITY
- ▣ CITY PROVIDES SPACE, EQUIPMENT, SUPPORT STAFF
- ▣ PAID BY THE HOUR
- ▣ PUBLIC OFFICIALS CAN'T BE CONTRACTORS

*Consistent with 1993 & 1994 Private Letter Rulings*

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# CITY ATTORNEY

## PUBLIC OFFICIAL

Charter/Answers to Council/  
Exercises City's Authority/Independent/  
Permanent & Continuing/  
Oath

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# CITY ATTORNEY

## COMMON LAW EMPLOYEE

- ▣ CONTRACT TERMINABLE AT WILL
- ▣ ACTS AS AGENT OF THE CITY
- ▣ PAID BY THE HOUR
- ▣ SUBMITS A BUDGET LIKE OTHER CITY DEPARTMENTS
- ▣ PUBLIC OFFICIALS CAN'T BE CONTRACTORS

*But Erich's Deal with the City is Set forth in a Written Contract and Looks Just Like His Deal with All His Other Clients...*

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# CITY PROSECUTOR

## PUBLIC OFFICIAL

Charter/Answers to Council/  
Exercises City's Authority/Independent/  
Permanent & Continuing/  
Oath

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**CITY  
PROSECUTOR**  
COMMON LAW EMPLOYEE

- ▣ CONTRACT TERMINABLE AT WILL
- ▣ ACTS AS AGENT OF THE CITY
- ▣ PAID BY THE HOUR
- ▣ SUBMITS A BUDGET LIKE OTHER CITY DEPARTMENTS
- ▣ PUBLIC OFFICIALS CAN'T BE CONTRACTORS

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**RECREATION  
INSTRUCTORS**

PUBLIC OFFICIALS?

*Nope.*

Woo Hoo...

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**RECREATION  
INSTRUCTORS**

COMMON LAW EMPLOYEES?

*Yep.*

Bummer.

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**RECREATION  
INSTRUCTORS**  
COMMON LAW EMPLOYEES

- ▣ INDEFINITE TERM
- ▣ PERFORM INDIVIDUALLY W/O ASSISTANTS
- ▣ CITY FACILITIES & EQUIPMENT
- ▣ EXCLUSIVE ARRANGEMENTS \*\*\*
- ▣ NO FINANCIAL INVESTMENT OR RISK
- ▣ CITY DETERMINES WHAT, WHERE & WHEN
- ▣ CITY ENROLLS PARTICIPANTS

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*Can Anyone Save Us?*

**SECTION  
530  
RELIEF**

**TO THE RESCUE!!!**

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**SECTION 530**

- ▶ UNCODIFIED STATUTE (1978)
- ▶ RELIEF FROM RECHARACTERIZATION
- ▶ REQUIRES THREE THINGS:
  1. Consistent Treatment as Independent Contractor;
  2. Consistently Issued Form 1099; *and*
  3. Reasonable Basis for IC Characterization, *e.g., "Industry Practice"*

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## SECTION 530

*The IRS has to consider whether  
Section 530 applies;*

**BUT**

**You HAVE to meet  
ALL Three Tests**

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## SECTION 530

*City of Dana Point v. Commissioner of  
Internal Revenue  
(U.S. Tax Court Docket No. 3457-10)*

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## SECTION 3509 RELIEF

- ▶ Section 530 Relief is Unavailable
- ▶ No Intentional Avoidance or Fraud
- ▶ Calculation of Amount Owed:
  - Fed'l Income Tax = 1.5% of Wages;
  - FICA = 20% of what should have been withheld from wages;
  - 100% of Employer's Share of FICA due

*Section 3509 is Available Whether or Not  
the Employer Settles with the Service*

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# SETTLEMENT

- ▶ NO PENALTIES
- ▶ NO INTEREST
- ▶ NO AUDIT OF SUBSEQUENT TAX YEARS

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# IRS NOTICE 989

*Commonly Asked Questions When IRS Determines Your Work Status as "Employee"*

- ▶ Unpaid FICA Taxes Deducted from Refund of Overpaid Self-Employment Tax.
- ▶ City can help, but cost is income.

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# And then there's PERA

*The Colorado Springs Municipal Judges*

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### Who Cares ???

- Internal Revenue Service
- US Department of Labor / WHD
- US Equal Employment Opportunity Commission (“EEOC”)
- Social Security Administration/Medicare
- Workers Compensation Program
- Unemployment Insurance Programs
- Colorado Dept of Labor & Employment
- I.C.E.

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Let’s Be Careful Out There.

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**AVOID SHIFTING  
W-2 TO 1099  
AT ALL COSTS**

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*Keep in Mind:*

The Number of **Hours**  
Somebody Works  
**DOESN'T  
MATTER.**

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SHIFTING FROM  
**1099 TO W-2**  
GENERALLY ISN'T A PROBLEM FOR THE  
IRS,  
*BUT*

- COMPENSATION
- BENEFITS
- SAY GOODBYE TO SECTION 530

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