Employee vs. Contractor: What You Don’t Know Could Bankrupt You

Presented by...
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- Pros & Cons between classifying music teachers as employees vs. independent contractors
- Criteria used to determine the employment status of a worker by most tax authorities
- Classification guidance
“Employee” Designation

Pros –

• Control work schedule
• Control teaching methods
• Control teaching rates
• Control compensation & benefits
• Limited issues with tax authorities

Cons –

• Burden of payroll taxes
• Burden of unemployment taxes
• Burden of worker’s comp insurance
• Burden of health insurance, retirement and other benefits without discrimination
“Independent Contractor” Designation

**Pros –**

- No payroll taxes
- No insurance costs
- No retirement benefits
- No employment benefits
- No payroll accounting
- Minimized tax reporting (1099-MISC at year-end)

**Cons –**

- No control over work schedule
- No control over teaching methods
- No control over teaching rates
BEWARE...
The incorrect classification can cause you to be held responsible for...

• All \textit{back} federal & state payroll taxes
• All \textit{back} unemployment taxes
• All \textit{back} employment benefits

BAD...VERY BAD!!
• The IRS updates Publication 15A each year with a section entitled “Who Are Employees?”

• Status is determined based on the degree of control in 3 categories:
  1. Behavioral Control
  2. Financial Control
  3. Type of Relationship
Understanding the Three Categories
I. Behavioral Control
Facts that show whether the business has a right to direct and control how the worker does the tasks for which the worker is hired, such as...
I. Behavioral Control

- When and Where to work
- How to do the work
- Who does the work
- Use of “sub contractors”
- Training
I. Behavioral Control

If you tell them what to do, when to work and how to do it...they are probably an employee!
II. Financial Control

Facts that show whether the business has a right to control the business aspects of the worker’s job, such as...
II. Financial Control

- **Who pays** for business expenses
- **Who made** the business investment – (i.e., facilities or equipment needed)
- Are services **available** to the general public
- **How are payments made** – hourly basis or project/fixed fee
- **Realization** of profit or loss
If the person performing the work does not experience the same business pressures you feel, they are probably not running their own business and are, in reality, an employee!
III. Type of Relationship

Facts that show the parties’ type of relationship, such as...

- W2
- 1099
III. Type of Relationship

- **Length** of relationship
- How is relationship ended
- **Who** may terminate relationship
- **Key aspect** of the business
Independent contractors are free to work wherever and for whomever.....if you would like to dictate those facets, they should probably be an employee.
Some Advice & Guidance
Which Form Do I Use?

EMPLOYEE

INDEPENDENT CONTRACTOR
Structure the Relationship

To best assure a favorable outcome in the event of tax scrutiny, employers should:

- Have “written” contracts or arrangements with their music teachers
- Have an attorney review all documents
- If need be, request assistance from the IRS in determining status by filing a Federal Form SS-8
Claim Denied

SS-8
Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

Names of firm (or persons) for whom the worker performed services:

Clients of Friedman, Kanenberger & Company

Firm’s address (include street address, apt. or suite no., city, state, and ZIP code):

11 South Main Street
West Hartford, CT 06110

Trade name:


Worker’s name:


Worker’s address (include street address, apt. or suite no., city, state, and ZIP code):


Telephone number (include area code):


Firm’s employer identification number:


Worker’s employer identification number:


If the worker is paid by a firm other than the one listed above, enter number of the payer:


We pay:


Yes


No


You may report:

A This

B Exploit

C Total number of workers who performed or are performing the same or similar services: Vocies (1-50)

D How did the worker obtain the job? □ Application □ Bid □ Employment Agency □ Other (specify) Networking

E Attach copies of all supporting documentation (contracts, invoices, memos, W-2, Forms 1099, IRS closing agreements, IRS rulings, etc.). In addition, please inform us of any current or past litigation concerning the worker’s status. If no income reporting forms (Form 1099-MISC or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue $ 0

F Describe the firm’s business:

Music, retail, sale, and rental of musical instruments, equipment, and print music, as well as music lessons and instruction services.
In a 1970 Court Case, the IRS challenged the worker status of music teachers at a music conservatory. These teachers taught students in accordance with a curriculum provided by the school, as well as provided private instruction to students as part of a lesson program administrated by the school.
Upon completion of their audit, the IRS issued Revenue Ruling 70-338 which stated “Teachers instructing regular classes at a music conservatory for regular remuneration are employees of the school; however, teachers who instruct pupils in private lessons in return for a percentage of the fees collected by the conservatory are not employees.”

Essentially, the determining issue was who had control over how the student was taught.
Making Certain of Independence

• The independent contractor provides:
  • an invoice for payment
  • services to other business besides yours
  • a certificate of liability insurance
  • a signed per project Agreement for service
• Your business does not train, direct the work responsibilities, or define the work schedules