

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

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Presented by...

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Session Objectives

- *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...

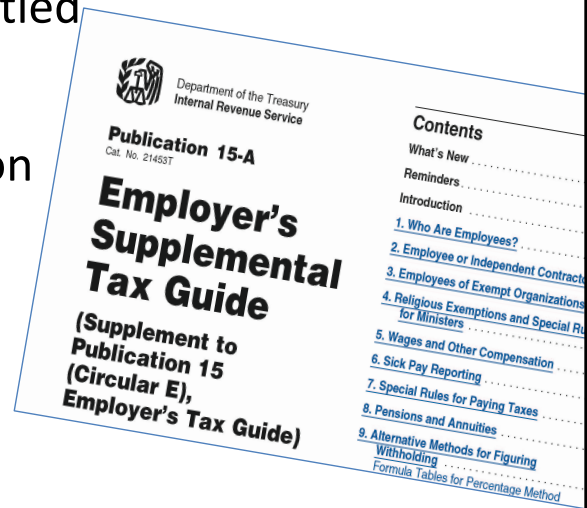
- All *back* federal & state payroll taxes
- All *back* unemployment taxes
- All *back* employment benefits

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



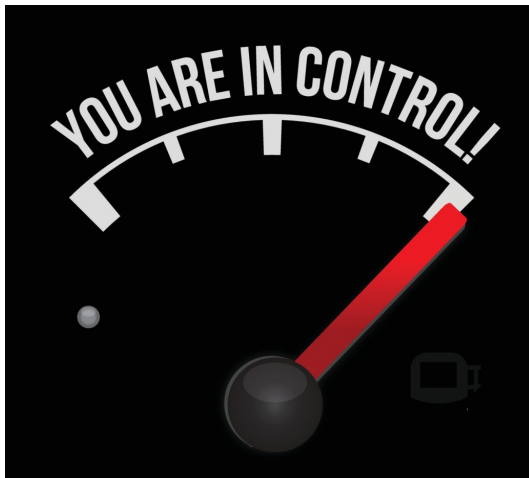
Understanding the Three Categories

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


NOW OPEN

TO THE PUBLIC



II. Financial Control



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**





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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
Clients of Friedman, Kanoenbergs & Co., P.C.

Worker's name

Firm's address (include street address, apt. or suite no., city, state, and ZIP code)
*91 South Main Street
 West Hartford, CT 06107*

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

Trade name

Telephone number (include area code)

Firm's employer identification number
06:1146038

Worker's employer identification number

Telephone number (include area code)

Worker's social security number

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

We pay the worker as an independent contractor as an employee

If you mark "independent contractor," explain why you believe the worker is an independent contractor. Attach a copy of the letter or other written communication that supports your determination.

CLAIM DENIED

We believe this worker is an independent contractor, in order to be able to provide additional letters based on a typical scenario routinely provided by our music retailing clients.

Total number of workers who performed or are performing the same or similar services *Varies (1-50)*

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

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*

Describe the firm's business
Music Retail, sale, and rental of musical instruments, equipment, and print music, as well as music lessons/instruction services.



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IRS Guidance

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

V BEST PRACTICE

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