KPMG

Payroll Insights

Employment tax news to guide you now and for the future

April 2024

John's *fresh take*: The complexity of gig worker classification

The gig economy, characterized by flexible, temporary, and freelance opportunities for individuals, has seen exponential growth over the past decade. Companies in the rideshare and food delivery industries have redefined traditional employment, offering millions of workers the opportunity to earn income on their own terms. However, this expansion of the independent contractor workforce and opportunities has also introduced a complex web of worker classification considerations and employment tax requirements, which was further complicated by new worker classification rules issues by the U.S. Department of Labor (DOL).

At the heart of the issue is the worker classification of gig workers. Should the individuals be classified as independent contractors or employees? This distinction is far from moot as there are significant potential implications for workers' rights, benefits, and employment tax obligations.

As independent contractors, gig workers are essentially self-employed. They are generally responsible for remitting their own taxes, don't have access to benefits like health insurance or retirement plans through their gig work, and are not protected by minimum wage or overtime laws. On the other hand, if classified as employees, these workers would be entitled to a range of benefits and protections under federal and state labor laws, as well as their wages being subject to employment tax withholding.

To clarify how an individual should be classified (i.e., independent contractor or employee), the U.S. DOL recently released a final rule that makes it more challenging for companies to classify workers as independent contractors under labor rules. The rule modifies the "economic realities" test used to determine a worker's status under the Fair Labor Standards Act (FLSA). Factors considered in this test include the degree of the worker's control over the work, the worker's opportunity for profit or loss, and investments by the worker and the employer.

While the rule endeavors to protect workers from being misclassified as independent contractors when they should be employees, it has been met with opposition. Critics argue that it threatens the flexibility and earning opportunities of independent contractors and could have significant negative impacts on the economy.

Moreover, the rule adds another layer of complexity to an already intricate issue. It does not provide specific guidance for any industry or job type, leaving businesses and workers to navigate the nuances of the rule. Furthermore, the rule does not go as far as some state-level legislation, such as California's three-factor ABC test, creating a patchwork of standards that businesses must navigate.

The DOL's rule is just the latest development in the ongoing debate over gig worker classification. As the gig economy continues to evolve, so too will the legal and tax landscape surrounding it. Businesses and workers alike should stay informed about these changes and understand the potential impacts.

To summarize, the gig economy, while offering flexibility and opportunities, also presents a complex set of challenges related to worker classification and taxation requirements. Recent legislation has added another layer to this complexity, emphasizing the need for clear, industry-specific guidance and fair labor practices that protect workers' rights without stifling innovation and flexibility. It is recommended that employers and businesses continue to review their workforce arrangements in conjunction with the ever evolving worker classification legislation to determine if any individuals are being misclassified as independent contractors.

Note that that IRS is not bound by the DOL's worker classification rules and is not involved in the development of such rules. As a result, an answer on worker classification could different under IRS and DOL rules.

Internal Revenue Service pilots new verification approach for employee retention tax credit claims

The Internal Revenue Service (IRS) is utilizing a new method to audit and confirm the accuracy of employee retention credit (ERC) claims submitted by employers. The IRS is requesting specific documentation from employers in order to identify and address ERC claims that were filed by ineligible employers.

Based upon current IRS guidance, businesses being audited should first receive the Form 6612 which communicates that the IRS is auditing the business' tax return(s) claiming the ERC. The ERC claim will then be held by the IRS until the audit is concluded. The Form 6612 will include a formal information document request (IDR), in which responses and documents can then be submitted to the IRS by either:

- Uploading the requested documents to the website provided in the letter (if applicable), or
- Faxing the requested documents to the fax number in the letter (if applicable), or
- Mailing the requested response and documents to the address provided on the Form 6612.

To respond appropriately to the IRS, it is recommended that the business review their eligibility for the claims filed as well as that the claims were filed correctly. Business can also take the proactive approach of documenting their eligibility to claim the ERC and confirming that all returns filed claiming the ERC were prepared correctly. Acting proactively can assist businesses with responding timely to the IRS and then receiving any ERC refund amounts being held by the IRS.

Updates on the employee retention credit processing window

The IRS has been struggling with a significant backlog of ERC claims, a situation that has been exacerbated by the ongoing moratorium. As per the latest updates, the IRS is processing claims that were received prior to the moratorium announced on September 14, 2023. The IRS had announced an immediate moratorium on processing new ERC claims to provide the IRS additional time to add more safeguards around the ERC program and prevent further abuse. However, any claims received during the moratorium are on hold and will not be processed until the moratorium is lifted. The expected timeline for the lifting of the moratorium is likely towards the end of April or the beginning of May, although it could potentially extend further.

As of December 31, 2023, the backlog of ERC claims stood at approximately 1.3 million. This vast number is indicative of the challenges that the IRS is currently facing in managing and processing these claims. The rate of processing is relatively slow, with about 1,500 claims being processed weekly. This sluggish pace is attributed to a combination of factors including an ongoing effort to improve processes, limited resources, and a focus on detecting fraud.

Additionally, a significant factor contributing to the slow rate of processing is the allocation of resources. A large part of IRS resources are currently dedicated to processing Forms 1040, *U.S. Individual Income Tax Return*. Once this task is completed, these resources should be redirected to assist with processing ERC claims filed by employers.

The current situation presents a complex challenge for the IRS, as it strives to balance the need for efficient processing with the necessity of maintaining stringent checks to prevent fraud. While the lifting of the moratorium is expected to accelerate the rate of processing, it is clear that the IRS faces a significant task in clearing the existing backlog of claims.

IRS releases 2024 Form 941 amid proposed changes to employee retention credit deadline

The IRS has released the 2024 versions of the Form 941, *Employer's Quarterly Federal Tax Return*; Schedule B, *Report of Tax Liability for Semiweekly Schedule Depositors*; and Schedule R, *Allocation Schedule for Aggregate Form 941 Filers*, along with their corresponding instructions.

Notably, there are no significant/ alterations to the Form 941 from the draft version released earlier this year. The lines that were previously used to report COVID-19-related credits have been eliminated from the form. Additionally, the instructions to the Form 941 have been updated to align with the changes to the form, and they no longer contain any worksheets.

This update comes at a crucial time due to the proposed legislation to move up the deadline to claim the ERC.

IRS to intensify scrutiny on corporate jet tax breaks, according to recent press release

In a recent announcement, the IRS indicated its intention to increase its focus on the tax benefits enjoyed by company executives, particularly those related to the use of corporate jets. The agency is planning to launch a series of new audits in the coming months, aimed at identifying the misuse of deductions and undeclared income that results from not properly allocating travel between business and personal.

The use of corporate jets for personal reasons by high-level executive employees is a common practice, but it complicates the eligibility for certain tax deductions. The issue at hand is the tax-deductible nature of corporate aircraft use for business purposes. However, the IRS is concerned that the line between business and personal travel is often blurred, leading to inflated tax savings. IRS Commissioner Danny Werfel stated that the initial focus of these audits would be on corporations and complex partnerships deemed to be at the highest risk of misuse, across a range of industries. If necessary, the focus could shift to individual audits.

To aid in these efforts, the IRS is creating a database of corporate jet activity to help identify potential targets for audits. These enforcement efforts will be part of a campaign within the Large Business and International Division, as per the press release. This move underscores the IRS's determination to scrutinize the taxable fringe benefit of corporate jet use more closely.

In light of these developments, we strongly recommend our clients to meticulously document their corporate jet usage, clearly distinguishing between business and personal travel, to ensure full compliance with IRS regulations and avoid potential audit complications.

Department of Labor identifies potential states for FUTA credit reduction in 2024

The U.S. Department of Labor (DOL) has flagged California, Connecticut, New York, and the Virgin Islands as states that may experience a credit reduction in 2024 under the Federal Unemployment Tax Act (FUTA). The final decision will be confirmed after November 10, 2024.

Under the FUTA, states with an outstanding Federal Unemployment Account (FUA) loan for a minimum of two consecutive years, specifically on January 1 and November 10 of the second year, are subject to a credit reduction on their Federal Unemployment Tax rate. This reduction persists until the loan is fully repaid. The credit reduction escalates by 0.3% each consecutive year that a state has an outstanding loan balance on January 1. However, states that have taken steps to manage their balances may be able to avoid the reduction.

For 2024, both California and New York, which experienced a credit reduction of 0.6% for 2023, could see a credit reduction of 0.9% for 2024. Connecticut, despite clearing its outstanding loan balance by the November 10, 2023 deadline and thus avoiding a credit reduction for 2023, resumed borrowing and had an outstanding loan balance on January 1, 2024. Consequently, due to having outstanding loans on three consecutive January 1 dates (2022, 2023, and 2024), it could face a potential credit reduction of 0.9% for 2024. If Connecticut succeeds in repaying its loan by November 10, 2024, it will evade a credit reduction for 2024.

The Virgin Islands, which began borrowing in August 2009 and currently has an outstanding loan balance of over $87 million, may face a significant credit reduction of 5% for 2024.

Considering these potential changes, we recommend our clients to diligently track their state's loan status and evaluate the possible effects on their Federal Unemployment Tax rate.

Exemption for specific venues from California's higher fast-food minimum wage approved by Senate panel

A California Senate Committee has approved a bill proposing exemptions to the state's new higher minimum wage for fast-food workers in specific locations. The bill (A.B. 610) deviates from a 2023 law that increased the minimum wage for fast-food workers to $20 per hour, up from the current $16 per hour statewide minimum wage. The proposed exemptions, supported by the union representing these workers, would apply to fast-food employees in airports, theme parks, hotels, large event centers, corporate campuses, museums, public parks, ports, and beaches. The bill still requires further votes in the state Senate and Assembly before it can be signed into law by the governor. The proposed changes underscore the complexities of implementing California's new minimum wage law for fast-food workers.

Given these legislative shifts, our clients in the fast-food sector should be aware that changes in minimum wage laws could significantly impact their employment tax obligations, potentially requiring adjustments to their payroll processes and overall tax planning strategies.

State leaders call for IRS clarity on taxation of growing paid family and medical leave programs

Governors from nine states - Colorado, Connecticut, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, and Washington - have collectively written to the IRS Commissioner, seeking guidance on the federal tax treatment of premiums and benefits under state paid family and medical leave (PFML) programs. This comes as PFML programs are gaining popularity and being adopted by an increasing number of states across the country.

The letter highlights the uncertainty that employers face regarding the correct calculation of PFML payroll contributions and reporting of the premiums withheld by employers from employee wages. Furthermore, the letter underscores the lack of clear guidance from the IRS on the tax treatment of these programs, which could potentially lead to unexpected and significant tax liabilities for those who depend on these programs for family leave, personal illness, or caring for vulnerable family members. The governors are advocating for the IRS to provide specific guidance on the taxability of these benefits and premiums to mitigate the risk of double taxation.

Louisiana finalizes tax breaks for digital nomads to boost remote workforce

Louisiana recently completed regulations that provide a significant tax break for digital nomads. These regulations allow remote workers to exempt up to 50% of their income earned in Louisiana from state income tax. This exemption applies to earnings up to $150,000 and can be used for two out of the four years between 2022 and 2025.

However, to be eligible for this tax break, there are a several requirements that are required to be satisfied:

a. Establish residency in Louisiana after December 31, 2021;
b. Be a policyholder, subscriber, enrollee, or other individual enrolled in or insured by a health insurance issuer for major medical health insurance coverage;
c. Work remotely full-time for a nonresident business;
d. Have the intent to work remotely in Louisiana prior to establishing residency;
e. File a Louisiana resident or part-year resident individual income tax return for the taxable year in which they are claiming exemption;
f. Not have been a resident or domiciliary of Louisiana for any of the three years immediately preceding the establishment of residency or domicile after December 31, 2021;
g. Not have been required to file a Louisiana resident or part-year resident individual income tax return for any of the three years prior to claiming the exemption; and
h. Performs the majority of employment duties in Louisiana either remotely or at a co-working space.

This move is part of Louisiana's strategy to attract more remote workers to the state and diversify its workforce. It offers a significant incentive for digital nomads considering making Louisiana their new home base.

Massachusetts sheds light on supplemental withholding following "Millionaire Tax" implementation

There has been recent confusion regarding the Massachusetts supplemental tax withholding rate, particularly in relation to the state's surtax for high earners. To address this, an update was released on March 6, 2024, providing clarity on how supplemental withholding interacts with the surtax, especially when a supplemental payment pushes an employee over the surtax threshold. Massachusetts Publication Circular M has been updated to provide the exact withholding methods.

To determine withholding on a supplemental payment, employers should first calculate the total taxable wages. This is done by adding the supplemental payment to the employee's annualized wages and then subtracting any allowable deductions, including any supplemental payments made earlier in the year, according to the state revenue department.

Following this calculation, the withholding rate is set at 5% of taxable wages of $1,000,000 or less, and then 9% on the portion of wages that surpass $1,000,000.

New York governor proposes prenatal leave expansion to state's paid family leave program

New York's Governor unveiled a proposal to broaden the state's paid family leave (PFL) program to include prenatal leave. This proposal, if passed, would make New York the first state to offer such a provision.

The proposed plan would mandate employers to grant employees 40 hours of paid leave for prenatal medical appointments prior to a baby's birth. However, for this plan to become law, it would need to be incorporated into legislation, approved by both houses of the state legislature, and then signed by the governor.

Currently, the state's PFL program does not offer benefits until four weeks before the expected birth of a child, following a seven-day waiting period. The governor suggests that by including prenatal care as a distinct qualifying event under the PFL program, pregnant workers can address their medical needs without depleting the leave meant for bonding with the baby post-birth.

Tax tug-of-war: Neighbors challenge New York's remote work levy

New York is among a few states that enforce a "convenience of employer" rule. This means that workers are required to pay income tax to New York if their employer is based in the state, even if they're working remotely. It's an arrangement that has worked well for New York due to the large volume of New Jersey and Connecticut telecommuters. However, Jeffrey Beckham, the head of the Connecticut Office of Policy and Management, expressed his dissatisfaction with this situation. He believes New York is overstepping its authority and that Connecticut residents should be paying taxes to their own state, where the tax rate is lower. It's a sentiment that many may agree with, especially as the lines between work and home locations continue to blur.

As a result, Connecticut and New Jersey are considering offering incentives to residents to legally challenge New York over its taxation of telecommuters. It's a shift that could potentially lead to significant changes in how we view employment arrangements and the taxation requirements.

Marion, Ohio retroactively increases credit for taxes paid to other municipalities

The city of Marion, Ohio, has made retroactive adjustments to its credit for income taxes paid to another municipality through the passage of two ordinances.

Initially, in June 2023, the city passed Ordinance 2023–29 with the intention of increasing its credit from 50% to 100% of the tax paid to another municipality. This change was to be effective retroactively from January 1, 2023.

To clarify the retroactive application of this change, the city passed another ordinance, Ordinance 2024–13, on February 12. This ordinance reinforced the retroactive increase in the credit for income taxes paid to another municipality.

Understanding Vermont's new child care contribution

Act 76 of 2023, a new law related to childcare and early childhood education, introduces a new Child Care Contribution (CCC) in Vermont. The CCC consists of a 0.44% payroll tax on wages and a 0.11% tax on self-employment income, to be implemented and administered by the Department of Taxes starting July 1, 2024.

Employers are required to pay the 0.44% payroll tax on all employee wages earned in Vermont, and they may choose to withhold up to 25% (i.e., .11%) of the required contribution from employee wages. The CCC payroll tax payments will be remitted to the Department in the same manner as Vermont Income Tax Withholding.

For employees, employers may withhold up to 25% of the CCC from their wages, and any withheld amount will be reported on their W-2 tax form at the end of the year.

Meet one of our Employment Tax professionals: Arifa Nagim

Arifa Nagim is an associate with our team in Short Hills, New Jersey and started with the firm in 2022. Arifa assists clients with state payroll tax issues, compliance services related to the corporate reorganizations, and annual reporting compliance at the federal, state, and local levels. When not in the office, Arifa loves grabbing coffee and going on nature walks with her friends and her family.

Contact us

John Montgomery
National Employment Tax Lead Partner
T: 212-872-2156
E: jmontgomery@kpmg.com

Reagan Aikins
Managing Director, Employment Tax
T: 703-286-6596
E: raikins@kpmg.com

Mindy Mayo
Managing Director, Employment Tax
T: 408-367-5764
E: mindymayo@kpmg.com

Manan Shah
Managing Director, Employment Tax
T: 404-739-5247
E: mananshah@kpmg.com

Jon Stone
Managing Director, Employment Tax
T: 408-367-1983
E: jwstone@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

Learn about us: **kpmg.com**