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Top 10 Tax Planning Mistakes

YES	NO	N/A

1) Failure to find out from your CPA your Federal, State, City and Social Security tax rates that you are paying on our business profits as a Business Owner.

Tax Guide P. 3

Action Step:

YES	NO	N/A

2) Failure to maximize Pension / 401(K), SEP / Simple Retirement Plan Contributions for Owners and minimize related costs for your employees.

Tax Guide P. 20
Tax Guide P. 26-27

Action Step:

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	YES	NO	N/A
3) Failure to fund HSA account annually.			

Tax Guide P. 21

Action Step:

	YES	NO	N/A
4) Failure to keep adequate receipts for business expenses and risk losing tax deductions if audited by IRS.			

Tax Guide P. 23

Action Step:

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	YES	NO	N/A
5) Failure to maximize business expenses for business use of autos - Actual versus Per Mile Rate or Travel expenses - Actual versus Per Diem Rate or Home Office Deduction			

Tax Guide P. 8
Tax Guide P. 23

Action Step:

	YES	NO	N/A
6) Improperly classifying workers as independent contractors when they should be Employees for payroll tax purposes.			

Action Step:

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	YES	NO	N/A
7) Failure to use proper tax entity to maximize income tax savings. Biggest mistake is failure to maximize Social Security / Medicare taxes by using S Corporation properly.			

Exhibit A

Action Step:

	YES	NO	N/A
8) Failure to maximize tax savings for business owners using cash basis for reporting taxable income or other methods to defer income legally			

Action Step:

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	YES	NO	N/A
9) Failure to use tax depreciation methods to maximize tax savings - Sec 179, bonus depreciation and MACRS accelerated depreciation methods.			

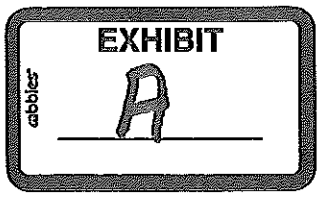
Tax Guide P. 21-23

Action Step:

	YES	NO	N/A
10) Failure to reimburse employees for business expenses using an accountable expense reimbursement plan or other methods to pay for dependent care, medical premiums or medical expenses on a pre-tax basis.			

Tax Guide P. 19

Action Step:



Session 1

Tax Savings Strategies for Small Business Owners

Choice of Entity
Tax Savings Strategies

William E. Hesch, Esq., CPA, PFS
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LLC - Choice of Entity

Sole Proprietor - 1 owner

Partnership - 2 or more owners

Corporation - File timely election

S Corporation - File timely election

MANAGER MANAGED LLC

or

MEMBER MANAGED LLC

	2015 Taxable Incomne / Schedule C	
Married-Joint Return	$75,300-$151,900	$18,550-75,300
Federal	25%	15%
Social Security	15%	15%
State	4%	4%
City	2%	2%
Total	46%	36%
Single	$37,650-$91,150	$9,275-$37,650
Federal	25%	15%
Social Security	15%	15%
State	4%	4%
City	2%	2%
Total	46%	36%

Sole Proprietor - Key Issues

1) All profits are subject to social security tax.
2) Employ Spouse - medical reimbursement plan.
3) Employ Children under age 18.
4) Home office expense deduction.
5) No limited liability for owners - can convert to LLC easily to get liability protection
6) Owner can not be an employee and should not have taxes withheld as an employee. Payments are owner draws and must make estimated tax payments.

Partnership - Key Issues

1) Allow losses to be specially allocated among partners.
2) Limited partners share of profits are not earnings subject to FICA.
3) Member Managed - All profits allocated to partners are subject to FICA.
4) Can increase basis of assets by step-up election.
5) No limited liability for owners - can convert to LLC easily to get liability protection.
6) Partner payments for services rendered are guaranteed payments.
7) No employee status - no taxes to be withheld as required for employees. Partners are required to make estimated tax payments.
8) Real estate investments have equity which can be favorably accessed under the partnership tax rules.

C Corporations - Key Issues

1) Lower Tax Rate - 15% on 1st $50,000 profits.
2) IRA/401(k) - Rollover to Corporation profit sharing plan is permitted and 401(k) can invest in stock in company without limitations.
3) Interest expense on buy-out of stock subject to investment interest expense rules.
4) Section 1244 ordinary loss for up to $100,000 investment in stock.
5) Subject to reasonable compensation rules and accumulated earnings tax rules.
6) Consider salary continuation plan.
7) Common strategy - If no unreasonable compensation issues, then pay out owner bonuses to reduce profits to $50,000.
8) Must follow corporate formalities or corporate veil may be pierced and subject owners to personal liability.

S Corporation - Key Issues

1) Profits distributed as dividends not subject to social security tax.
2) Low/Below market salaries to owners subject to IRS challenge.
3) Losses allocated pro-rata to stock ownership
   *Deductibility equal to basis generated by capital/loans directly invested by shareholer
   *Deductibility subject to material participation rules/passive loss rules
   *Corporation debts do not create basis for loss purposes
4) Late S elections are permitted under liberalized rules if certain requirements are met.
5) Shareholders are employees and non-reimbursed employees business expenses are deducted on Schedule A
6) Cannot claim home operating expenses on rental of home office to corporation.

Sale of Business - C Corp vs S Corp

Sale of Assets		$1,000,000	$1,000,000
Corporate Tax	x	40%	
	-	$400,000	$0.00
Dividends to Shareholders	=	$600,000	$1,000,000
Personal Tax	x	20%	205
	-	$120,000	$200,000
Net After Taxes to Shareholders	=	$480,000	$800,000

1) Assumes all gain on sale of assets related to capital gain assets.
2) C Corporation electing S Corporation is subject to double tax for 5 years under the built-in tax rules.

IRS

Part 4. Examining Process

Chapter 23. Employment Tax

Section 5. Technical Guidelines for Employment Tax Issues (Cont. 1)

4.23.5 Technical Guidelines for Employment Tax Issues (Cont. 1)

4.23.5.7
Government Entities

4.23.5.7.5 (02-01-2003)
Federal Agencies

1. Federal agencies are generally bound by the same statutory and common law rules as the private sector. The Federal, State and Local Governments office (FSLG) has overall responsibility for employment compliance efforts involving federal agencies.
2. There are unique protocol issues for federal agencies, including the military. If a compliance issue or lead involving a federal agency is received by another IRS office, this lead or issue should be referred to the Federal, State and Local Governments Headquarters Office in Washington, D.C.
3. Guidance has been provided to federal employers by the Office of Personnel Management on the employer-employee relationship and the proper classification of workers.

4.23.5.7.5.1 (11-03-2009)
Examination of Federal Agencies

1. The Federal, State and Local Governments office (FSLG) has primary responsibility for examination of employment tax returns filed by federal agencies. Because federal agency headquarters are in Washington, D.C., the Federal Agency Group will take the lead in identifying compliance issues and coordinating federal agency examinations. IRM 4.90 provides additional guidance and information.
2. If a potential employment examination issue for a federal agency is uncovered, a referral must be made to the Office of Federal, State and Local Governments in Tax Exempt/Government Entities (TE/GE). Refer to IRM 4.90.6, *Federal, State and Local Governments (FSLG) - Referrals*, for additional guidelines on referrals.

4.23.5.8 (02-01-2003)
Social Security Coverage of Employees of Nonprofit Organizations

1. The Social Security Amendments of 1983 extended social security coverage on a mandatory basis to all employees of IRC 501(c)(3) organizations with respect to services performed on or after January 1, 1984. Terminations of coverage by organizations which had waived their exemptions under IRC 3121(k)(1)(D) would not be permitted on or after March 31, 1983.

4.23.5.9 (12-10-2013)
Social Security Coverage for Church Employees

1. IRC 3121(w) provides that any church or qualified church-controlled organization may make an election within the time period described below, that services performed in the employ of such church or organization shall be excluded for purposes of Title II of the Social Security Act. An election may be made under this section only if the church or qualified church-controlled organization (see (4) below) states that such church or organization is opposed for religious reasons to the payment of the tax imposed under IRC 3111. The election is made on Form 8274, *Certification By Churches and Qualified Church – Controlled Organizations Electing Exemption from Employer Social Security and Medicare Taxes.*
2. The election under IRC 3121(w) must be made prior to the first date on which a quarterly return is due or would be due had the election not been made. This election does not apply to services as ministers of a church, members of a religious order, or to services performed in an unrelated trade or business of the church or qualified church organizations. An election under this section applies to current and future employees. This election may be permanently revoked by the organization by paying Social Security and Medicare taxes for wages covered by this section. The Service will permanently revoke the election if the organization does not file Forms W-2 for two years or more and does not provide the information within 60 days after a written request by the Service.

2. For periods prior to December 31, 2006, absent egregious circumstances or evidence of intentional noncompliance, an examiner should not treat a plan as entirely nonaccountable solely because excess per diem payments were not treated as wages. Instead, the examiner should only treat the excess amounts over the federal per diem limit as wages.

4.23.5.15.2 (08-31-2012)
Considerations for Periods After December 31, 2006

1. For periods after December 31, 2006, the examiner will determine whether the plan is abusive based on the extent of the excess payments that are not treated as wages and on whether a system for tracing excess payments is being utilized.
2. There are four considerations to be addressed:
    1. *When does an employer routinely make payments in excess of the deemed substantiated amount?* The examiner should apply the following criterion:
    ==========
    ==========

    Exception:
    ==========
    ==========
    ==========

    If the criterion is not met, excess payments will not constitute a pattern of abuse, absent other significant plan defects.
    2. *When does an employer fail to track excess allowances?* If the criterion above is satisfied, the agent must determine whether the employer has implemented and utilizes a system to track allowances that permits it to determine when the allowances paid, computed on a per diem basis, exceed the deemed substantiated amount and to treat such amounts as wages. If the agent determines the employer utilizes such a system, then the fact that the employer, due to errors in its system, routinely pays excess allowances that it does not treat as wages generally does not, on its own, evidence a pattern of abuse. Each case stands on its own, and a determination must be made based on the "facts and circumstances" of that particular case.
    3. *What happens if a plan evidences a pattern of abuse?* If a plan evidences a pattern of abuse, all of the per diem payments made under the plan will be treated as taxable wages.
    4. *What happens if a plan does not evidence a pattern of abuse?* If a plan does not evidence a pattern of abuse, but an employer has paid excess allowances without treating such amounts as wages, only the excess per diem payments will be considered taxable wages in the audit.

4.23.5.16 (08-31-2012)
Accountable Plans – Tool Reimbursements and "Rental" Payments

1. Examiners may encounter employers who treat part of an employee's compensation as "tool rental" or "tool reimbursement." They usually exclude these payments from wages. They may also report the payments on Form 1099-MISC as rental payments. These types of payments are no different from any other expense reimbursements and must meet the requirements of an accountable plan to be excluded from wages.
2. Payments to employees for equipment they are required to provide as a condition of employment are wages for employment tax purposes unless paid under an accountable plan. See Rev. Rul. 2002-35.
3. An employer who designates part of an employee's compensation as a "tool allowance" must meet accountable plan requirements. To be excluded from wages, amounts paid to employees to cover expenses incurred to acquire or maintain tools must be paid under a reimbursement or other expense allowance arrangement that meets the requirements of IRC 62(c). **An arrangement that provides for a tool allowance based upon hours worked or any other estimate fails to meet both the substantiation and the return of excess requirements, and thus does not qualify as an accountable plan.** See Rev. Rul. 2005-52.
4. A related issue is the payment of "rent" to employees for the use of tools and equipment provided by the employees as a requirement of the job. These payments are usually reported to the employees on Forms 1099. This may be an attempt by the employer to circumvent the accountable plan rules. Generally, payments to employees for the use of employee-provided equipment are wages and not rent since the payments are related to the services provided as an employee and are not paid under an accountable plan. Thus, the payments should be considered wages subject to employment taxes and reportable on Form W-2 and Form 1040 unless the payments were made under an accountable plan.
5. Typically, the employer will characterize a portion of each employee's compensation as a reimbursement for equipment rather than as wages, thus avoiding both employment and income taxes on the equipment payment amount.
6. Although the payment may be intended to reimburse the employee for the expenses incurred in purchasing and maintaining equipment, the amount is generally determined without reference to the expense that might be incurred. It is more likely that the payments are used to provide employee compensation that is treated as not subject to employment taxes. Employers do not include the rental payments in the employee's wages. Consequently, the employers reduce their liability for employment taxes.
7. The issue to be determined with respect to equipment rents is whether employees who furnish and maintain their own equipment are reimbursed for such expenses under an accountable plan. A reimbursement or other expense allowance arrangement will be treated as a nonaccountable plan if it fails to meet any one or more of the requirements of business connection, substantiation, or return of excess.

4.23.5.16.1 (08-31-2012)
Accountable Plan – Per Diem Payments and Wage Recharacterization

1. If an expense reimbursement plan serves to recharacterize amounts previously paid as wages, amounts paid under it will not be treated as paid under an accountable plan. Such recharacterization violates the business connection requirement of Treas. Reg. 1.62-2(d) because the employees receive the same amount regardless of whether expenses are incurred, the only difference being the ratio of the amount treated as taxable wages to the amount treated as nontaxable reimbursement. Consequently, all reimbursement allowances paid under the plan must be treated as paid under a nonaccountable plan, must be included in the employee's gross income, and must be reported as wages for FICA tax, FUTA tax, and income tax withholding purposes. The recharacterization as a reimbursement allowance of amounts previously paid as wages violates the business connection requirement of Treas. Reg. 1.62-2(c) regardless of whether the employee actually incurs (or is reasonably expected to incur) deductible business expenses related to the employer's business. See Rev. Rul. 2012-25.
2. An emerging issue is the bifurcation of wages between taxable wages and per diem payments, most often paid to employees who provide services through a temporary staffing service or other temporary employment arrangement and have to travel for the job. The payment arrangement typically pays the employee an hourly rate, but the rate is divided between taxable wages and "per diem" payments. The combined rate is comparable to the taxable wage rate paid to employees who work in the same location but do not travel for the job.

4.23.5.17 (11-03-2009)
Procedures at Conclusion of Examination

1. At the conclusion of the examination, discuss findings with the taxpayer. Explain the government's position in a convincing and professional manner. The objective is to obtain the greatest possible number of agreements without sacrificing the quality or integrity of examination determinations, which follows Policy Statement 4–40, *Early agreement primary objective*. Refer to IRM 1.2.13.1.16.
2. The closing conference will be productive if the taxpayer and representative are kept informed of the issues throughout the examination. This includes reviewing in detail with the taxpayer and representative any Form 5701, *Notice of Proposed Adjustment*, issued before the closing conference.
3. Determine if any information return penalties are applicable regardless of whether the forms are obtained during the examination or the taxpayer is permitted a delayed submission. See IRM 4.23.9, *Employment Tax - Employment Tax Penalty and Fraud Procedures*. If there is no reason for waiver of the penalties, propose and process the penalty package at the same time as the examination package. See IRM 4.23.8.11, *Information Return Penalty Case File*, for instructions on the penalty package.
4. Solicit payment for deficiencies if an agreement is indicated. See IRM 4.23.11, *Employment Tax - Prompt Action in Deficiency and Overassessment Cases*, for instructions on prompt action in deficiency and overassessment cases.
5. A Form 2504, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment*,Form 2504-S, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (including section 530 statement)*, or Form 2504-WC, *Agreement to Assessment and Collection of Additional Employment Tax and Acceptance of Overassessment in Worker Classification Cases*, will be accepted only when it discloses the date of calendar quarters involved, the return form number, the amount of the deficiency, overassessment or penalties if any, and is properly signed by the taxpayer or taxpayer's representative. Under no circumstances will a waiver, which has been completed by the taxpayer, be altered by Service personnel; nor will the taxpayer be requested to execute a blank waiver. A Form 2504 is considered a valid claim for refund when a taxpayer agrees to an overassessment determined by the Service. The date of receipt of the executed Form 2504 will be indicated in the upper right corner of the form. See IRM 4.23.10.15, *Agreed Employment Tax Reports*, for instructions on processing these cases.

4.23.5.17.1 (08-31-2012)
Alternative Dispute Resolution

1. If the taxpayer indicates disagreement with any of the proposed adjustments, solicit and consider a formal statement of the taxpayer's position on each unagreed issue before concluding the examination. If agreement cannot be reached, explain the procedures for administrative appeal, as well as the option to pay any deficiency and file a claim for refund, if the taxpayer or taxpayer's representative is not conversant with these procedures. Provide Publication 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree*, to the taxpayer. Alternate dispute resolution strategies are fully discussed in IRM 4.46.5.5.2, *Alternative Dispute Resolution (ADR) Tools and Procedures*.
2. When taxpayers disagree with proposed adjustments, it is beneficial to all parties to resolve disputes at the lowest level possible. IRC 7123 provides for alternative dispute resolution techniques by Appeals. This code section was added by section 3465 of the IRS Reform and Restructuring Act of 1998. Two processes that may expedite dispute resolution are early referral to Appeals and Fast Track Mediation.
3. **Early Referral:** If the examiner and taxpayer are unable to reach agreement on one or more issues, the taxpayer should be encouraged to request early referral of these unagreed issues to Appeals. Certain employment tax issues that are appropriate for referral are described in Rev. Proc. 99-28, 1999-2 C.B. 109, and include:
    1. Worker classification issues.
    2. Liability issues such as the applicability of section 530, IRC 3509 rates, and interest free adjustments.
    3. Other issues such as whether certain payments are excepted from the definition of wages, e.g., fringe benefits.
4. **Fast Track Mediation:** Another method designed to expedite the resolution of tax disputes with taxpayers at the earliest opportunity is Fast Track Mediation (FTM). Either the examiner or the taxpayer can propose mediation. FTM involves an appeals or settlement officer trained in mediation techniques, acting as a mediator between the taxpayer and Compliance. At the completion of a disputed determination, the examiner or manager will inform the taxpayer of the opportunity to request FTM to resolve the case. Both the Service and the taxpayer must complete and sign a simple agreement to use mediation. The mediator facilitates the discussion but cannot impose resolution. The taxpayer and the Service must agree on any resolution. Issues not resolved can follow the normal appeal process. See Publication 3605, *Fast Track Mediation - A Process for Prompt Resolution of Tax Issues*, for more information on FTM.
5. The enactment of IRC 7436 does not change these early referral procedures. If the issues are approved for transfer from Compliance to Appeals, the examiner will continue to develop other issues arising in the audit and will solicit consents from the taxpayer to extend the statute of limitation period for assessment, as appropriate.
6. **TAS:** The Taxpayer Advocate Service (TAS) is an independent organization within the IRS whose employees assist taxpayers experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal procedures, or who believe that an IRS system or procedure is not working as it should. Pub 1546, *Taxpayer Advocate Service - Your Voice at the IRS*, provides contact and additional information. The program is designed to alleviate taxpayer hardships that arise from systemic problems or the application of the Internal Revenue Code. In addition, see the TAS web site at: http://tas.web.irs.gov.

4.23.5.17.2 (08-31-2012)
Correction of Error on Form 2504

1. If an error was made in computing the deficiency, overassessment, or penalty shown on a Form 2504, where agreement was previously obtained, it is not necessary to obtain a new Form 2504 if the correction of the error is in favor of the taxpayer. In such case, the correct deficiency or penalty should be assessed or the correct overassessment scheduled for refund. An explanation of the correction should be made in the Employment Tax Examiner's Report (ETER) to the taxpayer.
2. If the correction of an error against the taxpayer is minor in amount, the case will be processed for the amount of the deficiency, overassessment or penalty shown by the original waiver and a suitable explanation will be included in the ETER to the taxpayer. Refer to IRM 4.10.2.3.1, *Large Unusual Questionable Items (LUQs) Defined*, for tolerance levels.

4.23.5.18 (05-22-2015)
Whistleblower Claims for Reward - General

1. IRC 7623 provides for the payment of awards, not otherwise provided for by law, for information that leads to the detection of underpayments of tax; or detection and bringing to trial and punishment of persons guilty of violating internal revenue laws or conniving at the same.
2. Treas. Reg. 301.7623–1 provides that whistleblowers may file a claim for an award on Form 211, *Application for Award for Original Information*.

- If a "b" claim, return to the SB/SE HQ Exam SEP&Q ET WB Coordinator. The coordinator, upon review and concurrence with the examiner, will forward the information to the WB Office and request the removal of the freeze code. When the freeze codes are removed, the examiner can close the case to the manager.

4. If the examiner determines the case needs to be re-assigned to another group, they will complete items 1 through 8 and 14 on Form 11369 and return as indicated:

   - If an "a" claim, return to the classification specialist in ET-CWSD. The classification specialist will update the *e-trak* system with the new group assignment information.
   - If a "b" claim, return to the SB/SE HQ Exam SEP&Q ET WB Coordinator, who will ensure the WB Office is made aware of the transfer of controls.

5. If the case will be examined, the examiner will develop the issues according to general employment tax procedures. When developing the issues related to information received from the whistleblower, examiners should attempt to independently corroborate and/or refute the information provided. The independently developed information will form the basis for any proposed assessment as well as the recommendation whether an award is appropriate.

6. Upon completion of the examination, the examiner must make a determination regarding the appropriateness of the award and complete Form 11369. This determination must be made for all cases, whether agreed or unagreed. The narrative attachment to the Form 11369 should contain:

   - Summary of the facts of the case,
   - Description of the timing of the receipt of the Form 211 submission to chronicle whether or not the taxpayer was already under audit when the claim was received,
   - Short description of the issue reported by the whistleblower,
   - Detail how the examiner used whistleblower's information,
   - Provide a detailed description of how the information assisted the examination,

   Note:
   Do not state any value determinations regarding the usefulness of the information. For example, avoid merely stating that the information was "great," "excellent," "useful," or "useless."

   - Description of the audit steps performed, including if a Technical Advisor or Counsel was involved,
   - Description of the issue(s) audited from the Form 211 claim,
   - Description of whether or not there were other issues examined and adjusted, e.g., the addition of another issue or additional years or related taxpayers specifically attributable to the claimant,
   - Description of the final results, including whether adjustments were proposed, if the case was agreed or not, if a 30-day letter was issued, if Appeals was requested, if the taxpayer has elected not to respond, and final disposition - the case was stat-noticed, etc.,
   - Brief statement specifically addressing the field's assessment of whether or not the whistleblower's information contributed to the adjustment or part of the adjustment (and what portion/percentage), and
   - Specific reasons if the referral is surveyed.

7. When the case is ready to close, the examiner must take steps to separate information pertaining to, or referencing the existence of, a whistleblower in the examination case file. There will be two case files:

   1. The whistleblower case file, containing all relevant information in the examination including a copy of the examination report, relevant workpapers, and all documents submitted with the initial whistleblower referral.
   2. The examination case file, the normal closed case administrative file.

   Any document that remains with the examination case file, such as the classification sheet, Form 5345-D, *Examination Request - ERCS Users*, or Form 5346, *Examination Information Report*, must have any reference to the presence of a whistleblower or the identification of a whistleblower case redacted. This includes deleting the tracking code from any of these documents.

8. **No whistleblower information, whistleblower files, or any references to a whistleblower should be included or associated with the examination files when sent for closing or to Appeals.** The whistleblower files and related information for "b" cases should be returned to the SB/SE HQ Exam SEP&Q ET WB Coordinator with the completed final Form 11369; The whistleblower files for "a" case closures are sent to the WB Office.

Exhibit 4.23.5-1
Determining the Right to Direct or Control

Behavioral Control	Facts that illustrate whether there is a right to direct or control how the worker performs the specific task for which he or she is hired: • Instructions • Training
Financial Control	Facts that illustrate whether there is a right to direct or control how the business aspects of the worker's activities are conducted: • Significant investment by the worker • Unreimbursed expenses • Services available to the public • Method of payment • Opportunity for profit or loss by the worker
Relationship of the Parties	Facts that illustrate how the parties perceive their relationship: • Employee benefits • Intent of parties/written contracts • Permanency • Discharge/Termination • Regular business activity

Exhibit 4.23.5-2
Employment Tax Treatment for Various Categories of Workers

Type of Worker	Income Tax Withholding	FICA	FUTA
Common Law Employee - IRC 3121(d)(1)	Withhold	Taxable	Taxable
Corporate Officer - IRC 3121(d)(2)	Withhold	Taxable	Taxable
Statutory Employees - IRC 3121(d)(3)			
Agent or Commission Driver - IRC 3121(d)(3)(A)	No Withholding	Taxable	Taxable
Full-time Life Insurance Salesperson - IRC 3121(d)(3)(B)	No Withholding	Taxable	Exempt
Full-time Traveling or City Salesperson - IRC 3121(d)(3)(C)	No Withholding	Taxable	Taxable
Home Worker - IRC 3121(d)(3)(D)	No Withholding	Taxable if paid $100 or more in cash during the calendar year	Exempt
218 Employee - IRC 3121(d)(4)	Withhold	Taxable	Exempt
Statutory Non-Employees			
Qualified Real Estate Agent — IRC 3508(b)(1)	No Withholding	Exempt*	Exempt
Direct Seller — IRC 3508(b)(2)	No Withholding	Exempt*	Exempt
Companion Sitter — IRC 3506	No Withholding	Exempt*	Exempt

* However, statutory non-employees are subject to SECA

Exhibit 4.23.5-3
Statutory Employees

FICA Statutory Employee Rules

In addition to common law employees, FICA rules provide for statutory employees, which include: (1) agent drivers and commission drivers, (2) full-time life insurance salesmen, (3) home workers, and (4) traveling or city salesmen.

General Requirements

The four occupational groups are briefly covered in Treas. Regs. 31.3121(d)–1. Workers in these four occupational groups who meet the following requirements are employees, for FICA purposes only, if they do not meet the common-law test:

1. The contract of service contemplates that the worker will personally perform substantially all the work, and
2. The worker has no substantial investment in facilities other than transportation facilities used in performing the work, and
3. There is a continuing work relationship with the person for whom the services are performed.

NOTE: Agent driver / commission driver and full-time traveling / city salesperson are FUTA taxable.

Contract of Service. Work performed in these occupational groups is done under a contract of service. The term "contract of service" , means the arrangement, oral or written, under which the work is done. This arrangement must contemplate that the worker will do substantially all the work. Thus, if the contract contemplates that the worker will do all the work personally and the alleged employer does not acquiesce in delegating part of this work to another, the fact that the worker does so would not preclude his coverage under this section. The important thing is not whether the worker delegates part of the work to another, but rather whether the arrangement contemplates the worker will do so. The mutual intent of the parties governs.

Sometimes a worker delegates part of his work to another when his contract or work agreement expressly forbids doing so. Conversely, the contract may contemplate a delegation of part of the work and the worker performs all the services himself. The examiner should determine whether the contract of service is being violated or whether it was modified to permit the change.

A contract that contemplates hiring a chauffeur would not affect the personal service requirement because the services of the chauffeur are incidental to the selling activity. Similarly, the right to hire a substitute or assistant occasionally would not preclude qualifying for this provision.

Substantial Investment in Facilities. The term "substantial investment" refers to substantial facilities being furnished by the worker for conducting the business. All the facts of each case must be considered to determine whether the facilities furnished by the worker for the work are substantial. Several factors listed below will be considered in these determinations:

1. What is the value of the worker's investment compared to total investment?
2. Are the facilities furnished essential to the work or for the personal convenience of the worker?
3. Are the facilities being purchased or leased from the person for whom the services are performed?
4. Are the facilities furnished by the worker considerably more extensive than those usually furnished by other workers performing comparable services?

Facilities include such items as office furniture and fixtures, premises, tools, and machinery. An expense may or may not relate to furnishing facilities. Expenses for facilities (for example, expenses for an office, store, showroom, warehouse, stenographic service, utilities, etc.) may be considered in determining whether the facilities furnished represent a substantial investment. Generally, a worker who maintains an office in his own home does not have a substantial investment, but the worker who maintains an office outside his home frequently has a substantial investment in facilities.

Facilities do not include:

1. Education, training or experience, or goodwill,
2. Tools, instruments, or clothing commonly or frequently provided by employees,
3. A vehicle for the worker's transportation, or
4. Transportation facilities for carrying the goods or commodities or for supplying laundry or dry-cleaning services.

Continuing Relationship. Work is considered to be of a continuing nature if it is regular or frequently recurring. Regular part-time work (for example, two days a week), is considered a continuing relationship. Regular seasonal employment is also work of a continuing nature. A single-job transaction, even though it takes a considerable period of time, is not generally a continuing relationship.

Specific Requirements

(1) Agent-Driver or Commission-Driver

This group is limited to workers who distribute meat or meat products, vegetables or vegetable products, fruit or fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services. These products and services are defined in their commonly accepted sense. The worker may sell at retail or wholesale establishments. He may operate from his own truck or one belonging to the company for which he works. Ordinarily, the worker services customers designated by the company as well as those the worker solicits. The following requirements, in addition to the three general requirements previously listed, must be met if the worker is to qualify as a statutory agent-driver or commission-driver.

The Worker Must Distribute One or More of the Types of Products or Services Listed Above. The worker may also be engaged in distributing products or services in addition to these if handling the additional products or services is incidental to handling the specified items. If the products are sold for the same principal, all the services are considered within the occupational category. A rule of thumb is that the services are incidental if the time spent handling the additional products or services is 20 percent or less of the time spent handling all products or services. If the time factor does not appear realistic, consider other factors such as ratio of income. If distributing additional products or services for the same principal is not incidental to handling the products or services listed above, the worker is not an employee. If the worker distributes for more than one principal, the services for each principal will be considered separately.

The Worker Must Perform the Services for the Person Engaging Him. The worker, who on his own account, buys merchandise and sells it, or furnishes services to the public as a part of his own independent business, is not included in this occupational category.

(2) Full-Time Life Insurance Salespersons

Ordinarily, this group includes salespersons whose full-time occupation is soliciting life insurance applications and/or annuity contracts primarily for one life insurance company. They are usually furnished with office space, stenographic help, telephone facilities, forms, rate books and advertising materials by the company or its general agent.

In addition to meeting the three general requirements, an individual must be a full-time life insurance salesperson, that is, one whose entire or principal business activity is devoted to soliciting life insurance and/or annuity contracts primarily for one life insurance company. Generally, the contract of employment will show whether a salesperson meets these requirements.

The intention of a salesperson and the company, shown by the contract of employment and their mutual performance, not the time devoted to the work, will govern in determining whether an individual is a full-time or a part-time salesperson. Thus, the entire or principal business activity of an insurance salesperson will be considered to be soliciting life insurance or annuity contracts if their arrangement with a life insurance company provides for soliciting life insurance or annuity contracts (or for soliciting such contracts and only incidentally soliciting accident and health insurance contracts) for such company as their entire or principal business activity.

Intent Expressed in Contract. When the contract clearly shows that full-time services are intended, a salesperson meets the full-time requirement. On the other hand, if part-time services are contemplated by the contract, a salesperson is not a statutory employee. This applies, regardless of the amount of time devoted to the work, unless a question is raised that the contract does not show what both parties originally or later intended.

Deviation From Original Intent—Parties Agree. If the performance of a salesperson is not consistent with the written contractual terms, determine whether the parties came to a mutual understanding on the deviation. If the parties agreed to the change in their original agreement or the company acquiesces in it, a salesperson's status will be modified, effective with the date the change took place. Their status before that date will be governed by the terms of the original contract.

Deviation From Original Intent—Parties do not Agree. If the performance of a salesperson is not consistent with the contract terms and the company knows of the inconsistency but refuses to change the original agreement or to acquiesce in the deviation, determine whether there is a reasonable basis for the company's position.

Example of Reasonable Position. The company has a set policy restricting the number of full-time salespeople it may employ in a certain territory and notifies all its salespersons under part-time contracts of this policy. It is aware that some of its part-time salespersons are devoting their whole time to selling for the company, but it discourages this custom and treats such salespersons as part-time workers in every respect, that is, pays them at a lower rate of commission than a full-time salesperson and does not include them in its pension and bonus plans, etc.

Example of Unreasonable Position. The company considers all its salespeople full-time if they work exclusively for their company. The company may know that only one hour a month is devoted to the sale of insurance by the salespersons, and the remainder of their time is spent in other work.

If the company's position is reasonable, a salesperson's status will be determined by the terms of the contract, regardless of his work history. However, if the company's position is unreasonable, a salesperson's status will be determined by a complete evaluation of the situation.

Intent Not Expressed in Contract—Parties Agree. If there is no written contract, or the contract does not clearly reveal the mutual intent of the parties on the full-time or part-time aspects of the relationship, a salesperson's status will be determined by the mutual intent of the parties shown by their answers to questions posed by the examiner.

Intent Not Expressed in Contract—Parties Do Not Agree. If the contract does not show whether full-time or part-time services are intended and the parties disagree, the determination of a salesperson's status will be based on a complete factual evaluation. Whether a salesperson's work for the company is their **entire or principal business activity** will be decided after considering the factors discussed in the following paragraphs under those headings. The company's classification of a salesperson should be given considerable weight, if there is a reasonable basis for the classification.

Concept of "An Entire Business Activity." An entire business activity may or may not be full-time. A salesperson does not necessarily have to spend 8 hours a day, 5 days a week, in one sole business activity to meet the full-time requirement. A salesperson may work regularly a few hours a day and qualify as a full-time insurance salesperson if other factors in the work relationship indicate a full-time status.

On the other hand, many salespersons work for only one firm but spend only an hour or two a day, or a day or two a week, at their occupations or make sales only occasionally. Generally, even though the services are a salesperson's only work effort, the services are not substantial enough to be considered an "entire business activity." In other words, a salesperson is not an employee if his/her efforts are so irregular, intermittent, or sporadic that the salesperson would be considered not to be engaged in any business activity.

Concept of "A Principal Business Activity." A principal business activity is one which takes the major part of a salesperson's working time and attention. When a salesperson is engaged in several business activities, it is necessary to determine the principal business activity. In making this determination, consider factors such as:

1. The opinions of the parties involved. A statement by the company that a salesperson is or is not required to devote their work effort principally to the sales of its policies should be given considerable weight. A similar statement by a salesperson should be supported by other evidence.
2. The salesperson's total working time; that is, the amount of time spent in connection with all business activities. What proportion of that time do they spend in soliciting for the firm?
3. The ratio of earnings from the services to total earnings. Does the ratio indicate that the major part of the sales income comes from this firm?
4. Insurance companies usually treat part-time and full-time salespersons differently for commission rates, renewal schedules, pension plans, etc. In what category has the company placed the salesperson?

Type of Insurance Sold. The salesperson's efforts must be devoted principally to soliciting life insurance or annuity contracts. Occasional or incidental sales of other types of insurance, such as accident and health insurance will not affect this requirement. However, a salesperson who is required to devote substantial effort to selling applications for insurance contracts other than life insurance or annuity contracts (e.g., accident and health, fire, automobile, etc.), does not meet the requirement.

Life Insurance Subagents. It may sometimes be necessary or desirable to determine whether life insurance subagents are employees of the general agent or of the insurance company. Generally, subagents hired by the general agent are employees of the insurance company if the contracts of employment are countersigned or approved by the insurance company. If not, fully explore the contractual arrangements to determine whether the general agent or the insurance company is the employer.

If the subagents are found to be employees of the general agent, this fact will usually preclude the general agent from meeting the personal service requirement since the general agent may delegate a substantial part of the sales services to subagents. In addition, most general agents cannot meet the full-time requirement. The various services required of them in operating and supervising their general agencies indicate that it is not contemplated that they devote their full time to soliciting life insurance or annuity contracts.

(3) Homeworkers.

This group generally includes people who make buttons, quilts, gloves, bedspreads, clothing, needlecraft products, etc. The work is done away from the employer's place of business, usually in the worker's own home, the home of another, or in his own workshop. The work is done on goods or materials furnished by the employer and in accordance with the employer's specifications. The worker returns the processed material to the employer or to a person designated by the employer.

Specific Requirements for Homeworkers Services Performed After 1954. To qualify as an employee, the homeworker must meet, in addition to the three general requirements previously listed, the following requirements:

1. They must do the work in accordance with specifications given by the employer. Generally, these specifications are simple and consist of patterns, samples, etc.,
2. The material or goods on which the work is done must be furnished by the employer, and
3. The finished products must be returned to the employer or a person designated by them. It is immaterial whether the employer calls for the work or the worker delivers it to them.

Special Wage Requirement for Homeworkers. A homeworker who meets the requirements is considered a statutory employee. However, IRC 3121(a)(10) provides that the payreceived for such work is not wages unless $100 or more in cash is received by the wage earner in the calendar year from one employer. Thus, a homeworker may be employed by several employers, but if the pay from one employer is to constitute wages, the homeworker must receive at least $100 cash in the year from that employer. If the $100 cash-pay test is met, all the non-cash pay from the same employer can be included as wages.

(4) Full-Time Traveling or City Salespersons.

This category includes the salesperson who operates away from the employer's premises. Their full-time business activity is selling merchandise for a principal employer. The test of "full-time" relates to an exclusive or principal business activity for a single firm or person, and not to the time spent on a job. Side-line sales activities for some other person do not exclude a salesperson from coverage.

Salespersons are ordinarily paid on a commission basis. Generally, they are not controlled as to the details of their service or the means by which they cover their territories. However, they are expected to work their territory with some regularity, take orders, and send them to the employer for delivery to the purchaser. This group does not include agent-drivers or commission-drivers.

In order for a traveling or city salesperson to fall within the statutory test, they must meet, in addition to the three general requirements, the following requirements:

1. Their entire or principal business activity must be devoted to soliciting, on behalf of and transmitting to their principal, orders for merchandise,
2. The orders must be obtained from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments, and
3. The merchandise they sell must be bought for resale or must be supplied for use in the purchasers' business operations.

The definition of an entire and a principal business activity, given under "Full-time life insurance salesperson" applies here. In addition, you should consider whether the contractual arrangement requires devoting a major portion of the salesperson's time and efforts to sales activity for the firm.

They Must Work for One Principal Employer. A worker who buys merchandise and sells it on their own account is not included in this occupational category. Neither is a manufacturer's representative who holds themselves out as an independent businessperson and serves the public through their connection with a number of firms.

The multiple-line salesperson generally is not an employee because their principal business activity is not soliciting orders for one principal. However, a salesperson who solicits orders primarily for one principal is not excluded because of side-line activities on behalf of other persons or firms. The salesperson may be an employee of the person for whom the orders were principally solicited.

Classes of Purchasers. Salespersons must sell to the classes of purchasers described in IRC 3121(d)(3)(D). They may also sell incidentally to others. In addition to considering the percentage of a salesperson's total working time spent in soliciting orders from the specified classes of purchasers, other factors, e.g., rates of income, number of sales, etc., should also be considered. If the sales to excluded purchasers are incidental, all of the salesperson's services for its principal are considered within the occupational category.

1. A wholesaler buys merchandise in large quantities and usually sells in small quantities to jobbers or to retail dealers but not to the ultimate consumer. The wholesaler does not process the merchandise in any way to cause it to lose its identity.
2. A retailer deals in merchandise by selling it in small quantities, usually to persons who consume or use it.

Retail establishments may perform service functions or processing or manufacturing operations with respect to the items they sell without losing their character as retail establishments. For example, a store that sells drapery and slip cover material and also makes draperies and slip covers for the consumer is a retail establishment and not a manufacturer. A neighborhood bakery is essentially a retail store, even though it changes the form of raw or prepared materials.

3. Contractors include such service organizations as window-washing contractors, wall cleaning contractors, other service contractors, and construction contractors.
4. The phrase "other similar establishments" refers solely to establishments similar to hotels and restaurants. It is limited to establishments whose primary function is furnishing food and/or lodging.

Status of Purchasers Composed of Several Business Units. An entity not within the included classes of purchasers may, through a unit of its organization, carry on a clearly identifiable and separate business which is in the included category. A salesperson who solicits orders from the entity for merchandise for resale by or for use in business operations in that unit has met the requirement regarding "classes of purchasers." For example, sales made to an unincorporated university bookstore, owned and operated by the university, are sales made to a purchaser included in the statutory definition of "traveling or city salesman."

Merchandise for Resale or Supplies for Use in Purchaser's Business Operations. Merchandise must be for resale or for use in the business operations of the purchaser. The phrase "merchandise for resale" includes only tangibles that do not lose their identity as they pass through the hands of the purchaser. "Supplies for use in the business operations" means supplies principally used in conducting the purchaser's business. Generally, it includes all tangible merchandise not considered "merchandise for resale." Services such as radio time, advertising space, etc. are intangible and outside of this definition. However, advertising novelties, calendars, etc. constitute supplies within this definition.

The fact that a salesperson performs substantial work in servicing the article sold does not necessarily preclude their meeting the requirements of IRC 3121(d)(3)(D). For example, a salesperson that spends a day selling a machine and a day supervising its installation, and perhaps training the purchaser's personnel in its use, may still have performed services as a full-time salesperson. Furnishing such services by a salesperson may be a necessary part of the inducement for the buyer to purchase. The question, therefore, is whether their total activity is essentially a selling activity. If it is, the services related to such sales, even though substantial, are an integral part of the sale. If it is not, they do not meet the requirements for coverage.

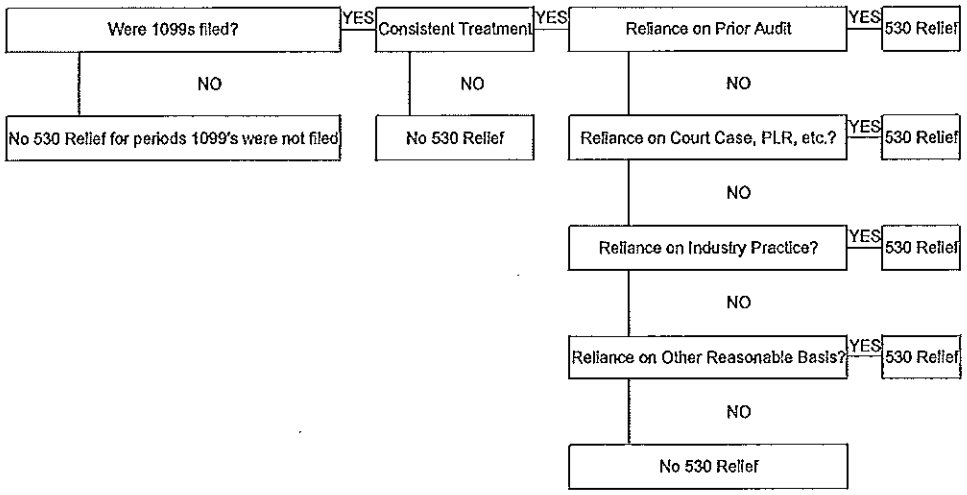
Exhibit 4.23.5-4
Employer-Employee Relationship Cases

The following is a partial list of cases dealing with the issue of worker classification. The cases are not listed in any particular order.

Ewens and Miller v. Comm, 117 T.C. 263 (2001)	In finding that bakery workers and cash payroll workers were common law employees, the Tax Court stated that "whether a worker is a common law employee or an independent contractor, for employment tax purposes, Tax Court considers: (1) degree of control exercised by the principal, (2) which party invests in work facilities used by the worker, (3) opportunity of the worker for profit or loss, (4) whether principal can discharge the worker, (5) whether work is part of principal's regular business, (6) permanency of relationship, and (7) relationship parties believed they were creating. 26 U.S.C.A. §3121 (d)." The case also discusses statutory employees.
Avis Rent A Car System. Inc. v. United States, 503 F.2d 423 (2d Cir. 1974)	Car shuttlers were employees, despite the transient nature of their relationship with the employer. The Court found seven relevant non-exclusive factors from *U.S. v. Silk*, 331 U.S. 704 (1947) and *Bartels v. Birmingham*, 332 U.S.,126 (1947) including working in the course of the service recipient's business (integration). The importance of avoiding single-fact analysis is stressed in this case. Facts considered relevant include: 1) the right to control the manner in which work is performed, 2) substantial investment, 3) expenses, 4) ability to profit, 5) special skills, 6) permanence, and 7) whether the services performed by the worker were part of the principal's regular business activity.
Ellison v. Commissioner, 55 T.C. 142, 144, 153, 156 (1970) acq. 1971--2 C.B. 2	A worker was an employee of a life insurance company and thus a stock option granted by the company was a restricted stock option. The worker did not bargain with the company with respect to the terms of the working agreement. The fact that an employee has an opportunity to exercise his own faculties in the business of the employer does not negate the employment relationship. The Court found that a provision in the contract indicating there was no employment relationship was not significant.
McGuire v. United States, 349 F.2d 644, 646 (9th Cir. WA 1965)	Truck unloaders ("swampers") required little supervision because the nature of the work was uncomplicated and they were generally familiar with the procedures of the job. "The absence of need to control should not be confused with the absence of right to control. The right to control contemplated by the regulations relevant here and the common law as an incident of employment requires only such supervision as the nature of the work requires."
James v. Commissioner, 25 T.C. 1296, 1301 (1956)	A doctor was an employee of hospitals for which he performed services. "[T]he control of an employer over the manner in which professional employees shall conduct the duties of their positions must necessarily be more tenuous and general than the control over nonprofessional employees." "[T]he general control of the hospitals over petitioner.... coupled with the controls over his method of working furnished by the high standards of his profession...., are sufficient to constitute petitioner an employee rather than an independent contractor."
Professional and Executive Leasing, Inc. v. Commissioner, 862 F.2d 751 (9th Cir. 1988)	A case similar to *James* above - Both cases focus on the right to control the manner in which the work of highly skilled professionals is performed.

Alsco Storm Windows, Inc. v. United States, 311 F. 2d 341, 343 (9th Cir. WA 1962)	Although no one factor is controlling, the test usually considered fundamental is whether the person for whom the work is performed has the right to control the activities of the individual whose status is at issue, not only as to the results, but also as to the means and method to be used for accomplishing the results.
Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992)	In this case under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), the Supreme Court held that traditional common law concepts should be used to interpret the term "employee" absent legislative direction to the contrary.
Weber v. Commissioner, 103 T.C. 378 (1994), aff'd per curiam 60 F.3d 1104 (4th Cir. 1995)	The importance of small factual differences is apparent in *Weber*, a Methodist minister was held to be an employee. Compare with *Shelley*.
Shelley v. Commissioner, T.C. Memo 1994-432	The importance of small factual differences is apparent in *Shelley*, a clergyman in another denomination was held to be an independent contractor. Compare with *Weber*.
Grey v. Commissioner, 119 T.C. 121 (2002), aff'd, in unpublished opinion, 93 Fed.Appx. 473 (3rd Cir 2004)	This case analyzes the employment status of an individual who is the president and sole shareholder of a corporation under IRC section 3121(d)(1), and concludes that the individual performed services for the corporation in his capacity as president, and therefore, was an employee for employment tax purposes under IRC section 3121(d)(1).
Kenney v. Commissioner, T.C. Memo 1995-431	The Tax Court noted that the business' intent was inconsistent with both the substance of the employment relationship and what the parties actually knew the relationship to be. The court found that the business knew that the workers were employees, but it called them independent contractors because the business did not want to pay employment taxes on them or include them in employee benefit plans.
Veterinary Surgical Consultants, P.C. v. Commissioner, 117 T.C. 141 (2001), aff'd in unpublished opinion sub nom. *Yeagle Drywall Co. v. Commissioner*, 54 Fed. Appx. 100 (3d Cir. 2002)	President of S corporation was an employee and amounts taxpayer paid him were wages for purposes of federal employment taxes. All of taxpayer's income was generated by consulting and surgical services performed by the president. (He was the sole shareholder and the only worker.) The Tax Court found that taxpayer had no reasonable basis for treating the president as other than an employee; thus, taxpayer was not entitled to relief under section 530.
Simpson v. Commissioner, 64 T.C. 974 (1975)	The IRS successfully argued in this case that an insurance agent was an independent contractor. Relevant facts were: 1) degree of control over details; 2) investment in facilities; 3) opportunity for profit or loss; 4) right to discharge; 5) whether work is part of principal's regular business; 6) permanency; and 7) the relationship the parties believed they were creating.

Exhibit 4.23.5-5
Section 530 Flowchart



Prev

More Internal Revenue Manual

Employee or Independent Contractor?: The Worker Classification Dilemma

By Susan C. Allen, CPA/CITP, CGMA, Durham, N.C.
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Editor: Valrie Chambers, Ph.D., CPA

The worker classification issue persists due to the inherent tug-of-war between workers, who tend to prefer employee status, and payers/businesses, which often prefer to classify their workers as independent contractors. The reasons are simple: Workers want payers to be held responsible for payroll taxes and employee benefits (pensions, insurance, etc.), and payers/businesses want to shift that responsibility to their workers to save money and lessen their administrative burdens. The proper classification of workers has for decades affected many businesses and workers as well as taxing authorities and other agencies such as the U.S. Department of Labor and similar state labor regulators.

In light of the Patient Protection and Affordable Care Act (PPACA), P.L. 111-148, which is partly policed by the IRS, worker classification is even more top-of-mind for taxpayers and the CPAs who advise them. PPACA requires employers in many cases to provide employees with health insurance. Therefore, payers/businesses have even more incentive to classify workers as independent contractors to avoid PPACA costs and burdens.

The IRS knows that the U.S. Treasury loses billions of dollars annually due to worker misclassification and has made closing the tax gap (the difference between what is actually collected and what should be collected) a strategic priority by correcting as many misclassifications as possible. Workers who are classified as employees and receive a Form W-2, *Wage and Tax Statement*, are historically much more compliant with their tax obligations. This item provides high-level guidance on IRS worker classification matters, but labor issues that may apply are outside its scope.

The 20 Common Law Factors to Determine a Worker's Status

There is no bright-line test to determine a worker's status, but the IRS looks to the 20 common law factors in Rev. Rul. 87-41. Practitioners need to be aware of these factors to help their business clients properly classify workers. Worker instructions, training, hours, location, realization of profit or loss, and investment in facilities are among the factors to review. The factors boil down to who has control over employee behavior and financial resources and the relationship between the parties.

Section 530 Safe Harbor

Section 530 of the Revenue Act of 1978, P.L. 95-600, established safe-harbor rules that allow an employer in many cases to treat a worker as not an employee for employment tax purposes, regardless of the worker's actual status under the common law test. Section 530 often serves as the best defense for payers that have a reasonable basis to classify a worker as an independent contractor.

- Consistently treated the worker and other workers performing similar tasks as nonemployees for all periods;
- Had a reasonable basis for doing so; and
- Filed all required information returns, such as Form 1099-MISC, *Miscellaneous Income*.

Practice tip: Section 530 relief is officially considered (and possibly granted) by an IRS examiner at the end of the audit/appeal process (should the IRS select the taxpayer's return for an audit). However, taxpayers and practitioners need to consider Section 530 when determining a worker's status.

Requesting a Form SS-8 Determination From the IRS

Firms and workers may file Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, to ask the IRS to determine the status of a worker under common law rules. Most Forms SS-8 are filed by workers who think they are employees and therefore are entitled to employee benefits. In fact, 90% of Form SS-8 requests are filed by workers (U.S. Government Accountability Office, *Employee Misclassification* (Rep't No. GAO-09-717), available at www.gao.gov (http://www.gao.gov/new.items/d09717.pdf)).

The IRS will acknowledge the receipt of Form SS-8 and then try to contact both parties to gather as much information as it can to make a determination. The case is assigned to a technician who will review the facts, apply the law, and make a decision. The IRS will then send a formal determination to the firm and worker (if it has enough information to make a determination).

The determination letter applies only to the worker (or class of workers) requesting it, and the decision is binding with the IRS. This means the payer/business doesn't technically have to do anything in response to the determination. However, it needs to carefully consider the findings because an employment tax audit could be looming.

Neither the Form SS-8 determination process nor the review of any records in connection with the decision constitutes an audit of a federal tax return. Because the determination is not an audit, audit appeal rights do not apply to it. If either party disagrees with a determination, it may request that the office reconsider it and provide additional information.

IRS Classification Programs May Reduce the Cost of Correcting Misclassifications

The Voluntary Classification Settlement Program (VCSP) was created by the IRS in 2011 to encourage taxpayers to come forward with worker misclassifications. If eligible, taxpayers will receive partial relief from retroactive federal employment taxes. Under this program, the employer pays 10% of the employment taxes that would have been due for the most recent year (as calculated under the reduced rates of Sec. 3509(a)). To apply for the program, taxpayers need to file Form 8952, *Application for Voluntary Classification Settlement Program*.

If a taxpayer is already in an employment tax audit, the IRS may present a Classification Settlement Program (CSP) closing agreement. The CSP operates much like the VCSP. (Review Internal Revenue Manual Section 4.23.6 for more guidance on the CSP.)

Due-Diligence Procedures and Considerations to Help Clients

due-diligence procedures and considerations:

- *Timely file information statements with the IRS:* Even if a taxpayer classifies a worker as an independent contractor and the IRS during an audit later reclassifies that worker as an employee, having filed Forms 1099 means that the taxpayer can be eligible for various relief provisions that can significantly decrease the total liability owed. Failure to file information statements, on the other hand, bars the taxpayer from the various settlement programs and even obviates Section 530 safe-harbor relief.
- *Document the intended relationship:* Payers/businesses should keep contracts/employment agreements in each worker's permanent file. If there may be a debate on a worker's status, document the rationale and consider Section 530.
- *Be aware of the trust fund recovery penalty for egregious situations:* If intentional disregard of the rules is proven, and the IRS is unable to collect the employment taxes that should have been paid from the employer, an individual who is a responsible person for employment taxes for the employer could be subject to the trust fund recovery penalty. This penalty is equal to the full amount of the unpaid trust fund tax plus interest.
- *Know that worker classification issues transcend taxes:* Some recent cases, such as *Berwick v. Uber*, No. 11-46739 (Cal. Labor Comm'n 6/3/15), which found that a driver for the ride-sharing service Uber was an employee, not an independent contractor, showcase the many implications of reclassifying a worker as an employee. Pensions, reimbursements of expenses, PPACA requirements, and more are affected by the worker's classification.

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