

Employment Issues Course

Slide 2 – Welcome

Leagle: Welcome to the Employment Issues Course. This course is presented by the Tax Exempt and Government Entities division's Exempt Organizations office.

Slide 3 – Introduction

Leagle: Hi. I'm Leagle and I'll guide you through the courses here at StayExempt.

Before you start, this course includes questions and activities to test your knowledge. No scores are kept and are for your reference only. They're designed to help you understand the material better.

Slide 4 – Objectives

- Classify employees, independent contractors, and volunteers for federal tax purposes.
- Identify your 501(c)(3)'s tax withholding, paying, and reporting responsibilities for all of its workers; and
- Recognizing the major employment tax forms and their uses for the typical small 501(c)(3)

Leagle: During this course, we'll talk about various the tax responsibilities for 501(c)(3) organizations with employees.

First, I'll show you how to classify employees, independent contractors, and volunteers for federal tax purposes. Then we'll review how to identify withholding, as well as how to pay and report taxes for your workers. Finally, we'll talk about employment tax forms for 501(c)(3) organizations and how to use them.

Let's meet Bobby. She wants to learn about the tax responsibilities for her 501(c)(3) organization because she has employees.

Slide 5 – Determining the Organization's Relationship to its Workers

Bobby: Hi, I'm Bobby and I run a cancer awareness organization. I recently learned that the IRS treats various workers differently for tax purposes. How can I be sure that my 501(c)(3) is properly classifying a worker for federal tax purposes?

Leagle: Well Bobby, each type of worker requires special treatment under the Internal Revenue Code. So, to understand your 501(c)(3)'s tax obligations regarding workers, you have to know what type of workers your organization has – employees, independent contractors or volunteers.

The key to classifying these workers is to understand that they are characterized by their relationship with the organization.

When looking at the relationship between the organization and the worker, pay special attention to the 501(c)(3)'s right to direct and control the worker. The more control the organization has over the worker, the more likely that he/she is an employee; and the more autonomy or independence the worker has, the more likely he/she is an independent contractor.

Bobby: So, it looks like independent contractors are self-employed and have their own independent trade or business.

Leagle: That's right. Basically, your organization tells an independent contractor what needs to be done, but not how to do it.

The IRS developed three broad categories of evidence to help you analyze the relationships. The categories of evidence are:

- Behavioral Control
- Financial Control, and
- Relationship of the parties

Let's look at how these can be used to determine each classification.

Slide 6 – The Behavioral Control Category

Bobby: What's behavioral control and how do you quantify it?

Leagle: Behavioral control is how much your 501(c)(3) controls its worker's behavior while he or she completes work-related tasks.

You can figure your level of control by considering two factors: **instructions** and **training**. Does your 501(c)(3) provide instructions to the worker by [bullet 1 appears] setting the time, place, and manner of accomplishing a task?

Bobby: For some workers, we do. What else should I consider?

Leagle: Here's an illustration to make it easier. Do you use any of these following instructional methods?

- Do you tell the worker which tools or equipment to use?
- Do you give them an order or sequence to follow?
- Do you require the worker to follow an employee manual?

Now, let's look at the training factor. Does your 501(c)(3) provide your workers with specific procedures to follow or if you indicate methods he or she should use in completing the task?

If you checked any of the questions on the screen, it suggests that your worker is an employee, not an independent contractor.

Slide 7 – Behavioral Control Case Study

Leagle: Let's look at an example:

Debbie is paid to help Bobby's organization on the weekends. Bobby told her to work at the organization's main office. She uses a computer provided by the organization. Does Bobby's organization exert behavioral control over Debbie?

Pause to consider the answer.

The answer is yes. Because Debbie must come into the office for the organization and use the organization's computer to work, the organization is exerting behavioral control over her work.

Slide 8 – The Financial Control Category

Leagle: You should also consider who directs or controls the financial aspects of the worker's activities, the organization or the worker? Here are some questions to ask yourself:

- Has the worker put a significant personal investment into the tools, equipment or facilities used to do the job?
- Does the worker maintain a separate office?
- Does the worker bear the risk of incurring a financial loss in doing the job?
- Are there many unreimbursed expenses, and does the worker hire and pay helpers?
- Does the worker advertise and maintain a visible business location?
- Is the worker paid a flat fee (rather than being paid on an hourly, daily, weekly or monthly basis)?

Bobby: Several of these apply to some of my workers.

Leagle: That's good to know. If you answered "yes" to any of these questions, your worker has more financial control, which points to classification as an independent contractor.

Slide 9 – Financial Control Case Study

Leagle: Here's another example.

The organization provides Debbie with tools, a computer and desk space for her to work. She doesn't maintain a separate office and she doesn't have the ability to hire and pay helpers.

Does the organization exert financial control over Debbie's activities?

Pause to consider the answer.

The answer is yes. Debbie does not have any financial liability in her activities. The organization pays for the tools and location and she doesn't make any independent financial decisions.

Slide 10 – The Relationship of the Parties Category

Leagle: Finally, you should also ask how your organization and the worker perceive their relationship? Consider the following questions:

- Is there a written contract specifying employee status?
- Does your organization provide the worker typical employee benefits, such as health insurance or a pension plan?
- Can your organization terminate or discharge the worker, or can the worker leave before the task is completed without becoming liable for nonperformance?
- Is the worker's service a key aspect of your organization's regular business activities? (For example, a receptionist at a busy drug treatment center scheduling patients, answering the phone and greeting visitors.)

Answering yes to any of these questions suggests you classify the worker as an employee.

Slide 11 – Relationships Case Study

Leagle: Look at this example.

Bobby doesn't have a contract that states that she's an employee and she doesn't receive benefits because she only works part time for an hourly wage.

Because she doesn't have a contract, she can stop working for the organization whenever she wants, although the organization and Bobby have agreed that she'll give her notice if that becomes necessary. Bobby is thankful because her organization would suffer without her filing and recordkeeping skills.

Based on the scenario, does Bobby's relationship with the organization qualify her as an employee?

Pause to consider the answer.

The answer is yes. Even though Bobby doesn't have a contract or receive benefits, she can be fired at any time, she can terminate her work at will and her work is vital to the organization's regular business activities.

Slide 12 – Putting the Evidence Together to Determine Employee or Independent Contractor

Leagle: So again, classifying a worker as employee or independent contractor is a simple matter of considering the evidence from the three categories.

Bobby: I can see that no single factor makes the worker an employee or an independent contractor.

Leagle: Yes, that's right. Also, factors that are relevant in one situation may not be relevant to others.

The key is to look at the entire relationship, consider the right to direct and control and finally, document each of the factors used when making the final determination.

Slide 13 – Statutory Workers

Bobby: Now I understand how to classify my workers as employees or independent contractors, but what about my officers and board of directors? Are they in a class by themselves?

Leagle: That's a great question, Bobby. The answer is yes. Unlike workers who are classified by weighing various criteria, certain types of workers are automatically classified as employees or non-employees by statute.

The Internal Revenue Code defines the officers of a corporation, such as the president, vice president, secretary or treasurer, as employees and your 501(c)(3) must classify them the same way for tax purposes if they're paid to perform their duties. A 501(c)(3) shouldn't classify corporate officers as employees if they perform no services or only minor services and they don't receive or are entitled to compensation.

By contrast, the Code defines the board of directors of a corporation as non-employees, so your 501(c)(3) must classify them as independent contractors or volunteers for tax purposes. This applies if your organization pays its board members to attend board meetings or otherwise compensates them for performing their duties as directors.

Slide 14 – Statutory Workers (cont.)

Leagle: More broadly, the term “officers” for federal tax purposes includes anyone who holds a position of trust, authority or command within an organization.

Note that many 501(c)(3)s have officers who are volunteers and work without compensation. The 501(c)(3) **may** pay these officers reimbursement or an allowance for out-of-pocket expenses.

So, if the 501(c)(3) requires an officer to attend a convention representing the 501(c)(3), they might pay for the trip. Similarly, a 501(c)(3) may provide a monthly allowance to an officer for automobile use. There are two methods your organization may use to pay and account for these reimbursements and allowances: the accountable and non-accountable methods. Each is treated differently for tax purposes.

Bobby: Can you give me an example of the difference?

Leagle: Sure. Substantiated, deductible business expenses made under **accountable** plans may be excluded from an officer’s or employee’s gross income and aren’t subject to withholding and employment taxes.

Under a **non-accountable** plan, however, amounts paid are included in the officer’s or employee’s gross income and are reported on Form W-2. The amounts are subject to all applicable employment taxes.

[Publication 535, Business Expenses](#), includes finer details.

Slide 15 – Statutory Workers (cont.)

Leagle: Workers categorized as **independent contractors** (not as employees) may also fall under the subsection of statutory employees. The following are considered statutory employees:

- A full-time traveling or city salesperson who solicits orders from wholesalers, restaurants or similar establishments on behalf of a principal. The merchandise sold must be for resale (like: food that’s sold to a restaurant) or for supplies used in the buyer’s business
- A full-time life insurance agent whose principal business activity is selling life insurance and/or annuity contracts for one life insurance company
- An agent-driver or commission-driver engaged in distributing meat, vegetables, bakery goods, beverages (other than milk) and laundry or dry-cleaning services
- A home worker performing work on materials or goods furnished by the employer

Slide 16 – Volunteer Workers

Bobby: We have many workers who are volunteers. How should we treat them for tax purposes?

Leagle: From time to time, some 501(c)(3)s may provide volunteers with awards, or gifts. In general, if these are non-cash items of nominal value, such as a ham around the holidays, your organization shouldn’t count these items as taxable wages.

But be careful! If your 501(c)(3) gives volunteers cash items, such as gift certificates or any other taxable fringe benefit, it must consider these items as taxable wages.

Bobby: What’s the problem with giving cash or gift certificates?

Leagle: Giving a volunteer cash can inadvertently put them in the category of “employee” or independent contractor, and the organization will have the same reporting and withholding requirements for this worker as it would for any employee or independent contractor.

We'll talk about those tax responsibilities later in this course.

Slide 17 – Knowledge Check

Leagle: Let's look at an example.

Melaney gets paid a salary for working on community relations. She works 40 hours per week in the organization's office and uses company equipment to track recruit volunteers. Lastly, she has an email address from the organization and has to follow the guidelines for employees while at the office.

Should the 501(c)(3) treat Melaney as an employee or independent contractor?

Pause your system to consider your answer.

If you said as an employee, you are right. Melaney doesn't have sufficient independence to be categorized as an independent contractor. The amount of control exercised by the organization makes her an employee.

Slide 18 – Knowledge Check

Leagle: Here's another example.

Phil, a computer programmer, is hired by a 501(c)(3). The organization pays him a flat amount to complete a one-time project. It's not clear how long it will take to complete the project, and he isn't guaranteed a minimum payment for the hours spent on the program. The organization provides Phil with no instructions beyond the specifications for the final product.

Based on this information, should the 501(c)(3) treat him as an employee or independent contractor?

Pause to consider your answer.

If you answered as an independent contractor, you're right. The organization isn't telling him “how” to do the job, just “what” must be done. Phil also takes on the risk of financial loss because it's not clear how long the project will take.

Slide 19 – Knowledge Check

An organization that distributes second-hand clothing to impoverished communities around the world hired Donna as Vice-President. She'll receive a fair salary for managing the international logistics for their operations in Asia.

Should the 501(c)(3) treat Donna as an employee?

Pause your system to consider your answer.

If you answered yes, you are correct. Donna's position of vice president, combined with her salary, make her an employee.

Slide 20 – Knowledge Check

Margaret is one the most dedicated volunteers and the community shelter and the organizations wants to recognize her dedication and diligence.

Acknowledgments such as certificates and plaques are usually given, but it's felt that Margaret's self-sacrifice merits something more substantial. The organization leader elects to give her a \$1,000 gift card to her favorite store.

Does the 501(c)(3) have reporting and withholding responsibilities for this gift to Margaret?

Pause your system to consider your answer.

If you answered yes, you're right. Because the gift has a monetary value, the organization must report and withhold for this worker as an employee or independent contractor.

Slide 21 – Recap

Leagle: Let's go over what you've covered so far.

We saw that different types of workers require different types of treatment under the Internal Revenue Code and that your organization must determine what types of workers it has – employees, independent contractors (IC) or volunteers.

We also saw that the key to classifying these workers is to understand that each type is characterized by its relationship with the organization.

I pointed out that the key aspect of the worker/organization relationship is whether the 501(c)(3) has the right to direct and control the worker or does the worker decide how the job will be done. More organizational control over the worker indicates that the worker is an employee, while more worker independence suggests that the worker is an independent contractor.

Then we looked at the three categories where this control is shown: work task-related behavior; financial burden and risk; and the perception of the relationship with regard to such things as benefits and contractual obligations. The more control that either party exercises in these areas determines whether the worker is an employee or independent contractor.

We also discussed how IRS statutes mandate that workers serving as 501(c)(3) officers are employees while officers who hold minor roles and receive no payment are not considered employees. Members of your board of directors are not employees.

Finally, we examined the volunteer worker and how your organization must be cautious when rewarding their service.

Now, let's try an exercise before moving on to the next section.

Slide 22 – Progress Check

Leagle: Well done! You've learned how to use the behavior, financial and perception of relationship categories to determine whether a worker is an employee, an independent contractor or a volunteer.

You've also learned that statutes mandate some workers, such as presidents and vice-presidents, be classified as employees or independent contractors, depending upon the nature of their work and compensation.

And, you've learned about the hazards of giving cash items or any other taxable fringe benefit to your volunteers.

Slide 23 – Additional Worker-Determination Resources

Leagle: Several resources are available to help you resolve questions about worker classification. These include free IRS publications you can read online, print out or request via mail.

Bobby: Is there anywhere I can go for help if I can't decide if a worker is an employee or an independent contractor?

Leagle: Yes. If you prefer, the IRS will determine a worker's classification for you. You can request a ruling by sending Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding* to the IRS. Also consider consulting your accountant or attorney for assistance. Note that federal and state agencies classify workers based on the facts of each case and the applicable law. Because of this, IRS determinations may differ from determinations made by state government agencies. If you plan to classify some of your workers as independent contractors, you may want to obtain separate rulings from the state agency and the IRS. See the below links for reference:

- <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee>
- www.irs.gov/businesses/small-businesses-self-employed/know-who-youre-hiring-independent-contractor-self-employed-vs-employee

Slide 24 – Identifying the 501(c)(3)'s Tax Responsibilities for Employees

Bobby: Okay, now that I know who is who, can we talk about my 501(c)(3)'s tax-related responsibilities regarding each type of worker?

Leagle: Sure, Bobby! Let's start with employees and the organization's duty to withhold and pay taxes for them.

Like other employers, 501(c)(3)s that pay wages to employees must pay federal employment taxes on those wages. These taxes are:

- Federal income tax
- Federal Insurance Contributions Act (known as FICA) taxes

Note that 501(c)(3)s are normally exempt from paying Federal Unemployment Tax Act (or FUTA) tax

Your 501(c)(3) generally must withhold and pay federal income tax from its employees' wages. 501(c)(3)s shouldn't withhold income tax for statutory employees. For more information, see [Publication 15 \(Circular E\)](#), [Employer's Tax Guide](#), and [Publication 15-A, Employer's Supplemental Tax Guide](#).

To figure out how much federal income tax to withhold, employers should ask employees to complete [Form W-4, Employee's Withholding Allowance Certificate](#). Ask each new employee to complete and sign a W-4 by his or her first day of work. Keep the form on file and send a copy to the IRS if the IRS directs you to do so in a written notice.

If a new employee fails to provide a completed Form W-4, your 501(c)(3) should assume single status with no withholding allowances.

Slide 25 – Withholding and Paying FICA Taxes

Bobby: Some of these taxes can be a bit confusing.

Leagle: Let me explain how they work.

FICA taxes go toward Social Security and Medicare. Your 501(c)(3) must withhold and pay these taxes from employees' wages, with one exception: If your organization pays an employee less than \$100 in any calendar year, then no FICA taxes are withheld for that employee. A 501(c)(3) must pay both the amount of FICA tax withheld from employees' wages and the organization's match of that amount.

Your 501(c)(3) must pay withheld income taxes, together with both the employer and employee portions of FICA taxes, electronically using the Electronic Federal Tax Payment System or by sending a check, money order or cash to an authorized depository.

Note that some taxpayers are required to deposit using the Electronic Federal Tax Payment System; see e-file for Charities and Non-Profits on the IRS website for details. The below links are for your reference as well:

- www.irs.gov/e-file-providers/e-file-for-charities-and-non-profits - Publication 3151, The ABCs of Federal Tax Deposits
- <http://www.irs.gov/pub/irs-pdf/p3151.pdf> - Notice 931, Deposit Requirements for Employment Taxes and <http://www.irs.gov/pub/irs-pdf/n931.pdf>

Slide 26 – Reporting Federal Income Taxes

Bobby: Now, I know what taxes to withhold. Is that all I have to do?

Leagle: Not quite. Once your 501(c)(3) deposits the federal income and FICA taxes, it must submit returns showing that it withheld and paid them. And remember, just as the 501(c)(3) pays federal income and FICA taxes together, it must report them together on the following forms:

- Form W-2, Wage and Tax Statement <http://www.irs.gov/pub/irs-pdf/fw2.pdf>
- Form 941, Employer's Quarterly Federal Tax Return <http://www.irs.gov/pub/irs-pdf/f941.pdf>

Bobby: How do the employees find out what taxes have been withheld and paid for them when they file their income taxes?

Leagle: Employees should receive a W-2, *Wage and Tax Statement*, from your organization by January 31st for the preceding calendar year. 501(c)(3)s use the W-2 external link to report employee wages and tips paid, income tax withholding, and FICA withholding. The W-2 also reports whether an employee is covered by a pension plan or receives other fringe benefits.

Organizations must also send copies of the W-2 for the preceding calendar year to the IRS by January 31. To mail your W-2s, send Copy A of the W-2 using Form W-3, *Transmittal of Wages and Tax Statements*. A copy of the W-2 must also go to the Social Security Administration. It's important to meet the requirements for the W-2; otherwise, penalties may apply. And don't forget to report federal income and FICA taxes on Form 941!

Slide 27 – Employment Eligibility Verification

Leagle: There's another important employment-related form your 501(c)(3) needs, the I-9, *Employment Eligibility Verification* (<http://www.uscis.gov/files/form/i-9.pdf>) Form.

The Federal Immigration and Nationality Act requires all employers to use the form for employees hired after November 6, 1986, to determine their status and verify their work eligibility. The Act prohibits employers from knowingly hiring people that aren't authorized to work in the United States. Organizations don't have to send their Form i9s to the IRS, but they do need to keep them on hand.

Both the 501(c)(3) and the employee must fill out the I-9, and the 501(c)(3) must keep it for three years after the date of hire or one year after the date employment ends, whichever is later.

Slide 28 – Knowledge Check

Which of the following taxes is a 501(c)(3) required to withhold and pay for its employees? (Choose all that apply.)

- a. Federal income tax
- b. Federal Insurance Contributions Act tax
- c. Federal Unemployment Tax Act (FUTA) tax
- d. All of the above

Pause to consider your answer or answers.

If you chose a and b, you are correct. Like other employers, 501(c)(3)s that pay wages to employees must pay federal employment taxes. However, 501(c)(3)s are exempt from paying FUTA tax.

Slide 29 – Knowledge Check

Select the statement that's FALSE regarding withholding and paying FICA taxes. (Choose all that apply.)

- a) FICA taxes are voluntary.
- b) 501(c)(3) must withhold and pay FICA taxes from employees' wages (but not Independent Contractor fees).
- c) 501(c)(3) doesn't withhold and pay taxes for employees receiving less than \$100 during the year.
- d) 501(c)(3) must pay withheld income taxes and the employer and employee portions of FICA taxes.
- e) Some organizations must make payments electronically using the Electronic Federal Tax Payment System.

Pause to consider your answer or answers.

If you chose a, you're right. FICA is a tax mandated by the federal government, so paying it is not an option, but a requirement.

Slide 30 – Knowledge Check

Select each of the following statements that correctly describe how the W-2 must be handled. (choose all that apply.)

The W-2 must be sent to employee by January 31st for the preceding calendar year.

- a) The W-2 is sent to the employee only.
- b) The Social Security Administration must receive a copy of the W-2.
- c) The W-2 must be transmitted to the IRS using Form W-3.

Pause your system to consider your answer.

If you chose a, b and c, you're correct. Remember that W-2s must be sent to the IRS by the last day of Feb. for the preceding calendar year or March 31 if filing them electronically.

Slide 31 – Recap

Leagle: Let's review. You know that 501(c)(3)s that pay employees must withhold and pay federal employment taxes on the wages. The taxes include:

- Federal income tax
- Federal Insurance Contributions Act (or FICA) taxes (which pay into Social Security and Medicare)

I mentioned that 501(c)(3)s are exempt from paying Federal Unemployment Tax (FUTA) and that they don't need to withhold income tax for statutory employees or employees earning less than \$100 during the year.

We also talked about reporting federal taxes, and how 501(c)(3)s must disclose the federal and FICA taxes withheld and paid by issuing a W-2, *Wage and Tax Statement*, to the employee by January 31st for the preceding calendar year. The 501(c)(3) must also send copies of the W-2 to the IRS by the last day of February (or March 31 if filing electronically) for the preceding calendar year.

One other important employment-related form the 501(c)(3) needs is Form I-9, *Employment Eligibility Verification Form*. The law prohibits employers from knowingly hiring or employing persons not authorized to work in the United States. 501(c)(3)s don't have to send Form I-9s to the IRS but do need to keep them on hand.

Let's try an exercise before moving on to the next section.

Slide 32 – Progress Check

Leagle: Well done! You've learned what 501(c)(3)s are required to withhold and pay for workers classified as employees.

You also learned the role of the W-2 Form in reporting taxes; that 501(c)(3) don't have to pay FUTA tax; and that Form I-9 is required and must be retained by 501(C)(3s).

Slide 33 – 501(c)(3)'s Responsibilities for Independent Contractors

Bobby: Okay, I understand my 501(c)(3)'s tax responsibilities for employees, so what do I do about independent contractors?

Leagle: The important thing to remember is that 501(c)(3)s need to report payments made to independent contractors, but they don't normally need to withhold or pay their federal employment taxes. I said "normally" because there are two important exceptions and both involve independent contractor identification.

First, if the independent contractor doesn't provide a Social Security or Employee Identification number or provides one that is obviously incorrect, like one with the wrong number of digits, your organization should withhold tax. This is called backup withholding, and it protects your organization if your independent contractors don't report their earnings to the IRS.

The second exception applies when the IRS notifies your organization that the identification numbers provided by the independent contractor are incorrect.

In both cases, your 501(c)(3) should send a notice to the independent contractor asking for a corrected number and it should backup withhold on future payments until the issue is resolved. A good link to reference for this information is:

<http://www.irsvideos.gov/SmallBusinessTaxpayer/Employers/BackupWithholding2011>

Slide 34 – Backup Withholding and Incorrect Employee Classification

Bobby: So, how much do I have to backup withhold and how do I get that money to the IRS?

Leagle: If your organization fails to get an independent contractor's identifying information, the backup withholding rate is 28%.

Your organization should file Form 945 and follow the normal deposit requirements for depositing the tax to the IRS and report the withheld amounts on Form 1099-MISC, which we'll talk about more in a minute.

You should also know that if your organization **incorrectly classifies** an employee as an independent contractor with no reasonable basis for doing so, the IRS may hold the organization liable for that worker's employment taxes.

That means your organization will have to pay the taxes, interest and the penalties. Refer to the below links for further information:

- [Form 945, Annual-Return-of-Withheld-Federal-Income-Tax](#)
- [Form 1099-MISC, Miscellaneous-Income](#)

Slide 35 – Reporting Independent Contractor Tax Payments

Bobby: So, once I have the correct documentation from my independent contractors, how do I report their pay?

Leagle: Before you report, make sure you meet IRS and state information reporting requirements on payments made to an independent contractor. These payments include all:

- Fees
- Salaries
- Commissions
- Wages

- Prizes
- Awards
- Any other forms of compensation

Generally, your organization has to report payments to independent contractors. The exceptions are if the contractor is a corporation or if you've paid the independent contractor less than \$600 during a calendar year. This exception doesn't apply to medical and attorney payments, even if the recipient is a corporation.

Also remember that the IRS requires 501(c)(3)s to report payments made to health care providers and attorneys, regardless of their corporate status.

Slide 36 – Is the Independent Contractor a Corporation?

Bobby: How do I find out if the independent contractor is a corporation?

Leagle: Good question! Simply have the independent contractor complete Form W-9, Request for Taxpayer Identification Number and Certification. He or she will indicate his or her business status as a sole proprietor, corporation or partnership, as well as his or her Social Security number or Employer Identification number and address. Remember that both the business status and the identification numbers must appear on the 1099-MISC. And keep in mind that if the independent contractor is a sole proprietor, the Social Security Number is preferred over an Employer Identification Number. The below links will help:

- [Form W-9, Request for Taxpayer Identification Number and Certification](#)
- [Form W-9 Instructions](#)

Your 501(c)(3) should keep completed W-9s in its records, but doesn't need to send them to the IRS.

Slide 37 – The Form 1099-MISC, *Miscellaneous Income*

Leagle: Earlier, I mentioned using Form 1099-MISC to report backup withholding for independent contractors. Your organization must use the same form to report payments made to its independent contractors. These payments will be reported as non-employee compensation. You're required to send the form to your independent contractor and the IRS.

You must send a copy for all payments made in the previous calendar year to your independent contractors by January 31 and file a copy with the IRS by January 31 if you are reporting payments in box 7. See the form instructions for additional deadline information. Use Form 1096 (<http://www.irs.gov/pub/irs-pdf/f1096.pdf>), *Annual Summary and Transmittal of U.S. Information Returns*, to deliver your 1099s to the IRS. Failure to comply with the requirements for Form 1099-MISC will result in penalties.

For more information on the 1099-MISC, see the Instructions for Form 1099-MISC <http://www.irs.gov/pub/irs-pdf/i1099msc.pdf> and Publication 1220, *Specifications for Electronic Filing of Forms* <http://www.irs.gov/pub/irs-pdf/p1220.pdf>.

Slide 38 – Form 1099-MISC Penalties

Bobby: You mentioned penalties for not complying with Form 1099-MISC requirements. What are those?

Leagle: Failure to **file** a correct Form 1099-MISC with the IRS by the due date and without reasonable cause, can result in a penalty of \$100 per document. This applies if your organization:

- Fails to file in a timely manner
- Fails to include all information required on the Form
- Provides incorrect information on the form

The same penalty applies for failing to **furnish** your independent contractors with a 1099-MISC. So, failing to both file AND furnish one 1099-MISC will result in a penalty of \$200 per form.

The maximum penalty is \$1,500,000 per year or \$500,000 per year for organizations with less than \$5 Million in gross receipts. If failure is found to be deliberate, there is no limit on the penalty.

Use this link for more details on penalties:

<http://www.irs.gov/instructions/i1099gi/ar02.html#d0e1828>.

Slide 39 – The 1099-MISC, the W-9 and Backup Withholding

Leagle: Here's an example of how your organization could become liable for an independent contractor's taxes:

Let's say that your 501(c)(3) mistakenly believed an independent contractor was a corporation – and your organization didn't report his earnings on a 1099-MISC - and the 1099-MISC and W-9 were never given to the independent contractor.

If you later find out that the independent contractor was incorrectly classified and your organization had a reporting requirement, your organization might be required to pay the backup withholding taxes because it never received the independent contractor's Social Security number, Employer Identification number or address. The penalties I just mentioned may apply, too.

Bobby: I guess I should always make sure the independent contractor completes and returns a W-9 to my organization before starting work and receiving any pay.

Leagle: That's the best insurance.

Slide 40 – Income Tax Recordkeeping

Bobby: It sounds like maintaining proper documentation is important.

Leagle: That's right, Bobby! It's very important to keep accurate and complete records for federal income tax and FICA taxes withheld and paid for each employee. Use your cursor to see a list of items your organization should keep for at least four years or use this link to review the Recordkeeping section on page 5 of Publication 15, Employer's Tax Guide:

http://www.irs.gov/file_source/pub/irs-pdf/p15.pdf.

The records you should keep for at least four years are:

- Your EIN
- Amounts and dates of all wage, annuity, and pension payments
- Amounts of tips reported to you by your employees
- Records of allocated tips
- The fair market value of in-kind wages paid
- Names, addresses, social security numbers and occupations of employees and recipients

- Any employee copies of Forms W-2 and W-2c returned to you as undeliverable
- Dates of employment for each employee
- Periods for which employees and recipients were paid while absent due to sickness or injury and the amount and weekly rate of payments you or third-party payors made to them
- Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, W-4(SP), W-4S and W-4V)
- Dates and amounts of tax deposits you made and acknowledgment numbers for deposits made by EFTPS
- Copies of returns filed and confirmation numbers
- Records of fringe benefits and expense reimbursements provided to your employees, including substantiation

Slide 41 – FICA and FUTA Tax Records to Retain

Bobby: That's quite a list. Is that all?

Leagle: Not quite. There are also records to keep for FICA taxes and for FUTA, even though 501(c)(3)s don't pay FUTA. Here's a couple more lists:

FICA tax records to retain:

- The amount of each wage payment subject to Social Security tax
- The amount of each wage payment subject to Medicare tax
- The amount of Social Security and Medicare taxes collected for each payment, and the date collected
- The reason, if the total wage payment and the taxable amount differ

FUTA tax records to retain:

- The total amount paid to your employees during the calendar year
- The amount of compensation subject to the unemployment tax and, if it differs from total compensation, why
- The amount you paid into the state unemployment fund
- Any other information required to be shown on Form 940 or Form 940-EZ

Bobby: Thank you, Leagle. With all this information in hand, I'm better prepared to handle the tax responsibilities that my 501(c)(3) organization has towards its employees.

Slide 42 – Knowledge Check

501(c)(3)s don't have to withhold and pay taxes for independent contractors, but there are two exceptions. What are the two exceptions?

- a) Worker provides incorrect Social Security or Employee Identification number
- b) Incorrect classification and backup withholding
- c) IRS notifies you that the identification numbers provided are incorrect
- d) Categorization and reserve payments

Pause to consider the exceptions.

If you chose a and c, you're right. If an independent contractor provides an incorrect Social Security or Employee Identification number, or if the IRS notifies you that the number was incorrect, you should backup withhold at the rate of 28%.

Slide 43 – Knowledge Check

Now that my 501(c)(3) has the correct documentation, what steps do we take to report payments to our independent contractor and to the IRS? (Choose all that apply.)

- a) Report all payments on Form 1099-MISC as non-employee wages.
- b) Send to independent contractor by Jan. 31 for all payments made in the previous calendar year.
- c) Send a copy to the IRS by Feb. 28 (Mar. 31 if electronic) for all payments made in the previous calendar year.
- d) Use Form 1096, *Annual Summary and Transmittal of US Information Returns*, to deliver your 1099-MISC to the IRS.

Pause to consider the answers.

If you chose a, b, c and d, you're right. Your organization will use Form 1099-MISC to report payments as "non-employee compensation." A copy goes to your independent contractors by Jan. 31, and a copy goes to the IRS by Feb. 28 (Mar. 31 if electronic) for previous calendar year payments. Form 1096 is used to deliver your 1099s to the IRS.

Slide 44 – Knowledge Check

Failure to file a correct Form 1099-MISC by the due date without a reasonable cause can result in a fine of \$_____ per document, with a maximum of _____.

\$150 for each document, \$500,000 maximum (\$250k for small organizations)

- a) \$100 for each document, \$1,500,000 maximum (\$500k for small organizations)
- b) \$50 for each document, \$10,000 maximum (\$5k for small organizations)
- c) \$50 for each document, \$50,000 maximum (\$150k for small organizations)

Pause to consider the answer.

If you chose b, you're correct. Generally, a penalty of \$100 per document applies (max of \$1,5M; \$500k for small organizations) if your organization fails to file in a timely manner, fails to include all information required to be shown on the Form 1099-MISC, or provides incorrect information on the form.

Slide 45 – Knowledge Check

What backup withholding percentage does my 501(c)(3) use for an independent contractor who didn't provide an accurate Social Security or Employer Identification number for the 1099-MISC?

- a) 33%

- b) 15%
- c) 28%
- d) 40%

Pause to consider the answer.

If you chose c, you're right. A 501(c)(3) needs to backup withhold 28% from the independent contractor's pay and report that withholding on the 1099-MISC if not given an accurate identification number.

Slide 46 – Recap

Leagle: Let's go over what we just discussed regarding independent contractors:

First, I pointed out that while all organizations must report payments made to independent contractors, most organizations don't have to withhold taxes for them – but, there are two important exceptions. Both are related to the independent contractor supplying incorrect identification numbers.

You also learned that 501(c)(3)s may need to meet IRS and state information reporting requirements and that it's important to have independent contractors complete Form W-9, *Request for Taxpayer Identification Number and Certification*, to determine corporation status.

Next, we reviewed the Form 1099-MISC, its function, and the possible penalties for not filing it correctly. From there, we saw how not having a proper W-9 and 1099-MISC can result in the 501(c)(3) organization paying backup withholding taxes to the IRS using its own resources.

Bobby: Don't forget that we also went over a list of records that must be kept for four years - including federal income, FICA and FUTA taxes (even though 501(c)(3)s don't pay FUTA).

Leagle: Good point, Bobby! Let's test you on another set of knowledge checks.

Slide 47 – Progress Check

Leagle: Well done! You've learned that most 501(c)(3) don't have to withhold and report taxes for independent contractors, but there are two exceptions that involve improper identification.

You discovered that the 501(c)(3) may need to meet IRS and state information reporting requirements on payments it's made to an independent contractor.

You also learned about Form 1099-MISC, its function, and the possible penalties from its improper use.

Finally, you learned about the records you must keep for federal income, FICA, and FUTA taxes for at least four years.

Slide 48 – Resources

Leagle: We've covered a lot of information. The resources listed throughout the lesson are also below.

- Independent or Employee criteria: <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee>

- IRS Know Who You Are Hiring guidelines: <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Know-Who-You're-Hiring-Independent-Contractor-Self-employed-vs-Employee>
- IRS e-File providers: www.irs.gov/e-file-providers/e-file-for-charities-and-non-profits
- Publication 3151, The ABCs of Federal Tax Deposits - <https://www.irs.gov/forms-pubs/about-form-945>
- Notice 931, Deposit Requirements for Employment Taxes - www.irs.gov/pub/irs-pdf/n931.pdf
- Form W-2, Wage and Tax Statement - www.irs.gov/pub/irs-pdf/fw2.pdf
- Form 941, Employer's Quarterly Federal Tax Return - www.irs.gov/pub/irs-pdf/f941.pdf
- I-9, *Employment Eligibility Verification* - www.uscis.gov/sites/default/files/files/form/i-9.pdf
- IRS Videos – Backup withholding presentation - www.irsvideos.gov/SmallBusinessTaxpayer/Employers/BackupWithholding2011
- Form 945, Annual Return of Withheld Federal Income Tax - <https://www.irs.gov/forms-pubs/about-form-945>
- Form W-9, Request for Taxpayer Identification Number and Certification <http://www.irs.gov/pub/irs-pdf/fw9.pdf>
- Instructions for the Requester of Form W-9 - <http://www.irs.gov/pub/irs-pdf/iw9.pdf>
- Form 1096, *Annual Summary and Transmittal of U.S. Information Returns* - <http://www.irs.gov/pub/irs-pdf/f1096.pdf>
- Form 1099-MISC, <http://www.irs.gov/pub/irs-pdf/i1099misc.pdf>
- Publication 1220, *Specifications for Electronic Filing of Forms* - <http://www.irs.gov/pub/irs-pdf/p1220.pdf>
- For penalty information - <http://www.irs.gov/instructions/i1099gi/ar02.html#d0e1828>
- Recordkeeping: section on page 5 of Publication 15, Employer's Tax Guide at http://www.irs.gov/file_source/pub/irs-pdf/p15.pdf

Slide 49 – Conclusion

Leagle: On behalf of Bobby and everyone in the IRS Exempt Organizations division, thank you for taking this “*Employment Issues*” Course.

If you have any feedback for the Exempt Organizations team, feel free to [send us an email](#).

After you complete this review, print out your own [Certificate of Completion](#) as recognition for attending.