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

HEIZER | PAUL LLP
“CONTRACT
EMPLOYEE”
"CONTRACT EMPLOYEE"
You hire employees for a wage or salary to work for the City for an indefinite period and you issue them a W-2.
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!
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
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

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
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
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