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Are Your Independent Contractors Misclassified? IRS Offers Employers a “Fresh Start” to Reclassify Workers

The Internal Revenue Service (IRS) and the Department of Labor (DOL) have launched a new program to permit employers that have classified workers as *independent contractors* to switch the classification to employee through a low-cost settlement program. The IRS will allow employers to change past worker classification issues by making a minimal payment and avoid substantial payroll tax obligations for prior years that would be assessed by the IRS under an audit. The IRS hails this as a “*Voluntary Classification Settlement Program (VCSP) [that] is designed to increase tax compliance and reduce burden for employers by providing greater certainty for employers, workers and the government.*” This program reinforces the belief that the IRS would like all workers to be treated as employees to improve tax collection and reduce deductions claimed by schedule C workers.

Eligible employers can obtain this substantial relief from federal payroll taxes they may have owed for the past if they prospectively classify their workers as *employees* versus *independent contractors*. To qualify for this program, employers must:

- Consistently have treated the workers in the past as independent contractors,
- Have filed all required Forms 1099 for the workers for the previous three years, and
- Not currently be under audit by the IRS, the Department of Labor, or a state agency concerning the classification of these workers

Employers will pay ten percent (10%) of the employment tax liability that would have been due on the compensation paid to the reclassified workers for the past year that would be assessed under a forced reclassification under audit. The voluntary payment for one year amounts to a tax of slightly more than one percent (1%) of the gross payroll for the prior year. The voluntary assessment would apply for only one year compared to the three (3) years subject to audit.

Employers who participate in this program will also benefit from being exempt from interest or penalty assessments on the payments, and they will not be audited on payroll taxes related to these workers for prior years. Employers will, however, be subject to a special six-year statute of limitations for the first three years under the program, rather than the usual three years that generally applies to payroll taxes. Other drawbacks include increased payroll taxes for the future years and other costs associated with having employees including the employer mandated provisions of the Health Care Reform Act.

It is important for employers to recognize that this program only addresses employment tax liability. It does not address the potential liability under other laws governing employees, such as overtime liability, state workers compensation contributions and other federal/state statutory protections for employees such as Title VII, ADA, FMLA, and GINA.

The IRS and the DOL are stepping up their efforts to prevent employee misclassification through increased information sharing and recordkeeping along with higher civil penalties for employers who have misclassified their workers. With this increased scrutiny and the low cost Reclassification program, it is critical for employers to review their worker

classifications to ensure that their workers are properly classified. They should also consider the benefits and drawbacks of participating in the program.

To review risks and opportunities for participation in this program and for assistance in classifying your workers, contact your Butzel Long attorney or the authors of this Client Alert today.

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