Publication 963

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Federal-State Reference Guide

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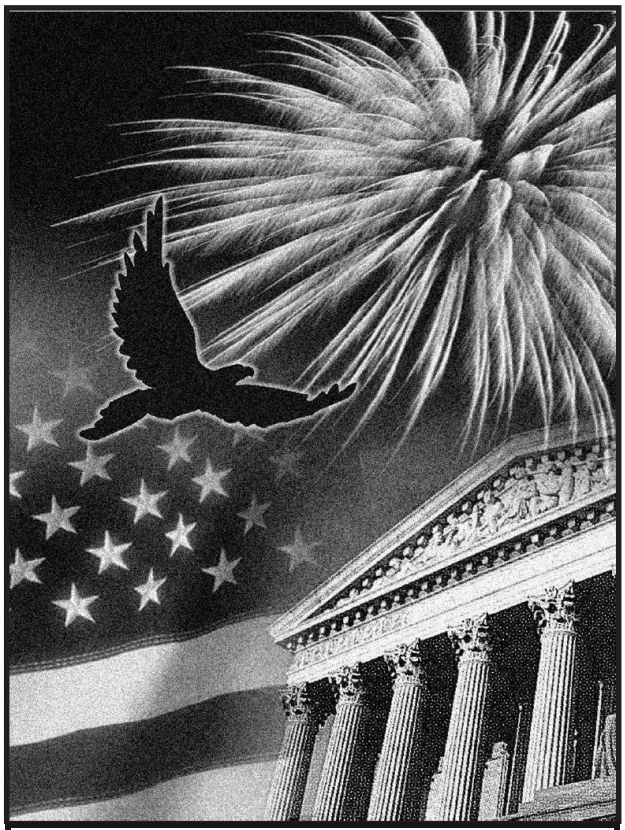

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Employer contributions to tax-sheltered annuities under Section 403(b) for public school employees are exempt from Social Security and Medicare taxes, unless the contributions are made by reason of a salary reduction agreement. Eligible participants may defer amounts from income tax up to an annual limit ($19,500 in 2020, subject to annual cost of living adjustments (COLA)). This amount may be increased for certain employees with more than 15 years of service. Employees age 50 or older may also make additional tax-deferred "catch-up" contributions.

Employee contributions, including those made by salary reduction arrangements, are subject to Social Security and Medicare tax (See IRC Section 3121(a)(5)(D)).

For more information, see Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans), and the 403(b) plan webpage on IRS.gov.

Section 457 (Nonqualified) Plans

Many public employees participate in nonqualified IRC Section 457 deferred compensation plans. These plans can be established by state and local governments or tax-exempt organizations. If they meet the requirements of Section 457(b), they are considered "eligible" plans; if not they are considered "ineligible" plans and are governed by Section 457(f).

Section 457(b) – Eligible Plans

Governmental Section 457(b) plans must be funded with assets held in trust for the benefit of employees. Plans eligible under Section 457(b) may defer amounts from income tax up to an annual limit ($19,500 in 2020, subject to COLA).

Governmental Section 457(b) plans may make "catch-up" contributions to employees age 50 or older, in addition to the basic Section 457(b) catch-up.

Social Security and Medicare taxes generally apply to all employer and employee contributions. Amounts deferred from wages into eligible Section 457(b) plans are not subject to income tax withholding until they are distributed from the plan or made available to the participant or beneficiary. See Section VI of Notice 2003-20 and IRC 457(b) Deferred Compensation Plans for more information.

Section 457(f) – Ineligible Plans

Nonqualified state or local government plans that do not meet the requirements of Section 457(b) are ineligible plans, or Section 457(f) plans. There is no limit on the annual deferrals on these plans, but to defer taxation, all deferrals must be subject to substantial risk of forfeiture. Amounts deferred under a Section 457(f) plan are generally subject to Social Security and Medicare taxes at the later of the time 1) when the services giving rise to the related

compensation are performed, or 2) when there is no substantial risk of forfeiture of the rights to the amounts.

Reporting Responsibilities

Basic federal tax requirements that generally apply to all employers are discussed below. For a more detailed explanation, see Publication 15.

Employer Identification Number (EIN)

When two entities are combined (for example, when one municipality annexes another, or when school districts are consolidated) the EIN of the annexed area or abolished district should no longer be used, as it is no longer a separate entity. A continuing entity that absorbs or annexes another can retain and use its EIN. However, if a new entity is created from the dissolution of two or more pre-existing entities, the new entity should obtain a new EIN. When an unincorporated

area is incorporated, it becomes a separate entity and must obtain its own EIN.

See Publication 1635, Employer Identification Number, Understanding Your EIN, and About Form 8832, Entity Classification Election, for additional information on how to avoid common EIN problems.

Notify the IRS immediately if you change your business name or address. Write to the IRS office where you file your returns, using the *Without a Payment* address provided in the instructions for your employment tax return, to notify the IRS of any business name or address change.

Form SSA-1945

State and local government employers must notify employees hired in jobs not covered by Social Security of the effects of the Windfall Elimination Provision and the Government Pension Offset. Section 419(c) of the Social Security Protection Act of 2004 requires newly

hired public employees to sign Form SSA-1945, Statement Concerning Your Employment in a Job Not Covered by Social Security. This indicates they are aware of a possible reduction in their future Social Security benefit entitlement. For more detailed information about this law, see Chapter 7 or Form SSA-1945.

Form W-2

An employer is responsible for furnishing Form W-2, Wage and Tax Statement, to each employee from whom income, Social Security or Medicare tax was withheld, or would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding on Form W-4, Employee's Withholding Certificate. The aggregate amounts are reported on Form W-3, Transmittal of Wage and Tax Statements.

Employers are required to send Copy A of Forms W-2 and W-3 to the Social Security

Administration by January 31 of the following year for both paper and electronic forms. Employers must furnish Copy B to employees by January 31 of the following year.

Employers who file 250 or more Forms W-2 must file them electronically. Statements may be furnished to employees electronically only if the employee affirmatively consents to it. See Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3, for more information.

SSA's Regional Employer Services Liaison Officers (ESLOs) provide assistance with filing Forms W-2 and other wage reporting questions. See ESLO or call 800-772-6270. Specifications for electronic reporting of Form W-2 information can be found at the SSA employer page.

Form 941

Form 941, Employer's QUARTERLY Federal Tax Return, is used to report:

- Wages paid,
- Federal income taxes withheld,
- Both the employer’s and employees’ share of Social Security and Medicare taxes, and
- Additional Medicare tax withheld from employees.

The IRS matches amounts reported on your four quarterly Forms 941 with Form W-2 amounts totaled on your Form W-3. If the amounts don’t agree, the IRS or SSA may contact you.

To prepare Form 941, the total wages and compensation for the quarter must be determined. Wage payments are included in the quarter in which they are paid. For example, an employee works for the county in a pay period ending on March 20 but is not paid until April 5. In this situation, the employee’s wage payment is included in the second quarter when the payment is made, not the first quarter when the work was done.

Special timing rules apply in determining when certain noncash fringe benefits are treated as paid. See Publication 15-B.

Total wages and compensation entered on line 2 of Form 941 include all payments to employees. Examples of these payments include:

1. Wages, salaries, commissions, fees and bonuses
2. Vacation allowances
3. Dismissal and severance pay
4. Tip income
5. Noncash payments, including goods, lodging, food, clothing or services

Wages from which Social Security and Medicare tax must be withheld may differ from total wages. This may be because certain amounts are not included in wages for income tax withholding purposes but are subject to Social Security and Medicare tax

(for example, deferred compensation in a nonqualified deferred compensation plan). Another common reason for a difference in the totals is that earnings exceeding the annual wage base are not subject to the OASDI portion of Social Security tax. The total income tax withheld (line 3) includes all federal income tax withheld from all employees for the calendar quarter covered by the return.

Form 941 must be filed with the IRS by the last day of the month following the calendar quarter. For example, the first quarter return covering January through March is due by April 30. See the Instructions for Form 941 for additional information.

Form 944

Certain taxpayers with small payrolls (those whose annual liability for Social Security, Medicare and withheld federal income taxes is $1,000 or less) will file and pay these taxes only once a year instead of every quarter.

The IRS will notify taxpayers when they must use Form 944, Employer's ANNUAL Federal Tax Return. An employer may contact the IRS to request to file a quarterly Form 941 instead of a Form 944. See Revenue Procedure 2009-51. The deposit requirements, discussed below, are the same for annual and quarterly filers. For more information regarding this form, see Publication 15 or the Instructions for Form 944.

Form 941-X and Form 944-X

Employers correct errors to Form 941 or 944 by filing Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund, or Form 944-X, Adjusted Employer's ANNUAL Federal Tax Return or Claim for Refund. These forms are stand-alone returns that should be filed as soon as the error is discovered. The return for the period when the error is discovered is not affected. Additional requirements are discussed in the Instructions for Form 941 and Form 944, as

well as in the Instructions for Form 941-X and Form 944-X.

Form 945

Nonpayroll federal income tax withholding (reported on Forms 1099 and Form W-2G, Certain Gambling Winnings) must be reported on Form 945, Annual Return of Withheld Federal Income Tax. Separate deposits are required for payroll (Form 941 or Form 944) and nonpayroll (Form 945) withholding. Nonpayroll items include:

- Pensions (including distributions from tax-favored retirement plans, for example, 401(k), 403(b) and governmental 457(b) plans) and annuities
- Payments subject to backup withholding
- Gambling winnings
- Certain other payments, such as unemployment compensation and Social Security, subject to voluntary withholding

Multiple Employers and the Wage Base

Because each employer must withhold Social Security tax on wages up to the annual maximum, an employee who works for more than one employer in one calendar year may have excess Social Security taxes withheld. To get a refund of the excess Social Security tax withheld by the employers, the employee shows the overpayment on Form 1040, U.S. Individual Income Tax Return. Employers are not responsible for making any adjustments based on wages paid by other employers and cannot claim a refund in this situation, because each employer is responsible for withholding and paying Social Security tax on wages paid to each employee up to the wage base.

Special Reporting Situations for Government Employers

Medicare Qualified Government Employment

As explained in Chapter 2, all employees hired after March 31, 1986, are subject to mandatory Medicare tax. Federal, state and local employers that provide coverage under a public retirement system may have employees who are not subject to Social Security but are subject to Medicare tax. This is referred to as Medicare Qualified Government Employment (MQGE).

MQGE Forms W-2 are filed separately from those for employees covered by Social Security and Medicare, or from Forms W-2 having no Social Security or Medicare wages. Paper MQGE Forms W-2 must be transmitted with a covering Form W-3 with "Medicare Govt. Emp." checked in box b. See the Instructions for Forms W-2 and W-3.

Employees Covered for MQGE and FICA

If they are employed in more than one capacity, some state and local employees may be subject to both Medicare-only withholding and full Social Security and Medicare in the same reporting year. When an employee is in a continuous employment relationship with the same employer for the year, and the employer has both types of employees, the employer has two reporting options:

1. Prepare a single Form W-2 with the total annual wages in box 1, the total Medicare wages and taxes from BOTH positions in box 5 and box 6. Social Security and Medicare wages and taxes are entered in box 3 and box 4 (SSA prefers that this method be used to reduce errors), or
2. Use a separate Form W-2 for wage data from the Medicare-only position and a second Form W-2 for FICA wage

data from the positions with both Social Security and Medicare coverage.

See SSA Specifications for Filing Forms W-2 Electronically (EFW2) for specifics on how to report these various employee wage situations. Special Situations - 2.5 – Government Employer, covers the situations discussed above.

Information Reporting for Election Workers

If the compensation of an election worker is less than a statutorily established amount that is subject to an adjustment for inflation each year ($1,900 for 2020), it is generally not subject to mandatory Social Security and Medicare tax (IRC Sections 3121(b)(7)(F)(iv) and 3121(u)(2)(B)(ii)(V)). However, under a state's Section 218 Agreement an election worker's compensation may be subject to Social Security and Medicare taxes at a level below the statutory amount. In any case,

compensation of election workers is not subject to income tax withholding.

If an election worker's wages are subject to withholding of Social Security and Medicare tax, Form W-2 reporting is required for all compensation, regardless of the amount. If an election worker's compensation is not subject to withholding of Social Security and Medicare tax, Form W-2 reporting is required for payments that aggregate $600 or more in a calendar year.

See Election Workers: Reporting and Withholding and Revenue Ruling 2000-6 for more information.

Information Returns

Government entities must file with the IRS, and furnish to recipients, information returns for certain types of payments. In most cases, these payments are reported on Form 1099-MISC, Miscellaneous Income.

IRC Section 6041(a) states that all persons engaged in a trade or business and making payment in the course of the trade or business to another person of rent, salaries, wages, premiums, annuities, compensation, remuneration or other fixed and determinable gains, profits and income (with certain exceptions) of $600 or more in any year must furnish an information return indicating the amount of the income and the name and address of the recipient of the payment.

Common payments that must be reported (payments of $600 or more) include services, rents, income payments, awards and prizes, and medical and health care payments.

Payees for whom payments must be reported include individuals, partnerships, estates, trusts, and medical and legal service providers.

Never use Form 1099-MISC to report payments for services by an employee. Only use Forms W-2 and W-3 to report compensation to employees.

The Form W-9, Request for Taxpayer Identification Number and Certification, is used to get the payee's correct name and taxpayer identification number by an individual or entity required to file information returns with the IRS. Obtain this information before payments are made. (See Backup Withholding, below.) Payments for nonemployee compensation are discussed in the Instructions for Form 1099-MISC.

Governments must file Form 1099-G, Certain Government Payments, for payments including:

- State or local income tax refunds
- Unemployment compensation
- Taxable grants

See the Instructions for Form 1099-G for more information.

Taxpayers responsible for filing 250 or more information returns of any one type (for example, Form 1099-MISC) must file them electronically with the IRS. If a written statement to an information return recipient is required, it may be furnished to them electronically rather than by paper if the recipient consents affirmatively to that and the payer meets necessary requirements. For more details on electronic and other information return requirements, see the General Instructions for Certain Information Returns and Publication 1220, Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G.

Backup Withholding

You generally must withhold 24% (starting in 2018, previously 28%) of certain taxable payments if the payee fails to furnish you with their correct TIN prior to payment. This

withholding is referred to as “backup withholding” and is reported on Form 945. Publication 15 provides additional information.

Information Reporting Customer Service Site

You may call 866-455-7438 (toll-free), 304-263-8700 (toll call) or 304-579-4827 (TDD/TTY for persons who are deaf, hard of hearing or have a speech disability) to discuss your questions. You can also reach the center by email at mccirp@irs.gov. Don’t include TINs or attachments in email correspondence because electronic mail isn’t secure.

Depositing Taxes

In general, employers are required to deposit federal employment taxes (federal income tax withheld and both the employer and employee Social Security and Medicare taxes) if the total tax liability for Form 941 or Form 944 for the current or previous quarter (year

for Form 944) is $2,500 or more. These taxes are required to be deposited using the Electronic Federal Tax Payment System (EFTPS). A balance due on the Form 941 or 944 of less than $2,500 is not required to be deposited; it may be paid with the return. For more information on using the EFTPS, see IRS Publication 966, Electronic Federal Tax Payment System A Guide To Getting Started.

Deposit Requirements for Nonpayroll (Form 945) Tax Liabilities

Separate deposits are required for nonpayroll (Form 945) and payroll income tax withholding. Don't combine deposits for Forms 941 (or Form 944) and Form 945 tax liabilities.

The general deposit rules and dollar thresholds that apply to Form 941 also apply to Form 945. However, because Form 945 is an annual return, the rules for determining your deposit schedule (discussed below) are different from those for Form 941. See the

Instructions for Form 945 for more information.

When to Deposit

An employer will use either the monthly or the semiweekly schedule for depositing Social Security, Medicare and withheld income taxes. These schedules determine when a deposit is due after a tax liability arises (a payday). Before the beginning of each calendar year, employers must determine which of the two deposit schedules they must use. The deposit schedule used is based on the total tax liability reported on Form 941 during a four-quarter lookback period. The deposit schedule is not determined by how often employees are paid. To determine your payment schedule for Forms 941, 944 and 945, review Publication 15.

Calculating Federal Income Tax Withholding

Employers are generally required to withhold federal income tax from the wages paid to employees. The withheld amount is credited to the employees' individual income taxes.

Each employee should submit a signed Form W-4 when employment begins. The amount of federal income tax withheld on an employee depends on five factors:

1. Payroll period;
2. Employee marital status, as shown on Form W-4;
3. Amount of wages;
4. Number of withholding allowances claimed by the employee on Form W-4; and
5. Additional amounts the employee requests to have withheld.

However, Form W-4 is revised annually. Future revisions of Form W-4 and Publication 15 may provide for a different procedure for determining the amount to withhold.

If a new employee doesn't give you a completed Form W-4, withhold income tax by treating the employee as single with the number of withholding allowances provided for this situation in the current year's revision of Publication 15. For 2020, withhold income tax on employees who don't give you a completed Form W-4 by treating them as single, with no withholding allowances.

Publication 15 contains the tax withholding tables and percentage tables to figure out how much to withhold. It also explains the procedure used in calculating withholding.

Federal Unemployment Tax Act

The Federal Unemployment Tax Act (FUTA) provides a federal-state insurance system for workers who lose their jobs. Most private

employers pay both a federal and state unemployment tax. State and local governments, including their political subdivisions are exempt from FUTA tax. However, state and local government employees, with certain exceptions, must be covered by state unemployment insurance. Contact your state employment or labor agency for more information.

Interest and Penalties

Tax that isn’t paid when due or in the manner required may be subject to civil penalties and interest on the amount due.

Employment Tax Penalties

The following are the most commonly assessed penalties related to employment tax. There are penalties for filing a return late and paying or depositing taxes late, unless there is reasonable cause.

IRC Section	Penalty Assessed For	Penalty Rates
6651(a)(1)	Failure to file a tax return (failure to timely file)	5% of the tax due per month up to 25%
6651(a)(2)	Failure to pay tax shown on the return (failure to timely pay) (imposed if the amount of tax shown on the return is not paid on or before the prescribed date)	0.5% (1/2 of 1%) of the tax due per month up to 25%

6651(c)	Both failure to timely file and failure to timely pay	When both penalties apply for any month, the failure to file penalty is assessed at 4.5%
6652(b)	Failure to report tips	Imposes a penalty for tip income unreported to the employer; the penalty is 50% of the employee Social Security and Medicare tax on the unreported tip income

IRC Section	Penalty Assessed For	Penalty Rates
6656	Deposit penalties:	
	1-5 days late	2%
	6-15 days late	5%
	More than 15 days late, but paid by the 10th day after notice and demand (Notice and demand date is the assessment date)	10%
	Taxes still unpaid after	15%

	the 10th day following notice and demand	
	Failure to deposit electronically	10%
6662	Underpayment of employment taxes due to disregard of the rules and regulations (accuracy-related)	20% of the underpayment attributable to negligence or disregard of rules and regulations
6672	Failure to withhold or pay over trust fund taxes	100% of unpaid tax (see below)

Trust Fund Recovery Penalty

To encourage prompt payment of withheld income and other employment taxes, IRC Section 6672 provides for the trust fund recovery penalty. These taxes are called trust fund taxes because the employees' money is held in trust until a federal tax deposit is made in that amount. This penalty may be imposed on all persons the IRS determines is responsible for collecting, accounting for and paying over these taxes, and who acted willfully in not doing so. The penalty is the full amount of the unpaid trust fund tax.

A responsible person can be an officer, employee or volunteer. A responsible person also may include one who signs checks for the business or otherwise has authority to cause the spending of funds. Willfully means voluntarily, consciously and intentionally. A responsible person acts willfully if the person knows that the required actions are not taking place.

Information Reporting Penalties

The penalty rates and maximums for not filing correct information returns or not furnishing correct payee statements, including inflationary adjustments, are reflected at Increase in Information Return Penalties.

Note that these penalties can be substantial amounts, and increased penalties can apply for certain failures in the case of intentional disregard.

Interest

Interest is assessed on any taxes due and unpaid, in addition to any penalties that may be imposed. However, the law allows an employer who has made an underpayment of Social Security and Medicare taxes or income tax withholding to make an interest-free adjustment (IRC Section 6205(a)(1)). The following requirements must be met:

1. Correction of the error must be made in the period in which the error was ascertained, and
2. Payment of the tax must be made no later than the due date of the return for the return period in which the error was ascertained. Additional tax due as a result of an IRS examination or ruling may qualify for an interest-free adjustment.

See Revenue Ruling 2009-39 for additional information about interest-free adjustments.

Frequently Asked Questions

1. If board members are paid nominal amounts, for example, under $1,000 per year, must Social Security and Medicare taxes be withheld?

Generally, yes. Elected and most appointed officials are employees of the public entity they serve and are generally subject to the withholding rules that apply to other workers.

Withhold Social Security and Medicare taxes for any official who is either 1) covered under a Section 218 Agreement or 2) not a qualified participant in a public retirement system (also called a FICA replacement plan) and therefore subject to mandatory coverage. Any official elected or appointed after March 31,

1986, is subject to Medicare. See Chapter 4 for more information on who is an employee. [IRS]

2. What is the statute of limitations date for an adjustment or claim for refund of payroll taxes?

The general rule is that an adjustment or claim for refund of any overpayment of federal payroll taxes must be filed within three years from the date the return was due or three years from the date it was filed, if that date is later. For this purpose, a Form 941 and Form 944 return for any calendar quarter is considered filed on April 15 of the

following calendar year, if it's in fact filed by that date. [IRS]

3. What is the Social Security tax treatment of prison inmate labor?

Generally, services performed by inmates, for the state or local political subdivision that operates the prison are excluded from Social Security coverage, whether or not performed outside the confines of the prison. Inmates usually are not in an employment relationship with the state or political subdivision. In general, services performed by inmates, as part of the rehabilitative and therapeutic program of the institution, are not usually performed as employees. Services performed by inmates for an entity other than the state or local governmental unit, for example a work-release program, may be covered if an employment relationship exists. The relevant factor for determining Social Security coverage is whether an employer/employee relationship exists between the inmate and

the nongovernmental employer, not the place where the inmate is incarcerated. Services performed by inmates outside the institution for the same unit of government that operates it are considered performed in the institution.

4. Are services of police officers and firefighters considered emergency services that are excluded from Social Security and Medicare coverage?

Police officers and firefighters are **not** considered emergency workers for purposes of the exclusion from Social Security and Medicare coverage for certain emergency workers. This exclusion applies only to services of an employee who was hired because of an unforeseen emergency to work in connection with that emergency on a temporary basis (for example, an individual hired to battle a major forest fire or to provide emergency assistance in other similar

disasters such as volcano eruption, severe ice storm, earthquake or flood). Regular, long-term police and fire employees are not emergency workers for this purpose and subject to the same rules as other public employees to determine whether they are covered by Social Security. [IRS]

5. How are tax deposits made?

Deposits of employment taxes must be made electronically. In some cases, employment taxes may be paid with the tax return if the amount of tax is below certain threshold and deposits are not required. See Publication 15, (Circular E), Employer's Tax Guide. [IRS]

Chapter 4

Determining Worker Status

It is critical for any entity paying compensation to know whether its workers are properly classified as employees or independent contractors. In some cases,

workers may be designated as employees by a Section 218 Agreement. In other

cases, workers may be defined as “statutory employees” or “statutory nonemployees” because specific laws address the occupation (see Publication 15-A for more information on these workers). In general, however, the determination of worker status is made by applying an established common-law standard that addresses the facts and circumstances concerning how the work is performed. Whether workers are employees has significant consequences for tax liability and reporting.

Generally, when workers are employees, the government entity that employs them must withhold and pay employment taxes and file employment tax returns. Employment taxes consist of federal income tax withholding, Old-Age, Survivors and Disability Insurance (OASDI or Social Security) tax and the Hospital Insurance (Medicare) tax. The Social

Security and Medicare tax make up the Federal Insurance Contributions Act (FICA) contributions, which are paid through employer and employee shares. State and local governments generally pay the Social Security tax on employees covered under Section 218 Agreements and on employees not covered by a public retirement system (mandatory coverage), and generally pay the Medicare portion on all employees hired after March 31, 1986. Wages paid by state and local governments are not subject to taxes under the Federal Unemployment Tax Act (FUTA), but state unemployment taxes may apply.

When workers are independent contractors, the governmental entity may have information-reporting and backup withholding responsibilities, but it is not required to withhold and pay employment taxes on behalf of those workers.

This chapter deals with the general rules for determining whether workers are employees, and the laws that apply to different categories of public employment.

Workers Covered Under Section 218 Agreements

As discussed in Chapter 1, states can enter into agreements with SSA to provide Social Security and Medicare coverage for their employees pursuant to Section 218 of the Social Security Act (Section 218 Agreements). If a position is covered by a Section 218 Agreement, then anyone holding that position is an employee. Therefore, the first question for a government to ask about a worker's status is whether the worker is in a position covered under a Section 218 Agreement. If Section 218 Agreement coverage applies, this fact takes precedence over other considerations, including the common law tests discussed below and the mandatory coverage rules.

If you aren’t sure whether the Section 218 Agreement covers a specific position, contact your State Social Security

Administrator (see NCSSA for a listing by state), or the SSA Regional Office for assistance. If a group of workers is covered under a Section 218 Agreement, the Agreement cannot be terminated or modified to exclude that coverage group.

Employees who are not covered under a Section 218 Agreement are generally subject to Social Security and Medicare unless they participate in a public retirement system that serves as a FICA replacement plan, discussed in Chapter 6. However, Medicare taxes generally apply to wages of all state and local government employees hired after March 31, 1986. See Chapter 5 for further information.

See IRC Section 7871 for information on the treatment of Indian tribes as governments. Indian tribal governments are not treated as states for purposes of Section 218. However,

the Tribal Social Security Fairness Act of 2018 provides information about Indian tribes wishing to offer Social Security coverage to tribal council members under Section 218A of the Social Security Act. For more information about Social Security coverage, Medicare and tribal governments, see the IRS Indian Tribal Governments website.

Common-Law Standard - Employee for Employment Taxes (FICA and Income Tax Withholding)

For employment tax purposes, an employee is defined by IRC Section 3121(d)(2) as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." The common law test for determining whether a worker is an employee is whether the service recipient (the government entity) has the right to direct and control the worker as to the manner and means of the worker's job performance. In

other words, does the entity have the right to tell the worker not only what will be done, but how it will be done? See Treas. Reg. Sections 31.3121(d)-1(c)(1) and 31.3401(c)-1(a).

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories:

1. **Behavioral:** Does the company control or have the right to control what the worker does and how the worker does their job?
2. **Financial:** Are the business aspects of the worker's job controlled by the payer? (These include things like how the worker is paid, whether expenses

are reimbursed, who provides tools/supplies, and so on.)

3. **Type of Relationship:** Are there written contracts or employee type benefits (for example, retirement plan, insurance, vacation pay)? Will the relationship continue and is the work performed a key aspect of the business?

All these factors must be weighed when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no “magic” or set number of factors that “makes” the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors that are relevant in one situation may not be relevant in another.

The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

Behavioral Control

Facts that fall under this category show whether the entity has a right to direct and control how the worker performs the specific task for which they are engaged. Many times, when workers perform their tasks satisfactorily, the entity does not appear to exercise much control. The critical question, however, is whether there is a **right to control**. If the entity has the right to do so, it isn’t necessary that it actually direct and control the manner in which the services are performed.

The following considerations address the elements of behavioral control with respect to government employees:

Instructions, Training and Required Procedures	An employee is generally subject to the government entity's instructions about when, where, and how to work. The employer has established policies, which the workers are required to learn and follow. Daily or ongoing instructions about the expected tasks are especially indicative of employee status. Training is a classic means of explaining detailed methods and procedures to be used in performing a task. Periodic or ongoing training about procedures to be followed and methods to be used

indicates that the employer wants the services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship. For instance, police officers and firefighters must be trained to comply with departmental rules and regulations. They don’t have the independence characteristic of independent contractors. Other examples of training that indicates employment include a state statute requiring that animal control officers receive state-sponsored training and a statute requiring that inspectors of sanitary facilities be trained and state-certified. These facts are indicative of a right to

control. Election workers are trained to follow uniform procedures established for the polling place. They are directed by a supervisor.

These facts suggest they would typically be employees. Government employees often work subject to regulations and manuals, which specify how their jobs are to be done. Teachers are required to receive periodic training in departmental policies. They are required to attend meetings, to follow an established curriculum, to use certain textbooks, to submit lesson plans and to abide by departmental policies concerning

	professional conduct. However, some types of training or minimal instructions may be provided to either an employee or an independent contractor, including orientation or information sessions about a government entity's policies and voluntary programs for which there is no compensation.
Government Identification	Government workers may be required to identify themselves by wearing a uniform or driving a marked vehicle. When individuals represent themselves as agents of a government, that gives them an appearance of authority. Wearing a uniform, displaying government

identification, or using forms and stationery that indicate one is representing a government are highly indicative of employee status.

Nature of Occupation

The nature of the worker's occupation affects the degree of direction and control necessary to determine worker status. Highly-trained professionals such as doctors, accountants, lawyers, engineers or computer specialists may require very little, if any, instruction on how to perform their specific services.

Attorneys, doctors and other professionals can, however, be employees. In such cases,

the entity may not train the individuals or tell them how to practice their professions, but may retain other kinds of control, such as requiring work to be done at government offices, controlling scheduling, holidays, vacations and other conditions of employment. Again, the government entity should consult state statutes to determine whether a professional position is statutorily created. On the other hand, professionals can be engaged in an independent trade, business or profession in which they offer their services to the public, including work for government entities. In this case, they may be

independent contractors and not employees. In analyzing the status of professional workers, evidence of control or autonomy with respect to the financial details is especially important, as is evidence concerning the relationship of the parties as discussed below.

Evaluation Systems

Evaluation systems are used by virtually all government entities to monitor the quality of work performed. This isn't necessarily an indication of employee status. In analyzing whether a government entity's evaluation system provides evidence of the right to control work performance, consider how the evaluation

system may influence the workers' behavior in performing the details of the job. If there is a periodic, formal evaluation system that measures compliance with performance standards concerning the details, the system and its enforcement are evidence of control over the workers' behavior.

Financial Control

This second category includes evidence of whether the entity controls the business and financial aspects of the workers' activities. Employees do not generally have the risk of incurring a loss in the course of their work, but generally receive a salary for as long as they work. An independent contractor has a genuine possibility of profit or loss. Facts showing possibility of profit or loss include significant investment in equipment, tools or

facilities; unreimbursed expenses, including the requirement to provide materials or hiring helpers; working by the day or by the job rather than on a continuous basis; having fixed costs that must be paid regardless of whether the individual works; and payment based on contract price, regardless of what it costs to accomplish the job.

The following considerations address the elements of financial control:

Method of Payment	The method of payment must be considered. An individual who is paid a contract price, regardless of what it costs to accomplish the job, has a genuine possibility of profit or loss and, therefore, would not generally be considered an employee. An individual who is paid by the hour, week or month is typically an employee. However, this is

not always the case; for example, independent contractor attorneys usually bill by the hour. An individual who is paid by the unit of work, such as a court reporter, may or may not be an independent contractor, depending on the facts.

Offering Services to the Public

Another factor favoring independent contractor status exists when the individual makes their services available to the public or a relevant segment of the market. Relevant questions that address this issue include:

- Does the individual advertise?
- Does the individual use a private business logo?
- Does the individual maintain a visible workplace?

	• Does the individual work for more than one entity?
Corporate Form of Business	If the individual is incorporated and observes corporate formalities associated with this status, this makes it unlikely that they are an employee of the government entity. (A corporate officer will be an employee of the corporation.) The mere fact of incorporation or use of a corporate name, however, does not transform an employee into an independent contractor. The corporation must serve an intended business function or purpose, or be engaged in business.
Part-Time Status	The fact that workers work on a part-time or temporary basis, or work for more than one entity,

does not make them independent contractors. A part-time, temporary or seasonal worker may be an employee or an independent contractor under the common-law rules.

Relationship of the Parties

The third category used to determine worker status is evidence of the relationship between the parties, including how they view their relationship. The relationship of the parties is generally evidenced by examining the parties' agreements and actions with respect to each other, paying close attention to those facts that show not only how they perceive their relationship, but also how they represent their relationship to others.

For example, the intent of how the parties perceive their relationship may be expressed in a written contract. A written agreement describing the worker as an independent

contractor is evidence of the parties' intent, and in situations where it is unclear whether a worker is an independent contractor or employee, the intent of the parties, as reflected in the contract, may resolve the issue.

However, a contractual designation, in and of itself, is not sufficient evidence for determining worker status. The facts and circumstances under which a worker performs services are determinative. The substance of the relationship, not the label, governs the worker's status (Treas. Reg. 31.3121(d)-1(a)(3)). The following items may reflect the intent of the parties:

- Filing a Form W-2 or withholding payroll taxes for an individual indicates the entity's belief that the worker is an employee.
- A worker doing business in corporate form, with observance of corporate

formalities, indicates the worker is not an employee of the government entity.

- Providing employee benefits, such as paid vacation, sick days and health insurance, is evidence that the entity regards the individual as an employee. The evidence is strongest if the worker is provided with benefits under a tax-qualified retirement plan, Section 403(b) annuity or cafeteria plan because, by statute, these benefits can be provided only to employees.

The following are other considerations in evaluating the elements involving the relationship of the parties:

Discharge or Termination	The circumstances under which a business and a worker can terminate their relationship have traditionally been considered useful evidence concerning the

status of the worker. However, business practices and legal standards governing worker termination have changed since these general principles developed. Under a traditional analysis, a government entity's ability to terminate the work relationship at will, without penalty, provided a highly effective method to control the worker. The ability to fire at will is indicative of employee status. In the traditional independent contractor relationship, the government entity could terminate the relationship only if the worker failed

to provide the intended product or service, thus indicating that the business did not have the right to control how the work was performed. In the current environment, however, a government entity rarely has complete flexibility in discharging employees. The reasons a government entity can terminate an employee may be limited by law, by contract, or by its own practices. Consequently, inability to freely discharge a worker, by itself, no longer constitutes persuasive evidence that the worker

is an independent contractor.

Termination of Contracts

Historically, a worker's ability to terminate work at will was considered to illustrate that the worker merely provided labor and tended to indicate an employer-employee relationship. In contrast, if the worker terminated work, and payment could be refused, or the worker could be sued for nonperformance, this traditionally tended to indicate an independent

contractor relationship. Today, however, it is more common that independent contractors may enter short-term contracts for which nonperformance remedies are inappropriate, or may negotiate limits on their liability for nonperformance. For example, professionals, such as doctors and attorneys, are typically able to terminate their contractual relationship without penalty. Accordingly, the worker's protection from liability for terminating the relationship does not

necessarily indicate employee status.

Nonperformance of Employees

Employers may successfully sue employees for substantial damages resulting from their failure to perform the services for which they were engaged. As a result, the presence or absence of limits on a worker's ability to terminate the relationship, by itself, is less relevant in determining worker status. On the other hand, a government entity's ability to refuse

payment for unsatisfactory work continues to be characteristic of an independent contractor relationship. Because the meaning of the right to discharge or terminate is so often unclear, and depends primarily on contract and labor law, these facts should be viewed with great caution.

Permanency

The permanency of the relationship between the worker and service recipient is somewhat relevant to determining whether there is an employer-employee relationship. If a worker is

engaged with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence of intent to create an employment relationship. However, a longterm relationship may also exist between a government entity and an independent contractor. There may be a long-term contract, or contracts may be renewed regularly due to superior service, competitive costs or lack of alternative service providers. Part-time, seasonal or temporary workers may also be

employees under the common law. The fact that workers do not have full-time, permanent status is irrelevant to their classification.

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

In difficult cases, the IRS can provide a determination as to whether a worker is an employee or an independent contractor.

To obtain a determination from the IRS, file Form SS-8. Either a governmental entity or a worker may submit Form SS-8. The IRS will acknowledge receipt of the form and will request information from the other party. If a contract has been executed between the worker and the entity, a copy of the contract should be submitted with Form SS-8. In some

cases, the State Social Security Administrator may help determine whether the entity and position are covered by a Section 218 Agreement. The IRS will generally issue a formal determination to the entity and will send a copy to the worker.

Note: The SS-8 determination is not an examination. It does not reopen a closed examination or change the findings for years previously examined.

Classification Issues Involving Government Employees

The following discussion addresses some special worker classification situations involving governmental employees.

Elected Officials and Officers

Under IRC Section 3401(c), an officer, employee or elected official of a state or local government is an employee for income tax withholding purposes. Thus, by federal statute, public officers are specifically

included within the term “employee” for income tax withholding purposes (and conversely are **not** “independent contractors” for income tax withholding purposes). Treas. Reg. 31.3401(c)-1(a) clarifies the officers or employees can either be elected or appointed.

For Social Security and Medicare purposes, elected officials (also referred to as individuals in elective positions) are subject to a degree of control that typically makes them employees under the common law, and therefore subject to these taxes. Elected officials are responsible to the public, which has the power to vote them out of office. Elected officials may also be subject to recall by the public or a superior official. Very few elected officials have sufficient independence to be considered independent contractors.

Public Officer or Official

The term “public officer” refers to someone who has authority to exercise the power of the government and does so as an agent and

employee of the government. The Internal Revenue Code does not define the term "public officer," but Treas. Reg. Section 1402(c)-2(b), addressing self-employment tax, provides that holders of "public office" are not in a trade or business and are therefore not subject to self-employment tax. Rather, an individual recognized as a "public officer" is an employee.

An exception to this rule applies for certain public officials paid solely on a fee basis (see Chapter 5).

The Treas. Reg. give the following examples of positions that constitute "public office":

- Governor
- Mayor
- Member of a legislature or elected representative (elective office)
- County commissioner

- State or local judge, or justice of the peace
- County or city attorney
- Marshal, sheriff, constable
- Registrar of deeds
- Tax collector or tax assessor
- Road commissioners
- Members of boards and commissions, such as school boards, utility districts, zoning boards and boards of health

It may not always be clear whether a worker holds public office. In Metcalf & Eddy v. Mitchell, 269 U.S. 514 (1926), the U.S. Supreme Court addressed the definition of an officer. The Court ruled that an office is a public station conferred by the appointment of a government. The term “officer” includes the idea of tenure, duration, emolument and duties fixed by law, and where an office is created, the law usually determines its term,

duties and compensation. In Buckley v. Valeo, 424 U.S. 1 (1975), the Supreme Court stated that anyone who exercises significant authority pursuant to the laws of the United States is an officer. The term “officers” embraces all appointed officials exercising responsibility under the public laws of the nation. Officers perform a significant governmental duty exercised pursuant to a public law and administer and enforce the public law.

If there is some question as to whether a worker is a public officer and employee, a critical factor to consider is whether there is a provision of the state constitution or a statute establishing the position. State statutes should be reviewed to determine whether they establish enough control for the individual to be classified as an employee under the commonlaw test. A statute may state that a specific position is that of a public official, in which case there is likely to be a

right to control sufficient to make the individual an employee. Statutes may also specify the duties of a public office and generally establish the officer's superiors and subordinates, if any. Statutes establish an official's term of office and sometimes the compensation. They may require that a public official take an oath of office. Statutes often establish general and specific penalties for dereliction of duty. For instance, members of boards who are paid for each meeting they attend may face termination if they fail to attend a certain number of meetings.

Example: State A establishes the position of city attorney by statute and indicates that the position holder is an officer and an employee. This statute defines the duties of the position. The city attorney is required to direct all litigation in which the city is a party, including prosecution of criminal cases; to represent the city in all legal matters in which the city or a city officer is a party; to attend meetings

of the commissioners, advise commissioners, mayors, and so on on all legal questions; and approve all contracts and legal documents. A city manager appoints, supervises and controls the work of the city attorney. The city attorney must take an oath of office. These facts show the importance of state statutes in establishing a right of direction and control over a public official and thus classifying the individual as a common-law employee.

Home Care Service Recipients

A home care service recipient (HCSR) is an individual who receives home care services while enrolled in a program administered by a federal, state or local government agency that provides funding for that individual's home care services. Home care services include health care and personal attendant care services rendered to the HCSR. Generally, the HCSR is considered the employer of the service provider under the

common-law rules. The provision of home care services generally constitutes household employment.

The HCSR may request that the IRS authorize, under Section 3504, an agent to act on their behalf to withhold, report and pay the federal employment taxes for the workers who provide home care services. See Revenue Procedure 2013-39 and Form 2678, Employer/Payer Appointment of Agent. Special rules apply when a state or local government agency acts as the Section 3504 agent. A state or local government agency acting as a Section 3504 agent on behalf of an HCSR files an aggregate Form 941 and aggregate Form 940, attaching Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers, and Schedule R (Form 940), Allocation Schedule for Aggregate Form 940 Filers. Agencies must have an employer identification number separate from the one used to report taxes of

its own employees for this purpose. The state agent may engage a reporting agent or subagent to perform the reporting and payment of employment taxes that the state agent would otherwise perform on behalf of the service recipient.

Volunteer Firefighters

Compensation paid in an employer-employee relationship is taxable wages (unless an exclusion applies), regardless of whether the workers are termed “volunteers.” In some cases, rather than receive salaries, firefighters may receive amounts intended to reimburse them for expenses. They may also receive other cash or in-kind benefits that may be wages. Unless these reimbursements are paid under an accountable plan, discussed in Chapter 3, these reimbursements are taxable as wages.

Amounts that are termed “reimbursements” but are not paid under an accountable plan are treated as wages and subject to income, Social Security and Medicare taxes.

Therefore, a per diem or fixed amount paid to a firefighter (or other worker), that does not reimburse actual, documented expenses, is includible in income and subject to income tax withholding, Social Security and Medicare.

The services of volunteers are generally not eligible for the exclusion from FICA for emergency workers, discussed in Chapter 5. IRC Section 3121(b)(7)(F)(iii) provides that services performed by employees on a temporary basis in the case of fire, storm, snow, earthquake, flood or other similar emergency are exempt from employment. Firefighters who are on call and work part-time or intermittently do not qualify for the emergency worker exclusion. This exception applies only for temporary workers who are hired because of an unforeseen emergency.

Medical Residents

Medical residents are generally common-law employees of the hospitals for which they work, and therefore are subject to Social Security and Medicare taxes (unless they are excepted by a Section 218 Agreement). IRC Section 3121(b)(10) provides an exception for students employed by a school, college or university (SCU) who are enrolled and regularly attending classes at the SCU. However, this exception is not available to full-time employees. Under Treas. Reg. Section 31.3121(b)(10)-2(d)(3)(iii), an employee whose normal work schedule is 40 hours or more per week is always considered a full-time employee. Therefore, medical residents generally do not qualify to exclude payments for their services from Social Security and Medicare taxes.

Identity of the Employer for Tax Purposes

In certain cases, it is clear that the work in question is performed by employees, but it may not be clear which of two or more entities, organizations or individuals is the employer. This situation may arise when workers are supplied or paid by one entity but work under the direction of another (for example, leased workers).

The term “employer” is defined in IRC Section 3401(d), for income tax withholding and reporting purposes, as the person for whom an individual performs any service, of whatever nature, as an employee. However, an exception is provided if the person for whom the individual performs the services does not have control of the payment of the wages. In this situation, the term “employer” means the person having legal control of the payment of the wages except for purposes of the definition of wages under Section 3401(a)

(IRC Section 3401(d)(1) and Treas. Reg. Section 31.3401(d)-1(f)). In the situation where there is an employer under Section 3401(d)(1), there are three parties for employment tax purposes: (1) the employee, (2) the employer under Section 3401(d)(1) (also known as a Section 3401(d)(1) employer) and (3) the employer under the common law rules (the common law employer).

When a question is raised about the identity of the employer, all facts relating to the employment must be considered. If there is any provision in a statute or ordinance that authorizes the employment by a government entity of the individual, and the individual is hired under this authority, the individual is generally an employee under the common law rules of that governmental entity. Any statutory provisions relating to the relationship should be reviewed. If there is no statutory authority, the identity of the

employer must be determined under the common law control test.

If an entity is a Section 3401(d)(1) employer with respect to payments of wages to an employee, that employer under Section 3401(d)(1) is liable for the payment of employment taxes on the wages. However, the determination of whether the remuneration paid the employee is wages under Section 3121(a) for Social Security or Medicare purposes and wages under Section 3401(a) for income tax withholding purposes is made with respect to the common law employer. Thus, for example, a Section 3401(d) employer who is paying wages to employees on behalf of two or more common law employers cannot aggregate employees' wages for purposes of calculating the wage base for taxes under FICA and FUTA. See Cencast Services, L.P. v. United States, 729 F.3d 1352 (Fed. Cir. 2013).

Employee Status for Other Purposes

A state or federal agency may make determinations of employee status for workers' compensation, minimum wage or other purposes. The state or federal agency may apply different standards from those used to determine worker classification for federal employment tax purposes. Characterizations of individuals as employees based on state or nontax laws should be weighed with caution, and in some cases disregarded, because the laws or regulations involved may use different definitions of an employee for their purposes.

Independent Contractor Reporting Responsibilities

Independent contractors are subject to the taxes imposed under the Self-Employment Contributions Act (SECA). Taxes imposed under the SECA are usually referred to as self-employment tax, or SECA tax, to distinguish from the Social Security taxes and

Medicare taxes under the FICA that apply in the case of employment. Generally, payments to independent contractors of $600 or more during a calendar year must be reported on Form 1099-MISC. Independent contractors are required to provide a taxpayer identification number to the entity that pays them. Form W-9 contains the required certification and can be used for this purpose.

For more information about requirements for information reporting to independent contractors, see the Instructions for Form 1099-MISC. Workers who have been treated as independent contractors but are later determined to be employees will need to file amended returns if they reported income on Form 1040, Schedule C, and calculated self-employment tax (SECA) on Schedule SE. A worker in this situation should use Form 8919, Uncollected Social Security and Medicare Tax on Wages, to figure and report the employee share of Social Security and

Medicare taxes imposed under the FICA. Entities that misclassify employees as independent contractors may be held liable for back taxes, penalties and interest.

Worker Providing Services as an Employee and as an Independent Contractor

Individuals who are employees for some services may not be employees for other services they provide. For example, a teacher may be retained to remove snow from school property. This individual may be an employee as a teacher but an independent contractor for the snow-removal activity. Apply the common law rules separately to each activity to establish whether it is an independent trade or business.