

Business Development Session 14 - Finish Registering Your Business: Are You An Employer?

If you are...there are 7 taxes, 18 forms, and other requirements explained and available at many chambers of commerce or by calling 800-331-8877 or using the internet at www.businesskit.com.

Determining if you are an employer can be complicated. Many small companies hope to avoid paying payroll taxes by hiring family members. Unfortunately, this doesn't work...if you hire family members, you must pay some employer taxes. Other companies try to save taxes by hiring "independent contractors". Because this is a popular tax loophole, the IRS is now carefully investigating whether independent contractors meet the required criteria. If they don't the employer can be held liable for ALL the employee's taxes.

Carefully read the criteria below. If you plan to use non-employee labor, we suggest that you confirm this with a labor attorney, the IRS, or our tax accountant.

Before We Begin...Are You An Employee?

Since you own a sole proprietorship or are in a partnership, you are not an employee. You are the owner. Any money you take from the company is a draw on your company's after-tax profit. It is not salary. Do not pay regular employee-employer taxes on yourself. However, you must pay social security self-employment tax on the first \$68,400 in profits and Medicare taxes on all your profits. Call us to fax you the appropriate forms if this applies to you.

Warning for Limited Partnerships: If you hire your limited partners, they are employees. However, please contact an attorney, because hiring limited partners may invalidate their limited partner status.

Are Your Other Workers Employees?

IRS rules determine this, not an agreement between you and the worker. The IRS and Employment Development Department pressure that, except for statutory non-employees (described below), *all* workers are employees unless the *hiring firm* can legally prove otherwise.

The IRS has two classifications for workers: non-employees and employees.

Non-employees

There are two types of non-employees: independent contractors and statutory non-employees.

1. Independent Contractor:

- must offer his services to the general public
- must supply his own tools and a place to work; AND
- Only he can control the methods used to accomplish the work; hiring firms should only be concerned with the end result.

2. Statutory non-employee:

- these are direct sellers who sell your product door-to-door to the final user
- Licensed real estate agents.

If you use non-employees in your business: In general, you do not have to collect or pay any employer taxes. All you have to do is send your non-employees annual 1099Misc forms (call for forms 15 and 16). Call the IRS at 800-829-1040 and request publication 937 (Business Reporting) to verify this.

Employees

Any non-owner who was not described under non-employee above is an employee. There are two categories of employees: statutory employees (where a specific law automatically makes them an employee) and common law employees.

1. Statutory employees:

- food (except milk) and laundry drivers;
- full-time traveling salespeople who sell your goods to people who will re-sell the item;
- full time life insurance agents (working mainly for one firm);
- At-home workers who are supplied with the materials or goods and are given specifications of the work to be done.

2. Common law employees:

- Everyone else not described in non-employees above (including family members).

If you have employees: You will have to file certain forms and deduct or pay some employee-employer taxes. The forms and instructions are in the *Employer's Kit* available at local chambers of commerce or by calling the California Chamber of Commerce at 800-331-8877.

Warning If You Want To Use Independent Contractors

If you plan to hire independent contractors instead of employees, it is NOT enough to rely on the three characteristics listed above! There are additional rules and specific "do's and don'ts" that you must follow or you will be vulnerable to tremendous government fines!

The IRS and other government agencies have begun an audit crackdown on companies that have ignored these rules. Many (if not most) companies are losing these audits. The fines and back taxes can easily be \$25,000 for one mis-classified worker.

Independent Contractors...The Bottom Line

In a true independent contractor relationship, the hiring firm has no right to control the worker or the work. The hiring firm can only control (specify) the results of the work - not how the work is accomplished.

If you hire independent contractors, you must be willing to give up control over their actions. This means:

- No set work hours
- No rules
- No supervision
- No reports
- No supervising their assistants
- No ability to fire at will
- No changing their work or schedule without their permission
- No deadlines (unless agreed upon in a contract)
- No training
- No ongoing instructions
- Treating your independent contractor like he owns a business with twenty employees!

To speak to an independent contractor for JLS, contact JLS M-F 8-1 at 530-878-1119 and speak with Paula.

Myths That Cause Firms to Lose Audits

Independent contractor status is NOT determined by whether the worker:

- Asked to be treated as an independent contractor
- Has a written contract
- Works for you sporadically, inconsistently, or on call
- Is paid commission only
- Works without supervision
- Works for more than one company

The **only** test to a true independent contractor relationship is whether the hiring firm has the right to control the worker or the process of his work.

What is Right to Control?

It is difficult to define what "right to control" is. The IRS has developed twenty factors, which point to the right of control. Many of these factors are listed above (Independent contractors...the bottom line). Independent contractors do not have to meet all twenty factors, but the hiring firm must clearly show that the factors that were not met were not important for that job or industry.

In addition to complying with the twenty factors, hiring firms cannot treat their independent contractors like employees. Many firms have lost audits because they ignored small details and had their contractors complete employment applications or time sheets, or designated someone to be their "supervisor".

IRS Form SS-8

If you are unsure whether a worker is an independent contractor or an employee, you can call the IRS at 800-829-3676 and ask them to mail you form SS-8. Complete and mail in this form for an official IRS ruling. We strongly suggest, however, that you learn about the independent contractor rules first so that you know what a true independent contractor relationship should be like and so you don't violate the rules later on.

Protect Yourself Before You Hire Anyone

The only way to protect yourself is through education and good professional advice. The California Chamber of Commerce publishes these educational guides:

- *Employer's Kit*: forms and tax information.
- *Labor Law Guides*: Do's and don'ts to help avoid common legal problems.
- *Independent Contractors: A Manager's Guide*: Examples of true independent contractors; dangerous myths, contract, worksheets; tips to avoid audit problems.

Additional information is available on the internet at www.calchamber.com or by calling 800-331-8877.

There is no homework for this session.