Legal Corner

Charles E. Schaub, Jr. Esq., Hinckley Allen Snyder LLP

New IRS Worker Misclassification Voluntary Disclosure "Safe Harbor"

Note: The following article appeared in the December 2011 issue of the Hinckley, Allen & Snyder Construction Group Newsletter. As the issue of "Employee/Independent Contractor" can significantly impact many entities in the construction industry, it was felt that a wider circulation was warranted.

Many businesses misclassify workers as independent contractors rather than as employees. Doing so may violate numerous state and federal laws which may lead to potential debarment and substantial financial consequences. This article will focus on a company's obligations to the IRS.

If the IRS discovers workers are misclassified, the employer may incur FICA, FUTA, federal and state wage withholding, as well as interest, and penalties.

Because the issue involves lost tax revenue, the IRS recently announced a new program under which employers are encouraged to voluntarily report misclassified workers.

Like all offers, there are benefits and risks.

The Carrot (as offered by the IRS): The benefits of enrolling in the new program are:

1. no penalties;
2. no interest;
3. no prior years will be audited; and
4. no tax for prior years will be collected for FICA, FUTA, and wages.

Classifying workers correctly prospectively will provide peace of mind, contain a potentially substantial risk, and minimize future legal costs. Entry into the program could also be the beginning of full compliance with other (non-IRS) rules.

The Stick: The costs of entering the program are:

1. formerly misclassified workers will be classified as employees going forward;
2. the taxpayer must pay 10% of the employment tax (i.e., generally only FICA) that would have been due on the misclassified workers for the immediately prior year (i.e., one year only); and
3. prospectively, a six (as opposed to three) year statute of limitations will apply to each of three years following entry into the program.

continued on page 27

Legal Corner *continued from page 25*

In conjunction with this program, the IRS announced its intention to rigorously enforce the misclassification rules and penalties in the future for those who do not participate in the program.

Other Issues: The IRS program does not address state taxes and laws, which generally relate to SUTA (state unemployment taxes), wage withholding, workers' compensation, minimum wage, overtime, and prevailing wage requirements. In sum, it does not insulate employers from myriad issues involving non-federal tax or tax-related federal and state compliance.

The Requirements: To be eligible for the program, taxpayers must

1. have consistently treated the workers as non-employees;
2. have filed all required Forms 1099 for the works for the previous three years, currently not under audit by the IRS, the U.S. Department of Labor (USDOL), or a state agency regarding classification of the workers in question; and
3. have complied with the results of any prior worker misclassification audits by the IRS or the USDOL.

What should you do? ***Companies with doubts about work misclassification should evaluate whether entry into this program is beneficial on the whole since it will involve making changes in future operations. The retrospective federal tax cost of entry into the program is low, but the prospective cost of treating workers as employees may be substantial. The full impact of re-classification should be addressed by a self audit and discussed with legal counsel and the company's accountants.*** ■