

# Understanding When A Taxpayer Should Be Issued a W-2 Form vs. Form 1099-MISC

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# Independent Contractor or Employee

**Issue:** *Withholding* of income taxes, Social Security and Medicare vs. not

*Matching* of Social Security & Medicare and **payment** of Unemployment taxes

Business *relationship* between worker and provider of work

**Reg. 1.31.3401(c) & Rev. Rul. 72-88**



# Common Law Rules: 20 Factor Test

**Behavioral:** *Control or right to control what worker does and how it is done*

**Financial:** *Control of business aspects (how paid, expense reimbursements, providing of tools & supplies)*

**Type of Relationship:** *Written contracts or employee type benefits, work a key aspect of business operations*



# Behavioral Control

Facts that show a “*right*” to direct or control “*how*” worker does the work

*Factors:* type of instruction, degree of instruction, evaluation system and training

*Type of instruction:* when, where and how

*Degree of instruction:* the more detail given then more indication of an employee



# Behavioral Control

*Evaluation System:* measuring of details (employee) vs. measuring end result (independent contractor)

*Training:* business provides worker with training on “*how*” (*employee*) vs. own methods (independent contractor)



# Financial Control: Economic Aspects

Significant investment: *Could* indicate I/C status but industry could be a factor e.g. construction

Unreimbursed expenses: *Could* indicate I/C status but many employees incur fixed costs

Opportunity for profit or (loss): I/C run the risk of excess costs over revenues

Services to the market: I/C generally need to seek out new business



# Type of Relationship: Perception

*Written contracts:* determined by “*how*” the parties work together

*Employee benefits:* insurance, pensions, disability, paid vacations not granted to I/C

*Permanency of relationship:* expectation that relationship is indefinite generally indicates employee

*Services provided are key aspect of business operation:* generally indicates employee



# Facts & Circumstances Determination

All factors weighed independently in each case  
No “magic” or set number of factors “makes”  
a worker an employee or an independent  
contractor

“20 Factor Test” *indicates* the degree of  
control and varies depending on occupation  
and factual context in which services  
performed



# Facts & Circumstances Determination

Designed only as a “guide”: special scrutiny required to determine “*substance over form*”

*Industry practice* or custom in area of parties involved

*Intent* of the parties

*Written, signed independent contractor agreements executed*



# FORM SS-8

Used *if after* reviewing the 3 categories of evidence (Behavioral, Financial, Type of relationship) the status of worker still unclear

*If* used, *then* the IRS reviews the facts and circumstances and determines the status of the worker?

Can be filed by either worker or provider of work



# Misclassification of Employees

**Sec. 3509:** imposes penalties on the payer if a worker is classified as an independent contractor and there is no reasonable basis

**Form 8919**

**IRS Announcement 2011-64: Voluntary Classification Settlement Program (VCSP)**

**Sec. 530 Relief Provisions: Publication 1976**



# Section 530 Relief Requirements

*Reasonable basis:* court case, ruling issued to taxpayer by IRS, audited by IRS on employment issues, industry practice, reliance on advise of lawyer or accountant

*Substantive consistency:* treated all workers performing similar functions the same way

*Reporting consistency:* filed all required federal tax forms consistent with treatment of each worker (**Filed Form 1099**)



# References

**IRS Website: Small Business, Self-employed**

**IRS Publication 15-A:** *“Employer’s Supplemental Tax Guide (Supplement to Publication 15 (Circular E), Employer’s Tax Guide)*

**IRS Internal Training Manual:**

*“Employee/Independent Contractor Manual”*  
(PDF) 160 pages

**Form W-9:** *“Request for Taxpayer Identification Number and Certification”*

