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MEMORANDUM

To: Senator Breeden
From: Chris Nielsen, Deputy Director
Re: Legislative Commission's Subcommittee to Study Employee Misclassification
Date: April 1, 2010

The following analysis contains information from the Department of Taxation's data files that attempts to answer the following question: How many independent contractors are there in Nevada?

BACKGROUND

The main mechanism businesses use to pay non-employee work performed or services rendered is via a TD1099-MISC. Reporting of these expenses is required by Internal Revenue Service (IRS) regulations on an annual basis via a TD1096, which is a summary of all TD1099's issued. It is common practice in industry to pay so-called Independent Contractors (ICs) via a TD1099. Individuals are then required to report this income on 1040 Schedule C.

Nevada requires payment of Nevada Modified Business Tax (MBT) on qualifying wages per Chapter 363B of the Nevada Revised Statutes. Wages are reported on a quarterly basis at a current rate of 0.5% for wages \$62,500 and under for wages over \$62,500 the rate is currently 1.17%. Per statute, the determination of qualifying wages for MBT is directly related to the amount of wages reported to the Employment Security Division (ESD). Any determination of wages subject to MBT must therefore be made by ESD.

ANALYSIS

Department of Taxation maintains a data warehouse of state tax records, quarterly ESD reported wages, and certain annual IRS extract data. A comparison of data files was performed to determine the potential number of ICs doing business in Nevada. The IRS provided TD1099-MISC extract files that provided the most useful data in this analysis. All data is based upon 2007 reporting, the most complete year currently available.

THE RAW DATA

- A total of 132,161 Schedule C returns were filed by Nevada residents for tax year 2007.
- A total of 190,985 payments were made to distinct SSN's of which 266,690 individual payments were made for a total of \$4,055,221,886.00 (term this Valid SSNs Payees).

EXHIBIT B - EMPMISCLASS
Document consists of 2 pages.
Entire exhibit provided.

- A total of 36,571 payments were made to invalid or no SSN's or Employee Identification Numbers (EIN's) (3,789) submitted to the IRS for a total of \$916,634,269.00. This data shows an approximate 50 – 50 split between individuals and named business entities (term this Invalid SSNs Payees).
- A total of 70,265 distinct business entities received 187,906 payments to valid IRS EINs. for a total of \$11,969,590,959 .00. No further analysis was performed on this group as these generally fall outside an individual operating as an IC.
- When comparing the IRS data to the Department's data, we found that there were 136,733 distinct payees (with valid SSN's) with Nevada addresses receiving \$3,170,909.250.00.
- Of this number we show 51,221 distinct payees receiving 97,895 payments contain in the records of the Department. Meaning the Department has either a business account or an IRS return on file.

CONCLUSION

Because Nevada does not impose a personal or corporate income tax, the data we have available from the IRS is limited. The best estimate we have is that the number of independent contractors operating in Nevada is somewhere between 51,221 and 132,161. The reason for the discrepancy is that some Schedule C returns contain information that does not necessarily indicate independent contractor activity. Another reason is that some individuals may be paying and reporting underemployment insurance to Nevada but not reporting that income to the IRS. Moreover, it is impossible to estimate how many independent contractors are truly attributable to data that the IRS deems as invalid on account of unmatched SSN's and EIN's. Finally, without auditing every business (including all individuals attributable to TD1099MISC reporting), it would not be possible to determine how many of these "independent contractors" are misclassified for modified business tax purposes – especially since the Department of Taxation relies on ESD's determination.