

Author Guidelines

Who We Are

NATP is the largest association dedicated to equipping tax professionals with the resources, connections and education they need to provide the highest level of service to their clients. NATP is comprised of almost 23,000 leading tax professionals who believe in a superior standard of ethics and exemplify professional excellence. Members rely on NATP to deliver professional connections, content expertise and advocacy that provides them with the support they need to best serve their clients. The organization welcomes all tax professionals in their quest to continually meet the needs of the public, no matter where they are in their careers.

Mission Statement

Our mission is to support tax professionals with the knowledge, training and resources necessary for their professional success and to protect the integrity and future of the profession.

Reader Profile

The *TAXPRO Journal* and the *TAXPRO Monthly* are published by NATP and are written specifically for association members. Members represent the tax profession in the following areas:

| | | | |
|--------------------|-----|-----------------|-----|
| Individual | 44% | Enrolled Agents | 31% |
| CPAs | 14% | ASFP | 10% |
| Financial Planners | 3% | Attorneys | 1% |

Editorial Concept

The intent of both publications is to inform members of current trends and developments within the tax preparation profession. Since their levels of expertise range from relatively inexperienced to highly adept, our goal is to publish a wide variety of articles that focus on practical situations and applications, and yet provide a broad level of appeal.

These professionals have no interest in academic studies, research reports, theoretical discussions or highly technical material. They do, however, appreciate articles that point out the opportunities and/or set-backs in the areas being discussed.

Such articles might include “how-to” approaches to tax preparation, practice management, assisting clients, increasing the bottom-line, applying the tax code, diversifying a tax practice, increasing tax knowledge, marketing a business or negotiating with the IRS.

We encourage writers to submit material that focuses on approaches to the treatment of unusual tax problems, or service-oriented articles that offer hands-on advice to our readers. These are most useful when based on the author’s own experience.

Choosing a Subject Matter

When choosing a subject, keep in mind that you should only write about the topics you know best. Members are interested in reading more on the following:

| | | |
|-------------------------------|----------------------------|----------------------------------|
| Americans living abroad | Extensions | Passive activities |
| Amending returns | Gambling | Pension plans |
| Auditing issues | Growing a business | Preparer liability/E&O insurance |
| Bankruptcy & insolvency | IRAs | Professional ethics |
| Basis | IRS penalties | QBID |
| Business use of home | Increasing clientele | Rental real estate |
| Cafeteria plans | Independent contractors | Retirement planning |
| Cancellation of debt | Installment agreements | Sale of partnership interest |
| Cannabis tax issues | Insurance & small business | Sales & use tax |
| Casualty and theft losses | Interim reporting | Sick & vacation pay deferral |
| Change in accounting method | Leases and leasing | Small business practices |
| Client representation | Mergers & acquisitions | Social Security benefit issues |
| Closing a business | Military tax issues | Special occupations |
| Collections | Negotiating with the IRS | Statute of limitations |
| Consulting | New tax legislation | Successful court cases |
| Corporations | Offers in compromise | Tax credits |
| DPAD | Office in home | Tax home |
| Depreciation | Opportunity zones | Tax law application |
| Diversifying a practice | Potential tax law changes | Tax liabilities |
| Divorce issues | Practice management | Training employees |
| Due diligence | Professional development | Virtual currency |
| Estate and financial planning | Partnerships | Year-end filing changes |

Getting Started

Proper organization is the most important key to writing a good article. By organizing your material and preparing an effective outline, you will eliminate some of the frustration usually involved in starting a new project. You'll also be able to pinpoint the areas that may need researching to better support your ideas.

Once you have an outline on paper, you can begin your rough draft. It's not necessary to start with the introduction. Instead, begin with the easiest topic on your outline. Write down everything you know about the subject and then proceed to the next. Don't be too concerned about style, punctuation, and grammar for now. You can apply these later.

Once you have covered each topic on your outline, develop the first draft. Work on proper sentence structure, grammar and style. Use the following three principles to help you in writing your first draft: (1) Use short words, sentences, and paragraphs. Avoid pretentious words, complicated terms, and technical jargon. (2) Write the way you talk, using the active voice. Instead of writing, “The new tax act has already been signed by the president,” write “The president has already signed the new tax act.” (3) Use strong nouns, verbs, and phrases.

Next, go back and write the introduction. The opening paragraph should indicate exactly what the article is about and how an individual can benefit from reading it. Include any vital background information that pertains to your main theme. The final paragraph should mirror or summarize this at the conclusion of the article.

Edit your manuscript a few days later. Define any weak areas and eliminate any irrelevant material. Cross out all the words that are not necessary. By doing so, you will make your article more concise and easier to read.

Here are some additional tips for more effective writing: (1) Use citations and footnotes. This will help in our technical review process. (2) Never assume the reader knows as much as you do. Explain complicated items in finer detail. (3) Write a conclusion that sums up your major points and explains why the article should be of interest to the reader. (4) Submit sidebars that contain resources, references, examples of completed tax forms or tips that relate to the topic.

Manuscript Requirements

Although there are no length requirements, most feature articles in the *TAXPRO Journal* run between 1,800–3,500* words, including a brief author bio. Keep in mind that these are only guidelines. Write what you feel is necessary to efficiently cover the topic. When you have completed your manuscript, please e-mail it to content@natptax.com as a Microsoft Word attachment. Contact us if there is a problem with this, as other formats are acceptable.

Each issue also contains one CPE-eligible feature article. To be eligible for 1 CPE, the article must be 6,000 words and include three review questions and answers. The answers must contain a brief explanation of why the choices are correct or incorrect. We also need a five-question exam, which doesn't count towards the 6,000 words. For the exam, only the correct answer needs an explanation. All questions must be multiple choice (A, B, C, D). We're including a sample CPE-eligible feature article at the end of this document.

* Articles shorter than 1,800 words will be considered for publication in the *TAXPRO Monthly*.

Editorial Board Review Process

If you would like to submit an article at any time for review or consideration, we encourage you to do so.

Upon receipt of your article, members of our editorial board will review it. The editorial board members, who themselves are tax professionals, will evaluate your article on several dimensions including but not limited to: (1) originality and timeliness of topic; (2) technical soundness and readability; and (3) practicality and applicability.

If, after reviewing your article, the editorial board believes your article is publishable without major revisions, the editorial board will authorize the editor to proceed with making editorial changes necessary for preparing the article for publication.

However, if, after reviewing your article the editorial board believes your article is publishable if certain revisions are made, the editorial board will authorize the editor to contact you by email delineating the suggested revisions and asking you to consider revising and resubmitting the article. Once we receive the newly revised article, the editorial board will review the revisions you have made and, if acceptable, will at that time authorize the editor to proceed with preparing the article for publication.

After we prepare the article for publication, the editor will send you a proof of the article as it will appear in print. You will have seven days to review the proof and notify the editor of any additional changes that you believe are essential. The editorial board will review your recommendations. If they agree with your changes, your article will then be ready for publication.

Manuscripts are accepted on a gratis basis. In appreciation, we'll mail you some complimentary copies of the issue in which your article appears. In turn, being published will provide name recognition for you.

If you have questions regarding your manuscript, the editorial review process or our editorial policies, please contact us at content@natptax.com. Again, thank you for your interest in writing for NATP's professional tax publications. We hope this will be an enjoyable and rewarding experience for you.

Classifying Workers

Common-law employee or independent contractor?

By Anthony Tocco, Ph.D. and Jamison Shipman, LL.M., J.D.

Most accountants and tax professionals have the same goals when tax planning for a client—to reduce the client’s tax obligation and minimize overpayment of tax liability. However, these professionals can add value to many small business clients by also considering how the tax planning for the client can be beneficial to the client’s employees.



The *Tax Cuts and Jobs Act of 2017* (TCJA) provides several tax planning opportunities for clients. One such opportunity that can benefit the client and the client's employees relates to the TCJA's elimination of the itemized deduction for unreimbursed business expenses for employees, which for some employees was a significant tax deduction. Accountants should consider opportunities to adjust the way employees are compensated to benefit the employee and tax neutral to the client. In some cases, it can be tax beneficial to the client.

classification of a worker serving in one particular capacity with respect to a business.

If a worker is classified as a common-law employee, the classification analysis is finished. The analysis then shifts to the tax and other legal ramifications of such classification. If the worker is classified as an independent contractor, it is necessary to consider whether the worker should be classified as either an independent contractor or statutory employee. Then the analysis turns to the tax ramifications of such classification.

If the worker is classified as an independent contractor, it is necessary to consider whether the worker should be classified as either an independent contractor or statutory employee.

One such opportunity is to analyze whether a client's workers have been properly classified as a common-law employee, independent contractor or statutory employee. The objective of this article is twofold:

- ▶ Assist the accountant in understanding whether a worker should be classified as a common-law employee, independent contractor or statutory employee
- ▶ Highlight the tax and legal issues associated with such classification, including differences

Determining worker classification

The starting point for this analysis is determining whether a worker should be classified as a common-law employee or independent contractor. A worker with particular assigned responsibilities can either be a common-law employee or independent contractor, but not both. It is possible that workers who serve an employer in two separate capacities can be treated as employees in one capacity and independent contractors in another. For example, an individual who is an officer of a corporation and is paid for providing services in such capacity generally will be classified as a common-law employee. If the same individual is also an attorney and agrees to provide legal services unrelated to the role as an officer, they may well be classified as an independent contractor after analyzing the factors discussed below. But those circumstances tend to be rare, and this article will focus on the

Common-law employee or independent contractor: A common-law employee is an individual who provides services to a business and is not classified as an independent contractor. The IRS focuses on three components when determining whether an individual should be classified as a common-law employee or an independent contractor.¹ Those components are behavior control, financial control and the type of relationship between the parties.

A business exerts behavioral control if it controls and directs how the individual accomplishes the assigned work. Key factors to consider when evaluating the extent of behavioral control include:

- ▶ Instructions that the business gives to the worker, including how, when and where to do the work;
- ▶ What tools to use to complete the work;
- ▶ What workers to use to assist with the work;
- ▶ What supplies, equipment and services should be purchased; and
- ▶ Training provided by the business on how to perform the work.²

A business exercises financial control if it directs or controls financial aspects of a worker's job. Key factors to consider when evaluating the extent of financial control include:

- ▶ The extent of the worker's investment in the facilities or tools used in performing services;
- ▶ The extent to which the worker makes their services available to the relevant market;

- ▶ How the business compensates the worker for services rendered; and
- ▶ The extent to which the worker can realize a profit or incur a loss.³

The relationship between the employer and worker, and how the parties perceive their relationship, is the other key component. Key factors to consider when evaluating the parties' relationship include:

- ▶ Written contracts describing the relationship the parties intended to create;
- ▶ Whether the business provides the individual with employee-type benefits, such as insurance, a pension plan, and vacation or sick pay;
- ▶ The permanency of the relationship;
- ▶ The extent to which services performed by the individual are a key aspect of the regular business of the employer; and
- ▶ The extent to which the worker has unreimbursed business expenses.⁴

Court cases are useful for tax accountants to help analyze and weigh the application of the factors used by the IRS to determine whether an individual should be classified as an employee. In *Dean Cibotti, et ux. v. Comm.*, T.C. Summary Opinion 2012-21, the tax court analyzed whether the taxpayer should be classified as an employee versus independent contractor to determine whether the taxpayer was able to claim certain expenses as business expense deductions on Schedule C. The taxpayer owned one-third of a mortgage company, and was the president and loan officer of the company. There wasn't a written agreement between the parties documenting the terms of their agreement. The mortgage company did not provide the taxpayer with an office in which to conduct his business, and he performed much of his work at his home and in meetings and closings with clients at various locations. The taxpayer was compensated by the company in his role as loan officer solely based on commissions, which were subsequently unilaterally reduced by the company because of market fluctuation. The taxpayer did not perform any services because, as president of the corporation, he was not entitled to nor did he receive any base pay or employee benefits.⁵ The company did not provide the taxpayer with potential clients or direct any facet of the solicitation of clients or closing of mortgage loans. The taxpayer used gift certificates and sporting event

tickets as incentives for clients to purchase mortgage loans. The taxpayer claimed his expenses incurred as a loan officer as a deduction on Schedule C.

The court stated that it is necessary to "consider all of the facts and circumstances of each case, and no single factor is determinative." The court noted in its analysis of the facts that selling mortgages was the company's regular business, which was the activity the taxpayer was engaged in, and that the parties had worked together for several years, indicating common-law employee classification. The court's opinion also highlighted that the company did not control or dictate the taxpayer's hours of business, total hours, route, office location or methods of obtaining clients. Additionally, the company did not supervise or control the manner or the means by which the taxpayer sold mortgages. The taxpayer obtained most of his clients through personal contacts and did not have an office at the company. His only interactions with the company centered around a weekly meeting and the payment of commissions, which provided the taxpayer with the opportunity for profit and loss. The court determined these factors supported the taxpayer's classification as an independent contractor and that they outweighed the factors indicating common-law employee classification. Accordingly, the taxpayer was classified as an independent contractor.

Example: Tim is a tax attorney who provides a variety of services to a medium-sized law firm based on his tax expertise. The parties do not have a written contract in place but have agreed that Tim would receive a base salary and an annual bonus if he meets certain billable-hour goals set by the firm. In addition, if he is responsible for originating new business for the firm, he is entitled to receive 25% of the fees collected from the client. The firm is responsible for billing and collecting the fees associated with Tim's work. He works for a few of the firm's clients and is required to provide regular status updates to the attorneys responsible for billing each client. Otherwise, the firm's management and other attorneys leave him alone because they know nothing about tax. Tim can use the help of younger attorneys at the firm if needed. In addition, Tim helps the firm complete its annual partnership income tax return and other tax filings. Tim works mainly from his home but will occasionally stop by the office and use an empty office if one is available. He also bought his own laptop to perform his work because the firm-issued laptop

was a cheap model and did not meet his standards. The firm does provide Tim with coverage under its malpractice insurance coverage, and he is also eligible to participate in the firm's 401(k) plan. The firm did not reimburse Tim for the laptop purchase, nor does it reimburse him for any entertainment expenses associated with developing clients.

Should Tim be classified as a common-law employee or independent contractor of the firm? Let's analyze the facts based on the three components noted above: (1) behavior control, (2) financial control and (3) relationship. See Table 1 on Page 13.

A count of the factors indicates that eight are in favor of employee classification, five are in favor of independent contractor classification and one favors neither. Although close, Tim would be classified as an employee if the analysis was based simply on adding up the factors in support of each classification and going by whichever one is greater. However, it is necessary to look closer at the specific factors and consider whether it is a close decision for each factor in concluding that it leans more toward one classification or not. For example, of the eight factors in favor of employee classification, 3, 7, 8, 9 and 13 heavily lean toward employee, while 4, 6 and 11 less so. All five factors in favor of independent contractor classification lean more toward independent contractor status. It becomes more evident that Tim should be classified as an employee once the weighting of the factors is considered.

Additionally, it is often helpful to consider the industry that is involved when evaluating the various factors. Doing so allows practitioners to consider how relevant or important each factor is with respect to the industry and the role served by the worker. Given the nature of the legal practice, the factors indicating independent contractor carry less sway given there is usually less instruction and training provided to lawyers on how to complete the work regardless of whether the worker is an employee or independent contractor. Thus, the appropriate classification for the worker in this example is as an employee.

Statutory employee: If a worker is classified as an independent contractor based on the analysis discussed above, then the work is not over. An independent contractor may be classified as a statutory employee for employment tax purposes. The term "statutory employee" is used by the IRS in Pub. 15-A to refer to an individual worker who is classified as

an independent contractor under the common-law employee classification rules discussed above but is treated as an employee for employment tax purposes if certain requirements are met. To be classified as a statutory employee, the individual's performance of services must fit within one of four categories specified in §3121(d)(3) of the Internal Revenue Code (IRC) and satisfy all three conditions specified in §3121(d)(3), regardless of the category.

The four categories of services from §3121(d)(3) and IRS Pub. 15-A, pg. 6 (2020) are:

- ▶ As a driver who distributes beverages (other than milk) or meat, vegetable, fruit or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is an agent or is paid on commission by the employer;
- ▶ As a full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company;
- ▶ As an individual who works at home on materials or goods that the employer supplies and that must be returned to the employer, if the employer also furnishes specifications for the work to be done; or
- ▶ As a full-time traveling or city salesperson who works on the employer's behalf and turns in orders to the employer from wholesalers, retailers, contractors or operators of hotels, restaurants or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for the employer must be the salesperson's principal business activity.

In addition to fitting within one of the four categories listed above, the statutory employee must meet all three of following conditions:

- ▶ The service contract states or implies that substantially all the services are to be performed personally by the individual;
- ▶ The individual does not have a substantial investment in the facilities, equipment and property used to perform the services (other than an investment in facilities for transportation, such as a car or truck, or items typically provided by employees); and
- ▶ The services are performed on a continuing basis for the same employer.

TABLE 1

| Behavior Control | | |
|---|--|---|
| Factor | Facts associated with factor | Supportive as employee or independent contractor |
| 1. Instructions that the business gives to the worker | Has special knowledge; provides status updates but otherwise works when he wants | Independent contractor |
| 2. Tools used to complete the work | Bought a better computer and was not reimbursed | Independent contractor |
| 3. Workers used to assist with the work | Uses other attorneys at the firm if needed | Employee |
| 4. Supplies, equipment and services should be purchased | The firm provided Tim with a computer; he was not required to buy one | Employee |
| 5. Training provided by the business | No specific facts provided but given expertise, training unlikely | Independent contractor |
| Financial Control | | |
| Factor | Facts associated with factor | Supportive as employee or independent contractor |
| 6. Extent of the worker's investment in the facilities or tools | Firm did provide a laptop, but Tim bought his own; works from home but can use firm office as needed | Employee |
| 7. Extent to which the worker makes their services available to the relevant market | Provides services to multiple clients provided by the firm and for the firm itself; no indication he works for other firms | Employee |
| 8. How the business compensates the worker for services rendered | Base salary; bonus for performance goals and percentage of fees collected; eligible to participate in retirement plan and is covered by firm's malpractice insurance | Employee |
| 9. Extent to which the worker can realize a profit or incur a loss | Incur profit or loss unlikely given compensation arrangement | Employee |
| Relationship | | |
| Factor | Facts associated with factor | Supportive as employee or independent contractor |
| 10. Written contracts describing the relationship | None | No impact |
| 11. Business provides the individual with employee-type benefits | Salary, retirement plan and malpractice insurance, yes; entertainment expenses and purchase reimbursements, no | Employee (more likely) |
| 12. Permanency of the relationship | Not permanent | Independent contractor |
| 13. Extent to which services performed are a key aspect of the regular business of the employer | Services provided by Tim are key aspect of the firm's business | Employee |
| 14. Extent to which the worker has unreimbursed business expenses | Entertainment expenses and purchases not reimbursed | Independent contractor |

Uber and Lyft

Not exactly California dreaming

What do DoorDash, Amazon, Uber, Lyft and Postmates have in common? They all are facing legal challenges to the classification of their workers as independent contractors rather than employees, at least with respect to state laws. California is leading the charge with its recent passage of California AB 5, which is designed to address concerns over those working in the “gig economy” and classified by businesses as independent contractors not having “the basic rights and protections they deserve under the law, including a minimum wage, workers’ compensation if they are injured on the job, unemployment insurance, paid sick leave and paid family leave.” [Legislative Counsel’s Digest, Assembly Bill No. 5, Chapter 296 (9/19/19)]

The California law went into effect on Jan. 1, 2020, and specifies that a business must classify a worker performing services on behalf of the business as an employee under California law unless all three of the following requirements are satisfied:

- ▶ The person is free from the control and direction of the “hiring entity” (i.e., the company operating the business) in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- ▶ The person performs work that is outside the usual course of the hiring entity’s business.
- ▶ The person is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed.

Uber and Lyft earlier this year filed a motion seeking a preliminary injunction against the enforcement of the law with respect to their drivers. In a ruling dated Aug. 10, 2020, the California Superior Court denied the motion on the basis that the work performed by the drivers was not outside the usual course of Uber and Lyft’s business.* Just a few days later, the California Appeals Court granted Uber and Lyft a stay on the lower court’s order to permit further arguments on the validity of the law. Uber and Lyft pursued other avenues for exemption from the law, including a ballot initiative in the November 2020 election providing for exemption from the law.** The ballot initiative was approved by California voters, meaning ridesharing and delivery drivers are to be classified as independent contractors rather than employees for purposes of California law.

Despite the impact of this law on businesses operating in California and potentially other states that are considering enacting a similar law, the determination whether a worker is classified as an employee or independent contractor for federal income and employment tax purposes is still determined under the three components outlined in this article: behavior control, financial control and the type of relationship between the parties. Thus, it is conceivable that a worker may be classified as an employee for state law purposes but an independent contractor for federal tax law purposes. Practitioners should continue to monitor the situation and keep in mind how classification can depend on the applicable law.



* <https://www.investopedia.com/california-assembly-bill-5-ab5-4773201>

** <https://www.wsj.com/articles/lyft-to-suspend-service-in-california-11597942614?mod=djemCFO>

Legal considerations

Business liability for worker's actions: There is a significant and substantial difference between common-law employees and independent contractors/statutory employees with respect to subjecting a business to tort and, to a lesser extent, contractual liability based on agency law. The most common type of tort liability triggered by a common-law employee is negligence (i.e., not acting with reasonable care and causing harm to a person owed a duty of care). Under the theory of *respondeat superior*, a business can be held liable for the negligence of an employee that occurred while the employee was acting within the scope of services provided on behalf of the business. However, an independent contractor/statutory employee generally does not trigger such liability. The primary reason for this is due to the control a business has over an employee as indicated based on the factors described above that is not present with respect to an independent contractor/statutory employee.

As the principal in an agency relationship, a business has the discretion to grant an agent the authority to act on behalf of the business, such as the authority to enter into contracts in the name of the business. A principal can grant this authority to an employee or independent contractor/statutory employee. The risk of granting such authority is that the worker can make bad decisions and enter into a contract on behalf of the principal that is a bad deal, or the principal is unable to meet the obligations provided in the contract. The authority exercisable by an employee tends to be broader than that of an independent contractor/statutory employee for a couple reasons. First, authority granted to an independent contractor/statutory employee tends to be narrower in scope because the business has less ability to monitor and control the independent contractor/statutory employee's activities. Second, a common-law employee tends to have broader implied authority to act on behalf of a business based on the business's control over the employee, and third parties' expectations and assumption made with respect to the employee's relationship with the business. Thus, there is a greater risk to a business to be stuck in a bad contract if a worker is classified as a common-law employee versus independent contractor/statutory employee.

Fair Labor Standards Act (FLSA): The FLSA establishes minimum wage and overtime pay

Review Questions (answers on page 17)

1. Which factor does not relate to behavioral control?
 - A. What tools to use to complete the work
 - B. What workers to use to assist with the work
 - C. What supplies, equipment and services should be purchased
 - D. Written contracts describing the relationship
2. An employer is required to provide a statutory employee with which of the following:
 - A. Form W-2 withholding and remitting of federal and state income taxes
 - B. Form W-2 withholding and remitting of the employee's portion of the FICA taxes
 - C. Form W-2 withholding and remitting of the employee's portion of FICA taxes and payment of the employer's portion of the FICA taxes
 - D. Form W-2 payment of the employer's portion of the FICA taxes
3. In *Dean Cibotti, et ux. v. Commissioner*, which rule is the most important in reaching the conclusion that a worker should be classified as an independent contractor?
 - A. Extent to which the worker has unreimbursed business expenses
 - B. How the business compensates the worker for services rendered
 - C. The employer has more control over how the job is to be completed than the worker
 - D. The worker has more control over how the job is to be completed than the employer

requirements, among other things, that generally apply to common-law employees. A business is subject to the FLSA rules if either: (1) the business has at least two employees who are engaged in interstate commerce and have an annual dollar volume of sales or business done of at least \$500,000; or (2) for employees of businesses not meeting the first requirement, any employee who engages in interstate commerce on behalf of the business.⁶

Assuming a business is subject to the FLSA rules, a business must determine whether its workers are considered employees under the FLSA. The factors used to evaluate a worker's classification for purposes of the FLSA are substantially the same as those used by the IRS for purposes of applying the IRC. Assuming a worker is classified as an employee for purposes of FLSA, employees must receive minimum wage and/or overtime pay unless they are exempt employees. The following categories of employees are considered exempt:

- ▶ Executive, administrative and professional employees, outside sales employees and employees in certain computer-related occupations;
- ▶ Employees of certain seasonal amusement or recreational establishments, employees of certain small newspapers, sailors employed on foreign vessels, employees engaged in fishing operations and employees engaged in newspaper delivery;
- ▶ Farmworkers employed by anyone who used no more than 500 "man-days" of farm labor in any calendar quarter of the preceding calendar year; and
- ▶ Casual babysitters and persons employed as companions to the elderly or infirm.

There is an incentive for an employer to classify its employees as exempt because the employer is not required to pay overtime (at least time and one-half of regular hourly pay) if the employee is exempt. Therefore, an employer may attempt to push the envelope in classifying an employee as an executive, administrative or professional employee. The FLSA's Field Operation Handbook provides guidance for determining whether an employee is exempt from minimum wage and overtime requirements. For example, an employee classified as an executive must (1) receive a weekly salary or fee-basis compensation equal to at least \$684 per week (prior to 2020 it was \$455); (2) have a primary duty of management;

(3) customarily and regularly direct the work of two or more employees; and (4) have the authority to fire or hire employees, or recommendations to hire and fire are given particular weight. An employer will be required to pay an employee for past due overtime or minimum wage pay if the employer incorrectly treats an employee as exempt, and the employer may be subject to federal and state penalties for violating the rules. The employer will also be obligated to withhold and remit any additional employment tax owed on such payments (see discussion regarding employment taxes below).

Employee benefits: A worker classified as a common-law employee who performs services on a full-time basis for a business is typically eligible to participate in any employee benefits offered by the business, such as medical insurance, qualified retirement plans and dependent care benefits. However, an independent contractor/statutory employee is not eligible for such benefits.

Income and employment taxes

Employee: If an individual is classified as a common-law employee, the business is required to withhold from the employee's wages federal income tax and the employee's portion of the FICA taxes equal to 6.2% of wages up to the applicable wage base limit (\$137,700 for 2020 and \$142,800 for 2021) for Social Security, and 1.45% for Medicare. In addition, the business must pay the same amount for the employer portion of the FICA taxes. Prior to 2018, a common-law employee who had unreimbursed business expenses related to their employment could deduct those expenses as an itemized deduction on Schedule A to the extent the expenses exceeded 2% of the employee's adjusted gross income. However due to the TCJA, for tax years beginning in or after 2018, an employee may no longer claim these expenses as an itemized deduction. Compare that with either an independent contractor or statutory employee who is permitted to claim business expense deductions on Schedule C.

Independent contractor: If an individual is classified as an independent contractor, the only responsibility of the business is to issue a Form 1099-NEC. For any independent contractor who earns \$600 or more, the employer (client) must fill out a Form 1099-NEC. The business enters the amount paid to the independent contractor in Box 1 of the Form 1099-NEC. (Prior to 2020, Form 1099-MISC, Box 7, was

used.) The Form 1099-NEC must be filed with the IRS and the applicable state department of revenue, and a copy must be sent to the independent contractor. The deadline for filing a Form 1099-NEC is generally Jan. 31 of the year following the year in which payments were made to the independent contractor. The 2020 Form 1099-NEC has a deadline of Feb. 1, 2021, because Jan. 31 falls on a weekend.

Depending on the amount earned by the independent contractor in any one year, an independent contractor may have to file federal and state estimated taxes to avoid penalties. The independent contractor only pays income taxes on the net income (gross income after deductible expenses) for the tax year. The independent contractor is also responsible for paying both the employee and employer portion of the FICA taxes, but is entitled to deduct one-half of the FICA taxes from gross income in determining the independent contractor's adjusted gross income.

Statutory employee: If an individual is classified as a statutory-law employee, the employer is required to withhold from the employee's wages the employee's portion of FICA taxes. In addition, the employer must pay the employer portion of the FICA taxes on the compensation paid to the statutory employee. However, the employer is not required to withhold federal income tax from the statutory employee's compensation. The statutory employee is still able to claim any unreimbursed business expenses associated with such services as a deduction (unlike the common-law employee after the TCJA) on Schedule C (Rev. Rul. 90-93, 1990-2 C.B. 33).

The employer is also required to fill out a Form W-2 for the employee. The employer must make the following entries on the Form W-2:

- ▶ Check Box 13 noting the employee is a statutory employee.
- ▶ Record in Box 1 the compensation paid to the employee (wages paid to the statutory employee are considered other compensation).
- ▶ Record in Boxes 3 and 5 the wages subject to Social Security and Medicare taxes. The employer is not responsible for withholding federal or state income taxes.

The IRS does not have any specific statistics on statutory employees because there were so few taxpayers who filed using this status. However, clues to accountants on who might be able to take

Review Answers

1. A. Incorrect. Providing the tools needed to complete the work is a factor that falls under behavioral control.
B. Incorrect. Hiring assistants is a factor that falls under behavioral control.
C. Incorrect. Determining what supplies, equipment and services should be purchased is a factor that falls under behavioral control.
D. **Correct.** Requiring a written contract describing the relationship falls under relationship control.

2. A. Incorrect. An employer with a statutory employee is not required to withhold federal and state income taxes. The employer is only required to withhold the employee's and employer's portion of FICA taxes and remit those to the IRS.
B. Incorrect. An employer with a statutory employee must not only withhold and remit the employee's portion of FICA taxes, but also must remit the employer's portion of FICA taxes to the IRS.
C. **Correct.** If an individual is classified as a statutory-law employee, the employer is required to withhold from the employee's wages the employee's portion of the FICA taxes and remit this to the IRS. In addition, the employer must also pay the IRS the employer's portion of the FICA taxes on the compensation paid to the statutory employee.
D. Incorrect. An employer with a statutory employee must not only withhold and remit the employee's portion of FICA taxes, but also must remit the employer's portion of FICA taxes to the IRS.

3. A. Incorrect. While the tax court looked at the extent to which the worker has unreimbursed business expenses, if the employer had more say or control over Cibotti, the court would have classified him as an employee.
B. Incorrect. While the tax court looked at how the business compensates the worker for services rendered, if the employer had more say or control over Cibotti, the court would have classified him as an employee.
C. Incorrect. Because Cibotti was independent of the employer's control on many factors, the court declared him an independent contractor.
D. **Correct.** In the court case of Dean Cibotti, the tax court's opinion highlighted the company did not control or dictate the taxpayer's hours of business, total hours, route, office location or methods of obtaining clients. Additionally, the company did not supervise or control the manner or the means by which the taxpayer sold mortgages. While A and B are factors the court looked at, if the employer had more say or control over Cibotti, the court would have classified him as an employee. Instead, because Cibotti was independent of the employer's control on many factors, the court declared him an independent contractor.

advantage of being classified as a statutory employee are provided by Form 2106, *Employee Business Expenses*, which reports statistics from before the TCJA enacted restrictions. (After TCJA, Form 2106 is for use only by Armed Forces reservists, qualified performing artists, fee-basis state or local government officials and employees with impairment-related work expenses.) Based on the latest statistics from the IRS, over 14 million taxpayers filed either Form 2106 or Form 2106-EZ in 2016. This represents approximately 10% of all individual returns filed. The total amount deducted on Line 21, unreimbursed employee expenses, on the 2017 version of Schedule A was approximately \$100 billion. This comes out to approximately \$7,100 per taxpayer prior to application of the 2% of adjusted gross income floor. Even if only one-third of those filing Form 2106 or Form 2106-EZ could be reclassified as a statutory employee, that still leaves over 4.5 million individuals who are losing a substantial tax deduction caused by the TCJA.

Based on the IRS tax numbers for unreimbursed business expenses, it is hard to estimate the impact to particular taxpayers. It is likely that some taxpayers were impacted more than others by the change to the deductibility of unreimbursed employee business expenses. In many cases, an employee is properly classified as a common-law employee and the taxpayer will lose out on the deduction for unreimbursed business expenses. However, a tax accountant working with clients may be able to identify whether certain

workers could be classified as statutory employees after taking into consideration the above rules and modifying the contractual relationship between the parties. The ability to change classification could provide a tax benefit for the employee at little cost to the employer.

Table 2, below, highlights the tax differences between the three types of worker classifications.

Impact of the pandemic on the future of the work force

Prior to the pandemic, it was estimated that less than 4% of the work force worked off premise. The longer people work from home the more likely they will want to continue to work remotely from home. In fact, it is estimated that 25–30% of the workforce will be working from home multiple days a week by the end of 2021. Can this be an opportunity for both the employee and the employer to revisit reclassifying their status from employee to statutory or independent contractor? This would be a perfect time for tax accountants, along with labor lawyers, to look over all employees' descriptions to see if any employee could be switched to a statutory or independent contractor. The switch could be beneficial to both the employee and the employer.

The employee must understand the economic impact and be willing to make the change, and the relationship between the employee and business must be sufficiently changed to qualify as either a statutory

TABLE 2

| Classification | Income Tax Rate | Employment/ Self-Employment Taxes | Deductible Business Expenses | Eligible for Employee Benefits | Income Reporting Form |
|------------------------|---|--|--------------------------------------|--------------------------------------|-----------------------------|
| Employee | Graduated ordinary tax rates | One-half of FICA taxes (7.65%); employer pays other half | No (after 2017 unless exception met) | Yes | Form W-2 |
| Independent Contractor | Graduated ordinary tax rates (net of business expenses) | 15.3% of self-employment taxes | Yes (Schedule C) | No | Form 1099-NEC |
| Statutory Employee | Graduated ordinary tax rates (net of business expenses) | One-half of FICA taxes (7.65%); employer pays other half | Yes (Schedule C) | No | Form W-2 |

employee or independent contractor. If they are, some of the benefits that can accrue to the employee/ employer are as follows:

- ▶ The employee would negotiate significantly higher wages since, under both alternatives (independent contractor or statutory employee), fringe benefits [health insurance, 401(k), life insurance, medical leave, vacation, employer contribution to health savings account, education reimbursement, etc.] would go away because these would represent financial control. Depending on the amount of fringe benefits the employee receives and the employee designation, the potential increase in compensation could be between 20% and 35%.
- ▶ The employer would not pay its portion of the FICA taxes if an employee's classification changes to independent contractor.
- ▶ A statutory employee and independent contractor would be able to deduct applicable business expenses associated with the business activity. Some examples would be in-home office, mileage, contract labor, legal and professional services, meals and retirement contributions. The employer on the other hand, could reduce occupancy requirements (rent or leasing costs), reduce bookkeeping costs regarding employee benefits, and reduce costs for office supplies.
- ▶ A significant benefit to the employee may be eliminating or reducing the cost of child care. While child care cost varies by region, currently it costs approximately \$15,000 per year for pre-school child care. If a couple had two pre-school children, eliminating or significantly reducing the cost of child care could result in significant savings for a family. Situations where this may work to the benefit of both parties is when you have both the husband and wife who work and have comparable fringe benefits, especially health insurance. One spouse may be willing to change their work status from employee to statutory employee or independent contractor, but the family would not lose important employee benefits such as health insurance.

Conclusion

There are nuances involved in how a worker is classified. Most tax accountants assume they know the rules of what constitutes an employee but may not be overly familiar with the rules regarding an independent contractor or statutory employee.

Additionally, with tax laws constantly changing and the impact of COVID-19, there is a seismic shift on how and where work will be done by employees. In situations like this, it is important for tax accountants not only to see which taxpayers benefit but also which ones are harmed by the changes. This is easy to do for individual clients. Tax accountants who serve businesses should reach beyond their clients to their client's employees.

Working with lawyers and their business clients to evaluate/re-evaluate whether reclassifying a worker's status from an employee to an independent contractor or statutory employee can be of benefit to both the business and the employees. ▶

Endnotes

1. IRS Pub. 15-A, page 7 (2020).
2. Id.
3. Id. at 8.
4. Id.
5. Thus, the taxpayer was not providing services in a dual capacity.
6. Many states have similar overtime and minimum wage requirements. Employees are generally entitled to receive the higher of the applicable requirements.

About the authors

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TAXPRO Journal CPE Exam

The following exam will provide one hour of federal tax law credit with the IRS or CTEC. The exam questions are taken from the article, Classifying Workers.

The exam must be taken online. This CPE is available for Professional and Premium level members. Go to natptax.com/tpj to register. To qualify for CPE credit, you must answer all exam questions and score a 70% or higher. You have unlimited attempts to pass the exam. Please contact Member Services with any questions at 800-558-3402, ext. 3, or at natp@natptax.com.

1. Distinguishing between employees and independent contractors is important because:
 - A. Income tax must be withheld for employees, but not independent contractors
 - B. Employers may have fewer legal obligations to independent contractors
 - C. There can be significant penalties and payment of back taxes by misclassifying one for the other
 - D. All of the above
2. If a worker is an employee, the employer must:
 - A. Withhold income taxes
 - B. Remit and withhold the employee's share of FICA taxes and pay the employer's share of FICA taxes
 - C. Remit the employee's share of FICA taxes without withholding from the employee their share
 - D. A and B only
3. Employers are required to send what form to independent contractors if they receive \$600 or more in income?
 - A. Form 1099-G
 - B. Form 1099-C
 - C. Form 1099-D
 - D. Form 1099-NEC
4. Which of the following is true of independent contractors?
 - A. They must provide for their own health insurance
 - B. The employer must withhold income taxes from their income
 - C. They must be paid a minimum wage and overtime
 - D. The employer must provide all necessary supplies, equipment and services to do the job
5. For a statutory employee, the employer must:
 - A. Provide fringe benefits
 - B. Withhold only the employer portion of the FICA taxes
 - C. Withhold and remit the employee portion of FICA taxes and pay the employer portion of the FICA taxes
 - D. Issue a Form 1099-NEC if the statutory employee earns \$600 or more

