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ICS LAW BRIEF

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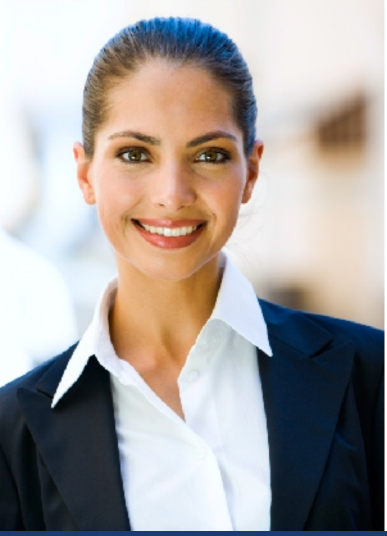

Employee or Independent Contractor?

By Gaylord Gardner

Imagine this. You've started a business and are so busy that you need help. You decide to hire a worker but want to keep the cost of hiring this worker as low as possible. You have been told that treating your worker as an independent contractor can save you money on payroll taxes–so you hire the worker as an independent contractor.

A few years later you are audited by the IRS. The auditor decides that you should have treated the worker as an employee. The IRS now wants you to pay all the back payroll taxes on your worker, plus interest and late fees.

Normally, companies are required to withhold federal income taxes, Social Security taxes and Medicare taxes from the wages paid to employees. Furthermore, companies are required match the Social Security and Medicare taxes paid by its employees and are required to pay unemployment taxes for those employees. Companies are not required to pay these taxes for independent contractors. Therefore, business owners think that they can save money by classifying a worker as an independent contractor in order to avoid payroll taxes.

Risks of Misclassification

Although classifying a worker as an independent contractor might initially save a company money, misclassifying an employee as an independent contractor can potentially cost a company more in the future. In addition to the having to pay the unpaid back taxes, a company can be subject to fines and interest on the unpaid taxes as a result of misclassification.

Worse, a company that has misclassified a worker as an employee will not be able to recover the unpaid back taxes from the misclassified employee.

In addition to the usual risk that a misclassification may be found during an IRS audit, misclassification is now even riskier. For the 2008 tax audits, the IRS will begin using a new electronic matching system in order to catch companies misclassifying employees as independent contractors. This system will be used to identify companies that issue 1099s with payments of at least $25,000 to five or more workers.

Furthermore, the "independent contractor" is on the hook for the proper payroll taxes as well.

Classifying a Worker

With the increased risk of an audit, it is important that business owners know the guidelines that the IRS uses to determine whether a worker is an employee or independent contractor.

Currently, the IRS uses four categories for classifying the workers of a company. These categories are independent contractor, common-law employee, statutory employee, and statutory non-employee. Most workers fall within either the independent contractor or common-law employee categories so most of this article will focus on these two categories. Nevertheless, a quick overview of the other two categories is necessary.

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Employee or Indepenent Contractor (Continued from page 1)

Statutory employees can be:

- drivers who distribute beverages (other than milk), meat, vegetables, fruits, or bakery products;
- drivers who pick up and deliver laundry or dry cleaning;
- full-time life insurance sales agents;
- individuals who work at home on materials or goods that are supplied and that must be returned; and
- full-time traveling or city salespeople.

Statutory non-employees can be:

- direct sellers:
- licensed real estate agents; and
- certain companion sitters.

If a company has any workers that may fall into either of these two categories, it is important to seek the advice of an attorney in order to correctly classify these workers.

For the remaining two categories, there are three major factors used to classify a worker as either an employee or independent contractor. These factors are: 1. behavioral control; 2. financial control, and 3. the type of relationship of the parties.

Behavioral Control

If a company retains the rights to control and direct how services are provided by a worker, the worker is usually considered an employee. On the other hand, if a company gives up its rights to control and direct how services are provided by a worker, the worker is usually considered an independent contractor.

While no factor is absolute in establishing the nature of the worker's relationship to a company, the following factors are used to determine whether a company has retained a right to control a worker. Factors that tend to establish an employee relationship are whether the company directs the worker regarding:

- when and where to do the work;
- what tools or equipment to use;
- what work to do;
- what other workers to work with;
- where to purchase supplies; or
- in what sequence to perform the work.

Furthermore, if a company provides the worker with training, this further establishes an employee relationship.

Conversely, if the worker provides the work on his or her own schedule, provides his or her own tools or equipment, selects what workers to work with, decides what work to do, decides in what sequence to perform the work, or receives no training from the company, these factors tend to establish an independent contractor relationship. Also, if a worker has the ability to send a substitute, the worker is more likely to be an independent contractor.

Financial Control

In addition to controlling how services are provided by a worker, the control that a company has over the business aspects of a worker provides evidence regarding the nature of the relationship that the worker has with a company.

How a worker is paid and if the worker is reimbursed for expenses, are factors used to classify a worker. If the worker is paid an hourly rate, the worker is more likely an employee, while if the worker is paid a flat fee for the services, the worker is more likely an independent contractor. If a worker is reimbursed for business expenses, the worker is likely an employee. On the other hand, if the worker is not reimbursed for business expenses and has ongoing business costs, regardless of whether services are being performed, the worker is more likely an independent contractor.

Whether the worker makes an investment in order to provide services and is free to market those services can be determinative factors in establishing whether a worker is an employee or independent contractor. Generally, employees do not have to make an investment in the facilities used by the worker while performing services. If the worker makes a significant investment in the facilities, the worker might be an independent contractor. If a worker provides similar services to other businesses and is free to solicit other businesses in order to provide these businesses services, the worker is more likely an independent contractor. Evidence of solicitation can be whether the worker maintains a visible business location or advertises in any way.

Finally, the potential for a worker to realize a profit or loss can be a major determinative factor in classifying a worker. Employees do not realize profits or losses while independent contractors have can make a profit or can have a loss.

Type of Relationship

The type of relationship that the parties intended to create, despite the classification applied by the company, is the final factor used to classify a worker. If there is a written contract between the company and the worker, the terms of the contract may be used to determine the type of relationship between the worker and company.

Independent contractors do not normally receive benefits such as insurance, a pension plan, vacation pay, or sick pay. If a worker receives benefits such as these, a worker is more likely an employee.

If the length of relationship between the worker and company is indefinite, the worker may be an employee. If the relationship is for a set period of time or until the completion of a project, the worker may be an independent contractor.

If the services provided by a worker are services that are a key aspect of the business, the worker is more likely an employee. For example, a plumber providing servicers to a plumbing company is likely to be an employee while a plumber providing plumbing services to a home builder may be an independent contractor.

Determining whether a worker is classified as an employee or independent contractor can sometimes be difficult process. It is advisable for all business owners to seek the guidance of an attorney when attempting to classify a worker as an independent contractor when it is not clear whether that worker qualifies as an independent contractor.

Do You Need a Living Trust?

By Gweyn Colaberdino

A frequent question posed by many clients to their estate planning attorney is "Do I need a living trust?" This question is answered by asking another question: How important is it to you that your estate avoids probate?

The primary purpose of a living trust is to avoid the court supervised transfer of title of your assets at your death, a process known as probate. The rules and complexities of the probate process vary from state to state and also depend on the number and types of assets being transferred. The process typically takes at least a year, and all documents filed with the court regarding your estate, including your will, become public record. The appointed executor will need to be represented by an attorney, so legal fees will be incurred. These fees can become significant if the estate is complex, where for example, a large number of creditors are involved and claims are filed or where assets need to be sold to satisfy distribution provisions.

One way to prevent having your estate go through probate at your death is to use a living trust. A living trust is an estate planning tool that:

- you create during your lifetime,
- takes title to and holds your assets during your life,
- distributes the assets at your direction during your life, and
- distributes your assets at your death according to the terms that you have stipulated in the trust document.

Probate is avoided because your trust, and not you, holds title to your assets. When you die, your trust survives you. Your named trustee will manage your affairs and can make distributions as directed by your trust. The trustee can perform these duties without the representation of an attorney.

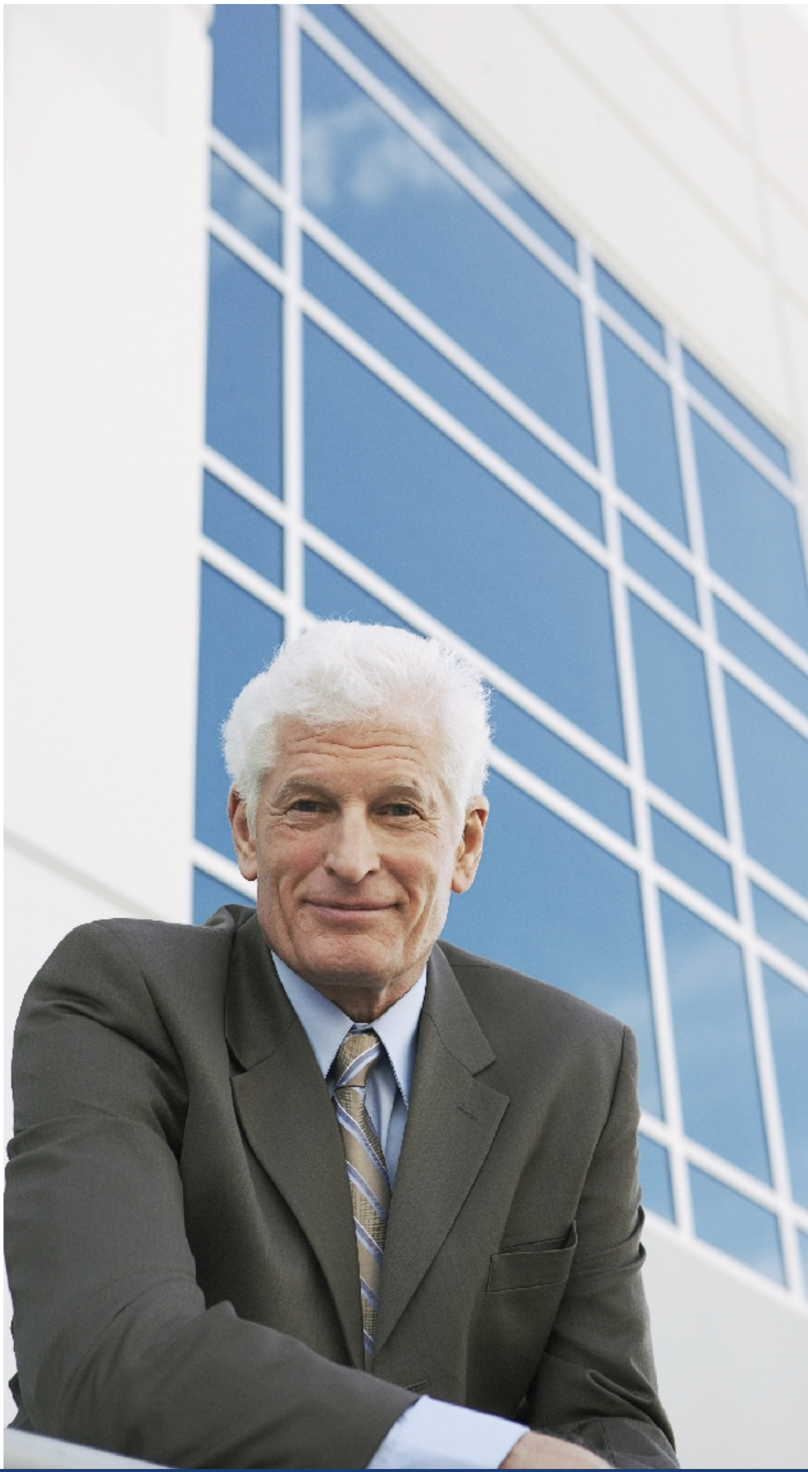
Although your trust will direct what happens to your assets after you die, it is still important to have a "pourover will." The pourover will deals with any assets that were never transferred into your trust by transferring them to your trust at your death. Those assets must go through probate since title to those assets was in your name, and not the trust's.

To achieve probate avoidance using a living trust, you must "fund" the trust by transferring all non-beneficiary individually titled assets to the trust. Any assets you obtain in the future should also be titled in the name of the trust. Once transferred, your assets will be owned by the trust and controlled by the trustee. You may be a beneficiary and trustee of your trust, in which case you will have the same control over your assets as before the transfer. You will also pay income taxes on your trust assets as before.

It is obvious that attention to detail is necessary to ensure that your living trust functions as intended. Because of the time and attention a trust will require, they best serve those who will benefit from avoiding probate. Individuals who own real property in multiple states may benefit from a living trust. These folks will avoid the requirement of opening a probate in each state where the real property is located. There are also those individuals who desire a living trust because they want to make handling their estate as easy as possible on their loved ones.

Some can avoid probate completely through simpler methods. Assets can pass outside of probate by being owned jointly with right of survivorship. Assets can also pass directly by using beneficiary designations or transfer on death designations to a named beneficiary. An advantage of using beneficiary designations is that they can be changed as your circumstances change, avoiding the effort and expense of amending your trust.

Whether a living trust makes sense as part of an estate plan ultimately depends on each individual's circumstances, and involves a full discussion as to what estate planning approach would best serve your needs. If you would like to discuss your estate plan, or want more information, please give our office a call.



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Guest Column:

How do I build an effective workforce?

By Paul Pike

Each issue, we invite trusted business colleagues to write a short article on a relevant topic. This issue's guest is Paul Pike.

The success of any company starts with people. Having the right employees can make or break you. But how do you fill a position to see a positive impact on the profitability and growth of your company?

Keep in mind:

- Person-position fit–will this candidate succeed in this role?
- Person-organization fit–will this candidate bring success to the company?

Identifying the right candidate for your organization can demonstrate real results. Companies utilizing person-organization fit have seen a 7.5% higher revenue growth, 6.1% higher profit growth and 17.1% lower employee turnover, according to a recent Cornell University Center for Advanced Human Resource Studies study.

Kevin and Jackie Friebert, authors of Hire People Who Don't Suck (Energy, Passion, and Enthusiasm Out of Others), say, "The type of people you hire today will determine the kind of culture, the kind of service standards, and the kind of reputation you have tomorrow."

How? One way to ensure candidate match is developing accurate and comprehensive job descriptions. Candidates base their decision on which opportunities to consider based on specific responsibility description. Don't assume "office manager" means the same thing to everyone.

An effective workforce does more than just get the job done. It helps drive the success of your business!

Paul Pike has worked in management and business development capacities in the Human Resources and Transportation industries. He consults with small to mid-size businesses consulting with them on employment management practices.

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