

Independent Contractor and 2% Withholding for Independent Contractors

In 2007, the Minnesota Legislature passed two laws in attempt to identify independent contractors that may not be paying worker's compensation, unemployment tax and/or state taxes. The 2007 tax bill requires any residential or commercial construction contractor to withhold 2% on any payments made to an individual construction contractor. The payment is then remitted to the Department of Revenue (DOR). The Independent Contractor Exemption Certificate (ICEC) grants authority to the Department of Labor & Industry (DOLI) to certify independent contractors. These two new laws are meant to complement each other.

2% Contractor Withholding Independent Contractor Classification

A contractor must withhold and remit 2% to DOR any payments over \$600 made to an independent contractor set up as a sole proprietorship. Only payments in excess of \$600 or more must be retained and reported. In cases where separate multiple payments are made throughout the calendar year, 2% must be withheld on the initial \$600 payment as well as all subsequent payments.

When employing an independent contractor an employer must retain the following information for submission to Revenue along with the 2% - name, address, social security number, amount paid, amount withheld, and a federal W-9 form. In addition to the federal W-9 form, a contractor must file a W-2 or a 1009 MISC form with the Department.

Each of these forms and their instructions can be found on the Internal Revenue Service website at www.irs.gov. BAM *highly recommends that you contact your tax consultant about how to file these forms* with the Department of Revenue and the Internal Revenue Service.

All forms must be submitted to the Department of Revenue by February 28th of each year unless the 28th falls on a weekend. If the reporting date falls over a weekend then the reporting date is the following Monday. The first filing date for the 2% Contractor

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Withholding provision is March 1, 2010 for the 2009 reporting period because February 28th falls on a Sunday.

This tax provision only applies to individual construction contractors that have set up shop under a sole proprietorship operation. It does not apply to individual construction contractors that are registered with the Minnesota Department of Revenue as LLC's, corporations or partnerships. Construction sales, most types of landscaping and construction cleaning or clean up are also exempt from this provision. Landscaping services provided as part of a contract for the building construction or improvement services are not exempt from the ICEC.

Construction trades defined in this provision are covered under the North American Industry Classification System (NAICS). The NAICS has an extensive website dedicated to classifying workers. The link for specific classifications in the construction trades is as follows: www.naics.com/naics23.htm.

The Minnesota Department of Revenue defines construction contractor as an individual or business entity that pays the individual contractor for services performed and/or goods sold. Conversely, an individual contractor is defined as a sole proprietor and is paid for services performed or goods sold by the construction contractor.

Independent Contractor Exemption Certificate

Contractors employing an independent contractor working under sole proprietorship status must **also verify** that the independent contractor has applied for and received an Independent Contractor Exemption Certificate (ICEC). A list of all certificate holders will be maintained on the Department of Labor & Industry's website. Visit www.doli.state.mn.us/ic and click the link titled *Verify an ICEC*.

As a contractor you are responsible for downloading and maintaining a copy of the ICEC certificate for 5 years. There is a penalty of up to \$5,000 for individuals and contractors who fail to comply with the law. They will also be reported to the worker's compensation, unemployment insurance and revenue regulation for further action.

It is important to remember that the ICEC certificate covers residential builders and remodelers who function as sole proprietors and perform jobs as independent

contractors. A separate application has been specifically created for dual purposes. Visit www.doli.state.mn.us/ic and click the link title *Apply for and ICEC*. (You will find certificate verification at the same site you look up a contractor license.)

Independent contractors choosing to apply for the certificate over becoming an LCC or corporation must meet the nine-factor test.

1. Maintains a separate business with the individual's own office, equipment, materials, and other facilities;
2. Holds or has applied for a federal employer identification number or has filed business or self employment income tax returns with the federal Internal Revenue Service if the person has performed services in the previous year for which the individual is seeking the independent contractor exemption certificate;
3. Operates under contracts to perform specific services for specific amounts of money and under which the individual controls the means of performing the services;
4. Incurs the main expenses related to the service that the individual performs under contract;
5. Is responsible for the satisfactory completion of services that the individual contracts to perform and is liable for a failure to complete the service;
6. Receives compensation for service performed under a contract on a commission or per-job or competitive bid basis and not on any other basis;
7. May realize a profit or suffer a loss under contracts to perform service;
8. Has continuing or recurring business liabilities or obligations;
9. The success or failure of the individual's business depends on the relationship of business receipts to expenditures.

In addition to meeting the nine criteria set forth above, the applicant is required to submit a full menu of items ranging from any judgments held against, previous employment, tax documents filed with the IRS or the Department of Revenue, copies of contracts or a template intended for use and current photo identification.

