

SUMMER HELP

ARE THEY EMPLOYEES OR INDEPENDENT CONTRACTORS?

By: Wayne Sanderson, CPA - Concord, CA

(Note from Sara – Fill in the title of any other person or function that you are trying to consider into this story to help you decide whether an individual is an independent contractor or an employee.)

The weather has turned warm at Shady Rest and the membership is ready to open the pool for the next season. Opening the pool will bring the usual spring debate over whether we should treat the pool monitors and Linda Erickson, the pool supervisor, as employees or as independent contractors.

This year I thought I would be ready for the debate and started calling experts for advice on the best way to compensate part time pool guards. My first call was to the Internal Revenue Service. The gentleman on the phone was friendly and told me the Government had a form that would solve my problems. I asked him to send me a copy.

A few days later I received Form SS-8, "Determination of Employee Work Status for purposes of Federal Employment Taxes and Income Tax Withholding." Form SS-8 is four pages long, consists of 67 multi-part questions, and came with a thick instruction book to explain each question. If Shady Rest completes SS-8, the Internal Revenue Service will issue a ruling as to whether the class of employment described on the SS-8 is an employee or an independent contractor.

I started to read the SS-8 instructions. Paragraph two states the government estimates that it will require 34 hours, 41 minutes to keep the records necessary to complete Form SS-8 and will require an additional 46 minutes to complete the form. The 34 hours of bookkeeping was enough to send me looking in a different direction!

I called our accountant. Sandy is our usual source for unscrambling government tax regulations. He had a few well chosen words to describe the practice of treating pool monitors as independent contractors. I will not repeat the exact words, but the clear message was to put them on the payroll.

Sandy explained that if Shady Rest gets caught treating the swim monitors as independent contractors, the taxes, interest, and penalties will cost four to five times the original tax bill. He saw no hope for our ability to prove to an auditor that 16 year olds are in business for themselves.

Sandy used the following example to illustrate the probable outcome of treating the kids as independent contractors:

Assume you pay the monitor's \$15,000 during the summer, the Associations cost for payroll taxes will be approximately \$1,400. If the government determines the payroll taxes at the time of an audit, the cost will be approximately \$6,000. They have the right to go back three years and they will send a bill for all three years. Simply stated, the Association will likely owe \$18,000 at the time of the audit as opposed to \$1,400 for each of the three years. For Shady Rest, \$18,000 is a big, big bill!

Sandy gave me three simple tests to use with gardeners, handymen and others we routinely hire as independent contractors.

1) Do they have an office that you recognize as a business address? In other words, do they have some way to prove they provide service to a lot of businesses or homeowner association. (A business card is an absolute necessity for a real independent contractor.)

2) Ask for their workman's compensation policy covering employees they will be working on your property. If they are an independent contractor, they will have coverage for their employees. If the independent contractor does not have coverage, then Shady Rest had better assume it is the employer.

3) Use your eyes and ears. Is there a name printed on the side of their truck? Are they going to bill you for the job or do they want to be paid by the hour?

Who will furnish the equipment and materials?

Sandy also pointed out that the individual that wants to save the Association taxes by being an independent contractor changes his song quickly under the following circumstances:

1) He is hurt and wants to file for State Disability.

2) The Association terminates the employment and the individual wants to file for unemployment benefits.

3) He just wants to "get even" because you did not treat him the way you "should" have.

The independent contractor turned employee is not subject to any tax or penalty for his change of heart. All the pain falls on the employer.

The neat part of payroll audits is they often come in bunches. The California Franchise Tax Board shares their information with the Internal Revenue Service and the IRS shares with the State. Both income tax agencies share with the State and Federal Unemployment and Labor departments and the Immigration Service.

If one agency finds you improperly classified your pool monitors as "independent contractors," you will likely be visited by all the other agencies.

It is good to remember that with employee tax audits, you are guilty until you prove yourself innocent. All governmental interest is aimed at finding an employee relationship. The government benefits from greater tax and fine revenue. The auditor feels good about protecting the employee from the nasty employer.

Shady Rest is looking for an expert to file payroll tax reports. I do not think we want to risk inviting seven Federal and State Agencies to visit our Association to save \$1,400 a year!

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