

EMPLOYMENT TAX UPDATE: WORKER CLASSIFICATION, IT'S NOT JUST ABOUT GIG WORKERS

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Ms. Mondrik and her associates represent the firm's state tax clients in administrative and legal proceedings before the Comptroller's office, the State Office of Administrative Hearings and the Texas state courts. They also represent federal tax clients in audits, at the administrative appeals level and in proceedings before the United States Tax Court and the United States District Courts. Ms. Mondrik is licensed to practice in the United States Tax Court, the United States District Court, Western District of Texas, and all of the Texas state courts.

Ms. Mondrik and members of her firm are frequent authors and lecturers on federal tax controversies and state taxation.

Ms. Mondrik was the 2019-20 Chair of the State Bar of Texas Tax Section. She has served twice on its governing council and has served as chair and vice-chair of its Tax Controversy, CLE and Solo and Small Firms Committee Committees. After completing her 2010-13 SBOT Tax Section council member term, Ms. Mondrik served as annual meeting committee chair for 2013-14. She was also State Bar Tax Section Leadership Academy co-chair for 2016-17.



The Texas Society of Certified Public Accountants (TXCPA) awarded Ms. Mondrik the Young CPA of the Year Award for 2009-10 and the 2012 Rising Star Award. She was awarded the 2016-17 Special Recognition Award from the TXCPA Chairman for her work on the Federal Tax Policy Committee and Bylaws Tax Force and the 2017-18 Outstanding Committee Chair Award for chairing the Federal Tax Policy Committee. The Austin Chapter of CPAs awarded Ms. Mondrik the 2015 Distinguished Service Award.

Ms. Mondrik served as chair of the TXCPA Federal Tax Policy Committee from 2016-2018. She also serves on the State Bar of Texas and TXCPA State Taxation Committees. She also served a three-year term on the TXCPA Executive Board. Ms. Mondrik was the 2009-10 President, and has served as manager of education and leadership and chair of the Oversight Council of the Austin Chapter of CPAs (now TXCPA Austin). Ms. Mondrik has also served as chair of the TXCPA Texas State Tax Conference Committee and its State Taxation Committee. As chair of the State Taxation Committee, she was a principal drafter of comments submitted by the TXCPA in response to state tax legislation and various administrative rules.

Ms. Mondrik earned her B.B.A. in Accounting and her J.D., with honors, both from the University of Texas at Austin. She has been licensed by the State of Texas since 2001.

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I. INTRODUCTION

The Internal Revenue Service (IRS) and the Texas Workforce Commission (TWC) impose payroll tax, withholding, unemployment tax reporting and payment requirements for employees but not for independent contractors. Payments to independent contractors may still be reportable on Form 1099, but the contractor is responsible for his or her own estimated tax payments and self employment / income tax reporting. Worker classification issues are important for tax purposes but are also very important for a variety of other purposes including labor law, ERISA, employee benefits law, OSHA, etc. This outline primarily covers the tax implications of worker classification and related strategies. Taxpayers and employers should also seek advice from financial advisors and employment law attorneys when planning for worker classification.

IRS officials have stated their intention to increase worker classification cases.¹ In addition, the Service intends to increase the number of cases for which information is being sent to 37 participating states (including Texas) through the questionable employment tax program (QETP).²

A. Worker Classification Criteria

Worker classification criteria have evolved over time. The courts, the IRS, the states and TWC may differ in their classification criteria.

In general, an independent contractor is an individual business owner or contractor who provides services to other businesses, and is generally considered self-employed as a sole proprietor. Self-employed individuals receive Forms 1099 and are required to make their own quarterly estimated tax payments using Form 1040-ES, or suffer the consequences of estimated tax penalties when they report their

taxes on Schedule C, file their Forms 1040 "U.S. Individual Income Tax Returns," and pay their taxes individually. In addition, self-employed individuals are required to pay self-employment tax on their net income, which roughly equates to the employment taxes they would have paid as an employee and an employer. There is a deduction in calculating adjusted gross income on Form 1040 for one-half of the self employment taxes paid by self-employed individuals. Examples include doctors, dentists, veterinarians, lawyers, accountants, contractors, subcontractors, public stenographers, and auctioneers, who offer their services to the general public. However, these types of workers may also be employees, depending upon the circumstances.

Employees, on the other hand, work for the business owners who employ them. They generally receive more direction, more resources from their employers, and have more restrictions (or control) placed upon them than do independent contractors. Employees have payroll taxes and federal income taxes withheld from their paychecks and their employers pay additional social security, Medicare and state and federal unemployment taxes on their behalf. At the end of the year, employees receive Forms W-2, which summarize the income earned and taxes deducted from their paychecks.

1. Internal Revenue Service

The determination of whether an individual is properly classified as an employee or an independent contractor is a highly fact-intensive analysis, which considers all of the facts and circumstances surrounding the relationship between the business and the worker. The factors considered have evolved somewhat over time, but the primary determinative factor continues to revolve around the degree of control a business has over the worker and the

¹ "IRS Intends to Increase Worker Classification Cases, Official Says," by Lydia Beyoud, Bloomberg BNA Daily Tax Report, May 14, 2013.

² *Id.* Referencing a presentation by John Tuzynski, head of IRS employment tax policy, at the American Bar Association Section of Taxation 2013 May meeting in Washington DC.

work. The more control the business retains, the more likely the worker is to be determined an employee rather than a contractor. As the work environment becomes more flexible, the worker classification issue becomes a more difficult challenge, particularly when a worker performs work for only one or a small number of businesses.

Form SS-8

IRS Form SS-8 sets forth the factors the IRS considers in determining whether a particular worker should be classified as an independent contractor or an employee. Tax practitioners should be cautious in advising their clients regarding completion of a Form SS-8, as the form appears to be designed to lead reviewers toward classifying workers as employees, rather than contractors. Generally, a detailed narrative is necessary to supplement the Form SS-8 and more clearly describe the contractual arrangement between the business and its worker(s).

The Twenty Factor Test

Historically, the IRS implemented a twenty-factor test to determine whether workers should be classified as employees or contractors. The twenty factors were:

1. **Instructions**. A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the business has the right to require compliance with instructions. Control over the details of an individual's work, does not require that the employer actually stand over the individual and direct every move. Having the right to do so is sufficient to meet the test.
2. **Training**. Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the business wants the services performed in a

particular method or manner.

3. **Integration**. Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends significantly upon the performance of certain services, the workers performing the services must be subject to a certain amount of control by the business.
4. **Services Rendered Personally**. If the services must be rendered personally, presumably the business is interested in the methods used to accomplish the work as well as the results, which indicates an employment relationship.
5. **Hiring, Supervising, and Paying Assistants**. If the business hires, supervises, and pays assistants, this generally shows control over the workers on the job. If the worker hires, supervises, and pays the assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for attaining a particular result, this indicates independent contractor status.
6. **Continuing Relationship**. An ongoing relationship between the worker and the business indicates an employer-employee relationship. A continuing relationship may exist when work is performed at frequent, recurring, although irregular, intervals.
7. **Set Work Hours**. Establishing set work hours indicates control. Flexible hours set under an agreement between the business and the worker does not necessarily indicate a contractor arrangement. If the flexible hours result from the worker's unilateral actions this is more indicative of a contractor arrangement.
8. **Full Time Required**. If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, the business has control over the amount of time the worker

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