EMPLOYMENT ISSUES

With Independence Comes Responsibility - Negotiate and Verify the Terms

For the independent instructor, employment law is there to protect you as a worker and tax law is there to ensure you pay what the IRS considers fair. Here's a quick education in both.

By John Torsiello, Contributing Writer

It is perhaps the most dreaded message a golf professional can receive by mail—notice from the Internal Revenue Service that you've been flagged for a tax audit.

That unwelcome letter sparks visions of anxious hours spent gathering documents, searching for receipts you probably tossed and meeting with stone-faced bureaucrats who pore through every detail of your professional life.

For golf instructors who are employed on a staff and paid a salary, the IRS audit is a very slight possibility. Those of you who operate as independent contractors are the ones likely to attract attention from fed auditors. There is an array of benefits as well as drawbacks to functioning (and being classified) as independent and self-employed. But if you opt for independent-contractor status rather than employee status—or if the club chooses that option for you—you're advised to make very sure what you can and cannot deduct on Schedule C of your tax return.

Meanwhile, any golf professional who's involved with teaching activities that use non-employee instructors needs to understand how federal employment law views the relationship between a golf facility (or academy) and the lesson-giving pros who are on property plying their trade.

PROPONENT GROUP MEMBERS SPEAK TO THE TAX-AUDIT ISSUE

Erika Larkin, Director of Instruction at Stonewall Golf Club in Gainesville, Va., had to endure a two-year audit by the IRS and called the entire process "aggravating and upsetting." Larkin found out in the fall of 2009 that she and her husband were being audited for two years' worth of income and deductions. "The matter became somewhat clouded," says Larkin, "because we also own a family business, a restaurant, and they were eyeing our business deductions, such as a home office we keep."

She said the IRS came to her and her husband's home and measured the square footage of their home office. "One of the big issues the IRS had with some of my personal write-off expenses was golf clothes. I put them down as uniform expense because I wear them when I'm teaching and to promote the companies I have relationships with. I wrote off sunglasses to protect my eyes when I'm teaching and they wouldn't accept that as equipment for my job." In the end, the Larkins wound up paying no more than what they paid their accountant to help with the issue. "It was an amazing waste of time."

Larkin advises golf professionals to keep detailed records, electronically if possible, so that they can be quickly retrieved if and when needed. And she advises you to be sure such seemingly insignificant matters as deductions for work clothing and equipment can pass muster with IRS officials wielding sharp pencils.

Independent Contractor Erika Larkin recommends keeping detailed records of all your deductions.

Another Proponent Group member who preferred not be identified for this article said his place of employment endured a long auditing process by the IRS. In hindsight, he sensed that payment in cash by his students was the precipitating factor in the decision to audit him. But it was also his independent-contractor status that stirred the pot.

"The simplest way, in my view, for the IRS to generate additional tax revenue is to target businesses with independent contractors and force them to justify the classification," he surmises. This could be presented as an effort to protect the worker, given that Social Security and Medicare benefits depend in good part on regular infusions of funds via payroll deduction. He asserts that businesses using contractors to do a job that people often do as a salaried employee are subject to the "very subjective '20-Factor' test," wherein an

audit is done on everything from timesheets and payroll transaction to "control" of the workforce and "everything in between." This allows the IRS to make a subjective judgment as to whether or not workers are classified correctly. Part and parcel of that is judging whether or not sufficient tax dollars have been withheld.

More Specifics and Examples Online

This article is an excerpt of a longer and more detailed Business Guide prepared and researched for Proponent Group members. You can access the complete Guide to an Instructor's Status as an Employee vs. Independent Contractor by clicking on Business Guides in the member-only website.

In 2012, this Proponent member's business was asked to justify its classification for the tax year 2010 and satisfactorily did so. But a year later they were asked to do so again for years 2011 and 2012.

"It was an incredibly painstaking process and took roughly 10 months," he reports. "It is necessary to account for everything, at all times. But in all honesty, there did not seem to be good reason for additional scrutiny from the IRS, especially with a past successful defense of the workforce classification." The longer the ordeal went on, the more this golf instructor felt there was some correlation between type of organization—in this case an S Corp—the deployment of an independent contractor workforce, and IRS scrutiny. "In our case, and possibly a few others from my research, S Corporations set off many of the IRS's red flags," he says, "which may cause them to want to take a look. Otherwise, it might just come with the territory."

Those who have undergone this scrutiny agree it is important to decide early on the type of business/academy being operated (proprietorship, LLC, S Corp, etc.) and to choose whether you're using independent contractors or employees. Take an honest look at why you are making your decision, because the IRS may one day ask you how you came to that choice. If this decision is long since made, you are advised to seek safe harbor before acquiescing to the demands of the auditors if you believe you meet the criteria for safe harbor.

Parity is hugely important, as is documentation if you go the independent contractor route. "Everyone's the same and they have been made hyper-aware of how they are classified," our Proponent Group member reports. "That means W-9s for all involved, a signed statement of understanding, and equal treatment when appropriate, which, in my opinion, is across the board."

A SUMMARY OF THE ISSUE

The "tax gap" is a point of contention between the IRS and businesses claiming the use of independent contractors. For the last three years, the IRS has audited employers with heavy usage of independent contractors in an attempt to identify any "misclassification." There are several guidelines regarding the classification of a workforce but no specific requirements. There are also tests and case law that come into play.

Ken Heuer, a CPA with Brock and Company of Colorado, warns that golf professionals "have a new risk in that the IRS will be looking into individual tax returns that show one IRS Form 1099MISC. The IRS wants to know why the person only did work for one company, i.e., is this person an employee?" He adds that there is a national joint task force involving the Internal Revenue Service, the U.S. Department of Labor, and state revenue and labor departments that is charged with "going after noncompliant businesses on independent contractor issues."

The risks to the club or a business can be significant, including:

1. Additional Federal and state payroll taxes.
2. Penalties and interest for not paying in the payroll taxes.
3. Possible additional audits as a result of the payroll tax audit–i.e. an audit of the income tax returns of the club or business.
4. The audits will cover three years, possibly more years depending on filing issues related to the statute of limitations.
5. Possible personal liability for the taxes, interest, and penalties to the club's GM, CFO, and board members.
6. Additional costs for workmen's compensation insurance, general liability insurance, other overhead costs, etc.

Says Heuer: "This has been going on for a long time and the IRS has put this problem in their top five audit priority list. The possible tax monies along with the related penalties and interest to be recovered are generally large and worth the tax authorities' time and resources to go after non-compliant businesses."

Heuer reports that a client came to his firm with the results of an IRS audit assessing $80,000-plus in penalties and interest and additional taxes of approximately $200,000 related to employees being misclassified as independent contractors. Heuer's advice was to settle the case. "My client did not believe me and decided to litigate the case and spent $70,000-plus in legal fees to find out that I was right."

Mitchell L. Stump, a Florida-based CPA with Club Capital Planners and author of the "Club Tax Book," says a common mistake made by golf pros and their employers in setting up classifications for tax purposes has involved lesson income getting placed in a separate, off-paycheck stream. "Many clubs were reporting lesson income on Form 1099 and designating the professional—for purposes of lesson revenue—as an independent contractor. The rule of thumb is this: Once you pay a person as an employee, all pay they receive is as an employee."

Knowledge of guidelines for independent contractor/employee tax status, choosing the correct status that meets your day-to-day duties and responsibilities, and keeping detailed records of all expenditures and income can go a long way toward keeping that dreaded letter from the IRS away from your mailbox.