

Is that an employee or an independent contractor?



The pandemic is only exacerbating the ancient question of whether a worker is an employee or independent contractor. (We think this must have been etched onto the Rosetta Stone, which is, no kidding, the first known written tax code). Some employees who've been let go or who retired because of the coronavirus pandemic are being welcomed back by their old employers as consultants.

This may solve a temporary problem for you, since you're still getting the benefit of their skills. But your former employees' problems have just begun.

You can help smooth the transition from employee to consultant by explaining the rudimentary tax rules for the self-employed.

It's going to be a bumpy ride

Quite apart from the how the IRS feels about any of this—it usually frowns on terminated employees coming back as independent contractors—the transition from employee to independent contractor can be quite jarring. If you've only ever been an employee, you probably haven't thought much about your taxes. After all, they're withheld from your pay.

Once someone has gone independent, that is no longer the case. Newly minted consultants are responsible for

paying their own federal and state quarterly estimated taxes. And the size of those checks can be eye-popping. The quarterly check to the U.S. Treasury will be especially hefty, since they're paying income and SECA taxes—the equivalent of the employer's and employee's portion of FICA.

It takes discipline and a fairly good sense of humor to write these checks. The good news is they can deduct half the SECA taxes on their 1040s, so they're really still only liable for the employee's portion of FICA.

Although they may ask, there is no mechanism that will allow you to withhold taxes from their checks. The IRS issued regulations years ago allowing it to define the circumstances under which such voluntary withholding would be permitted, but it never followed up with it. There is also no mechanism that will allow you to continue their employee health and retirement benefits.

You may reimburse them for their invoiced business expenses, but those reimbursements are income, which must be reported on [Form 1099-NEC](#). These expenses can be then deducted on [Schedule C](#). They will also have to attach [Schedule SE](#) to their 1040s.

Once an employee, always an employee

Have you bought worker classification trouble with the IRS? Possibly.

The IRS takes a rather expansive view of the employment relationship and with good reason—it gets its money upfront, through withholding:

- You can't give pricey gifts to employees, because the IRS will consider those gifts to be compensation.
- Payments made after an employee terminates are still considered taxable and reportable as wages.
- You usually can't engage the services of a former employee to do the exact same job they did as an employee.

Is there any hope you could beat the odds? Maybe a teeny, tiny sliver.

Although it's not directly on point, because the individual was still employed, the IRS did give a little slack in a 2012 [general information letter](#), in which it concluded that an individual who was working as a professional consultant on two separate consulting jobs for the same employer could, indeed, hold dual status in a company.

IRS: In instances where an individual provides services in two separate roles to the same business, each relationship is examined based on facts that fall into the three categories of evidence. If an employer-employee relationship is found with regard to only one set of services, compensation with regard to those specific services will be subject to payroll taxes.

The problem with information letters, as well as private letter rulings, is they're intended as private advice from the IRS to the requesting party. You can't use or cite them as precedent. You may, however, use them for informational purposes.