



Independent Contractor or Employee? (1099 or W-2)

The question of whether a worker is an independent contractor or an employee is a complex issue. The definition of an independent contractor is derived from court cases rather than from the tax code. This is the reason that it can become very "grey." Recently, company audits by governmental agencies have increased at both the state and federal levels. They have been focusing on this area due to the high degree of noncompliance by many companies. The Treasury Inspector General for Tax Administration released results from a review of the IRS's controls and procedures on March 23, 2010.* This report detailed areas of noncompliance and gave suggestions that would make enforcement activity more effective.

Generally, dealers want to classify sales personnel as independent contractors. This eliminates payment of employment taxes and requirements for federal and state withholding by the dealer. This may or may not be "allowed" and proper classification (as independent contractor or employee) is based on the facts and circumstance of each individual case. Some of the main factors that determine if a person qualifies as an independent contractor include:

1. The degree of supervision over the sales person
2. The degree of instruction and training provided by the dealer to the sales person
3. Whether the sales person receives any assistance in making sales
4. Who determines the hours that the sales person must work
5. Is the sales person entirely commission based
6. How can the sales person be terminated
7. Is the sales person provided with an office space
8. Can the sales person hire other people

What can you do to ensure compliance?

Generally, a dealer has two options to ensure compliance. First, a determination letter can be obtained from the IRS which will bind the IRS to their decision to treat the sales person as an independent contractor. Unfortunately, the average wait time for a determination letter is 128 days (according to the Treasury Inspector General in their March 23, 2010 report). The second option is to pay the sales person as an employee and have all the proper withholdings and employment taxes withheld and paid. The second option is not necessarily the best option since the dealer is responsible to pay for their "share" of the employment taxes. In any case, each situation is different and must be evaluated based on its own merits to determine the best option for the dealer.

Is there any opportunity for Dealers?

Absolutely, if you currently have workers that you think may qualify as independent contractors, filing for a determination letter may be an excellent opportunity. Although this may be a non-issue for the employee (since they will have to file and pay the taxes individually), the dealer will save money on each worker that is classified as an independent contractor.

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* <http://www.treas.gov/tigta/auditreports/2010reports/201030025fr.pdf>.