



September 2015 Newsletter

[News From Silver Bridge CPAs - Business Edition](#)

Contractor or Employee: Is Your Business in Compliance?

New legislation in June 2015 recently increased penalties for each 1099 misclassification to \$250 per issue (previously \$100) up to 1.5 million. In the event of an audit, employers will be held liable for all previously unpaid payroll taxes. Are you protected?

Worker classification is fact-sensitive, and the IRS may see a worker labeled as an independent contractor in a very different light. One key point to remember is that the IRS generally frowns on independent contractors and actively looks for factors that indicate employee status. A 3-factor system is used to determine how an employee should be classified:

1. Behavioral Control
2. Financial Control
3. Relationship Test

Behavioral Control. Does the company control what and how the worker performs the duties; work arrival and departure times; break times? If the answer to any of these questions is "yes," the worker may be classified as an employee under the Internal Revenue Service Tax Code.

Financial Control. Does payment to the worker occur on a regular, timely basis (i.e. weekly, bi-weekly, etc.?) Does the worker use tools owned by the company? If the answer to any of these questions is "yes," the worker may be classified as an employee under the Internal Revenue Service Tax Code.

Relationship Test. Does the worker provide a service considered on a continual, permanent basis or do they receive paid time off and/or other fringe benefits? If the answer to any of these questions is "yes," the worker may be classified as an employee under the Internal Revenue Service Tax Code. NOTE: A written contract stating the worker is an independent contractor will *not be considered* if there is an employee relationship.

Penalties

The IRS is devoting a greater amount of its resources to uncover noncompliance by means of employment-related income tax audits in an effort to reduce the "tax gap" on uncollected

revenues. If an independent contractor believes they are being improperly classified, they can also alert authorities by filing Form 8919 in an effort to collect uncollected Social Security and Medicare taxes on previous compensation.

Relief for Misclassification

Congress introduced legislation in late 2013 in an attempt to encourage employers to come forward regarding employee misclassification. If you think some of your workers may be misclassified, the Voluntary Classification Settlement Program may be an option. Favorable terms include capping penalties to 10% of worker income for the current and prior year only, rather than full employment tax audits for all years.

Please call one of our CPAs today for advice on Best Tax and Employment Practices!

Tax laws are complex and this is not a comprehensive summary of employee classification. If you are interested in reviewing your employment practices, please contact Silver Bridge CPAs for advice specific to your unique tax situation.

Tax Planning

This year tax planning is especially relevant as many changes have occurred. Fall is the season to implement tax planning strategies to really make a difference in your 2015 return.

We can help you make adjustments before year end - don't put it off!

Please call 208-376-8808 to schedule a meeting

Office Hours:

Our current office hours are **Monday** through **Thursday** from **9:00 am to 5:00 pm** and we are **closed on Friday**.

We appreciate our clients!

We wanted to take this opportunity to say thank you for choosing Silver Bridge CPAs to be your trusted advisors for your accounting needs and tax returns. Thank you for your loyalty and your referrals! We appreciate you and the value you place on our service.

TAX NEWS

More on Employment Classifications...

[IRS takes aim at employment tax compliance](#)

The current likelihood that your business will become involved in an employment tax audit or an employment-related income tax audit has increased: the IRS is aggressively attempting to reduce

the "tax gap" of uncollected revenues in a time of increasing budget austerity. Employment tax noncompliance is estimated by the IRS to account for approximately \$54 billion of the tax gap. Under-reporting of FICA makes up \$14 billion; under-reporting of self-employment tax accounts for \$39 billion; and under-reporting of unemployment tax accounts for \$1 billion in lost revenue. Add to that total amount over \$50 billion in estimated employment-associated income tax lost that is the result of missteps in withholding obligations, tip reporting, and proper fringe benefit classification . . . and employers are forewarned. The IRS is stepping up its auditing in these areas and has been conducting studies to maximize the best use of its agents' time to do so.

Latest audit survey

The IRS is conducting an intensive audit of 6,000 employment tax returns to obtain an up-to-date picture of taxpayers' employment tax practices. This will enable the IRS to better devote its compliance resources to the most important areas of noncompliance and to the taxpayers most likely not to be in compliance.

Based on these audits, the IRS's Chief of Employment Tax Policy has spotlighted several areas of concern that the IRS will focus on. These areas include backup withholding, tip reporting, worker classification, and fringe benefit reporting.

Backup withholding. Backup withholding is the number one problem uncovered in the audits. The IRS can impose backup withholding on income reported on Forms 1099 that is not ordinarily subject to withholding, such as interest, dividends, and nonemployee compensation. Failure to provide a taxpayer identification number (TIN) on the Form 1099, an incorrect TIN, or a TIN that does not match the name on the form can trigger backup withholding. A taxpayer's failure to report the income can also trigger backup withholding.

Tip reporting. Tip reporting is a major concern of the IRS. The IRS considers noncompliance a widespread problem, especially for small businesses that are not aware of the issues. The IRS has been focusing on educating employers, and is not auditing employment tax returns filed before 2014. An important issue is the failure to differentiate between service charges and tips. A payment that is automatically added to a bill may be a service charge. A service charge is characterized as Social Security wages, rather than Social Security tips. The distinction is important, because employers can claim a Social Security credit for FICA obligations attributable to tips that exceed the minimum wage, but cannot claim a credit for taxes paid on service charges.

Worker misclassification. To avoid FICA and FUTA taxes and income tax withholding, some employers intentionally classify employees as independent contractors. This has been a longstanding concern for the IRS, and the recent audits have shown that the problem continues. The agency regularly conducts employment tax audits to reclassify workers as employees. To facilitate reclassification to employee status, the IRS has two settlement programs for employers: the Classification Settlement Program (CSP) for taxpayers under audit, and the Voluntary Classification Settlement Program (VCSP) for companies that are not under an employment tax audit and meet other requirements. The IRS has received 1,550 applications under the VCSP and

has reclassified approximately 25,000 workers. Companies that agree to prospectively treat workers as employees generally pay reduced taxes and may get audit protection for past years.

Fringe benefit reporting. Fringe benefits can be cash or noncash benefits provided in addition to regular wages. As a compliance matter, fringe benefits are taxable and must be included in the recipient's income, unless the Tax Code specifically excludes the benefit from taxable income. Moreover, if the recipient is an employee, the value of the benefit is additional compensation subject to employment taxes. Fringe benefits can be a particular problem for small companies, where owners seek to reduce their taxable income by taking noncash benefits, such as the use of company vehicles. A bargain sale of a house to an employee could also generate taxable income subject to employment taxes.

Conclusions

Employment taxes present an increasing risk to employers as the IRS steps up focuses on what it suspects is a heretofore largely untapped source of revenue. The IRS is certain to use the data now being harvested through its latest audit surveys. Many employers may do well to review how their employment tax compliance now measures up to this new degree of scrutiny.