

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

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**EMPLOYMENT and
EMPLOYEE BENEFITS for
PUBLIC & PRIVATE
SECTOR EMPLOYERS**

**“ CONTRACT
EMPLOYEE ”**

~~“ CONTRACT
EMPLOYEE ”~~

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**.

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**.

Make 'em employees,
unless you can prove they
aren't.

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.**

IRS

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

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

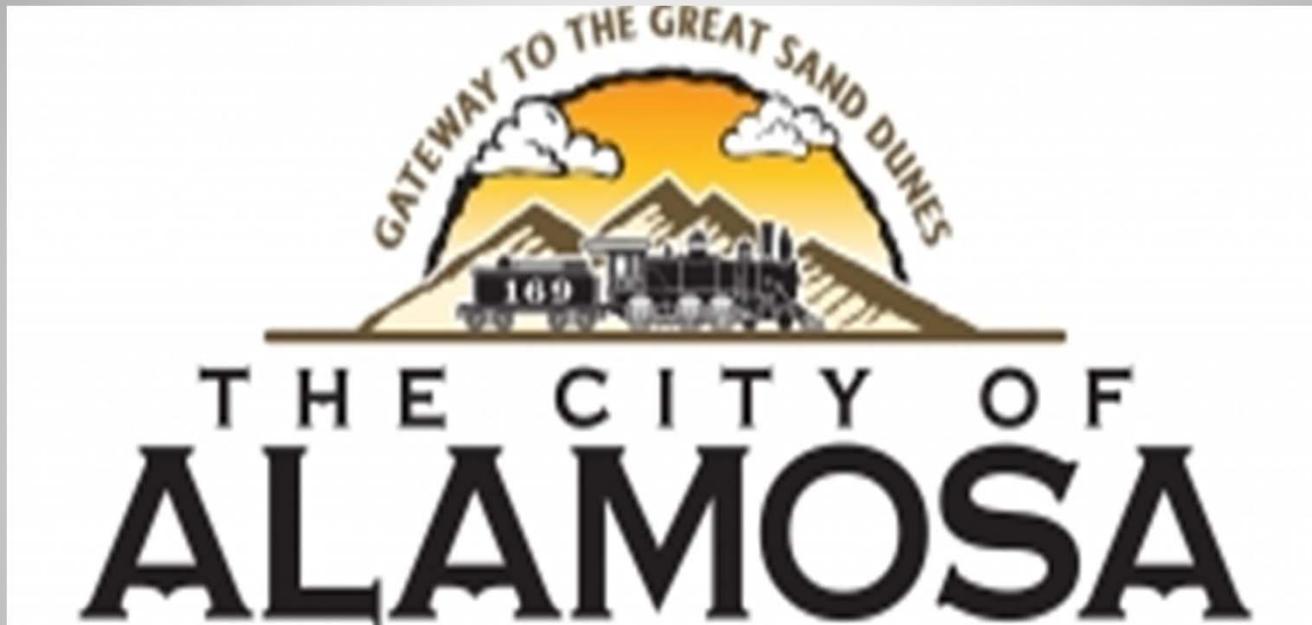
And the IRS considers these easy taxes to collect

IRS

**Characterization
of
MUNICIPAL OFFICIALS
and EMPLOYEES**

IRS

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



Thanks, Erich!

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

IRS

Two Tests:

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

▶ 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.**

▶ 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. * * *

▶ 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

▶ 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)

▶ 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...

▶ 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... *

▶ THE “PUBLIC OFFICIAL” TEST

UNLESS

You’re a

FEE-BASED

Public Official

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

IRS

Two Tests:

- ▶ THE “PUBLIC OFFICIAL” TEST; and
- ▶ THE “COMMON LAW EMPLOYEE” TEST

▶ **THE “COMMON LAW
EMPLOYEE” TEST**

*In a word,
it's all about*

CONTROL

▶ **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

▶ THE “COMMON LAW EMPLOYEE” TEST

The Old Twenty-Three Factors
were consolidated into

THREE BROAD CATEGORIES:

- BEHAVIORAL CONTROL
 - FINANCIAL CONTROL
- TYPE OF RELATIONSHIP

■ 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.

■ 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.

■ 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...*

**A
WRITTEN
CONTRACT**

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

IRS FORM SS-8

Read It;

Don't Send It.

MUNICIPAL JUDGE

PUBLIC OFFICIAL

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

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

CITY ATTORNEY

PUBLIC OFFICIAL

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

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...

CITY PROSECUTOR

PUBLIC OFFICIAL

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

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

RECREATION INSTRUCTORS

PUBLIC OFFICIALS?

Nope.

Woo Hoo...

RECREATION INSTRUCTORS

COMMON LAW EMPLOYEES?

Yep.

Bummer.

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

Can Anyone Save Us?

SECTION

530

RELIEF

TO THE RESCUE!!!

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”***

SECTION 530

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

BUT

*You **HAVE** to meet
ALL Three Tests*

SECTION 530

*City of Dana Point v. Commissioner of
Internal Revenue*

(U.S. Tax Court Docket No. 3457-10)

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*

SETTLEMENT

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

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.**

And then there's PERA

*The Colorado Springs
Municipal Judges*

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.**

Let's Be Careful Out There.



AVOID SHIFTING
W-2 TO 1099
AT ALL COSTS

Keep in Mind:

The Number of **Hours**
Somebody Works

DOESN'T

MATTER.

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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