

# **STAY CLASSY: THE TAX CONSEQUENCES OF WORKER CLASSIFICATION**

## Overview

- Tests for Worker Classification for Tax Purposes
- The Consequences of Misclassification
- Worker Classification in the “Gig” Economy

# Basics of Worker Classification



# Tax Obligations for Employers of Employees

- Withhold and/or Pay:
  - Federal Income Tax Withholding (FITW)
  - Social Security and Medicare Taxes (FICA)
  - Federal Unemployment Tax (FUTA)
  - State Unemployment Tax

# Tax Obligations for Employers of Independent Contractors



# Internal Revenue Service



## 20-Factor Test

- Revenue Ruling 87-41
- Weighs all 20 factors in making determination of whether worker is an employee or independent contractor
- No one factor is determinative

## The 20 Factors

- Instructions
- Training
- Integration
- Services Rendered Personally
- Hiring, Supervising and Paying Assistants
- Continuing Relationship
- Set Hour of Work
- Full-Time Required
- Work Done on Premises
- Order or Sequence Set
- Oral or Written Reports
- Payment by Hour, Week or Month
- Payment of Expenses



## The 20 Factors (continued)

- Furnishing of Tools and Materials
- Significant Investment
- Profit or Loss
- Working for More than One Firm at a Time
- Making Service Available to the General Public
- Right to Discharge
- Right to Terminate (by Worker)

# Simplified Three-Factor Test

- New and Improved!
- Groups the 20 factors into three categories:
  - Behavioral Control
  - Financial Control
  - Relationship Factors

## Behavioral Control

- Instructions
- Training
- Services Rendered Personally
- Hiring, Supervising and Paying Assistants
- Continuing Relationship
- Set Hours of Work
- Full-Time Required
- Work Done on Premises
- Order or Sequence Set
- Oral or Written Reports

## Financial Control

- Payments by Hour, Week or Month
- Payment of Expenses
- Furnishing of Tools and Materials
- Significant Investment
- Profit or Loss

## Relationship Factors

- Integration
- Working for More Than One Firm at a Time
- Making Services Available to General Public
- Right to Discharge
- Right to Terminate (by Worker)

## Statutory Employees

- Compensated Corporate Officers
- Certain Drivers
- Certain Salespersons
- Certain Home Workers
- Different for FICA and FUTA

## Section 530 Relief

- Employers may be relieved of employment tax liability if they can meet three criteria:
  - Reporting consistency
  - Substantive consistency
  - Reasonable basis

# Consequences of Misclassification





## How Do Misclassification Issues Arise?

- Routine audit
- Contractor's failure to pay income taxes
- Worker applies for Social Security benefits
- Worker "blows the whistle"

## Federal Tax Liabilities

- Section 3509 – Failure to Withhold. If an employer fails to deduct and withhold, then the employer is liable for:
  - 1.5% of wages paid to employee
  - 40% of employee's share of FICA (Social Security tax)
  - 100% of employer's share of FICA
  - 100% of federal unemployment tax

## Federal Tax Liabilities

- Failure to Pay. 0.5% of unpaid tax liability for each month up to 25% of total tax liability
- Penalties for Failure to File W-2s or 1099s:
  - \$50 for each W-2 employer failed to file
  - Between \$50 and \$550 for each 1099 employer failed to file [NOTE: Different upper limits will apply depending on the tax year the failure occurred in]

## State Tax Liabilities

- MCL § 205.23 imposes interest and the following penalties for failure to pay:
  - If due to negligence, greater of \$10 or 10% of unpaid tax
  - If due to intentional disregard of the law, greater of \$25 or 25% of unpaid tax
  - If due to fraudulent intent to evade tax, 100% of unpaid tax

# Worker Classification in “Gig” Economy

