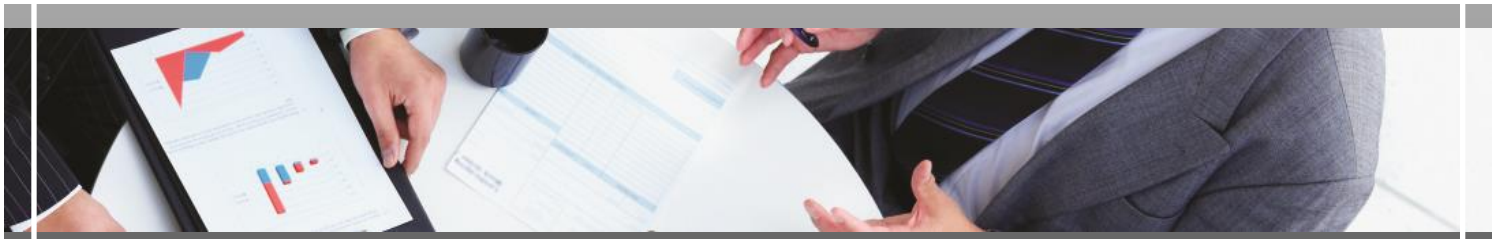


Small Business Focus:
Employees and Independent Contractors

Bruce Rosen
REC Law Group
BRosen@RECDC.com
(202) 577-3552

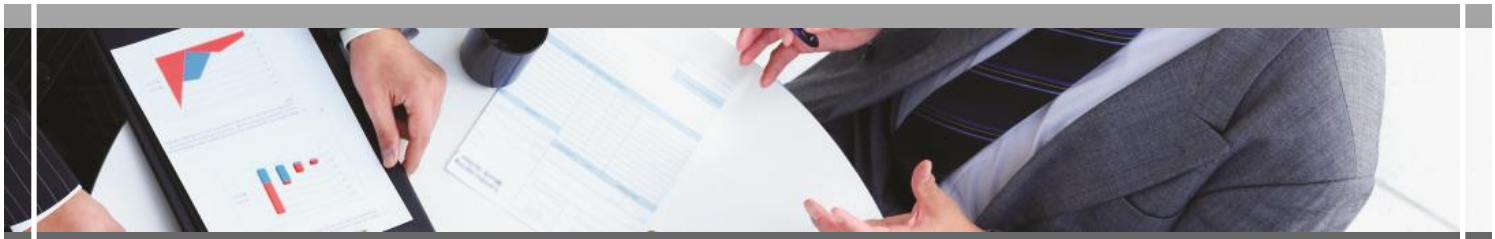
Samantha Timmons
Lewis Bess
stimmons@lewisbess.com
(303) 228-2539

WHEN A PERSON OR BUSINESS NEEDS SOMEONE TO PERFORM SERVICES, that relationship may be structured in different ways. In some cases it may make sense for the person or business to hire someone as an employee, while other times they may be hired as an independent contractor. Absent clear documentation, and behavior consistent with intended roles, whether a party is an employee or contractor may not be clear.

- **Employees** – Determining whether someone is an employee depends on the facts in each case, but is generally determined based on who retains control over the manner and methods of the party's work, though there are other factors to consider.

  In fact the Internal Revenue Service ("**IRS**") has listed twenty factors to aid in determining an employee-employer relationship under common law. Factors are not weighted equally, but weighted according to their significance in each particular case:

  - *Instructions*. The worker is required to comply with the service recipient's instructions about when, where or how he or she is to work.
  - *Training*. An experienced employee worked with the worker, corresponded with the worker, required the worker to attend meetings, or indicated that the service recipient wanted services performed in a particular manner.
  - *Integration*. The worker's services are integrated into the service recipient's business operations.
  - *Services Rendered Personally*. The services must be rendered personally.
  - *Hiring, Supervising, and Paying Assistants*. The service recipient hires, supervises, and pays any worker assistants.
  - *Continuing Relationship*. The worker has a continuing relationship (frequently recurring even if irregular intervals) with the service recipient.
  - *Set Hours of Work*. The worker has set working hours established by the service recipient.



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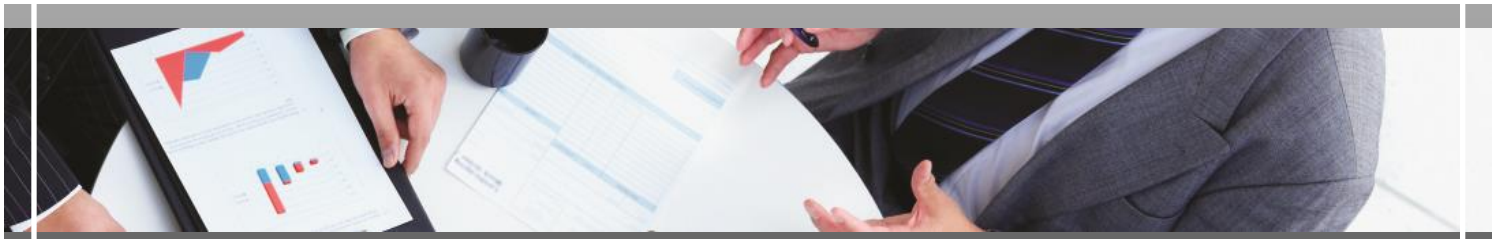
- *Full Time Required*. The worker devotes substantially full time to the business of the service recipient.
- *Doing the Work on Employer's Premises*. The worker performs the work on the premises of the service recipient.
- *Order or Sequence Set*. The worker performs services in the order or sequence (through established routines and schedules) set by the service recipient.
- *Oral or Written Reports*. The worker required to submit regular or written reports to the service recipient.
- *Payment by Hour, Week, Month*. The worker is paid by the hour, week, or month.
- *Payment of Business and/or Travel Expenses*. The worker's business and/or traveling expenses is paid for by the service recipient.
- *Furnishing of Tools and Materials*. The worker's tools, materials and other equipment is furnished by the service recipient.
- *Significant Investment*. The worker does not invest in facilities that are used by the worker in performing services for the service recipient.
- *Realization of Profit or Loss*. The worker cannot realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees).
- *Working for More than One Firm at a Time*. The worker does not perform more than minor services for a multiple of unrelated persons or firms at the same time.
- *Making Service Available to the General Public*. The worker does not make his or her services available to the general public on a regular and consistent basis.
- *Right to Discharge*. The service recipient has the right to discharge the worker.
- *Right to Terminate*. The worker has the right to end his or her relationship with the service recipient at any time he or she wishes without incurring liability.



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- **Independent Contractors** – In contrast to employees, independent contractors generally determine the manner and method of their work, and can work with multiple parties. In contrast to employees, contractors typically determine the cost of their work themselves, and take the economic risk of their decisions.

- **Tax Implications** – If an employer-employee relationship exists, the employer has several tax-driven obligations. The employer must pay retain a portion of the employee's salary for federal taxes, and pay other taxes to the IRS (as well as state and possibly local governments) and account for such amounts in a Form W-2.

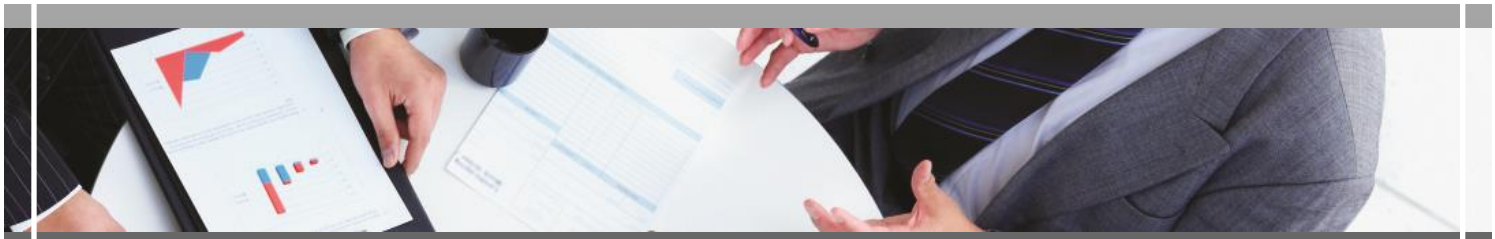
  On the other hand, a party paying an independent contractor does not have to retain any portion of the amount payable to the contractor, or pay any such taxes. If the amount paid to the contractor is more than $600, the party paying the contractor must provide a Form 1099-MISC to the contractor. And the Contractor is responsible for keeping their own records and paying their own income and self-employment taxes.

- **Getting Clarity** – Either the worker or the party that pays them may request an IRS opinion on a situation by submitting a Form SS-8. The form includes all of the above questions and is designed to bring out all the facts of your situation.

- **Reclassified Workers** – So what happens if a relationship that one or more parties thought was an independent contractor situation is reclassified by the IRS as an employer-employee relationship?

  If, it appears that workers thought of as contractors are to be classified as employees, the relief provisions (under Section 530 of the Revenue Act of 1978) may limit liability for the employment tax. Section 530 terminates the business but not the worker's employment tax liability, including any interest or penalties attributable to the liability for employment taxes.

  Section 530 of the Revenue Act of 1978, P.L. 95-600, was made available indefinitely by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), P.L. 97-248, §269(c). The purpose of Section 530 is to prevent the IRS from retroactively reclassifying workers from independent contractor status to employee status, if the employer meets certain tests. This statutory prohibition does not speak to the actual status of workers, but merely relieves employers of liability for employment taxes even when the true status of the workers is that of employees. Relief was generally intended for employers who had a reasonable basis for using independent contractor status for their employees and filed all required federal tax returns for any period beginning after 1977.



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- **Reclassified Workers** (continued) – Whether the requirements of Section 530 have been met is generally treated by the courts as a question of fact and the employer, not the IRS, has the burden of proof. The employer must demonstrate by a preponderance of the evidence that relief under Section 530 should be granted. But, once the taxpayer employer makes a prima facie showing that Section 530 relief is appropriate, the burden shifts to the IRS if — and only if — the taxpayer employer has fully cooperated with the IRS' reasonable requests for information.

  The Section 530 tests are as follows:

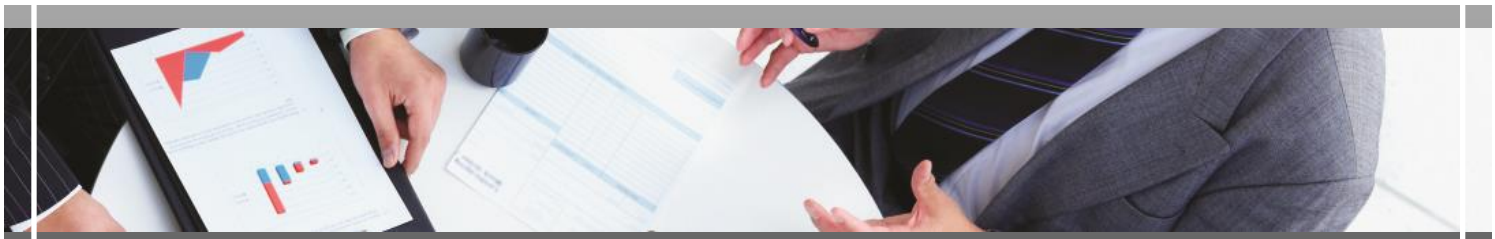
  (1) Reasonable Basis Test. An employer meets the "reasonable basis" test for treating the worker as an independent contractor if the employer placed reasonable reliance for the action upon at least one of the following four bases:

  a. **Decision**: The employer is entitled to rely on a judicial precedent, or published rulings, or a technical advice memorandum with respect to the employer, or a letter ruling issued to the employer.
  b. **Past Audit**: The employer is entitled to rely on a past IRS audit of the taxpayer in which there was no assessment of employment tax deficiencies for amounts paid to individuals holding positions substantially similar to a position held by the employee.
  c. **Industry Custom**: The employer is entitled to rely on a long-standing recognized practice of a significant segment of the industry in which such individual was employed.
  d. **Other Reasonable Manner**: Even if the employer lacks a decision supporting Section 530 relief, has no past audit to rely upon, and cannot prove an acceptable level of industry custom, the employer can still get Section 530 relief "if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee."

  (2) Tax Return Test. To obtain Section 530 relief, a taxpayer employer must pass the "tax return test", which requires that all federal tax returns (including information returns) be filed on a basis consistent with the taxpayer's treatment of the worker as an independent contractor. If the taxpayer employer has filed the required returns for some periods and not for others, Section 530 relief will still be available for the periods for which the required returns were filed.

  (3) Position Test. Section 530 relief requires that the taxpayer employer, as well as the business' predecessors, not have treated any worker holding a substantially similar position as an employee.

  If an IRS audit finds that workers are employees, but the consistency and reasonable basis tests have been met, then the employer will not have to pay employment tax on the workers. The workers, however, remain liable for paying their share of the FICA tax on the wages received. If the workers have paid self-employment tax on their income, they may be entitled to a refund of the tax paid.



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- **Conclusion** – Whether a worker is an employee or independent contractor may not always be determined by the terms of an agreement. The relationship of the parties, the exercise or lack of control over the performance of the work and a variety of other factors may be relevant.

  The facts of each particular situation are unique and we recommend our readers to consult an attorney for advice on questions they may have.

Real Estate Counselors, PLLC

Real Estate Counselors is a boutique law firm specializing in commercial real estate and business transactions. **REC Law Group** is special practice group of attorneys associated with Real Estate Counselors, PLLC.

Bruce Rosen's practice includes representing restaurant and food service tenants, office and retail tenants, landlords and developers. He is the Managing Partner of Real Estate Counselors. Prior to that, he was with the law firm of Akin, Gump, Strauss, Hauer & Feld.

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Samantha Timmons' practice focuses on tax planning for mergers and acquisitions, private equity, corporate restructuring, and tax controversy and litigation. Ms. Timmons joined Lewis Bess with over 18 years of experience advising clients on complex tax issues relating to structuring business acquisitions and reorganizations, including domestic and cross-border transactions. Ms. Timmons has also advised clients on tax matters related to net operating loss analysis, workouts and restructurings; and counseled taxpayers in tax audit and litigation matters.