

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

NAMM[®] | U



Grow Your Business

Presented by...

Alan Friedman & Daniel Jobe



- *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



Employee



**Independent
Contractor**



Renter



BEWARE...

The incorrect classification can cause you to be held responsible for...

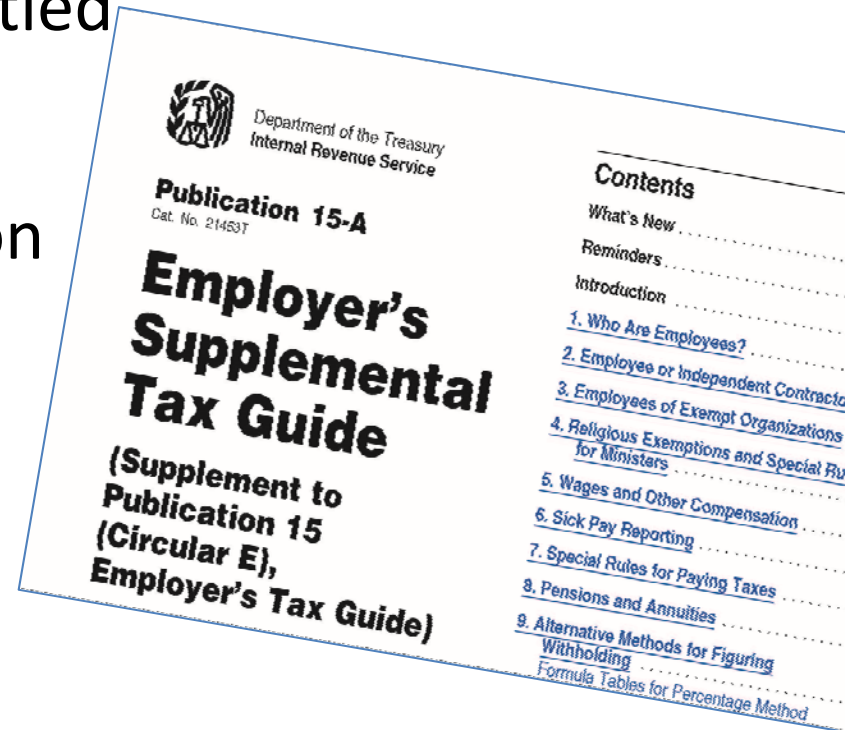
- All *back* federal & state payroll taxes
- All *back* unemployment taxes
- All *back* employment benefits

BAD...VERY BAD !!



IRS Guidelines

- 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



NAMM® | U



Grow Your Business



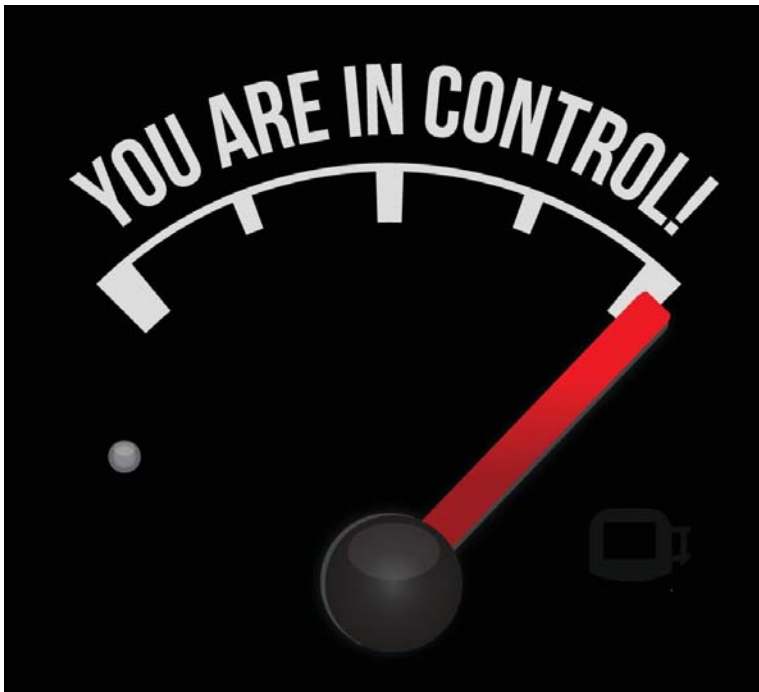
Understanding the Three Categories



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...



Winning The Independent Contractor Argument



- **When** and **Where** to work
- **How** to do the work
- **Who** does the work
- **Use** of “sub contractors”
- **Training**



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



NOW OPEN

TO THE PUBLIC

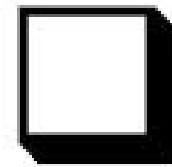


If the person performing the work does not experience the same business pressures you feel, they are probably not running their own business and are, in reality, an employee!

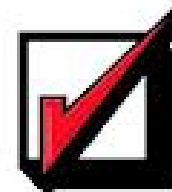


III. Type of Relationship

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



W2



1099

- **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



NAMM



Grow Your Business

Which Form Do I Use?

EMPLOYEE

INDEPENDENT CONTRACTOR

Form W-4 (2012)

Purpose. Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes.

Exemption from withholding. If you are exempt, complete only lines 1, 2, 3, 4, and 7 and sign this form to validate it. Your exemption for 2012 expires February 15, 2013. See Pub. 505, Tax Withholding and Estimated Tax.

Note. If another person can claim you as a dependent on his or her tax return, you cannot claim exemption from withholding if your income exceeds \$600 and includes more than \$200 of exempt income (the example, interest and dividends).

Basic instructions. If you are not exempt, complete the **Personal Allowances Worksheet** below. The worksheets on page 2 before adjust your withholding allowances based on married deductions, certain credits, adjustments to income, or two-earner/multiple jobs situations.

Complete all worksheets that apply. However, you may claim more for zeroed allowances. For regular wages, withholding must be based on allowances you claimed and may not be a flat amount or percentage of wages.

Head of household. Generally, you can claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals. See Pub. 501, Exemptions, Standard Deduction, and Filing Information, for information.

Tax credits. You can take projected tax credits into account in figuring your allowable number of withholding allowances. Credits for child or dependent care expenses and the child tax credit may be claimed using the **Personal Allowances Worksheet** below. See Pub. 505 for information on converting your other credits into withholding allowances.

Nonwage income. If you have a large amount of nonwage income, such as interest or dividends, consider making your payments using Form 1042-ES, Estimated Tax for Individuals. Otherwise, you may over-withhold tax. If you have pension or annuity income, see Pub. 505 to find out if you should adjust your withholding on Form W-4 or W-4P.

Two-earner or multiple jobs. If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4. Your withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the highest paying job and zero allowances are claimed on the others. See Pub. 505 for details.

Nonresident alien. If you are a nonresident alien, see Section 1202, Supplemental Form W-4 Instructions for Nonresident Alien, before completing this form.

Check your withholding. After you Form W-4 takes effect, use Pub. 505 to see how the amount you are having withheld compares to your projected total tax for 2012. See Pub. 505, especially if your earnings exceed \$30,000 (single) or \$40,000 (married).

Future developments. The IRS has created a page on IRS.gov for information about Form W-4, at www.irs.gov/efile. Information about any future developments affecting Form W-4 (such as legislation enacted after we release it) will be posted on this page.

Personal Allowances Worksheet (Keep for your records.)

A Enter "1" for yourself if no one else can claim you as a dependent **A**
 • You are single and have only one job; or

B Enter "1" if: **B**
 • You are married, have only one job, and your spouse does not work or
 • Your wages from a second job or your spouse's wages (if the total of both) are \$1,500 or less.

C Enter "1" for your spouse. But, you may choose to enter "-0-" if you are married and have either a working spouse or more than one job. (Entering "-0-" may help you avoid having too little tax withheld.) **C**

D Enter number of dependents (other than your spouse or yourself) you will claim on your tax return. **D**

E Enter "1" if you will file as head of household on your tax return (see conditions under Head of household above) **E**

F Enter "1" if you have at least \$1,900 of child or dependent care expenses for which you plan to claim a credit **F**
 (Note. Do not include child support payments. See Pub. 503, Child and Dependent Care Expenses, for details.)

G **Child Tax Credit** (including additional child tax credit). See Pub. 972, Child Tax Credit, for more information.
 • If your total income will be less than \$61,000 (\$90,000 if married), enter "2" for each eligible child; then less "1" if you have three to seven eligible children or less "2" if you have eight or more eligible children.
 • If your total income will be between \$61,000 and \$84,000 (\$90,000 and \$119,000 if married), enter "1" for each eligible child **G**

H Add lines A through G and enter total here. (Note. This may be different from the number of exemptions you claim on your tax return.) **H**
 For accuracy, complete all worksheets that apply:
 • If you plan to itemize or claim adjustments to income and want to reduce your withholding, see the **Deductions and Adjustments Worksheet** on page 2.
 • If you are single and have more than one job or are married and your and your spouse both work and the combined earnings from all jobs exceed \$40,000 (\$10,000 if married), see the **Two-Earner/Multiple Jobs Worksheet** on page 2 to avoid having too little tax withheld.
 • If neither of the above situations applies, stop here and enter the number from line H on line 5 of Form W-4 below.

Separate here and give Form W-4 to your employer. Keep the top part for your records.

Form W-4 Employee's Withholding Allowance Certificate (OMB No. 1545-0044) **2012**

Department of the Treasury Internal Revenue Service

1 Your first name and middle initial Last name 2 Your social security number

Here address (number and street or rural route) City or town, state, and ZIP code

3 Single Married Married, but withheld at higher Single rate.
 Note: If married, but legally separated, or spouse is nonresident alien, check the "Single" box.
 4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ▶

5 Total number of allowances you are claiming from line H above or from the applicable worksheet on page 2 **5**

6 Additional amount, if any, you want withheld from each paycheck **6** \$

7 I claim exemption from withholding for 2012, and I certify that I meet both of the following conditions for exemption.
 • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability, and
 • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability.
 If you meet both conditions, write "Exempt" here. ▶ **7**

Under penalties of perjury, I declare that I have examined this certificate and, to the best of my knowledge and belief, it is true, correct, and complete.

Employee's signature (This form is not valid unless you sign it.) ▶ Date ▶

8 Employer's name and address (Employer. Complete lines 8 and 10 only if sending to the IRS.) 9 Other code (optional) 10 Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 10299Q Form W-4 (2012)

Form W-9 Request for Taxpayer Identification Number and Certification

Form W-9 (Rev. December 2011) Department of the Treasury Internal Revenue Service

Name (as shown on your income tax return)

Business name/disregarded entity name, if different from above

Check appropriate box for federal tax classification:
 Individual/sole proprietor C Corporation S Corporation Partnership Trust/estate
 Limited liability company. Enter the tax classification (C-C corporation, S-S corporation, P-partnership) ▶ Exempt payee

Other payee instructions ▶

Address (number, street, and apt. or suite no.) (Requestor's name and address (optional))

City, state, and ZIP code

List account number(s) here (optional)

Part I Taxpayer Identification Number (TIN)

Enter your TIN in the appropriate box. The TIN provided must match the name given on the "Name" line to avoid backup withholding. For individuals, this is your social security number (SSN). However, for a resident alien, sole proprietor, or disregarded entity, see the Part I instructions on page 3. For other entities, it is your employer identification number (EIN). If you do not have a number, see How to get a TIN on page 3.

Note. If the account is in more than one name, see the chart on page 4 for guidelines on whose number to enter.

Social security number

Employer identification number

Part II Certification

Under penalties of perjury, I certify that:

- The number shown on this form is my correct taxpayer identification number (or I am waiting for a number to be issued to me), and
- I am not subject to backup withholding because: (a) I am exempt from backup withholding, or (b) I have not been notified by the Internal Revenue Service (IRS) that I am subject to backup withholding as a result of a failure to report all interest or dividends, or (c) the IRS has notified me that I am no longer subject to backup withholding, and
- I am a U.S. citizen or other U.S. person (defined below).

Certification instructions. You must cross out item 2 above if you have been notified by the IRS that you are currently subject to backup withholding because you have failed to report all interest and dividends on your tax return. For real estate transactions, mortgage interest paid, acquisition or abandonment of secured property, cancellation of debt, contributions to an individual retirement arrangement (IRA), and generally, payments other than interest and dividends, you are not required to sign the certification, but you must provide your correct TIN. See the instructions on page 4.

Sign Here Signature of U.S. person ▶ Date ▶

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Form

A person who is required to file an information return with the IRS must obtain your correct taxpayer identification number (TIN) to report, for example, income paid to you, real estate transactions, mortgage interest you paid, acquisition or abandonment of secured property, cancellation of debt, or contributions you made to an IRA.

Use Form W-9 only if you are a U.S. person (including a resident alien), to provide your correct TIN to the person requesting it (the requester) and, when applicable, to:

- Certify that the TIN you are giving is correct (or you are waiting for a number to be issued),
- Certify that you are not subject to backup withholding, or
- Claim exemption from backup withholding if you are a U.S. exempt payee. If applicable, you are also certifying that as a U.S. person, your allocable share of any partnership income from a U.S. trade or business is not subject to the withholding tax on foreign partners' share of effectively connected income.

Note. If a requester gives you a form other than Form W-9 to request your TIN, you must use the requester's form if it is substantially similar to this Form W-9.

Definition of a U.S. person. For federal tax purposes, you are considered a U.S. person if you are:

- An individual who is a U.S. citizen or U.S. resident alien,
- A partnership, corporation, company, or association created or organized in the United States or under the laws of the United States,
- An estate (other than a foreign estate), or
- A domestic trust (as defined in Regulations section 301.7701-7).

Special rules for partnerships. Partnerships that conduct a trade or business in the United States are generally required to pay a withholding tax on any foreign partners' share of income from such business. Further, in certain cases where a Form W-9 has not been received, a partnership is required to presume that a partner is a foreign person, and pay the withholding tax. Therefore, if you are a U.S. person that is a partner in a partnership conducting a trade or business in the United States, provide Form W-9 to the partnership to establish your U.S. status and avoid withholding on your share of partnership income.

Cat. No. 10311X Form W-9 (Rev. 12-2011)



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

NAMM[®] U



Grow Your Business

Form **SS-8**
(Rev. June 2003)
Department of the Treasury
Internal Revenue Service

**Determination of Worker Status
for Purposes of Federal Employment Taxes
and Income Tax Withholding**

OMB No. 1545-0004

Name of firm (or person) for whom the worker performed services <i>Clients of Friedman, Kannerberg + Co., P.C.</i>		Worker's name	
Firm's address (include street address, apt. or suite no., city, state, and ZIP code) <i>91 South Main Street West Hartford, CT 06107</i>		Worker's address (include street address, apt. or suite no., city, state, and ZIP code)	
Trade name	Telephone number (include area code)	Worker's social security number	
	<i>(860) 521-3790</i>		
Telephone number (include area code)	Firm's employer identification number	Worker's employer identification number	
<i>(860) 521-3790</i>	<i>06-1146038</i>		

If the worker is paid by a firm other than the one listed on the front of this form, enter the name and address of the payer.

We pay the worker as an independent contractor? Yes No

You must attach copies of all supporting documentation (contracts, invoices, memos, Forms W-2, Forms 1099, IRS closing agreements, IRS rulings, etc.).

A This worker is an independent contractor in your business.

B Explain why you are treating this worker as an independent contractor. *We are treating this worker as an independent contractor in order to... In order to... independent contractor issues, we... based on a typical scenario routinely... our music retailing clients.*

C Total number of workers who performed or are performing the same or similar services: *Varies (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, Forms 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 \$ *N/A*

F Describe the firm's business. *Music Retail - sale and rental of musical instruments, equipment and print... music, as well as music lessons/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 administered 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

