



# HEDMAN PARTNERS

Certified Public Accountants

YOUR TRUSTED ADVISOR FOR 25 YEARS

## ANNUAL INFORMATION RETURNS NEWSLETTER

JANUARY 2020

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### California Worker Classification: Independent Contractor vs. Employee

In California, a new law – A.B. 5 – took effect January 1, 2020, and will make 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 same nature as the work performed. If the worker passes the ABC test, they can be classified as an independent contractor and issued a 1099. Otherwise, the worker must be made an employee. Significant fines may apply if a worker is incorrectly classified. The legislation provides a number of exemptions that may apply, so please contact us if you have questions about specific circumstances.

### Form 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 the 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 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 expenses 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.

FOREIGN BANK ACCOUNT REPORTING

“Taxpayers who do not disclose their foreign accounts, if required, risk severe penalties.”

United States persons may have an FBAR filing requirement if the following is true: the US person had a financial interest in or signature authority or other authority over any financial account in a foreign country, and the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year. These disclosures are made on a special U.S. government form, FinCEN Form 114, Report of Foreign Bank and Financial Accounts (known as the “FBAR”) which must be filed separately from your income tax return and is due on or before April 15, 2020 and can be extended until October 15. Electronic filing of FBARs is mandatory.

Taxpayers who do not disclose their foreign accounts, if required, risk severe penalties. Depending on the taxpayer’s facts and circumstances, some of the penalties include, but are not limited to, penalties for failing to file certain returns, fraud penalties, and an accuracy-related penalty on underpayment of tax. Non-willful noncompliance penalties

range up to \$12,921 per violation; if willful, up to the greater of \$129,210 or 50% of account balances. The IRS can also seek criminal sanctions against a taxpayer.



FOREIGN ASSET REPORTING

Certain United State citizens, resident aliens, domestic corporations, partnerships, and trusts may be required to file form 8938, Statement of Specified Foreign Financial Assets. You may have a filing requirement if you have financial accounts maintained by a foreign financial institution, stock, securities, notes, bonds, debentures, or interest in a foreign entity issued by someone who is not a US person. Certain thresholds must be met. For unmarried Individuals living in the US, total value greater than \$50,000 as of the last day of the year, or more than \$75,000 at any time during the year, triggers a filing requirement. Likewise, married individuals living in the US meet the filing requirement

if the value of assets is \$100,000 on the last day of the year, or more than \$150,000 at any time during the year. The respective amounts for individuals living outside the US are \$200,000 and \$300,000 if unmarried and \$400,000 and \$600,000 if married. For specified domestic entities the respective amounts are \$50,000 and \$75,000. Form 8938 is due and filed with your income tax return, subject to extension. You are not required to file form 8938 if you do not have an income tax return filing requirement. Filing form 8938 does not relieve form FinCEN 114 requirements and vice-versa. Penalties for failure to file are \$10,000 for failure to disclose and an additional \$10,000 for each 30 days of non-filing after IRS notice of failure to disclose for a

maximum penalty of \$60,000. Criminal penalties may also apply.



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) \$2,100 or more in cash, the taxpayer must withhold and pay social security and Medicare taxes (FICA) on the entire wages, not just the excess. However, if the nanny is under age 18 and child care is not his/her principle occupation (such as a student who is a part-time baby sitter), 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, without regard to filing status. Cash wages do not include value of food, lodging, clothing, transit passes or other noncash 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 Allowance Certificate*. The W-4 will show whether the employee is married or single, the number of exemptions he or she is claiming, and any additional amounts of tax to be withheld. The amount to be withheld is

provided in IRS Circular E, "Employer's Tax Guide." 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.



FORM 1099 FILING REQUIREMENTS 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.

Payments to be Reported

Payments for various types of non-

employee compensation must be reported on Form 1099. This requirement generally includes payments for personal services, as well as rental, interest, and dividend payments. Payments of any nature to banks or corporations (except to corporations organized for medical, health care or 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;
- Commissions, prizes and awards, and other income of \$600 or more, to non-employees;
- 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;
- Gross proceeds of \$600 or more paid for legal services;
- Barter exchange transactions.

Please contact us  
if you have any  
questions.

**FORM 1099 FAQ'S AND MISCELLANEOUS DETAILS (CONTINUED)**

**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);
- Payments made by credit card;
- Any otherwise reportable payments of less than \$600 in the aggregate;
- Payments of bills for merchandise;
- Wages and 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.

**Filing Due Dates**

Forms 1099-MISC must be issued to recipients on or before **January 31, 2020**, while Form 1096 and the duplicate 1099's must be transmitted to the IRS on or before **February 28, 2020 if transmitting by mail or by March 31, 2020 if transmitting electronically**. However, the IRS

**copies must be transmitted before January 31, 2020 if there are any payments for nonemployee compensation reported in box 7.** If you are filing more than 250 information returns, you are required to file electronically. A 30-day extension can be requested by filing form 8809.

**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 compensation, and certain other payments may require backup withholding of 24% if the payee fails to furnish his or her TIN to the payer. The IRS may also notify you requiring backup withholding because the payee furnished an incorrect TIN. The payer may become liable to the IRS for any uncollected amount if not withheld from the payee as required. 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, 2020.

**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 the appropriate completed W-8 form. If the payee refuses to provide the

requested information, the payee is subject to Federal penalties. Any taxpayer who refuse to furnish their SSN or TIN are subject to "backup withholding," as noted above.

**Information Return Penalties (Forms 1099)**

Significant penalties can apply for failure to file these information returns. Federal law provides for up to a \$270 assessment for each failure to provide a correct information return to a recipient, and another \$270 for failing to file a correct information return with the IRS. In certain instances, other penalties may apply. The maximum penalty is \$3,339,000 per year (\$1,113,000 for small businesses). If you are required to file electronically, but fail to do so, you may be subject to a penalty of \$270 per return filed in excess of the 250 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.



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Hedman Partners is an advisor to middle market businesses, their owners, and other high net worth individuals. We have assembled a team of CPAs and other trusted advisors to serve the unique needs of our clients. Our strong commitment to intimate client relationships, exceptional service, and our business and technical expertise enables us to successfully guide our clients to secure their future in both their business and personal life.

Our areas of concentration include businesses in a variety of industries including *Manufacturing, Distribution, Aerospace & Defense, Real Estate, Construction, Beauty, Software, Service, Entertainment, Transportation, Food & Beverage, Medical Device, Financial Services & Employee Benefit Plans.*

With a genuine interest in each of our clients' unique goals and dreams, we apply our experience in accounting, finance and consulting to help them plan for and achieve their financial objectives. We enjoy going beyond the traditional role of being an accountant to being our clients' most trusted advisor. Serving clients throughout Southern California, we offer a full range of services through our firm and its affiliates, Hedman M&A Advisors and Raleigh Hedman Financial Services.



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