

Employer LINC™

LEGAL INFORMATION, NEWS AND COMMENTARY FOR EMPLOYERS

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Businesses with misclassified workers may find relief under new IRS settlement program



BY KEITH PETERS

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For the last two years, McAfee & Taft has been warning employers of the consequences of misclassifying workers as independent contractors instead of employees.

To support its belief that worker misclassification is an area of widespread abuse by some employers to avoid paying income and employment taxes and other benefits, the Internal Revenue Service and state agencies have strengthened their investigation and enforcement efforts. In fact, just last week the IRS, U.S. Department of Labor and state authorities announced an information sharing partnership to help detect worker misclassification.

The IRS, however, also recognizes the legal uncertainty and potentially crippling consequences of misclassification. Two days after announcing its information sharing partnership, the IRS announced a program called the Voluntary Classification Settlement Program (VCSP), which may provide relief to some businesses.

Under the VCSP, if a business agrees to reclassify its workers as employees prospectively, then the IRS will assess back employment tax for only the most recent year and at a greatly reduced rate. The IRS will also waive interest and penalties and will agree not to audit any prior years.

To be eligible for relief, a business must have been consistent in treating the workers as independent contractors in the past and must have issued Forms 1099 for the past three years. A business is ineligible if it is currently under audit by the IRS or DOL, or if it is under a worker classification audit by a state agency such as the Oklahoma Tax Commission, the Oklahoma Employment Security Commission or the Oklahoma Department of Labor.

Any business considering reclassifying its workers as employees must weigh a host of considerations. However, federal tax exposure is often the biggest risk of misclassification,

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and the VCSP presents an opportunity to mitigate that risk significantly. A business that may have misclassified its workers should contact a qualified advisor who can help analyze the potential benefits and risks of entering the VCSP and help the business navigate the VCSP process with the IRS.

While this new IRS settlement program provides a significant amount of financial relief on the employment tax front, it does not address the other employment-related issues related to misclassifying an employee as an independent contractor. For example, employers may still be liable for state tax withholding, unpaid workers' compensation and unemployment insurance premiums, and penalties for labor law violations such as noncompliance with minimum wage and overtime pay regulations.

In addition, generally, only employees, unlike independent contractors, are eligible for employer-sponsored health and retirement plan benefits, including paid time off.

The IRS' information sharing partnership, as well as its settlement program, makes this an ideal time for businesses to review their current use of independent contractors. That review should include determining whether the employer has misclassified employees as independent contractors and what steps it should take going forward.

As always, the attorneys at McAfee & Taft stand ready to assist you with any questions you may have.

Keith Peters is a tax attorney with McAfee & Taft who has successfully represented clients before the IRS, the Oklahoma Tax Commission, the U.S. Tax Court, and in other federal and state courts

This employment law update has been provided for information of clients and friends of McAfee & Taft. It does not provide legal advice, and it is not intended to create a lawyer-client relationship. Readers should not act upon the information in this newsletter without seeking professional counsel.

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