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## IRS Announces Settlement Offer on Workers Misclassified as Independent Contractors

The IRS has announced a new initiative for employers, known as the Voluntary Worker Classification Settlement Program. The program allows employers who have misclassified workers as “independent contractors” rather than “employees” to reclassify the workers. The employers would only have to pay a small percentage of the employment tax liability that would have been due to cover past payroll taxes, with no interest or penalties. While the IRS program is available to businesses of all sizes, as a practical matter, it is likely to most affect smaller entities.

### Background

The classification – or misclassification – of an employee as an independent contractor, as the case may be, has been a hot-button issue of late. The import of the proper classification of a worker as an employee or an independent contractor goes beyond a mere label: A substantial monetary and employee benefit impact is at stake for the employer and the worker alike. Worker classification is also an important issue to the IRS, since a significant percentage of federal revenue comes from employment taxes. The IRS has been conducting random audits of businesses to ensure employment tax compliance.

### Tax Impact

Employees and independent contractors are treated differently for income-tax withholding and employment-tax purposes. With an employee, the business generally must withhold income taxes from the employee’s pay and remit those taxes to the federal (and state, if applicable) government. The business and the employee share the responsibility for Social Security and Medicare (FICA) taxes on the employee’s earnings. The business also must pay unemployment taxes for the worker. In the case of an independent contractor, income-tax withholding is not required and the worker is fully liable for his or her own self-employment taxes (essentially equivalent to the total

of the employee-employer contributions to FICA taxes) and unemployment taxes do not apply.

In determining a worker’s classification, the IRS applies a “facts and circumstances” test involving numerous factors; an analysis of the entire relationship needs to be taken into account. A key issue that the IRS has traditionally examined is whether the employer had the right to direct and control the actions of the worker as to how to perform the services. Other factors include how the worker is paid, whether there is a written contract, whether expenses are reimbursed, and whether the business or the worker provides tools and supplies.

### The New IRS Initiative

The new program enables certain employers to resolve past worker classification issues and gain clarity as to the worker classification issue at a relatively low cost by voluntarily reclassifying their workers.

As opposed to waiting for a potential IRS audit, businesses (and other entities, including tax-exempt organizations and government units) may use the Voluntary Worker Classification Settlement Program to achieve compliance by making a minimal payment (generally, 10% of the employment tax liability deemed owed) to cover past payroll tax obligations. To be eligible to take advantage of the IRS’ offer, a business must satisfy some basic requirements. The entity must:

- Have consistently treated the worker(s) as non-employees in the past,
- Have filed all required IRS Forms 1099 for the workers for the past three years, and
- Not currently be under a worker classification audit by federal or state agencies.

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The IRS created the program ostensibly to increase tax compliance and reduce the burden placed on employers by providing greater certainty for the worker, the business, and the IRS as to a given worker's employment classification status.

### **How to Apply**

Employers who are interested in applying to the new voluntary classification program can do so by filing IRS Form 8952, Application for Voluntary Classification Settlement Program, at least 60 days before intending to treat a contractor as an employee. If all conditions are met, the employer will not be audited on payroll taxes related to the worker for prior years.

### **Doeren Mayhew Can Help**

We would be happy to discuss any questions or concerns that you may have relating to the new IRS worker classification initiative. We can help you determine whether your organization is eligible and, if so, how to participate in the program. Contact your Doeren Mayhew representative at (248) 244-3000 for more information.

