

Independent Contractors v. Employees - An Update

Worker classification is a hotly contested audit issue that has caused anxiety for business owners all across the country. Whether a worker is classified as an employee or as an independent contractor can mean a substantial difference in the amount of employment taxes that the business pays. And, as stories in the popular press have underlined, an incorrect classification can lead to interest, penalties and tax liens that can cripple an otherwise successful business.

The IRS, not just business, has felt pressure on this issue. It has now responded with the announcement of a three-pronged relief package that goes some way towards alleviating businesses' well-founded fears. As a result of the initiatives, many businesses will be able to operate with less downside exposure in dealing with worker misclassification. And others may be able to formulate plans for structuring their work force with more certainty that they will be able to withstand a challenge from the IRS.

Foremost in the relief package, the IRS has revised the rule book used by its employment tax agents. The new Manual is good news not only because IRS agents must now conform to one set of rules on worker classification, but also because preventative steps can be taken in light of the Service's current thinking.

Second, a business that may have in fact misclassified workers as independent contractors may be able to strike a deal by paying back taxes, interest and penalties up to what, practically speaking, amounts to an 87.5-percent discount. This program, which is being tested, can be a relatively easy way to put what might otherwise be large misclassification headaches behind you. It is, however, only available if information returns have been properly filed.

Finally, businesses that do have a classification controversy arise during an audit no longer need to have it hanging over their heads while other audit issues are resolved. A new, early referral system is being tested for a year. It will allow a business to go straight to IRS Appeals on the employment controversy, saving time and money. This also means that some businesses can afford to take a more aggressive position in defending their classification of workers since the audit process is less damaging.

In light of the IRS's predominantly pro-taxpayer initiatives, you may want to re-examine your worker classifications at this time. Even when potential employment tax liabilities are not overwhelming, it's important to remember that misclassification can also cause pension plan difficulties. Please do not hesitate to call if we might be of assistance.