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Even Consulates Have Independent Contractor Problems!

If you're in business and think you're the only one targeted by the IRS, unemployment insurance authorities or others, think again. See [Worry Over Worker Status Isn't Crying Wolf](#). Even foreign governments can be caught within the IRS grasp, as occurred in [Rosenfeld](#). There, the U.S. Tax Court ruled a British Consulate trade officer was an employee not an independent contractor even though the Consulate and worker thought otherwise.

But unlike most disputes focusing on the employer, this was a tax disaster for the worker. See [1099 Or W-2?](#) Since the Tax Court ruled he wasn't an independent contractor, he couldn't claim expenses on [Schedule C](#) to his Form 1040 or make deductible [simplified employee pension](#) (SEP) plan contributions.

Who is an employee isn't controlled by contracts. All the facts are relevant, including:

- the control exercised by the principal;
- which party pays for the work facilities;
- the worker's opportunity for profit or loss;
- whether the company can fire the worker;
- whether the work is part of the company's regular business;

- the permanency of the relationship;
- what relationship the parties believed they had; and
- whether employee benefits are provided.

The British Consulate treated Rosenfeld as self-employed and didn't withhold taxes. It seemed reasonable for him to account for his own expenses and set up his own SEP pension plan. Yet the IRS ruled he was a common law employee. Why?

The Consulate had the right to control his work, tell him to attend meetings and do assignments. Control is key, but [some control won't convert independent contractors to employees](#). He had to work 40 hours a week and was paid a fixed salary, even if there was no withholding! Plus, what he did was integral to the Consulate's business.

A big issue: he had the opportunity to participate in the Consulate's health and pension plans. He didn't have a written contract, but only a letter saying he would be "self-employed for tax purposes."

Even that letter created an employment relationship, said the court. Oddly, the court said the fact that the Consulate didn't withhold taxes was neutral. Nevertheless, the Tax Court didn't impose penalties, finding Rosenfeld reasonably believe in good faith that he was an independent contractor. See [Criminal Penalties For Misclassifying Independent Contractors?](#) Rosenfeld had consulted his return preparer who agreed.

Foreign Governments? If you're thinking there's an exception for employees of foreign governments, you're right, but it's only for Social Security tax. See [Treas. Reg. § 31.3121\(b\)\(11\)-1\(a\)](#). However, services performed by U.S. citizens employed by a foreign government, a wholly owned foreign government instrumentality, or an international organization are subject to self-employment tax. See [Treas. Reg. § 1.1402\(c\)-3\(d\)](#).

Bottom Line? Have a good and clear contract, and be consistent. See [Drafting Independent Contractor Agreements](#).

For more, see:

[IRS Nightmare: What Employment Taxes?](#)

[Publication 15-A, Employer's Supplemental Tax Guide](#)

[Publication 1779, Independent Contractor or Employee](#)

[Publication 1976, Do You Qualify for Relief under Section 530?](#)

[Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding](#)

[White House On Contractor vs. Employee: There Will Be Blood](#)

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