

Nevada County Employee/Independent Contractors

REASON FOR INVESTIGATION

The Nevada County Civil Grand Jury decided to investigate if the County was correctly handling payments to employees and independent contractors under Internal Revenue Service (IRS) rules.

PROCEDURE FOLLOWED

The Grand Jury interviewed:

County Counsel James Flageollet
Auditor-Controller Bruce Bielefelt
Assistant Auditor-Controller
An Accounts Payable clerk

The Grand Jury also reviewed Auditor-Controller accounting records, employment contracts and numerous e-mails.

FINDINGS

1. Documents revealed that several Nevada County employees for whom tax withholding is required, in some circumstances are also being paid as independent contractors for whom tax withholding is not required.
2. At least three top-level personnel were being paid as independent contractors. Their employment contracts specified work hours and prohibited doing like work for others, clearly making them employees under IRS rules.
3. The IRS has 20 specific rules for determining who is an employee and who is an independent contractor.
4. In the event of an IRS audit, should they find actual employees being paid as independent contractors, the IRS could assess significant penalties against Nevada County.
5. A review of Auditor-Controller e-mails on several cases dealing with employee/independent contractor status revealed that no one took the responsibility to make a final binding decision upon employee/independent contractor status. The Grand Jury was unable to determine where that responsibility lay.
6. The Auditor-Controller testified that he believed the decision-making responsibility should belong to the County department heads.

COUNTY OF NEVADA

STATE OF CALIFORNIA

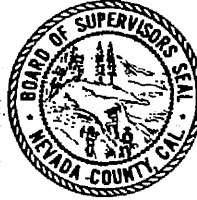
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BOARD OF SUPERVISORS



Peter Van Zant, 1st District
Karen Knecht, 2nd District
Bruce Conklin, 3rd District
Elizabeth Martin, 4th District
Sam Dardick, 5th District

September 27, 2000

Cathy R. Thompson
Clerk of the Board

The Honorable Carl Bryan
Presiding Judge of the Nevada County Courts
Nevada County Court House
Nevada City CA 95959

Subject: Board of Supervisors Responses to the 1999-2000 Nevada County Civil Grand Jury Interim Report No. 5, dated May 31, 2000, regarding Employee/Independent Contractors; and Grand Jury Interim Report No. 6, dated June 5, 2000, regarding the Nevada County Assessor's Office.

Dear Judge Bryan:

The attached responses by the Board of Supervisors to the 1999-2000 Nevada County Civil Grand Jury Interim Report No. 5, dated May 31, 2000, and Interim Report No. 6, dated June 5, 2000, are submitted as required by California Penal Code §933.

These responses to the Grand Jury's findings and recommendations were approved by the Board of Supervisors at their regular meeting on September 26, 2000. They are based on either personal knowledge, examination of official county records, review of the response by the Assessor, or testimony from the Auditor-Controller, Board Chairman, or county staff members.

This submission completes the Board of Supervisors reply to the 1999-2000 Nevada County Civil Grand Jury Final Report, including all Interim Reports.

The Board of Supervisors would like to thank the members of the 1999-2000 Grand Jury for their participation and effort in preparing this year's report.

Sincerely,

Bruce Conklin
Chairman of the Board

Attachment

bc:pb

cc: Foreman, Grand Jury
Ted Gaebler, County Administrator
County Counsel

NEVADA COUNTY BOARD OF SUPERVISORS RESPONSES TO
1999-2000 CIVIL GRAND JURY INTERIM REPORT NO. 5
DATED MAY 31, 2000

RE: NEVADA COUNTY EMPLOYEE/INDEPENDENT CONTRACTORS
FINDINGS & RECOMMENDATIONS

Responses to findings and recommendations are based on either personal knowledge, examination of official county records or testimony from the Auditor-Controller, board chairman or county staff members.

I. GRAND JURY INVESTIGATION:

Nevada County Employee/Independent Contractors

A. RESPONSE TO FINDINGS & RECOMMENDATIONS:

The Board of Supervisor's response to this Grand jury investigation is partially based on staff discussion with the Auditor-Controller regarding the Findings and Recommendations in the report.

The Board believes it would have been appropriate for the Grand Jury to request the Auditor-Controller also formally respond to these Findings and Recommendations. Most of the Findings relate to Grand Jury contact with the Auditor-Controller, examination of Auditor-Controller contract, financial, and e-mail records, and IRS-related issues generally under the responsibility of the Auditor-Controller to monitor for the County. Additionally, the Grand Jury recommendation would directly impact Auditor-Controller operations if implemented and appears to be contrary to his recommendation, as reported by the Grand Jury in Finding No.6, on where responsibility and authority for employee/independent contractor should be assigned.

Findings:

- 1. Documents revealed that several Nevada County employees for whom tax withholding is required, in some circumstances are also being paid as independent contractors for whom tax withholding is not required.**

Neither agree nor disagree. The Board has no knowledge of what documents were reviewed by the Grand Jury.

Board staff discussion with the Auditor-Controller indicated he agrees with this Finding.

- 2. At least three top-level personnel were being paid as independent contractors. Their employment contracts specified work hours and prohibited doing like work for others, clearly making them employees under IRS rules.**

Neither agree nor disagree. The Board has no knowledge of the "three top-level personnel" referenced by the Grand Jury. Without this information, the Board can not review their employment contracts and validate the Grand Jury Finding.

Board staff discussion with the Auditor-Controller indicated he agrees with the Finding.

3. **The IRS has 20 specific rules for determining who is an employee and who is an independent contractor.**

Agree.

Board staff discussion with the Auditor-Controller indicated he agrees with this Finding.

The IRS is in the process of eliminating the "20 factors test" for determining a worker's status. It is being replaced with three factors that count towards this determination. State law is also relevant in determining employee/independent contractor status. New California Employment Development Department (EDD) reporting criteria will go into effect January 1, 2001 requiring every county vendor who is identified as a sole proprietorship and who receives a 1099 as an independent contractor to be reported to the state. (See attached draft Auditor-Controller memorandum, dated September 15, 2000).

4. **In the event of an IRS audit, should they find actual employees being paid as independent contractors, the IRS could assess significant penalties against Nevada County.**

Agree.

The Board believes the intent of this Finding is to state that significant penalties could be assessed against the county if the IRS determines that persons being paid as independent contractors should have been paid as employees

Board staff discussion with the Auditor-Controller indicated he agrees with this Finding.

5. **A review of Auditor-Controller e-mails on several cases dealing with employee/independent contractor status revealed that no one took the responsibility to make a final binding decision upon employee/independent contractor status. The Grand Jury was unable to determine where that responsibility lay.**

Neither agree nor disagree. The Board does not have access to Auditor-Controller e-mails. The Board also has no knowledge of what Auditor-Controller e-mails were reviewed by the Grand Jury.

Board staff discussion with the Auditor-Controller indicated he agrees with this Finding.

Board staff discussion with the Auditor-Controller indicated he agrees with this Finding.

6. **The Auditor-Controller testified that he believed the decision-making responsibility should belong to the County department heads.**

Neither agree nor disagree. The Board has no knowledge of the Auditor-Controller's testimony to the Grand Jury.

Board staff discussion with the Auditor-Controller indicated he agrees with this Finding in that if he is assigned authority and responsibility for employee/independent contractor decisions, he will work with the Department heads and the County Administrator to ensure they comply with all county, state, and federal requirements.

RECOMMENDATIONS

1. **The Grand Jury recommends that the Board of Supervisors assign the responsibility and authority for making employee/independent contractor decisions to the Auditor-Controller.**

The recommendation requires further analysis.

The Board will direct the County Administrator, in conjunction with County Counsel, the Personnel Department Director, and the Auditor Controller to evaluate our current procedures regarding employee/independent contractor decisions. He will also be directed to provide a recommendation to the Board by January 31, 2001 on where the authority and responsibility for employee/independent contractor decisions should be assigned and that effective procedures are in place to ensure full compliance with all applicable federal, state and county laws.

In the interim, the Auditor-Controller will continue to work with Department Heads and Special Districts to tighten controls over independent contractor contracts to meet the new state EDD employee reporting requirements that go into effect January 1, 2001.

B. OTHER RESPONSES REQUIRED:

None

COUNTY OF NEVADA

BRUCE A. BIELEFELT

Auditor-Controller

Eric Rood Administrative Building

950 Maidu Avenue

Nevada City, CA 95959

(530) 265-1244

(530) 265-1568, FAX

DRAFT

9/15/00

DATE: September 15, 2000

TO: All Departments

FROM: Dave Felthousen
Assistant Auditor-Controller

SUBJECT: EDD Reporting Requirement for Independent Contractors

EDD Reporting Requirement

Effective January 1, 2001, any California business or government entity that is required to file a Federal Form 1099-MISC for services performed by an independent contractor has a new reporting requirement with the California Employment Development Department (EDD). The County will be required to report specific information such as name, Social Security Number, start date of contract or date payments equal \$600 or more, amount of contract and contract expiration date to EDD within twenty (20) days of EITHER making payments totaling \$600 or more OR entering into a contract for \$600 or more with an independent contractor in any calendar year, whichever is earlier. In order to meet this requirement and not pay penalties associated with failing to report correctly, the Auditor's office is requesting information from you regarding current agreements with independent contractors. The Auditor's office is also implementing several procedure changes that will enable us to gather necessary data for reporting new contracts with independent contractors. In addition, this memo includes information to help you identify independent contractors. We are planning to report every vendor who is identified as a sole proprietorship and who receives a 1099 as an independent contractor.

Current Independent Contractor Vendors

Each department needs to provide us with a list of all their current independent contractors noting vendor number, Social Security Number and purchase order or blanket order number. Please provide this list by *December 1, 2000*.

Encumbrance/Contract Requirement

In order to track reportable information (start date of contract, amount of contract and contract expiration date) all agreements with independent contractors **will** need to be encumbered. Encumbrance (purchase order or blanket order) **must** be supported by a signed service agreement covering the complete terms of the contracted service. There will be no County direct pay independent contractors.

New Vendor Number Procedure

The Auditor's office will be using the vendor file to flag the vendor as an independent contractor. This will be used in conjunction with the encumbrance to provide information for EDD reporting. In order to accomplish this we will need to implement a procedure change regarding ALL vendors. Effective November 1, 2000, a vendor will not be set up on the accounting system vendor file without a Federal W-9 or the County version of this form signed by the vendor and a completed vendor request form. A purchase order cannot be issued without a vendor number and therefore payment cannot be made without this information. As noted above we are implementing this procedure for all vendors, not just 1099 reportable or independent contractors. We feel we need to be consistent with all vendors. We cannot always tell the vendors reporting status from the vendor's name. If the vendor is already in the vendor file, it is not necessary to submit a new W-9 unless there is a name change, ownership change, etc. Independent contractors need to be listed as noted above under **Current Independent Contractor Vendors**.

I recommend that you provide the vendor with the County's W-9 form as soon as you enter into an agreement with the vendor. This form and the Vendor Request Form will be available on the 'I' drive or from the Auditor's office. It will include a field for you to note independent contractor. Copies of the forms are attached to this memo. Photocopies are acceptable. Although Email requests are no longer appropriate, we will continue to accept a fax of these forms.

Independent Contractors

This new reporting requirement brings up the whole issue of independent contractors. The County is at considerable financial risk if independent contractors are treated more like employees than true independent contractors. The IRS could require a reclassification of these independent contractors to employees and require payment of all taxes by the County plus penalties.

The IRS is eliminating the infamous "20-factor test" for determining a worker's status. It is being replaced with three factors that count toward this determination:

- Behavioral control
- Financial control
- The employer-worker relationship

Five of the most important factors in the "20-factor test" are embodied in the "new" criteria.

1. **Continuing relationship.** The relationship with the independent contractor should not go on and on. This is more of an employer-employee relationship. Be sure the contract has a completion date. [Corresponding new criteria: Employer-worker relationship.]
2. **Set hours of work.** Independent contractors need to be able to come and go as they please. If you have much control over when they work, they need to be treated as an employee. [Corresponding new criteria: Behavioral control.]
3. **Working with more than one firm.** Exclusivity can be a real problem. The individual receiving a 1099 should also be working for others. [Corresponding new criteria: Employer-worker relationship.]
4. **Full-time work requirement.** In addition to not being too strict on when an independent contractor works, you should not require the person to work for you full-time. The worker needs to have time to work for someone else. [Corresponding new criteria: Behavioral control.]
5. **Payment by the hour, week or month.** If you pay an independent contractor this way, it looks like a salary. It is best to base payment on percentage of the job completed. [Corresponding new criteria: Financial control.]

The IRS is in the process of revising SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding. I have attached a copy of the old version of this form since it provides good guidance on determining if your worker is an independent contractor or an employee. The revised SS-8 is scheduled to be out this fall and will be available through the IRS web page (www.irs.ustreas.gov). Please do not file the return with the IRS, use it as a tool for making your determination. EDD also has a good handout regarding independent contractors. I have attached a copy for your information.

Please feel free to call me at 265-1251 if you have any questions regarding this new procedure or independent contractors in general.

CONCLUSIONS

1. The lack of assigned responsibility and authority for determining independent contractor status indicates a failure in management control and could subject the County to IRS penalties.
2. The authority for making employee/independent contractor decisions should reside with the Auditor-Controller, not with some 30-plus department heads.

RECOMMENDATIONS

The Grand Jury recommends that the Board of Supervisors assign the responsibility and authority for making employee/independent contractor decisions to the Auditor-Controller.

REQUIRED RESPONSES

Board of Supervisors, Due Sept. 28, 2000

Rev 4
05/00