

CLIENT REPORT:

2008 Planning - Independent Contractor vs. Employee

Dear Client:

Understanding the difference between an employee and an independent contractor is very important. If you are an employer, you are required to withhold and contribute a matching amount of FICA and Medicare taxes from your employee's income. However, if your workers are independent contractors, you are only required to report payments of \$600 or more on a Form 1099-MISC (Miscellaneous Income). Failing to make the right classification could cost you money.

If you have workers who make substantial financial investments in tools, equipment, or a place to work, or undertake some entrepreneurial risks, they are probably independent contractors. However, when you control and direct the workers who perform services for you as to the end result and how it will be accomplished, you are probably involved in an employer-employee relationship.

Unless there is a reasonable basis for treating your employees as independent contractors, failing to withhold income and employment taxes from their wages can result in severe penalties and interest, in addition to the back taxes owed. Of course, penalties for intentional worker misclassifications are harsher than they are for inadvertent mistakes.

Your benefit plan may also be in jeopardy if any eligible employees have been misclassified as independent contractors. Since these employees have been excluded from plan participation, your retirement plan may lose its tax-favored status. The problem is compounded when excluded employees seek restitution for lost benefits not only due to their exclusion from the benefit plan, but also for health coverage and other employee benefits.

Since the potential liability is considerable, we feel that it would be beneficial for you to verify that your workers are properly classified. We would like to discuss other planning opportunities available to your business, as well as answer any questions you might have. Please contact our office at your earliest convenience to make an appointment.

[USE FOR ENTITIES WHO PAID STATUTORY NONEMPLOYEES]

As you probably know, compensation paid to certain workers considered nonemployees is not subject to income tax withholding, FICA or FUTA taxes. Generally, qualified real estate agents and direct sellers are considered statutory nonemployees. For nonemployee classification purposes:

* Qualified real estate agents must be salespersons (or the person who recruits, trains or supervises salespersons); licensed real estate agents; and compensated based upon their sales or other output, rather than the number of hours they worked.

* Direct sellers must sell or solicit the sale of consumer products to a customer, or to a buyer for resale, in the home or other non-permanent retail establishment. Workers who perform services related to the delivery or distribution of newspapers or shopping news are also considered direct sellers.

Since your business currently employs statutory nonemployees, a review of your procedures to ensure that you are not paying unnecessary employment taxes is in order. We would like to discuss other

planning opportunities available to your business, and answer any questions you might have. Please contact our office at your earliest convenience to make an appointment.

[USE FOR ENTITIES WHO PAID STATUTORY EMPLOYEES]

As you probably know, sometimes workers are specifically designated as employees by the Internal Revenue Code even if the facts do not suggest an employer-employee relationship. Generally, the following types of workers are considered statutory employees:

- * Full-time traveling or city sales representatives;
- * Agent-drivers or commission-drivers;
- * Life insurance sales representatives; and
- * Home workers.

However, there are distinct rules for each worker type, and their employment tax treatment also varies. In addition, statutory employees must personally perform substantially all of the services required under your contract. These workers cannot have a material investment in your facilities, and your relationship with them must be ongoing.

Since your business currently employs statutory employees, a review of your employment tax and withholding procedures to ensure compliance with these special rules is in order. We would like to discuss other planning opportunities available to your business, and answer any questions you might have. Please contact our office at your earliest convenience to make an appointment.