



## ANNUAL INFORMATION RETURNS NEWSLETTER

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*Please contact us if you have any questions.*

### California Worker Classification Independent Contractor vs. Employee

In California, a new law – A.B. 5 – took effect on January 1, 2020, making it significantly more difficult for businesses to classify workers as independent contractors. Under A.B. 5, most workers are presumed to be employees unless the hiring entity meets a three-factor test known as the ABC test. Under this test, the following three factors must be met: A) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; B) the worker performs work that is outside the usual course of the hiring entity’s business; and C) the worker is customarily engaged in an independently established trade, occupation, or business of the exact nature as the work performed. If workers pass the ABC test, they can be classified as independent contractors and issued a Form 1099. Otherwise, the worker must be made an employee. There are exemptions from the ABC test under California legislation for qualifying industries and workers. You may find a list of exemptions at <https://www.caltax.com/files/2020/abcexemptions.pdf>. If your line of work falls under the exemption purview, you must use the Borello test to determine independent contractor status. Please note that at the time of this letter, app-based drivers that fall under Proposition 22 are generally classified as independent contractors. However,

there is a chance that Proposition 22 may be struck down as it is currently being debated in the courts. Significant fines may apply if a worker is incorrectly classified, so please contact us if you have questions about specific circumstances.

### Forms W-2 and W-3

As a reminder, the IRS requires that all compensation to employees, including Christmas bonuses, year-end bonuses, auto allowances, and the personal use of company owned vehicles be reported as wages on Form W-2, subject to both FICA and income tax withholding.

### Personal Use of Company Owned Vehicle

If you have employees who use company-owned vehicles, we recommend that a written policy regarding the personal use of automobiles be implemented. This written policy should document the valuation method to be used and establish procedures for required records to be maintained by the employee and submitted to the employer. If you have any questions about how to calculate the value of the personal use of vehicles or would like some more information on company automobile policies, please contact us.

### Expense Reimbursements

Reimbursements to employees of business expenses are considered taxable income and should be reported on Form W-2 unless the reimbursements were made under an “Accountable Plan.” An Accountable Plan requires that 1)

reimbursements, advances, or allowances are made only for business expenses incurred by the employee in connection with his performance of services as an employee; 2) employees must be required to substantiate to the employer the expenses covered by the arrangement; and 3) employees must be required to return any excess reimbursements within a reasonable period of time. Thus, for example, a car allowance with no substantiation as to the amount of expensed incurred for business purposes would be fully taxable to the employee and should be reported on Form W-2. Please contact us if you have any questions about Accountable Plans.

### More than 2% Shareholder/Employee of an S Corporation

IRS Notice 2008-1 states that health insurance premiums paid on behalf of a “more than 2% shareholder” of an S Corporation must also be reported as taxable wages on Form W-2 (similarly, partnership payments of health insurance premiums for a partner must be reported as guaranteed payments on the Schedule K-1). Relief is provided, however, as an S Corporation shareholder can deduct 100% of these premiums on his or her individual tax returns provided the amount was included in wages. These premiums are considered non-FICA wages, and as such are exempt from FICA taxes.

## HOUSEHOLD EMPLOYEE (NANNY TAX)

Taxpayers who hire people to perform domestic services may be responsible for paying certain employment taxes for their workers. Generally, you have a household employee if you provide the tools and supplies and control not only what work is done, but how the work is done. If, during any calendar year, a taxpayer pays a household employee (e.g., babysitter, house cleaner, cook, or driver) \$2600 (\$2,700 in 2024) or more in cash, the taxpayer must withhold and pay social security and Medicare taxes (FICA) on the total wages, not just the excess. However, if the nanny is under age 18 and childcare is not his/her principal occupation (such as a student who is a part-time babysitter), a taxpayer does not have to withhold FICA taxes. Further, the taxpayer must pay federal unemployment tax (FUTA) if cash wages paid to household employees totaled more than \$1,000 in any calendar quarter of the current or previous year.

The .9% additional Medicare tax also applies for wages in excess of \$200,000 for single taxpayers (\$250K for married taxpayers). Cash wages do not include the value of food, lodging, clothing, transit passes, or other non-cash items given to a household employee.

If the employer is to withhold income taxes, the worker must provide a completed Form W-4, *Employee's Withholding Certificate*. The W-4 will show whether the employee is married or single and any adjustments that affect withholding calculations. The amount to be withheld is provided in Publication 15-T, "Federal Income Tax Withholding Methods." You may also use the Income Tax Withholding Assistant for Employers at [IRS.gov/ITWA](https://www.irs.gov/ITWA). A Form W-2 must be filed for each employee who is paid FICA wages and each employee who has income taxes withheld from his or her wages.

Withheld income tax is reported and paid using Form 1040, Schedule H, which is due on April 15th. In addition, separate California payroll returns must be filed. You must register with the Employment Development Department (EDD) by submitting a Employers of Household Workers Registration and Update Form (DE1 HW) (PDF) within 15 days after you pay in excess of \$750 in total cash wages in a calendar quarter. Section 1086 of the California Unemployment Insurance Code (CUIC) requires an employer to register with the EDD within 15 days after hiring one or more employees and paying wages in excess of \$100 for employment in a calendar quarter.



## FORM 1099 FILING REQUIREMENTS AND MISCELLANEOUS DETAILS

### **Form 1099 FAQ's and Miscellaneous Details**

Any person engaged in a trade or business generally must file an information return with respect to certain payments aggregating \$600 or more to the same taxpayer in the calendar year. This information is reported on the Form 1099 series to satisfy Federal requirements. Please note that the IRS shares Form 1099 information with the State of California. Therefore if you file with the IRS, you do not file a copy of the same forms with the Franchise Tax Board. You may use a truncated SSN, ITIN, or ATIN on payee copies for form series 1098, 1099 and 5498. This includes substitute and composite substitute statements furnished to the payee in paper or electronic form. For example xxx-xx-xxxx would appear on the payee statement as \*\*\*-\*\*-xxxx. Generally, keep copies of information

returns you filed with the IRS, or have the ability to reconstruct the data, for at least 3 years (4 years for Form 1099-C), from the due date of the returns. Keep copies of information returns for 4 years if backup withholding was imposed.

### **Trade or Business Reporting Only**

Report on Form 1099-MISC and 1099-NEC only when payments are made in the course of your trade or business. You are engaged in a trade or business if you operate for gain or profit. Personal payments are not reportable. Organizations engaged in a trade or business and subject to reporting include nonprofit organizations, trusts of qualified pension or profit-sharing plans of employers, certain organizations exempt from tax under section 501(c) or 501(d), farmers' cooperatives that are exempt from tax under section 521, and widely held fixed investment

trusts. Payments by federal, state, or local government agencies are also reportable.

### **Form 1099-NEC**

Nonemployee compensation should be reported on form 1099-NEC and filed by January 31, 2024. Continue to use the 1099-MISC for reporting other types of payments such as rents, prizes, royalties, medical and health care payments and nonqualified deferred compensation.

### **Form 1099-K**

For tax year 2023, payment apps and online marketplaces are required to file a 1099-K for personal or business accounts that receive over \$20,000 in payments from over 200 transactions for goods or services

**PAYMENTS TO BE REPORTED ON FORM 1099-NEC**

**Payments to be Reported on Form 1099-NEC**

Payments for various types of **non-employee** compensation must be reported on Form 1099-NEC. This requirement generally includes payments for personal services. Payments of any nature to banks or corporations (except to corporations organized for legal services) need NOT be reported. Following is a list of **some** of the common types of payments, which must be reported:

- Payments for services of \$600 or more, including cost of materials incidental to the services provided;
- Gross proceeds of \$600 or more paid for legal services;
- Commission, prizes, and awards of \$600 or more to non-employees, related to services performed.

**Payments Not Required to be Reported on Form 1099-NEC**

- Payments required to be reported on form 1099-MISC;
- Other income not subject to self-employment tax;
- See *Payments Not Requiring Information Returns* below for additional information.

**Payments to be Reported on Forms 1099 (Other Than 1099-NEC)**

Payments for various types of income must be reported on Forms 1099. This requirement generally includes rental, royalties, prizes, interest, and dividend payments. Payments of any nature to banks or corporations (except to corporations organized for medical and health care) need NOT be reported. Following is a list of **some** of the common types of payments, which must be reported:

- Commissions, prizes, awards and other income of \$600 or more, to non-employees, and not related to services performed;
- Rents of \$600 or more;
- Royalties of \$10 or more;
- Interest totaling \$10 or more paid or credited to any person's account;
- Corporate dividends of \$10 or more;
- Patronage dividends, rebates or refunds totaling \$10 or more;
- Payments for medical or health care services of \$600 to each physician or supplier of medical services;
- Barter exchange transactions;
- Canceled debt;
- Payments \$600 or more to an attorney for settling a claim. (not fees paid for attorney services which are reported on 1099-NEC).

**PAYMENTS NOT REQUIRING INFORMATION RETURNS**

**Payments Not Requiring Information Returns:**

The following list details some common examples of payments, which need NOT be accompanied by the filing of 1099's:

- Payments of any type made to a bank, corporation, or LLC treated as a C or S corporation (other than for medical, health care, broker and barter transactions, merchant card and third-party networks, withheld federal income tax or foreign tax, or attorney fees);
- Any otherwise reportable payments of less than \$600 in the aggregate;

- Payments of bills for merchandise;
- Wages & other employee compensation or employee business expense reimbursements reported on form W-2;
- Payments made by those not engaged in a trade or business;
- Rent payments to real estate agents or property managers;
- Payments by a partnership to a partner where they are reflected on Schedule K-1 of the partnership tax return.
- Payments made by credit cards or Venmo.
- Payments to a tax-exempt organization including tax-exempt trusts, the United States, a State, a U.S. possession or territory, or a foreign government.



FORM 1096

Form 1096

Remember, when preparing paper 1099 forms you must submit duplicate 1099 copies. Group the forms by form number and submit each group with a separate form 1096.



Filing Due Dates

Most forms 1099 must be issued to recipients on or before **January 31, 2024** including forms 1099-MISC and 1099-NEC. Form 1096 and the duplicate 1099s (other than 1099-NEC) must be transmitted to the IRS on or before **February 28, 2024** if transmitting by mail or by **March 31, 2024** if transmitting electronically. If filing the 1099-NEC, IRS copies must be transmitted before **January 31, 2024** whether by mail or electronic. If you are filing more than 10 information returns, you are required to file electronically. A 30-day automatic extension can be requested by filing form 8809 by the due date of the returns with an explanation. The extension is not available for form 1099-NEC.

Backup Withholding

Payments subject to 1099 reporting requirements may be subject to backup withholding if a TIN (taxpayer identification number) can't be obtained by the payer from the payee. In general, payments including interest (including tax-exempt interest), dividends, rents, royalties, commissions, nonemployee compensa-

tion, & certain other payments may require backup withholding of 24% if any of the following are true:

- The payee fails to furnish his or her TIN to the payer;
- Investment broker accounts opened, and instruments acquired after 1983 where payee fails to certify TIN;
- The IRS sends a notice requiring backup withholding because the payee furnished an incorrect TIN;

The IRS may send notice CP2100 or CP2100A which includes a listing(s) of the information returns filed that had missing, incorrect, and/or not currently issued TIN(s). You should compare the listing(s) to your records to determine which of the following required actions you must take.

A TIN is considered by the IRS to be missing if it is not provided or if it is obviously incorrect. For accounts with missing TIN(s), ensure backup withholding has begun and continue backup withholding until you receive a TIN. If you have not begun backup withholding, generally you must begin backup withholding on any reportable payment you make and continue backup withholding until you receive a TIN. You must make an annual solicitation for the TIN by the end of each year that the TIN is missing, during which there were reportable payments.



If you have received IRS notice CP2100 or CP2100A due to an incorrect name/TIN combination, you are required to

promptly furnish a "B" notice, or an acceptable substitute, to the payee along with form W-9 within 15 business days from the date of the IRS notice or the date that you received the letter (whichever is later). Also, you must begin backup withholding on payments made to payees who do not return a signed Form W-9 in response to your first "B" Notice, no later than 30 business days after the date of the IRS notice or the date you received it (whichever is later). Stop backup withholding within 30 calendar days after you receive the signed Form W-9 from the payee. TIN information may not be solicited by telephone. A signed W-9 is required in order to stop current backup withholding or prevent backup withholding from starting.

The payer may become liable to the IRS for any uncollected amount not withheld from the payee as required. See IRS Publication 1281, Backup Withholding for Missing and Incorrect Names/TINs, for detailed information as well as helpful decision-making flowcharts. For a list of payees exempt from backup withholding see instructions to form W-9. If backup holding is required you will need



to file form 945 by January 31, 2024.

**FORM W-9 / INFORMATION RETURN PENALTIES (FORMS 1099)**

**Form W-9**

Form W-9 is completed by the payee and provided to the requester. The information provided on form W-9 is necessary to file information returns such as the 1099-MISC form discussed above. Throughout the year it is good business practice to request a completed W-9 before transacting with a new vendor (payee). Doing so will assist year end 1099 reporting compliance and help avoid penalties. Foreign payees will need to provide a completed Form W-8. If the payee refuses to provide the requested information, the payee is subject to Federal penalties. Any taxpayer who refuses to furnish their SSN or TIN is subject to backup withholding as described above.



**Information Return Penalties (Forms 1099)**

Significant penalties can apply for failure to file these information returns. Federal law provides for up to a \$310 assessment for each failure to provide a correct information return to a recipient, and another \$310 for failing to file a correct information return with the IRS. In certain instances, other penalties may apply. The maximum penalty is \$3,783,000 per year (\$1,261,000 for small businesses). All numbers on the next table are correct.

If you are required to file electronically, but fail to do so, you may be subject to a penalty of \$310 per return filed in excess of the 10 total information returns requirement for electronic filing. Additionally, failure to file a Form 1099 could result in disallowance of the deduction for a claimed payment in the event of an audit. Taxpayers who fail to timely file the required state information returns to the CA Franchise Tax Board, or who fail to include all the required elements in the information return, are subject to similar penalties imposed under IRC §§6721 and 6724, as modified by California.



*Please contact us if you have any questions.*

**INFORMATION FORM PENALTIES**

2023 FORMS FILED IN 2024	PENALTY	MAXIMUM/MAX SMALL EMPLOYER*
Corrected within 30 days of due date	\$60 per return or statement	\$630,500/\$220,500
Corrected more than 30 days of due date but by <b>August 1</b>	\$120 per return or statement	\$1,891,500/\$630,500
Corrected after <b>August 1</b> or not at all	\$310 per return or statement	\$3,783,000/\$1,261,000
Intentional disregard	\$630 per return or statement	No Maximum

\*Small Businesses with Gross Receipts of \$5 Million or Less

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