Gig Worker Filing Guide

How to Know If You're an Employee or a Contractor

Here's why your "worker status" matters: If your employer says you're an independent contractor (Form 1099-NEC income), but you think you're an employee (Form W-2 income), you may be surprised by a large tax bill when you file your return.
That's because independent contractors have to pay their own income tax and self-employment taxes during the year, while employers withhold and cover parts of these taxes for employees.

Millions of workers are surprised every year when they get a Form 1099-NEC (before 2020 this was the 1099-MISC) and end up with a tax bill because they haven't paid enough (or any) taxes on that income. Also, if you don't pay estimated taxes during the year, you can get an estimated tax penalty.

So, it’s important for employers and employees to get worker status right because the consequences can be expensive. Many times, employers make the decision on a worker’s status. But it’s a “facts and circumstances” test, and each person’s situation is different.

It’s important to be proactive and have a clear understanding of your status as an employee or an independent contractor. To do that, you need to know the rules.

Are you an independent contractor or an employee

You need to look at three factors. All of them basically boil down to whether you or the business that pays you has more control.

1. Who has the right to control your behavior at work?

The IRS is more likely to consider you an employee if:

- The business gives you instructions on when and where to work, what tools to use and/or where to purchase supplies and services.
- Instructions from the business are highly detailed.
- Evaluation systems measure how you do the work, rather than just measuring the results.
- The business trains you on how to do the job. It’s even more likely you’re an employee if the training is ongoing and involves procedures and methods.

2. Who has the right to control financial and business aspects of your job?

The IRS is more likely to consider you an employee if:

- You don’t significantly invest in your work equipment.
- You don’t have many unreimbursed expenses.
- You don’t have the opportunity for profit or loss.
- Your services aren’t available to the market.
- The business guarantees you a regular wage for hourly, weekly, or other periodic work, even if you also get a commission. Independent contractors often charge flat fees for a job.

3. What’s your relationship with the business?

The IRS is more likely to consider you an employee if:

- You have a written contract that states you're an employee (but this alone can't determine your status).
- You receive employee-type benefits, such as insurance, a pension plan, or vacation or sick pay. Companies generally don't grant these benefits to independent contractors.
- You and the company expect that the relationship will continue indefinitely, rather than for a specific project or period.
- You provide services that are a key activity of the business.

Some of the factors aren't as clear cut as others. Some may point toward employee status, while others indicate you're an independent contractor.

The IRS weighs worker status on a case-by-case basis. If you're unsure about your situation or want a professional opinion, a tax pro can help.

What to do if you think you're incorrectly classified

If your employer treated you as an independent contractor but you think you're really an employee, here's how to file your return:

- Report your earnings on your tax return using Form 8919, *Uncollected Social Security and Medicare Tax on Wage*. This form allows you to calculate and report your taxes as if you were an employee.
- Next, contest your status as an independent contractor by filing a Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes, and Income Tax Withholding*. On Form SS-8, you'll provide the IRS with the facts to determine whether you're an employee or an independent contractor.

If you've already filed your return without Form 8919, file an amended return (Form 1040X) with a Form 8919. After that, file Form SS-8.
Don't submit Form SS-8 with your tax return because it will delay processing. Instead, send the form to the address on the Form SS-8 Instructions.

What happens when you file Form SS-8

The IRS will let you know when it receives your Form SS-8 and will assign a technician to review the case. During its review, the IRS may request more information from you, and will ask your employer for the same information on your Form SS-8. In doing so, the IRS may share some or all the information on your Form SS-8 with your employer.

It can take at least six months to get a determination from the IRS. Once the IRS decides how to classify you, the IRS will send a letter to your employer and a copy to you letting you know about its decision.

If you disagree, you can identify facts from the original submission that you don't think the IRS fully considered or provide new information and ask that the IRS reconsider the decision.

The results

If the IRS decides you're an employee, you won't owe any more taxes after you filed Form 8919 with your return.

If you're a contractor, you'll owe self-employment taxes.

Gig economy turn workers into small business owners

Gig economy jobs have boomed in recent years and even more so since the onset of the coronavirus pandemic. With new business opportunities from companies such as Uber, Airbnb, and Door Dash, taxpayers are finding it easier than ever before to work for themselves. As workers take on these new jobs, they're probably not thinking of what the gig economy means for their taxes.

Many people are surprised that as an independent contractor, they actually own a small business in the eyes of the IRS. And small businesses have extra tax rules – and potentially more IRS audits and notices. This is true whether your gig economy job is your primary source of income or your side hustle.

It's important to know that filing taxes as an independent contractor can get complicated. You'll usually have more requirements to file and pay taxes. That means things like:

- Quarterly estimated tax payments
- Payroll tax deposits and filings
- Reporting payments to contractors each year
- Reporting sales tax
- State and local licensing requirements

Because of all these rules, you'll interact a lot more with the IRS and your state. And, these tax authorities are much more likely to question you.

The 6 most common problems when filing taxes

1. **"I didn't know I had to pay self-employment taxes."**

This is a common miss for people who are newly self-employed.

You may be surprised when you file a return and find out that, on top of your income taxes, you'll owe another 15.3% tax. This is called self-employment tax and it covers Social Security and Medicare taxes. It can result in a large tax bill if you didn't know about it.

If you were an employee, you'd pay half of this amount, and your employer would pay the other half. As a self-employed person, both are your responsibility. On the bright side, a special tax deduction for independent contractors (self-employed individuals) lets you deduct half of your self-employment tax to offset your income.

2. **"I didn't know I had to pay throughout the year."**

Instead of having taxes automatically withheld (like employees do), self-employed people must send in tax payments four times a year (called estimated tax payments).

If you didn't know or forgot about sending in your quarterly payments, the best time to learn about estimated payments is now. But take note: missing these payments for several months may mean you'll owe a big tax bill plus likely penalties when you file.
If you can't pay, you can ask for an extension or set up a monthly payment plan (called an IRS installment agreement) when you file.

3. **"I keep getting behind in paying taxes."**

Self-employed people sometimes get behind in paying estimated taxes. When they do, they often file and end up with large tax bills they can't pay.

If you already have a payment plan with the IRS but then file, owe and fail to pay, you could be considered as defaulting on your agreement. You'll spend more money to set up a new installment agreement, owe more penalties and interest, and interact more with the IRS. If you owe tax on a later return, you can potentially add it to your current installment agreement, but again it is likely more penalties and interest would be assessed.

If your tax bill adds up to more than $50,000, there are other consequences. The IRS may ask for more information about your financial situation to set up a payment plan, and the IRS can file a federal tax lien, which typically hurts your ability to get credit.

4. **"I didn't report cash payments."**

Depending on the type of job you have, the IRS may receive copies of forms that validate your income – such as Form 1099-NEC or Form 1099-K. However, many small businesses, especially gig economy job workers that operate in cash, are on the honor system for reporting their income.

And with cash-intensive businesses, the IRS has few, if any, Forms 1099 to validate the income. It makes sense then, that every IRS audit of small businesses starts with scrutiny about whether the business reported all its income.

5. **"I 'wrote off' personal expenses."**

This is another major area where the IRS looks in small business audits.

New small-business owners often deduct certain expenses, like cars, cell phones, in-home offices, and travel and meal expenses. But the IRS views many of these expenses as personal (and not deductible) – unless you can prove that the expenses were business-related.

The takeaway: Keep excellent records.

6. **"I didn't file on time (or, at all)."**

Many small businesses put off filing because they can't pay their taxes. Procrastinating like this causes many businesses to run up large tax bills and penalties. The failure to file penalty is 5% per month (or partial month) that the return is late. If you file your return more than 60 days late (including extensions), the minimum penalty is 100% of your unpaid tax or $435, whichever is smaller. As you can see, it's better to file on time even if you can't pay right away.

As mentioned above, the IRS receives information about your income through various tax forms. For example, in recent years, the IRS has identified many nonfliers with Form 1099-K, which reports payments the business receives from debit/credit cards and third-party processors, such as PayPal.

Many online-retail small businesses are now having to reconcile their revenues to this form. Independent contractors that don't file taxes and receive this form are experiencing IRS delinquent-filing notices and IRS enforcement actions.

What are self-employment taxes?

Self-employment tax is a tax consisting of Social Security and Medicare taxes primarily for individuals who work for themselves. It is similar to the Social Security and Medicare taxes withheld from the pay of most wage earners.

How do you determine self-employment taxes?

Self-employment taxes are figured on Schedule SE.

Who must file self-employment taxes?

If your net earnings from self-employment equal $400 or more, you must do both:

- File Schedule SE
- Pay self-employment tax

This is true regardless of your age, and even if you're receiving Social Security benefits.

You're considered self-employed if you own your own business or the company you work for classifies you as an independent contractor. Because tax is usually not withheld from self-employment income (nonemployee compensation), you're required to make estimated tax payments during the year to cover your federal income tax and self-employment tax.

What is the self-employment tax rate?

For 2020, the self-employment tax rate is normally 15.3%. The rate is made up of both:

- 12.4% Social Security tax

- 2.9% Medicare tax

For 2020, the maximum amount subject to Social Security tax is $118,500. However, all self-employment income in excess of $400 is subject to Medicare tax.

To figure net earnings from self-employment, multiply your net business profit by 92.35%. You use this percentage since an employee is only required to pay one of these:

- 1/2 of Social Security and Medicare taxes
- 7.65% of wage income

A self-employed individual must pay "both halves," or 15.3%. So, the law equalizes the tax burden by reducing the income subject to tax by 7.65%. Here's the formula:

100% – 7.65% = 92.35%

You can deduct the employer portion of your self-employment tax as an adjustment to income on Form 1040. The amount you can deduct is usually 1/2 of the employer portion. This decreases your taxable income and, as a result, your federal income tax.

What happens if you don't pay self-employment tax?

If you don't pay self-employment tax, you could run into issues. In fact, taxpayers sometimes don't understand this rule, and end up with a notice from the IRS.