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**Re: Tax Reporting for Using
Independent Contractors**

Dear Clients, Colleagues, and Friends:

The IRS is working on its enforcement for reporting independent contract labor income. One of its enforcement measures is making sure businesses issue Form 1099s to contract workers. Recent Form 1099 enforcement efforts started with certain provisions of the Affordable Health Care Act (a/k/a Obamacare). The Act originally had extensive Form 1099 reporting requirements. Subsequent changes have scaled back the Act with respect to 1099s. The IRS, however, is now asking specific questions on business tax returns about the business properly issuing 1099s.

To help companies better comply with the tax rules, this Newsletter addresses the tax reporting requirements resulting from using independent contractors. It first discusses the basic differences between an independent contractor and an employee, and then discusses when an independent contractor relationship requires the filing of Form 1099-MISC.

Who Qualifies as an Independent Contractor?

It is important to determine whether a worker qualifies as an independent contractor or an employee because the tax payments and filing requirements vastly differ between the two. Unfortunately, it is not always easy to determine whether a worker qualifies as an independent contractor. Neither the form of payment, the frequency of payment, nor the length of time the worker spends working is determinative in resolving this question. The IRS suggests businesses explore three relevant areas to make this determination:

1. Whether the business controls the behavior of the worker. Does the business control what the worker does and how the worker does it?
2. Whether the business is responsible for the worker's expenses, tools, and supplies.
3. Whether there is a written contract or employee type benefits.

Affirmative answers to these questions tend to suggest that a worker is an employee, while negative answers suggest the worker is an independent contractor. If there is still ambiguity as to a worker's status after exploring these three areas, the IRS can help. Either the worker or the business using the worker can submit Form SS-8 to the IRS. The

IRS will then make the determination as to whether the worker qualifies as an employee or an independent contractor. Be forewarned: this process can take at least six months, so when there is confusion, it should be addressed early.

Form 1099-MISC Requirements for Independent Contractors

As mentioned above, the classification of a worker as independent contractor or employee is necessary because the tax filing requirements differ. While businesses provide their employees W-2s, businesses must provide independent contractors and the IRS with a different form – Form 1099-MISC. This form shows the payments rendered to independent contractors. However, even when dealing with independent contractors, Form 1099-MISC is not always required. The general rule is that payments for rents or services of at least \$600 made in the course of business require the filing of Form 1099-MISC. This applies to businesses that operate for gain or profit and to nonprofits.

Qualifying payments include:

- Payments to the independent contractor.
- Payments for parts and materials for the independent contractor.
- Payments from a contract to an individual, partnership, or estate.
- Payments of at least \$600 to an attorney.
- Payments of state or local taxes imposed on a service provider that you pay to the service provider. However, taxes imposed directly on you are not included.

There are several exceptions to the general rule. The following are not reportable on Form 1099-MISC:

- Personal payments. Only payments made in the course of business are reportable.
- Payments made to corporations. However, attorneys' fees paid to a corporation are still reportable.
- Payments to tax-exempt organizations.
- Payments for merchandise, telephone service, and storage.
- Rental payments to real estate agents.

Conclusion

See the sample 1099 information gathering form. **Caution:** It does not create an independent contractor relationship when one does not otherwise exist. Our suggestion is to have the worker complete the form prior to their first payment. For an electronic sample of the form, see our website at paulhburgess.com or by scanning the **QR Code** in the letterhead. On our website the form can be found by selecting “Newsletters” from the left hand column. Then click “May 2012 – Form 1099 Reporting.”

This newsletter is not exhaustive and only addresses the most common tax scenarios with independent contractors. It is important to correctly classify workers and to provide them with the correct form. If you incorrectly classify an employee, you may be held liable for employment taxes for that worker. If you or your business would like more information about the tax implications of using independent contractors, please contact our offices via email at paul@paulhburgess.com or via telephone at **918.599.7755**.