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Tax & Business Alert

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THE HIGH COST OF WORKER MISCLASSIFICATION: TAX IMPLICATIONS AND RISKS

The consequences of misclassifying an employee as an independent contractor can be costly. You could be liable for back taxes (including the employee's shares of unpaid payroll and income taxes), penalties and interest. There may be serious nontax consequences as well.

HOW IMPORTANT IS THIS?

Businesses must withhold federal and state income taxes and the employee's share of Social Security and Medicare taxes from employee wages. They must also pay the employer's portion of Social Security, Medicare, and unemployment taxes for employees. Generally, none of these obligations apply to the business for workers who are independent contractors.

Misclassifying an employee as an independent contractor can result in liability for unpaid payroll taxes, penalties and interest. You may also owe the employee's share of taxes.

Beyond taxes, misclassification can mean liability for minimum wages, overtime pay, benefits, workers' compensation, and state disability insurance. Ensuring proper classification helps avoid costly legal and financial consequences.

WHAT FACTORS SHOULD YOU CONSIDER?

Determining the correct classification requires reviewing the key factors that the IRS evaluates. No single factor is conclusive; all must be taken into account.

Here are the three categories of factors the IRS assesses:

1. Behavior control. Who controls what work is done and how it's performed? A higher degree of control suggests the worker is likely an employee. It's important to consider how much training and education the business provides a worker to do the job.

2. Financial control. Who controls the economic aspects, such as how the worker is paid and how expenses are reimbursed? Independent contractors generally have financial risk. They may work for flat fees and work for more than one business.

3. Types of relationships. Workers hired for an indefinite period and performing core business functions are likelier to be employees.

HOW REMOTE WORK AFFECTS CLASSIFICATION

It's tempting to think that if a person works for you remotely, he or she automatically qualifies as an independent contractor. Not so fast! Even if the individual chooses to work remotely, the classification is still subject to scrutiny.

The key considerations are the same as for on-site workers, such as whether you – the business owner – have the right to control the details of the worker's services and how they're performed. Don't risk a mistake. Your trusted tax advisor can answer your questions.

Labeling a worker as an independent contractor in a written contract doesn't make it so. However, it may serve as evidence in a dispute between parties.

WORRIED YOU'LL MAKE A MISTAKE?

Don't underestimate the importance of this issue. The consequences of misclassification can indeed be severe. Using a reasonable basis for classifying workers may relieve penalties and employment taxes.

You can ask the IRS to weigh in by filing Form SS-8, "Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding." Before you do this, a better option may be to ask your trusted tax advisor to review the details.

BEYOND FEDERAL TAXES

Even if you're confident in your classification of workers for federal tax purposes, it's essential to consider how they're treated under state taxation and federal and state wage and hour regulations. Classifying workers as employees in some cases and independent contractors in others can create significant administrative challenges, so evaluate their status comprehensively before making a final decision. ■

TRAVELING WITH YOUR SPOUSE ON BUSINESS? KNOW WHAT'S DEDUCTIBLE

If you own a company and travel for business, you may wonder whether you can deduct all the costs of having your spouse accompany you on trips. It's possible, but the rules are restrictive.

WHEN YOUR SPOUSE IS ALSO YOUR EMPLOYEE

If your spouse is your employee, you may be able to deduct most of his or her travel expenses. But there are strict rules: You can deduct travel costs only if his or her presence on the trip serves a bona fide business purpose. For example, if you're attending a trade show and your spouse is one of your company's leading sales reps, negotiating and closing sales at the show would likely qualify as a bona fide business purpose.

But it isn't sufficient for your spouse to merely be "helpful" in incidental ways, such as by typing your meeting notes.

Similarly, a spouse's participation in social functions, such as being a host or hostess, generally isn't enough to establish a business purpose. That is, if his or her purpose is to develop general goodwill for customers or associates, this is usually insufficient. Further, if there's a vacation element to the trip (for example, if your spouse spends time sightseeing), it will be more challenging to establish a business purpose for his or her presence on the trip.

On the other hand, a bona fide business purpose exists if your spouse's presence is necessary to care for your serious medical condition while you're traveling for business.

If these tests are satisfied in relation to your spouse, you can claim the typical deductions allowed for business travel away from home. These include the costs of transportation, meals, lodging and incidentals such as dry cleaning and phone calls.

WHEN YOUR SPOUSE ISN'T YOUR EMPLOYEE

If your spouse *isn't* your employee, then even if your spouse has a bona fide business purpose for making the trip with you, you won't likely qualify to deduct all of his or her travel costs. But you may still be able to deduct a substantial portion of the trip's costs. This is because the rules don't require you to allocate 50% of your travel costs to your spouse, only any *additional* costs you incur for him or her.

For example, in many hotels, the cost of a single room isn't much lower than a double. If a single room would cost you $150 a night and a double room would cost you and your spouse $200, the disallowed portion of the cost allocable to your spouse would only be $50. In other words, you can write off the cost of what you'd have paid traveling alone. To prove your deduction, ask the hotel for a room rate schedule showing single rates for the days you stay.

If you drive your car or rent one, the cost will be fully deductible even if your spouse is along. Of course, public transportation, meals and any separate expenses incurred by your spouse won't be deductible.

WHAT CAN YOU DEDUCT?

While the employee and bona fide business purpose requirements prevent tax deductibility of a spouse's travel costs in most cases, there are circumstances when some expenses can be deducted. Contact us if you have questions about this or other tax-related topics. ■

YOUR RETURN IS FILED! 3 THINGS TO KEEP IN MIND POST-FILING

Most people feel some relief after filing their income tax returns each year. But even if you've successfully filed your 2024 return, you may still have questions. Here are three common ones:

1. What's the status of your refund? You can learn the status of your tax refund using an IRS online tool. Go to irs.gov and click on "Get Your Refund Status." You'll need your Social Security number, filing status and refund amount.

2. What if you forgot to report something? In general, you can file an amended tax return and claim a refund within three years after you filed your original return or within two years of the date you paid the tax, whichever is later. So, if you filed your 2024 tax return on April 15, 2025 (the due date for 2024 returns), and barring any changes in the rules, you'll generally have until April 18, 2028 (because April 15 is a Saturday and April 17 is a holiday in Washington, DC) to amend your return.

However, there are a few situations when you're allowed more time to file an amended return. One example is claiming a bad debt deduction. Generally, you may amend your tax return to claim a bad debt for seven years from the tax return's due date for the year the debt became worthless.

3. How long must you keep tax records? Retain tax records as long as the IRS can audit your return or assess additional taxes. The statute of limitations is generally three years after filing, meaning most 2021 tax year records can now be discarded if you filed by the April deadline

in 2022. If you filed an extension, keep records from the extended due date for three years.

The statute extends to six years for substantial under-reporting (over 25% of gross income). There's no time limit if you never filed or filed fraudulently. So, keep actual tax returns indefinitely to prove legitimate filing.

Retirement account records should be kept until the account is depleted, plus three (or six) years. Real estate and investment records should be kept for as long as you own the asset, plus at least three years after selling — or six years to be extra cautious.

Being diligent with recordkeeping can help you avoid IRS issues down the line.

QUESTIONS? WE'RE HERE

Contact us if you have further questions about your refund, filing an amended return or record retention. We're here all year! ■

HELPING A FAMILY MEMBER BUY A HOME

Making a family loan isn't the only way to assist a loved one with purchasing a home. If you aren't concerned about being paid back, a straightforward option is gifting cash. In 2025, you can give up to $19,000 to anyone without federal gift tax consequences under the gift tax annual exclusion.

If your loved one is married, you can gift up to $38,000 to the couple tax-free. If you're married, you and your spouse can jointly give up to $76,000 to the couple, all without federal gift tax consequences (4 x $19,000).

Gifts exceeding these limits reduce your lifetime gift and estate tax exemption, which for 2025 is $13.99 million ($27.98 million for married couples) and will require filing a gift tax return.

Alternatively, if your financial situation allows it, you can purchase a home and gift it to your loved one. This transfer can be gift tax-free through a combination of your available annual exclusion and gift and estate tax exemption. It would reduce your gift and estate tax exemption by the amount of the home's value minus your yearly exclusion. So, a single taxpayer who gifts

a home worth $500,000 can subtract his or her $19,000 annual exclusion and reduce his or her lifetime exemption by $481,000 ($500,000 - $19,000).

Another option is to buy and rent a home to your family member. You can then allow the loved one to inherit it in your will when you pass away. However, this approach has federal income tax implications.

State tax consequences must also be considered. Each option has pros and cons — consult us to explore the best approach for your situation. ■